

Near-unsophisticated fraud: The case of former Dixon's Comptroller

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ABSTRACT

This case discusses a recent fraud perpetrated by a trusted city employee over two decades. Incidents of fraud continue to manifest even though the issue is acknowledged widely. The case shows fraud involving significant financial implications can and do occur in government institutions and not only within the private sector. The fraud analysis shows cash remains the most vulnerable asset of any organization, and that fraud occurrence is possible in non-complex transactions. The content and subject matter of the case is appropriate for use in financial accounting, auditing, forensic accounting, and business ethics courses.

Keywords: Fraud, internal control, asset misappropriation, trust, embezzlement



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INTRODUCTION

So very often, people assume fraud cases have to be elaborate and sophisticated. We expect fraud cases to involve accounts that are complex in nature such as derivatives. It is true that some recent fraud cases involved accounts that are unfamiliar to the average person. However, the truth that cash is still the most liquid resource and the account most vulnerable to theft and abuse should not be forgotten.

In April 2012, news broke about fraud allegations in the city of Dixon, Illinois, a city known to few people before the “breaking news.” Dixon, Illinois is a city of about 16,000 people (Smith et al., 2012). Rita Crundwell, the well-known comptroller of the city was accused of fraud in excess of \$53 million (Babwin, 2013). According to Smith (2012), the fraud is the biggest municipal embezzlement in U.S. history. While most studies on fraud focus on private organizations, accounting students need to understand that fraud occurs in all types of organizations. Also, increasing our students’ awareness of fraud in government institutions is important as not all of them will work in private organizations.

ABOUT RITA CRUNDWELL

Rita Crundwell, aged 59, was the comptroller of the city of Dixon, Illinois since 1983 (Smith, 2012; Lense, 2012). Ms. Crundwell started working in the city hall as a part-time employee while she was still a student (Smith et al., 2012). Over the years, she climbed the corporate ladder to the position of a comptroller. She was a likeable person, and her fame grew as she excelled in world championships (Smith, 2012; Smith et al., 2012). Ms. Crundwell’s annual salary was about \$80,000 (U.S. Attorney's Office, 2012). Rita owned over 400 horses in her horse farm, which had near-state-of-the art facilities for the horses (Smith et al., 2012). Needless to say, Rita Crundwell was wealthy, and she lived flamboyantly. The residents of the city of Dixon assumed her wealth was from the horse business, and most were impressed that she maintained her “day job” as the city comptroller (Smith et al., 2012).

ABOUT CITY OF DIXON

According to Smith (2012), the City of Dixon lies about two hours west of Chicago, and the City is operated as a city commission form of government. In a city commission government form of government, voters elect a small commission, consisting of about five members. These elected persons (commissioners) become responsible for the legislative and executive functions of the city. One of the elected persons is chosen to perform the duties of a mayor, by the commission. This role conveys no additional power to the chosen individual beyond the powers held by the commission as a unit. Each commissioner is assigned a responsibility area, such as finance (Smith, 2012).

Further, as noted from Smith (2012), in Dixon, the commissioners earn stipends. However, due to the meager nature of the stipends, the commissioners have other full-time jobs. As a result, the commissioners invest a minimal amount of time in performing their duties as commissioners of the City. In addition, Smith’s (2012) account suggests some of the elected commissioners may not have the qualifications or competence necessary for them to function effectively in their roles. This seems to be commensurate considering what the city offered as stipends.

In recent years, Dixon faced severe financial difficulties. The financial issues escalated during the recent economic recession, resulting in the City owing about three million dollars in debt (Babwin, 2012; Smith et al., 2012). City employees did not receive raises for about three years, the infrastructures were in deplorable conditions, and there was hiring freeze in some departments (Smith et al., 2012). Further, according to the account of Smith et al. (2012), during the time frame of the fraud, the elected members of the City's commission have changed.

THE FRAUD SCHEME

According to Lense's (2012) account, the financial statements of the City were audited annually by Samuel S. Card, CPA P.C., a Public Accounting firm in Sterling, Illinois. Further, the city of Dixon also hired another accounting firm Clifton Larsen Allen LLP, to compile and present the City's financial statements. These processes indicated no instances of fraudulent activities and non-compliance. In addition, the Comptroller's Office at Illinois conducts audits of filed annual financial statements and this process also showed no instances of fraudulent activities and non-compliance (Lense, 2012).

Many of Dixon's accounts were maintained at Fifth Third Bank (Lense, 2012), including the RSCDA account. The RSCDA account was opened in December 1990, and Ms. Crundwell was the only person in control of this account (U.S. Attorney's Office, 2012). According to the U.S. Attorney's Office (2012), between December 1990 and April 2012, Ms. Crundwell transferred funds from Dixon's Money Market account to Dixon's Capital Development Fund account, and to other bank accounts. From these accounts, she would transfer the funds to the RSCDA account and use the funds to pay for her personal expenses. Ms. Crundwell showed the city's auditors fictitious invoices, which she claimed were from the state of Illinois. The invoices were created to show the misappropriated funds were properly applied towards the city's activities.

The U.S. Attorney's Office (2012) notes Ms. Crundwell, on September 8, 2009 wrote two checks, one for \$150,000 and the other for \$200,000. The checks were drawn from multiple Dixon accounts and deposited in Dixon's Capital Development Fund (CDF) account and, later another check for \$350,000 payable to "Treasurer" was drawn from the CDF account and deposited in the RSCDA account. Further, the U.S. Attorney's Office notes Ms. Crundwell created fictitious invoices for the sewer project in Dixon to support the payment of \$350,000 to the state of Illinois. On the same day, Ms. Crundwell wrote a check of \$225,000 drawn on the RSCDA account. This check was deposited in her RC Quarter Horses account. She used the fund to cover a check of \$225,000, dated September 1, 2009, drawn on the RC Quarter Horses account for the purchase of a quarter horse named Pizzazzy.

The account of the U.S. Attorney's Office (2012) further notes that to hide the fraud scheme, Ms. Crundwell told the commissioners the State was late in disbursing tax revenue, hence the city's budgetary shortfalls. Also, Ms. Crundwell, the City's Comptroller picked up the city's mail, including all the bank statements. When she was unavailable at work, she asked a relative or other city employees to pick up mail and sort the mails, separating her mails including the statements for the RSCDA account, from the rest of the mail.

THE DISCOVERY

According to the accounts of Smith (2013), Smith et al. (2012), U.S. Attorney's Office (2012), and Lense (2012), the Dixon fraud was discovered as follows. In October 2011, a city clerk filled in for Rita Crundwell, who took a long unpaid vacation to attend horse shows. Ms. Crundwell was absent for about sixteen weeks. Four of the sixteen weeks were paid while twelve weeks were unpaid. The employee requested, received and reviewed all of Dixon's bank statements. The employee, Kathe Swanson noted a RSCDA bank statement, but she was unable to reconcile this bank statement to any of the City's financial information. Ms. Swanson showed the bank statement to the mayor, but the mayor was unaware of the bank account which held thousands of dollars.

The mayor, Mr. Burke observed from the bank statement that hundreds of thousands of dollars totaling about \$775,000 had moved between the RSCDA bank account and other Dixon's bank accounts. The mayor took the RSCDA bank statement to the FBI for further investigation. The investigation lasted for about five and half months. The employee who discovered the bank statement and the mayor acted as if they were unaware of the odd bank account while the investigation was in progress.

CHARGES AND PLEA

In April 2012, Rita Crundwell was arrested and charged with 60 counts of felony and one count of federal wire fraud (Smith et al., 2012). According to Smith et al. (2012), the prosecutors of Lee County alleged Ms. Crundwell embezzled more than \$53 million from the city of Dixon's funds. The theft was perpetrated over about 20 years (Babwin, 2013). The allegations against Ms. Crundwell indicated she created fictitious invoices, and she also moved money between multiple bank accounts and finally deposited the money in an account operated solely for her personal use (U.S. Attorney's Office, 2012).

Rita Crundwell pled guilty to a federal fraud charge and admitted to misappropriating more than \$53 million of the funds of the City of Dixon since 1990. She further admitted to using the stole funds to support her horse farming business and extravagant lifestyle (Babwin, 2013; U.S. Attorney's Office, 2012).

SENTENCING

According to Babwin (2013), on Thursday, February 14, 2013, Rita Crundwell was sentenced to nearly twenty years in prison, and she was also ordered to pay restitution amounting to more than \$53 million, by the court. After her arrest in April 2012, the U.S. Marshals began auctioning off Rita Crundwell's assets, including houses, horses and jewelry, in the hope of recovery some of the embezzled funds (Babwin, 2013; U.S. Attorney's Office, 2012; Smith et al., 2012).

FRAUD TRIANGLE

Fraud occurs as a result of three key factors: opportunity, rationalization and motivation (AICPA SAS No. 99 2002). These factors need not all be present for a fraud to occur. The presence of either rationalization or motivation and opportunity is sufficient to make an

individual initiate a fraud scheme. Opportunity may be manifested in the following ways: lack of internal control, ineffective internal controls, or management override of internal controls (AICPA SAS No. 99 2002).

Rationalization focuses on the normative beliefs and the individual factors (AICPA SAS No. 99 2002). Some people may justify inappropriate behavior on various grounds including, no one is hurt by their action, or it is their right considering the compensation they receive for their hard work. From SAS 99 (AICPA 2002), the third factor, motivation relates to pressures from an individual's life (e.g. huge debt) or pressures from external forces (e.g. meeting expected financial performance at work).

INTERNAL CONTROL

The Government Accounting Office (GAO) defined internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations (GAO *Standards for Internal Control in the Federal Government* 1999).

The details of internal control as described by GAO follow the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) Internal Control - Integrated Framework. The integrated framework consists of five interrelated components. These components are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring (AICPA SAS No. 55 2004).

The America Institute of Certified Public Accountants (AICPA) in Statement of Auditing Standard No. 55 (*Consideration of Internal Control in a Financial Statement Audit*), states:

- a. "Control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
- b. Risk assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
- c. Control activities are the policies and procedures that help ensure that management directives are carried out.
- d. Information and communication systems support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- e. Monitoring is a process that assesses the quality of internal control performance over time."

DISCUSSION QUESTIONS

1. What may be considered the motivation for the Dixon fraud?
2. What factors created the opportunity for the Dixon fraud case?
3. Suggest factors that may have been the rationalization for the fraud.
4. If you were the auditor for the city of Dixon, what might you do differently?
5. Suggest ways the city of Dixon can improve its internal control.
6. Suggest ways banks could help prevent similar fraud schemes.

TEACHING NOTES

1. The city of Dixon's fraud case is obviously not a story about a "Robin Hood" impersonator. The motive for the Dixon fraud case seems to be greed and a desire for economic benefits. The culprit appears to be driven by a desire to achieve great personal prestige. The duration of this fraud, which is over 20 years, and the purposes for which the misappropriated funds were applied suggests a motivation to amass wealth and maybe a strong desire to satisfy a hobby (horse breeding) at any cost.
2. A number of factors created the perfect storm for the city of Dixon fraud. Some of the factors are discussed below.
 - The governance structure of the city is such that those charged with governance could not serve in their roles as full time employees of the city. The stipends for the commission members were minimal. This meant that those charged with governance had to fend for their sustenance through other means and serve in their "spare time" as commissioners. With such a governance structure, oversight will at best be ineffective. This, in turn, creates an opportunity for fraudulent activities to be initiated.
 - The size of the city of Dixon and the smallness of the community may have created an environment where people are trusting of one another. Trust is a good attribute, however, even President Ronald Reagan, whose boy home was the city of Dixon, said, "trust but verify." Overly trusting, especially in a professional setting, can result in people being less skeptical and critical of information and activities.
 - There seems to be a lack of segregation of duties, which is a critical control activity. The comptroller had custody of checks, signed checks, maintained records (e.g. invoices and bank statements), performed reconciliations, and even picked up mails. The fact that these activities and probably other activities were all performed by one person creates an opportunity for fraudulent activities.
3. The information available about the city of Dixon fraud case does not indicate the rationalization for the fraud. However, below are suggestions about possible rationalizations based on other known facts about the fraud case.
 - The perpetrator may have rationalized the fraud based on the reasoning that she did a lot of work, and she was the "go-to" person whenever there was an issue, so she deserved to enjoy some benefits.
 - The perpetrator may have rationalized the fraud as a game that was hurting no one. As such, dissociating the funds from people. So instead of thinking about the funds as resources for salaries and pension, the funds may just have been thought about as money sitting in a bank account.
 - The perpetrator may have been convinced the community did not quite care or need the funds considering the duration of the fraud scheme. Since if they did care or needed the funds, they would have sought for it. Especially, since those charged with governance believed her explanations without critical questioning and assessment.
 - Also, the perpetrator may be convinced that the funds were borrowed, and she may have planned to pay each penny back someday.

4. As expected, the audit procedures performed during the audits of the city of Dixon, and the audit work-papers are not publicly available information. Auditing is a process that requires auditors to give an opinion about the fairness of a financial statement based on an applicable financial reporting framework. The process of auditing requires the exercise of professional skepticism and professional judgment. In view of this, below are suggestions about additional work that may be done from the auditor's perspective.
 - Use of cash confirmation may have led to a timely discovery of the fraud scheme. If the bank sent the bank statements including the RSCDA bank account to the city, the bank would have confirmed the existence of the RSCDA account and the balance in the account.
 - In addition to the invoices presented for the fictitious expenditures such as the sewer project, approved by the state, a request for the approval document for the project from the state describing the project, the contractor, the work period may have led to the discovery of the fraud scheme since the perpetrator may not be able to create easily a fictitious copy of such documents. A failure to produce the documents would indicate potential red flags.
 - The issue of a lack of segregation of duties would be considered a potential fraud risk. In view of this issue, the signatories to the city's bank accounts will be considered, and extended audit procedures will be performed on cash disbursements.
 - One of the "golden rules" in audit is to "follow the money." The fraud scheme appears to be perpetrated by moving funds from one account to another account. As part of cash disbursement procedures, the cash movement could be followed to its end point. Such a procedure would have raised some concern about the final destination being the RSCDA account.
 - As part of the audit procedures, inquiries will be made of all the commissioners. Issues that may be inquired about will include the cash flow situation of the city. The expectation is that the commissioners are well aware of matters going on in the city, and so a high level of consistency in information will be anticipated. For example, the commissioner in charge of public utilities and at least the city mayor should be aware of the sewer project. Inquiry about matters like the sewer project and a failure to obtain corroborative information would indicate potential audit issues.
5. Internal controls are designed and implemented so that material misstatements are prevented from entering the financial reporting system or at least timely detected and corrected. To improve the internal control system in place in the city of Dixon, the following suggestions may be helpful.
 - Those charged with governance should consider requiring that a member of the elected commissioner be at least a part-time employee. This person will thus be available to provide oversight in the daily activities of the city.
 - Other members of the commission should be required to perform the review functions periodically (e.g. monthly). This may include reviewing the bank statement and bank reconciliation.
 - Review the policies and procedures and make necessary changes such as adequate segregation of duties.

- The signatories to the bank account should be reconsidered, and it may be helpful to establish approval limits, and the number of required signatories for certain thresholds of amount. For example, the need for a minimum of two approved signatories for disbursements exceeding \$10,000.
 - Further, the city of Dixon should consider eliminating the procedure whereby checks can be written to a payee with the description “treasurer” or similar non-specific descriptions. As such, checks should be made to only identifiable individuals and entities, and proper documentation should exist to validate the payee.
 - Establishing a “whistle-blower” system may encourage city employees to disclose activities they observe that appear questionable without concern of being ridiculed.
6. Based on the information available about the fraud case in the city of Dixon, it does not appear the bank’s activity in any way made it easier for the fraud scheme to be perpetrated. However, as a courtesy to a key customer, the bank may consider requiring approval documents from those charged with governance before bank accounts are opened. Also, the bank may consider discussing with their client (the city of Dixon) the need for more than one signatory to the city accounts especially since checks of significant amounts are drawn on the accounts. Further for accounts such as money market and capital development accounts, the bank may request further authorization from the city before funds are released.

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