

A Case Study of Municipal Government Financial Management and Effective Internal  
Controls

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by

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Prescott Valley, Arizona  
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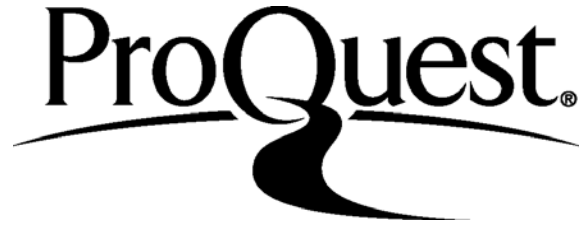
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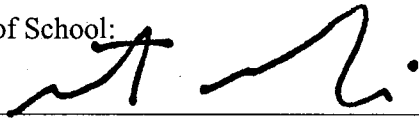
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## Abstract

There are numerous examples of how local government employee embezzlement is a serious issue in the United States. There are numerous examples of local government fraud and local government embezzlement where local government employees faced accusations of stealing from their employer. A review of several of these cases reveals that the fraudster stole money over a multi-year period. There are 89,386 municipal governments or special purpose municipal government entities in the United States and understanding how municipal government employee embezzlement occurs in these localities can help government leaders build in safeguards to detect and/or deter fraudulent activity. The purpose of this qualitative single instrumental case study was to fill an identified gap in existing scholarly research on fraud triangle theory, bureaucratic management theory, and organizational theory by studying a municipal government with a known incident of multi-year employee embezzlement of at least \$50,000. The research method for this study is a qualitative single-case study approach. The case study took place in the municipality of Dixon, Illinois. Dixon experienced one of the country's largest historical cases of multi-year embezzlement, making it an ideal case for this study. Current city leaders, prior city leaders, current city employees, auditors, local business owners, and the local news media agreed to participate in the research study. Participant interviews and analysis of town financial documents made up the data collection method for this study. Participant recruitment began in August 2015 with an invitation letter sent to the relevant city administrators, auditors, media, and business owners. The responses resulted in a sample size of nine and the completion of nine interviews. The results in this section answered the study's three main research questions. To restate, the three

questions are (1) how can financial internal controls be used to detect or deter multi-year municipal government employee embezzlement of at least \$50,000; (2) how is a municipal government affected by a known multi-year incident of municipal government employee embezzlement of at least \$50,000; and (3) why did a municipal government with a known multi-year employee embezzlement of at least \$50,000 fail to implement effective internal controls to help detect or deter municipal government employee embezzlement? In particular, the findings of the study highlighted how important financial internal controls are for municipal government to avoid fraud and embezzlement from taking place. The city suffered major changes because of the embezzlement. The interview data, media data, and archival reports showed that Dixon, Illinois' government consisted of a small commission of part-time elected members who each carried out separated and unmonitored activities. Moreover, there were several points during the city's history when there were referendums about whether the government should change from a commission style to a managerial style of government, but the votes often led to the proposals being defeated. However, once the city uncovered the comptroller Rita Crundwell's fraud, these proposals resurfaced, and this time, the government approved and implemented them. The thematic categories that emerged as a result of the research interviews were accountability, public trust, and system. Each of these thematic categories explain the case study's history, explain how the embezzlement occurred, and explain the consequences that resulted from the discovery of the financial fraud.

## Acknowledgements

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## Chapter 1: Introduction

As of 2013, there were 89,386 municipal governments or special purpose municipal government entities in the United States (National League of Cities, 2013). Among these various governments, the goal of improving financial accountability and oversight is vital in order to protect public financial assets and prevent embezzlement (Aikins, 2011; Barra, 2010; Dey, 2010; Grill, 2014; Hermanson, Smith, & Stephens, 2012; Huefner, 2011; Kopic, 2013, Lingenfelter & Veal, Jr., 2010; Raghavan, 2011). Existing research shows that the phenomenon of municipal government employee financial embezzlement is a serious issue for many communities across the country (Aikins, 2011; Aikins, 2012; Berkshire Eagle, 2013; Camilli, 2013; Elson & Dinkins, 2009; Hammersley, Myers, & Zhou, 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrjean, 2013; Raghavan, 2011; Verschoor, 2012; Wechsler, 2012; Zecheru, 2012), as embezzlement can damage local economies, exacerbate the divide between poverty and wealth, and erode the public's trust in elected officials (Perri, 2011). Indeed, the embezzlement actions of officials in local government can cause extreme financial stresses for the local government, a situation that might lead to the government defaulting on bond payments or needing to declare bankruptcy because of insolvency (Fudge, 2014; Williams & Fadairo, 2013). Between January 2011 and June 2012 alone, there were 26 municipal government bankruptcies with municipal government employee embezzlement contributing to the problem (Maciag, 2012). Poor oversight of financial transactions results in municipal government corruption and scandals (Elson & Dinkins, 2009; Elson, O'Callaghan, Holland, & Walker, 2012; Etheridge, 2012; Kopic, 2013, Raghavan, 2011).

Modern public accounting practices require different aspects of finances to be put under the control of multiple people, so that no one person can receive, spend, transfer, or otherwise control money without the participation of others (Maciag, 2012; McDermott, 2012; Miller, 2012). Nonetheless, municipal governments do not always segregate job responsibilities (Maciag, 2012; McDermott, 2012; Miller, 2012). For example, local governments should use several auditors instead of only one; likewise, local governments should also assign oversight of financial matters to individuals who are qualified (as opposed to elected) to provide effective oversight (Kapic, 2013; McDermott, 2013). Municipal governments also should conduct audits using independent external auditors as a way of identifying material weaknesses with respect to internal controls. Once the government discovers weaknesses, it should then implement new internal control policies based on the external auditor's recommendations (Aikins, 2012; Bame-Aldred, Brandon, Messier Jr., Rittenberg, & Stefaniak, 2013; Elson & Dinkins, 2009; Gheorghe, 2008; Huefner, 2011; Jones & Bowrey, 2013). Even though the aforementioned procedures are implementable, municipal governments do not always segregate job responsibilities, nor do they often implement independent external audit controls (Maciag, 2012; McDermott, 2012; Miller, 2012). The failure to implement these procedures can create a situation where embezzlement is possible.

### **Background**

There are numerous examples of how local government employee embezzlement is a serious issue in the United States (Aikins, 2012; Camilli, 2013; Elson & Dinkins, 2009; Hammersley et al., 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrjean, 2013; Raghavan, 2011; Verschoor, 2012; Wechsler, 2012; Zecheru, 2012). An

Internet search for local government fraud or local government embezzlement reveals numerous cases of local government employees facing accusations of stealing from their employer. A review of several of the articles reveals that the fraudster stole money over a multi-year period. Current researchers of government financial embezzlement call for additional qualitative research because there is more to learn about employees stealing from their employers. Specifically, scholars call for additional research to explain the value-added contributions of government internal controls (Aikins, 2011; Dorminey, Fleming, Kranacher, & Riley, 2012; Elmore, 2013, Murphy & Dacin, 2011), how segregation of duties supports the fraud triangle theory (Elson et al., 2012), how removing opportunity to commit a fraud deters a multi-year fraudster (Dorminey et al., 2012), and how the use of interview methods to explore a government organization's internal control strength is appropriate (Hermanson et al., 2012). Scholars have called for additional research into whether government embezzlement scandals create public distrust (Cosmin, 2011) and further research to explore how corruption can possibly affect municipal bond ratings (Butler, Fauver, & Mortal, 2009). Finally, scholars have noted that there is a need for additional research about whether corruption is the driver of policy change (Fleischman, 2014) or whether public managers are more likely to act on auditor recommendations when they received the recommendations (Aikins, 2012). They also have cited a need for case study research to better understand the inside story that allowed the fraud to occur (Soltani, 2014) and research using interviews of key stakeholders to identify why local governments did not comply with auditor recommendations that could have prevented a fraud (Jones & Bowrey, 2013). Each of the research questions for this study helps contribute toward the aforementioned scholars'

requests for additional research while filling a gap by adding to what literature and evidence currently exist about the phenomenon of municipal government financial management and employee embezzlement.

### **Statement of the Problem**

Existing scholarly research on municipal government internal controls reveals that the phenomenon of municipal government employee financial embezzlement is a serious issue for many communities across the country (Aikins, 2012; Camilli, 2013; Elson & Dinkins, 2009; Hammersley et al., 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrjean, 2013; Raghavan, 2011; Verschoor, 2012; Wechsler, 2012; Zecheru, 2012). As previously noted, there are 89,386 municipal governments or special purpose municipal government entities in the United States (National League of Cities, 2013). Understanding how municipal government employee embezzlement occurs in these localities can help government finance managers build in safeguards to detect or deter illegal activity (Elson & Dinkins, 2009). Improving municipal government financial accountability and oversight is important (Cosmin, 2011; Elmore, 2013; Elson & Dinkins, 2009; Ference, 2014; Gabriel, 2014; Hoitash, Hoitash, & Johnstone, 2012; Kapic, 2013; Lee & Fargher, 2013; Matkin, 2010; Moore, 2010; Simona & Elisabeta, 2013; Verschoor, 2012) because poor oversight of financial transactions often results in municipal government corruption and scandals (Elson & Dinkins, 2009).

Researchers have called for additional investigations of key stakeholders to identify how internal controls can detect or deter municipal government employee embezzlement (Aikins, 2011; Agarwal & Medury, 2014; Bame-Aldred et al., 2013; David, 2009; Dorminey et al., 2012; Elmore, 2013; Elson & Dinkins, 2009; Gabriel,

2014; Hermanson et al., 2012; Huefner, 2010; Matkin, 2010; Murphy & Dacin, 2011; Noland & Metrejean, 2013), to explain the consequences for failing to detect or deter financial internal control weaknesses (Cosmin, 2011; Hammersley et al., 2012;), and to explain why municipal governments do not implement internal controls to detect or deter financial embezzlement (Aikins, 2012; Elson & Dinkins, 2009; Jones & Bowrey, 2013; Simona & Elisabeta, 2013; Soltani, 2014). To this end, several municipal governments did not detect employee multi-year employee embezzlement in a timely manner. The researcher explored the issue of detecting or deterring employee embezzlement by municipal governments. As part of this exploration, the problem involved understanding how a known multi-year incident of employee embezzlement of at least \$50,000 affects a municipal government.

### **Purpose of the Study**

The purpose of this qualitative single instrumental case study was to fill an identified gap in existing scholarly research on fraud triangle theory, bureaucratic management theory, and organizational theory by studying a municipal government with a known incident of multi-year employee embezzlement of at least \$50,000. The study was intended to examine how certain municipal government financial internal controls detect or deter multi-year employee embezzlement of at least \$50,000, to understand how municipal governments are affected by a known incident of multi-year employee embezzlement of at least \$50,000, and to gain comprehensive understanding why municipal government officials fail to implement effective internal controls to help detect or deter employee embezzlements. According to Trompeter, Carpenter, Jones, and Riley (2014), limited research exists on the consequences of fraudulent acts and about what

remedial actions organizations have taken after the discovery of fraud. Exploring how municipal government employee embezzlement occurs and elucidating the consequences of multi-year embezzlement can help municipal government finance managers build in safeguards to detect or deter future employee financial embezzlement (Barra, 2010; Cosmin, 2011; Elmore, 2013; Elson & Dinkins, 2009; Ference, 2014; Gabriel, 2014; Hobbs & Costantino, 1996; Hoitash et al., 2012; Kapic, 2013; Lee & Fargher, 2013; Matkin, 2010; Moore, 2010; Simona & Elisabeta, 2013; Verschoor, 2012). Internal controls are important for protecting municipal government financial assets, but additional research is necessary to explicate how internal controls are effective (Dorminey, Fleming, Kranacher, & Riley, 2010). Understanding why municipal governments do not implement recommended changes to internal control weaknesses identified in a financial audit can also help municipal government managers overcome barriers to internal control implementation (Eckhart, Widener, & Johnson, 2001; Elson & Dinkins, 2009).

For the study, carrying out a single instrumental case study served as the main data collection method. As Creswell (2014) noted, a single instrumental case study focuses on a single issue and then uses gathered information to illustrate the single issue in question. Gathering data via a single instrumental case study research method involves creating theoretical constructs from case-based empirical evidence (Eisenhardt & Graebner, 2007). Because the researcher sought to document and understand the nature of a phenomenon that was not well understood at the current time (i.e., the nature of multi-year embezzlement of at least \$50,000 by a municipal employee), and because of the paucity of accessible cases where a municipal employee has embezzled more than



\$50,000, a single instrumental case study method was appropriate. Specifically, the use of a single instrumental case study methodology demonstrated whether effective municipal government internal control implementation can succeed under the following conditions: (1) when either the external auditor repeatedly brings a lack of controls to the attention of the governing body until they take appropriate action; (2) implementation of effective internal controls was a specific job requirement of the municipality's chief administrative officer; (3) the chief administrative officer is educated in the area of effective financial internal controls and implements protections voluntarily; or (4) the governing body was compelled to re-examine its internal control environment because of a known embezzlement. The use of a single instrumental case study methodology helped to identify why either the replacement of key management personnel after a known incident of municipal government employee embezzlement or the hiring a chief administrative officer might be a necessary, but not a sufficient, condition for the implementation of effective internal controls.

### **Research Questions**

The research questions for this study were designed to explore how certain municipal government financial internal controls detect or deter employee embezzlement, to understand how municipal governments are affected by a known multi-year incident of employee embezzlement of at least \$50,000, and to understand why municipal government officials fail to implement effective internal controls to help detect or deter employee embezzlements. The answers to these questions may have theoretical implications for the understanding of fraud triangle theory and bureaucratic management theory within the scope of municipal government embezzlement. Their findings may be

of assistance to municipal government finance managers and elected officials as they establish effective internal controls to detect or deter financial embezzlement, as well as to understand the barriers to effective internal control implementation. A final goal of this project was to understand better the consequences of failing to detect or deter multi-year municipal government employee embezzlement of at least \$50,000.

The following are the core research questions that guided this study:

**RQ1.** How can financial internal controls be used to detect or deter multi-year municipal government employee embezzlement of at least \$50,000?

**RQ2.** How is a municipal government affected by a known multi-year incident of municipal government employee embezzlement of at least \$50,000?

**RQ3.** Why did a municipal government with a known multi-year employee embezzlement of at least \$50,000 fail to implement effective internal controls to help detect or deter municipal government employee embezzlement?

In order to answer the research questions, the researcher conducted in-depth, semi-structured interviews with stakeholders of a municipality with a known incident of multi-year employee embezzlement of at least \$50,000. The stakeholders included appointed officials, elected officials, external auditors, members of the local news media, and business owners. Additionally, data came from an archival review of previous audit reports, bond rating reports, internal control policies in place before and after the discovery of the embezzlement, internal e-mails, news articles, and news editorials from the locality where the municipal embezzlement took place. The collected data was used as part of the single instrumental case study design to answer the three primary research questions of this investigation.

## Nature of the Study

There are numerous examples of internal control material weaknesses in municipal governments that contribute to employee embezzlement (Aikins, 2011; Aikins, 2012; Berkshire Eagle, 2013; Camilli, 2013; Elson & Dinkins, 2009; Hammersley et al., 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrjean, 2013; Verschoor, 2012; Wechsler, 2012; Zecheru, 2012). The literature on the topic of internal controls in municipal government financial management reveals that there is a need for additional research in the area of municipal government internal control effectiveness (Coram, Ferguson, & Moroney, 2008; Cosmin, 2011; Dorminey et al., 2012; Elmore, 2013; Hermanson et al., 2012; Jones & Bowrey, 2013; Murphy & Dacin, 2011). To address this need, the researcher used a qualitative single instrumental case study design to investigate the topic of municipal government financial management and internal control effectiveness. As Yin (2014) and Merriam (1998) noted, a case study approach allows a researcher to gather and analyze data within a defined set of boundaries to gain an in-depth understanding of the case under examination. A municipality that has experienced a financial embezzlement of more than \$50,000 was selected as the case for this investigation. The mayor, city manager, finance director, auditors, certain local business owners, and members of the news media were interviewed as a way to gather data for this project's case study. Archival records in the form of audit reports, bond rating reports, fund balances, internal control policies in place before and after the discovery of the embezzlement, internal e-mails, news articles, and news editorials were gathered as a way to obtain additional information on the nature and extent of the embezzlement. This research contributes to fraud triangle theory, bureaucratic

management theory, and theoretical perspectives on the topic of municipal government employee embezzlement.

### **Significance of the Study**

Existing research shows that the phenomenon of municipal government employee financial embezzlement is a serious issue for many communities across the country (Aikins, 2011; Aikins, 2012; Berkshire Eagle, 2013; Camilli, 2013; Elson & Dinkins, 2009; Hammersley et al., 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrjean, 2013; Raghavan, 2011; Verschoor, 2012; Wechsler, 2012; Zecheru, 2012). With 89,386 municipal or special purpose governments in the United States (National League of Cities, 2013), there is a need for financial managers and municipal public officials to understand the barriers to financial internal control implementation to detect or deter municipal government employee embezzlement, to understand why effective internal controls are not implemented, and to understand the consequences to the municipal government from a known incident of employee embezzlement. To this end, the current investigation was based on a single instrumental case study research project in order to examine municipal government employee embezzlement from the perspective of a municipal government that experienced a multi-year employee embezzlement of at least \$50,000. The outcomes of this project should not only assist local government managers and elected officials better prepare their own organizations to detect or deter embezzlement, but also add to the body of theory on bureaucratic management theory and fraud triangle theory by filling a gap with respect to the phenomenon of a high-dollar multi-year municipal government employee embezzlement.

## Definition of Key Terms

**Community population.** A community population is the population of the municipal government community as listed for 2010 from the United States Census Bureau (United States Census Bureau, 2014).

**Embezzlement.** “Embezzlement is the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come. It differs from larceny in that the original taking was lawful, or with the consent of the owner, while in larceny the felonious intent must have existed at the time of the taking” (US Department of Justice, 2016).

**Financial internal controls.** “A financial internal control is a process, affected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance” (Wilkins & Haun, 2014, p. 48).

**Municipal government.** A municipal government is a city, village, town, or county responsible for providing municipal services such as water supply, property tax collection, police, parks, recreation, sewage, building codes, street lighting, and roads (Libonti, 2012).

**Professional municipal government manager.** A professional municipal government manager is a city manager, city administrator, village manager, village administrator, or similar job title who is an active member of the International City/County Management Association (ICMA, 2014).

**Segregation of duties.** “Segregation of duties (SOD) is a basic building block of sustainable risk management and internal controls for a business. The principle of SOD is

based on shared responsibilities of a key process that disperses the critical functions of that process to more than one person or department. Without this separation in key processes, fraud and error risks are far less manageable” (Ghosn, 2016).

### **Summary**

The information presented in chapter one included an introduction into the phenomenon of multi-year municipal government employee embezzlement, a background on the problem, a succinct statement of the problem, and detailed information on the purpose of the study. Additionally, data included the theoretical framework to be used with this study, a listing of the three research questions for the study, a description of the nature of the study, information on the significance of the study, and definitions of key terms used in the study. With 89,386 municipal governments or special purpose municipal government entities in the United States (National League of Cities, 2013), there is a need for municipal government managers to identify how internal controls can detect or deter municipal government employee embezzlement (Aikins, 2011; Agarwal & Medury, 2014; Bame-Aldred et al., 2013; David, 2009; Dorminey et al., 2012; Elmore, 2013; Elson & Dinkins, 2009; Gabriel, 2014; Hermanson et al., 2012; Huefner, 2010, Matkin, 2010; Murphy & Dacin, 2011; Noland & Metrejean, 2013).

Existing scholarly research on municipal government internal controls reveals that the phenomenon of municipal government employee financial embezzlement is a serious issue for many communities across the country (Aikins, 2012; Camilli, 2013; Elson & Dinkins, 2009; Hammersley et al., 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrejean, 2013; Raghavan, 2011; Verschoor, 2012; Wechsler, 2012; Zecheru,

2012) and organization theory, fraud triangle theory, and bureaucratic management theory provided the theoretical framework for this study. Each of the study's three research questions in this qualitative single-case study were designed to promote a better understanding for municipal managers and public officials as to what internal controls can best detect or deter multi-year municipal employee embezzlement, what the consequences are to the municipal government of a known incident of multi-year employee embezzlement, and why municipal government officials did not implement effective internal controls sooner to detect or deter the embezzlement.

The information contained in chapter two includes a detailed literature review that highlights what is already known on the subject of multi-year municipal government employee embezzlement. The literature review includes information on the theoretical perspectives for this research, information about local government financial management, local government internal controls, the use of Sarbanes-Oxley Act reforms in the public sector, the use of whistle-blowers, the use of audit committees, and what is currently known about the consequences of an incident of multi-year municipal government employee embezzlement of at least \$50,000. Chapter three will include methodological information about the research design; population; sample study selection; materials and instruments; the interview protocol; data collection and analysis; research study assumptions, limitations, and delimitations; and ethical assurances that help ensure the study's integrity.

## Chapter 2: Literature Review

The purpose of this review was to analyze literature applicable to understanding how municipal governments can detect or deter financial fraud committed by their employees, to understand why municipal government officials fail to implement effective internal controls, and to understand consequences to the municipal government when an incident of multi-year employee embezzlement of at least \$50,000 occurs. The literature review is important because it identifies what is already known about the phenomenon, and it shows how a new case study research can expand understanding of the topic. The literature review will focus on evaluating existing knowledge on the fraud triangle theory, bureaucratic management theory, organizational theory as an overarching theory, the municipal government internal control environment including internal audits, the external audit function, material weaknesses in municipal government audit reports, the use of audit committees, the Sarbanes-Oxley Act of 2002 and the potential future applicability to municipal governments, employee whistle blowing, local government financial management, local government bankruptcy and bond defaults, local government ethics, consequences of embezzlement, and current cases of local government financial embezzlement. Understanding how municipal government employees commit financial fraud against their employer is important in order to develop effective internal control policies and procedures that will help municipal governments detect or deter employee fraud.

This review is organized into ten sections. The first section is a review of research literature related to the theoretical perspectives of fraud triangle theory (FTT), bureaucratic management theory (BMT), and organizational theory (OT) because OT is



an overarching theory that helps explain organizational behavior. The second section is a review of internal controls and the internal control environment in municipal governments. This section includes the importance of internal controls for municipal government financial management. The third section is a review of municipal government internal and external audits, including audit committees and the role an audit committee can play to help ensure that an organization's internal control environment is effective. The fourth section is a review of the Sarbanes-Oxley Act of 2002 and how there might be future applicability to the standards in that act for municipal governments.

The fifth section reviews literature on the topic of employee whistleblowing and then focuses on how whistleblowing can potentially offer benefits for municipal governments in their effort to detect financial embezzlement. The sixth section is an overview of the basic importance of local government financial management. The seventh section examines information about local government bankruptcies and bond defaults. The eighth section discusses ethics and the importance of a strong ethical climate to promote a positive municipal government financial management environment. The next section is a review of consequences to local governments that experienced a known employee fraud incident and a review of certain recent examples of multi-year local government employee embezzlement. The final section is the chapter review.

### **Theoretical Perspectives**

Bureaucratic management theory (BMT) and fraud triangle theory (FTT) are the foundational theories for this research study. Bureaucratic management theory is a subset of a larger theoretical concept known as organizational theory (OT). The study of organizations, and the use of OT in the current project, is important because scholars

recognize that change in organizations is political and that implementing organizational change takes premeditated interventions (Battilana & Casciaro, 2012). While OT is not an overarching theory for this study, its general tenets overarch the theories of FTT and BMT, and as such, having a basic understanding of OT is important. OT considers organizations as meaningful and yet discrete units of analysis with fluid dynamics that change with time (Davis, 2010). Organizational theory has been studied for over half a century (Davis, 2010), and the study of organizational theory is important to understanding the performance of individuals who operate within organizations (Greenwood & Miller, 2010).

According to OT, organizational actors behave in patterns that are routine and often viewed as the only possible way to behave (Battilana & Casciaro, 2012). It is only by breaking with the norms of an organization that a municipal employee will commit embezzlement; thus, knowing the organization's norms is the first step in understanding the point at which the employee broke from these norms (Davis, 2010). Other researchers take this concept further by examining the relationship between organizational change and the degree of that change as it relates to the status quo (Battilana & Casciaro, 2012). The results of the research show that organizational change is difficult to implement, yet when the change agent uses personality and reduces structural holes within the organization's network, that change is easier to accomplish (Battilana & Casciaro, 2012). The authors of this study explained that organizational structural holes relate to the social influence of the change agent. The more influential the change agent, the fewer structural holes will exist (Battilana & Casciaro, 2012). Additional research shows that proponents of organizational theory hold that organizations often remain the same over long periods

of time, unless some significant outside source puts pressure on the organization to change (Nielsen, 2013).

Greenwood and Miller (2010) explained how important it is for organizations to understand that the management of collective effort is improved when there is a thorough understanding of the organization's design. Some research has suggested that organizations are too mechanical and do not have the ability to change (Cornelissen & Kafouros, 2008). By design, organizational theory is about the collective efforts of an organization's stakeholders (Greenwood & Miller, 2010). How an organization brings together its people and resources will often dictate the organization's efficiency, effectiveness, and success (Greenwood & Miller, 2010). If an organization is poorly designed, it can all too easily fail to achieve the collective goals of its stakeholders (Greenwood & Miller, 2010). Using the research results of Greenwood and Miller (2010), a municipal government organization's design might prevent its management from developing internal controls, simply by not requiring them. If external auditors make mention of weaknesses in a government's internal control environment but do not mandate changes after having recommended them in an audit report, that organization's design might be part of the problem regarding why effective controls do not exist prior to the discovery of a fraud event. This new case study research helps further explain what is known about the phenomenon of municipal embezzlement by answering the research question regarding why the government failed to adequately implement internal controls prior to the discovery of the multi-year fraud event.

According to OT scholars, organizations are highly complex entities accountable to different stakeholders (Boxenbaum & Rouleau, 2011; Greenwood & Miller, 2010).

The design of the organization is based on various behavioral and economic factors (Greenwood & Miller, 2010), and change in organizations occurs due to political influence and premeditated interventions (Battilana & Casciaro, 2012). The rationale for this research study's use of organizational theory is predicated upon several propositions. These include the propositions that organizations are complex entities with symbiotic qualities (Stacey, 2007) and that communication within organizations resonates throughout the organization (Raukko, 2009). Organizational theory also had utility for the current project insofar as it provided a focus for each of the research questions (Schallock, 2009) by providing a conceptual framework for this exploratory case study (Palmberg, 2009).

Bureaucratic management theory informs researchers and local government practitioners addressing the problem of local government employee embezzlement by explaining how bureaucratic structures can affect organizational outcomes (Fleischman, 2014; Gittell & Douglass, 2012; Hirst, Knippenberg, Chen, & Sacramento, 2011; Sager & Rosser, 2009; Stensota, 2011; Wise, 2004). Bureaucratic management theory was used in this project to understand the inherent limitations of local government bureaucratic structures (Heady, 1959; Stensota, 2011; Van Buren III, 2008; Wise, 2004). Scholars have noted the need for new research in this area (Aikins, 2011; Cosmin, 2011; Hammersley et al., 2012; Jones & Bowrey, 2012; Mead, 2008). The current investigation adds to the existing body of theory on this topic.

According to BMT, organizations are impersonal institutions with a strict hierarchy and employee rules (Heady, 1959; Sager & Rosser, 2009; Van Buren III, 2008; Wise, 2004). The study of bureaucracy is important to show the impact that public

employees have on the public interest, especially when one considers that public employee attitudes are affected by the nature of a bureaucracy (Wise, 2004). A more recent study of street-level bureaucracy revealed that local pressure might affect local government and in so doing, cause that local government to operate differently (Stensota, 2011). According to Stensota (2011), political preferences often influence policies; however, policy implementation must be left up to administration, and as such, political pressures should not influence policy implementation. This might be important because a working theory for why a municipal government did not implement effective internal controls prior to the discovery of an incident of multi-year employee embezzlement is that there was no political pressure to implement such policies and that the administration is not going to implement them on their own accord. This working theory might be supported by the findings of Perrow (1985) who suggested that bureaucracies can evolve, but the assumption is that this evolution occurs primarily as a function of environment.

The study of bureaucracy is important because it helps describe the effect public employees have on their achievement of goals that are in the public interest (Wise, 2004). Bureaucratic management theory states that organizations are impersonal institutions (Van Buren III, 2008) and that actors within the bureaucracy follow a certain set of organizational rules (Heady, 1959; Wise, 2004). Bureaucratic organizations are often described as filled with red tape, as being inflexible, and as having managers who are not willing to exercise decision-making discretion (Heady, 1959). There are often rigid sets of written rules provided to those who work within the bureaucracy, and there is a strict hierarchy of authority to ensure order (Perrow, 1985; Van Buren III, 2008). Additionally, bureaucracies are described as structures with task specialization, operating in a formal

manner, and having specific career ladders for employees to climb (Perrow, 1985). According to Perrow (1985), the very nature of “traditional workers” (p. 286) does not lend itself to an effective bureaucratic organization. Classical BMT theorists such as Wilson and Hagel suggest that the hierarchical nature of bureaucracies is a good thing because the misuse of power (e.g., fraud) can be reduced as a direct result of a hierarchical organizational structure, with employees always knowing to whom they must answer (Sager & Rosser, 2009).

There is literature on bureaucracy that addresses employee attitudes and organizational norms as influential factors that explain output and behavior (Stensota, 2011). Employee attitudes within local government are very important because local governments serve their citizens through employee actions. Generally, local governments do not make things for sale, but rather they carry out specific functions authorized by their governing body to serve people. As the employees of the local government carry out this service function, it is important that they keep a positive workplace attitude. Positive employee attitudes in the workplace might explain why an employee is willing to offer suggestions for ways to improve operations, such as implementation of internal controls. Moore (2010) espouses the suggestion that a positive workplace environment can benefit public administrators in their efforts to detect or deter fraud. Moore (2010) also stated that open communication could help foster collaboration, encourage feelings of employee loyalty, and even provide employees with a sense of ownership in the organization. Employee attitudes are clearly important in the effort to reduce fraud, abuse, and waste (Moore, 2010).

One aim of this research was to reveal information about how employees feel about working for the municipal government, what the employees' views were regarding organizational rules, and whether they felt any desire to offer suggestions for changing the status quo of operations prior to the discovery of the embezzlement. This type of bureaucracy might be considered "relational bureaucracy" (Gittel & Douglass, 2012, p. 709). Relational bureaucracy includes a two-way effort between management and staff to maximize production, coordination, and leadership within an organization (Gittel & Douglass, 2012). An example cited by Gittel and Douglass (2012) is that of Southwest Airlines. Employees are taught that customers are family, and as such, they are treated like family, although that does not mean that family is allowed to be abusive. All positions within the organization are equally important, from the skycap to the pilot, and employees know that if they ever have concerns that they can go to management for an honest two-way communication about the issue (Gittel & Douglass, 2012). This type of relational bureaucracy differs from a traditional bureaucratic model as espoused by Heady (1959) and many others; this type of bureaucracy might be beneficial for municipal government organizations in their efforts to adapt to challenges that face the organization.

A municipal government that treats its employees like equals, that listens to employees and truly values them, and that treats the citizens they serve like family, might just improve employee output as espoused in Stensota (2011). Employee output, for the purpose of this paper, means employees of the municipal government that feel like they can blow the whistle on suspected wrongdoing, that feel like they can offer suggestions to improve operations (i.e., ways to better detect fraud), and that feel like they have a voice

within the organization. Although this study's goal was not to study employee attitudes, it is possible that employee attitudes will reveal useful information to help answer the research question about why the local government did not implement effective internal controls before the discovery of the embezzlement.

There are many management theories of the twentieth century, but bureaucracy theory is the one that is most concerned with managers being restricted from accomplishing what is best for the organization because of rules and procedures (Heady, 1959; Van Buren III, 2008). There are bureaucratic motives that drive organizational outcomes, and understanding how managers and policy makers create policy in public organizations is an existing research need (Wise, 2004). Bureaucracies within the public sector traditionally stifle employee inventiveness, and unless local governments change the traditional bureaucratic paradigm, the public sector will continue to struggle with its ability to perform beyond the status quo (Lapsley & Skaerbaek, 2012). This new case study research is important because it might contribute toward a call for additional research to determine if local government employees will prevent their fraudulent acts if the effort to commit the act increases (Barra, 2010). The rationale for this research study's use of bureaucratic management theory is that if it can be determined that the bureaucratic structures in place within local government organizations are contributing to a lack of effective financial controls that provide opportunity for employees to commit embezzlement, public managers and elected officials can institute measures to detect or deter employee fraud.

Fraud triangle theory is a theoretical model drawn from fraud theory that examines why someone commits fraud (Dellaportas, 2013; Dorminey et al., 2010;



Kassem & Higson, 2012; Trompeter et al., 2013). The theory is that people commit financial fraud because of a problem in their life that they are not able to share with others, mainly because that problem is considered too embarrassing or will cause shame (Dellaportas, 2013). If municipal government officials can remove one of three things present in incidents of employee fraud, the government can possibly stop the fraud from occurring. These three things are pressure, opportunity, and rationalization (Dellaportas, 2013; Gabriel, 2014; Dorminey et al., 2012), which other researchers have referred to as rationalization, opportunity, and incentive (Stalebrink & Sacco, 2007). Pressures, or perceived pressures, include financial pressures, work-related pressures, vices, or a desire for power or ego (Dellaportas, 2013). Opportunities, or perceived opportunities, include a lack of internal controls to detect the fraudulent behavior, a failure to discipline offenders, apathy toward fraud detection, and a lack of effective audits (Dellaportas, 2013). Rationalization is the reasoning necessary for the person who commits the fraud to feel okay about the event. Common rationalizations include the feeling that something is owed, that nobody will get hurt, the money will be paid back; the organization can afford it, and a feeling of not being treated with respect (Dellaportas, 2013).

According to FTT, an employee commits fraud after feeling pressure, having the opportunity to commit the crime, and rationalizing the action (Dellaportas, 2013; Dorminey et al., 2010; Kassem & Higson, 2012). While pressure and rationalization are two elements of fraud triangle theory that were not directly explored by the research questions in this research study, the opportunity to commit fraud, as something municipal government officials can influence, was directly addressed by the research questions. This is because if people perceive that they do not have adequate opportunity to get away

with the crime, they might not even try to commit that crime (Dellaportas, 2013; Dorminey et al., 2010; Kassem & Higson, 2012).

Fraud triangle theory informs researchers and local government practitioners addressing the problem of local government employee embezzlement by explaining the causal relationship between certain conditions and employee embezzlement (Dellaportas, 2013; Dorminey et al., 2012; Gabriel, 2014; Stalebrink & Sacco, 2007). The rationale for using fraud triangle theory in this research study rests upon the fact that if municipal government officials understand the value of restricting or removing employee opportunity to commit financial fraud, the municipal government will have a reduced risk of embezzlement.

The framework for reducing opportunity includes a risk assessment of the internal environment, the control environment, control activities, monitoring controls, and effective communication (Trompeter et al., 2014). The fraud triangle's value is that financial managers can develop controls to detect, prevent, and remediate fraudulent actions (Trompeter et al., 2014). Government regulations require certain auditors to assess an organization's fraud risk assessments using the core theory of the fraud triangle (Trompeter et al., 2013). Although there are many advantages for an organization to promote programs such as whistleblowing, to reveal an embezzlement, organizations are encouraged to have a comprehensive program that deters or detects financial fraud (Reidy & Theobald, 2011). This new case study research is important because it helps explain the internal control environment as it existed in the organization before and after the discovery of the known employee embezzlement.

Researchers have used both BMT and FTT on numerous occasions to explain employee behavior (Fleischman, 2014; Gittel & Douglass, 2012; Martin et al., 2013; Sager & Rosser, 2009; Wise, 2004). Because local government employee financial embezzlement theoretically occurs in part due to employees having the opportunity to commit the crime, and because government bureaucracy possibly interferes with implementation of adequate internal controls that could have detected or deterred the crime, it is logical to use both BMT and FTT as lenses to view and examine a case study of the phenomenon of multi-year municipal government employee embezzlement of at least \$50,000.

### **Internal Controls**

Local governments have a vast amount of financial resources to manage each year and ensuring that their internal control environment is sound can help detect or deter fraud by strengthening the risk management environment of the organization. According to Kapic (2013), internal control is a risk management instrument. Ensuring a sound system of internal controls is important before something negative happens because effective internal controls in municipal government financial management should not be the result of a scandal after years of apathy on the part of the municipal governing body (Huefner, 2011). Internal controls include the control environment, control activities, information and monitoring, risk assessment, and monitoring (North Carolina Department of the Treasurer, 2011). Additionally, effective internal controls are those that prevent fraud, those that detect fraud if it occurs, and those that correct weaknesses once a problem is discovered (Dorminey et al., 2012; Miller, 2012). Even though financial policies might exist in municipal government entities, there are few legal

requirements for financial internal controls at the municipal government level (Governmental Accounting Standards Board, 2013). Given the absence of legal requirements for local governments to adopt effective internal controls to help safeguard their financial resources, the aim of this study was to provide information related to actual high-dollar, multi-year fraud events at the local government level so that other local government leaders can better protect their own organization's financial resources from fraud. This study is important because a sound internal control system helps to detect or deter material weaknesses and helps ensure reliable financial reporting (Abiola & Oyewole, 2013; Devries & Kiger; Etheridge, 2012; Filipiak, 2009; Kopic, 2013; Moore, 2010; Tsay & Turpen, 2011). Public administrators might not feel as though it is their responsibility to implement internal controls unless directed to do so by the governing body; however, public managers are in the best position to identify risks to the organization and to develop internal controls to detect or deter fraud (Moore, 2010).

Even the perception of fraud detection is an important deterrent for an employee committing an act of embezzlement against an employer (Trompeter et al., 2014). According to Reidy and Theobald (2011), organizational embezzlement is much more than just a concern of company management. The responsibility for detecting and deterring fraud is shared with many organizational stakeholders including the board, internal auditors, an audit committee, and the organization's external auditor (Reidy & Theobald, 2011). There has been significant scholarly research in the area of weak governance being associated with a greater likelihood of someone committing organizational fraud (Trompeter et al., 2013). Trompeter et al., (2013) described research that explains how unethical senior managers will continue to be unethical and repeat their

violations of organizational behavior. That research suggested the importance of detecting or deterring public sector embezzlement because multi-year embezzlement of a municipal organization can have serious consequences for the municipality (Elson & Dinkins, 2009). This is one of the reasons that this new case study research is important.

Modern public accounting practices call for different aspects of finances to be put under the control of multiple people (also called segregation of duties), so that no one person in an organization can receive, spend, transfer, or otherwise control money without the participation of others in the organization (Kapic, 2013; McDermott, 2012). As a general overview, prevention, detection, and corrective procedures are the three main parts of a good control environment (Kapic, 2013). Preventive controls are designed to prevent a fraud from occurring, and while many frauds are probably stopped at this level, the other two levels are very important (Kapic, 2013). The second level of the control environment, detection, is designed to detect actual fraud events that for whatever reason were not prevented (Kapic, 2013). The final level is corrective controls, and those are designed to ensure that better controls are implemented when detective controls identify a weakness in the control environment (Kapic, 2013). This new research is important because even with prior research and knowledge of some of the causes of financial fraud, of 307 financial audits conducted by one auditing firm in the state of New York between 2003 and 2009, 1,587 internal control deficiencies were noted (Huefner, 2011). Clearly, internal control deficiencies were not corrected before an audit and this new research will help identify some of the reasons why an organization that experienced a multi-year, high-dollar fraud event failed to implement effective controls prior to the discovery of the fraud.

Internal controls are an essential part of municipal governments' fraud risk assessment, with the managers playing a key role in ensuring that the internal control environment is effective (Moore, 2010). Early fraud detection is almost twice as effective at detecting fraud as compared to the use of only traditional external auditing (Lee, Churyk, & Clinton, 2013). This statistic reveals the importance of municipal organizations in having an effective internal control system in place before the discovery of a fraud incident involving a municipal employee. Examples of ways to improve an internal control environment within an organization's administrative controls are to require approval of purchase orders before the purchase occurs, using pre-numbered purchase orders, ensuring that all orders are received and inventoried, and monitoring the condition of the suppliers to ensure that the organization is buying at a discount when possible (Kapic, 2013). Even with this prior research data, a recent Internet search revealed dozens of recent fraud events involving local government employees. This new research aimed in part to help understand why local government leaders fail to implement effective internal controls before an actual fraud event within their organization. This new case study research also examined the internal control environment in a municipality that experienced a known incident of multi-year, high-dollar embezzlement, and in so doing added to the existing knowledge base on effective internal controls.

Implementing an effective internal control system at the municipal government level is important, yet public officials must realize the cost limitations of such a system (Kapic, 2013); a positive cost to an effective internal control system is that they are "value-added activities" (Murphy & Tibbs, 2009, p. 127). Studies have revealed that internal control policies are effective (Amoruso, Brooks, & Riley Jr., 2005; Barra, 2010;

Dey, 2010; Gagliardi, 2014; Gilfillan & Bacon, 2013; Gissel, 2014; Grill, 2014; Hermanson et al., 2012; Kapic, 2013, Tsay & Turpen, 2011). Additional qualitative research is needed to better understand municipal government internal control methods (David, 2009; Davies, 2008; Hermanson et al., 2012; Lee & Fargher, 2013). As such, the objective of this project was to examine the internal control environment in a municipal government with a known incident of multi-year embezzlement of at least \$50,000. This will help to contribute to theory and add to the existing knowledge base about effective internal controls.

A material weakness in internal controls is defined as a deficiency or several deficiencies that create a reasonable possibility that a material misstatement in the financial reports will not be prevented or detected in a timely manner (Elson & Dinkins, 2009; Etheridge, 2012). Local government organizations are often designed to have employees working in multiple different areas of the community. A local government organization needs to have proper internal controls in place to help ensure that management policies are implemented at all levels of the organization (Tsay & Turpen, 2011). In 108 audits from 300 towns and villages in New York between 2003 and 2009, 456 specific control deficiencies were identified for cash receipts and disbursements (Huefner, 2011). The results revealed that of 234 town and village audit reports reviewed for control deficiencies, the researchers discovered 1,587 total deficiencies (Huefner, 2011). Effective internal controls contribute to a municipal government's financial resources, as they help improve delivery of services to the community, and they help keep municipal taxes at a minimum (Huefner, 2011). Raghavan (2010) found that financial issues at the local government level usually were the result of a failure of the

organization to implement an effective internal control system. The consequences of those local government financial management failures included city officials resigning, capital projects being cancelled, public officials jailed, and in every circumstance, the taxpayer bearing the financial consequences of the failures (Raghavan, 2010).

The researcher examined whether internal control material weaknesses existed in the case study community and how municipal government officials reacted after learning of the weaknesses. Failing to mitigate the weaknesses in the control environment allowed the employee's financial embezzlement to continue undetected. The current research project shed light on this issue.

### **Internal and External Audits**

Municipal government audits identify material weaknesses in internal controls, yet municipal governments do not always implement new internal control policies because of external auditor recommendations (Aikins, 2012; Elson & Dinkins, 2009; Huefner, 2011). Internal audits positively affect the municipal government audit process and often result in municipal government adoption of audit recommendations (Aikins, 2012). Researchers have made significant progress in understanding important qualities of an effective internal audit function including competency, objectivity, and performance (Bame-Aldred et al., 2013). Despite these advances, researchers still noted that there is a need to investigate the municipal government internal and external audit environment process (Davies, 2009; Lee & Fargher, 2013; Soltani, 2014). This new case study research contributes to this knowledge base.

Internal and external audits provide similar functions of ensuring financial accountability so that both types of audits working in conjunction with each other add



value to the internal control environment (Gheorghe, 2008; Jones & Bowrey, 2013). External audits are mandated for publically traded companies (Ahmed, McAnally, Rasmussen, & Weaver 2010; Dey, 2010; Zhang, 2007) and they are often required for municipal government units (Jones & Bowery, 2013). Organizations with internal audit functions are more likely to detect or deter fraud (Coram et al., 2008; Moore, 2010), and effective internal audits are able to provide important resources for an organization as they offer unique insight into an organization's climate, culture, operations, and risk (Jones & Browery, 2013). Internal auditors can be community volunteers, elected officials performing the function, or certain employees of the organization, and the function of internal auditors is to supplement management's work and combine that with a solid understanding of organizational risks of fraud, company operations, controls, and then to position themselves to best support management (Reidy & Theobald, 2011). Internal controls are not likely to be effective without someone, or a group of people, performing internal audits and ensuring compliance with internal control policies (Moore, 2010). According to Moore (2010), internal auditors can help ensure that written policies exist regarding prohibited activities, ensure that mechanisms are in place to safeguard assets, and can proactively audit various aspects of organizational operations.

An audit committee is a way for a municipal government to provide an independent review of financial reporting, internal controls, and independent auditors (Government Finance Officers Association, 2014). Audit committees are financial-oversight committees used by nearly 50% of U.S. municipal governments (Matkin, 2010), although another study estimates that only 28% of U.S. governments have audit committees (Eckhart et al., 2001). Audit committee members are encouraged to consider

specific fraudulent schemes as well as how one might conceal the act; in so doing, the committee can develop a risk assessment to determine how effective the organization's internal controls are in detecting or deterring fraud (Trompeter et al., 2013). Audit committees are also a way to provide another forum separate from management for auditors and other stakeholders to talk openly about financial concerns of the organization (Raghavan, 2010). Indeed, the U.S. Government Accountability Office recommends that public sector entities use audit committees (George, 2005). Research shows that organizations with large audit committees are more likely to ensure remediation of identified weaknesses within the organization's internal control environment; this remediation effort can help reduce the risk of fraud within the organization (Hammersley et al., 2012). There is much research on reducing opportunity through the control environment, including examining the effectiveness of audit committees, and weaknesses in the overall internal control environment are often associated with embezzlement (Trompeter et al., 2014). According to Raghavan (2010), the creation of an audit committee should be required for all government organizations.

Government internal audits contribute positively toward risk management of financial operations (Aikins, 2011; Agarwal & Medury, 2014). Effective internal control audits assess operational risks, mitigate those risks, and evaluate ways to enable organizations to accomplish operational objectives (Aikins, 2011; Etheridge, 2012; Matkin, 2010). An examination of controls over financial reporting helps to determine the validity of financial statements (Matkin, 2010), and unless these government financial statements accurately reflect the true financial condition of the government, organizational stakeholders cannot possibly understand the government's financial

position. Auditor recommendations for improving internal controls provide municipal government managers with the opportunity to strengthen controls over financial operations (Aikins, 2011). To improve internal control effectiveness, the need for documented financial management internal control policies is vital (Aikins, 2011; Cosmin, 2011). In this new case study, the researcher examined the internal control policies within a specific municipal government and assessed how those policies changed from before the discovery of the multi-year employee embezzlement to after the discovery.

Many municipal governing bodies are not particularly well qualified, nor inclined, to perform any audit-related functions (Huefner, 2011). Inadequate monitoring leads to weaknesses in internal controls (Soltani, 2014), and these weaknesses in internal controls provide an environment for fraud, abuse, and waste (Huefner, 2011). Fraud, waste, and abuse could potentially add up to higher costs paid by taxpayers (Huefner, 2011). Because municipal governments operate on limited financial resources and must provide public services in a cost-effective manner to main the lowest property taxes as possible, it is important to keep expenditures to a minimum. Keeping this in mind, internal audit committees that are effective might reduce the cost to a municipal government for an external audit (Bame-Aldred et al., 2013).

Internal auditors can help promote trust in municipal government, and this trust is a necessary element for democracy (Elmore, 2013). Government audits add value to the organization, but their effectiveness depends on the capabilities of the members of the organization (David, 2009). Both internal auditors and external auditors can benefit from analysis of a specific organization's risks toward a fraud event occurring within that

organization (Trompeter et al., 2013). The person committing the fraud used certain elements to commit the fraud and the implementation of internal controls, which are outside of the control of the fraudster, increases the chances that the fraud will be detected or at least be less severe (Trompeter et al., 2013). With all of this in mind, research has shown that there are issues associated with a local government implementing the process of an independent audit committee (Frank & Fink, 2008). These challenges include the independent audit committee not receiving full support from local elected officials because of a perceived view that the committee has too much power, a perceived threat by senior managers that the independent audit committee has too much control over selection of the external auditor, and the challenges associated with finding qualified people to serve on the committee (Frank & Fink, 2008). This new research attempted to reveal useful information regarding the reasons why a municipal government did not implement an audit committee.

An auditor's role as it relates to organizational fraud includes more than just an examination of the basic requirements of the fraud triangle (Trompeter et al., 2013). Trompeter et al. (2013) explains that the auditor's role when examining the possibility of organizational fraud includes looking at inherent risk, detection risk, and control risk. The auditor must examine the organization's existing fraud detection procedures and the consequences of financial reporting by looking at management's likelihood of committing financial fraud. While these additional auditor roles with respect to fraud are important, the auditor must still design uniquely for the specific organization under examination using the basic principles of the fraud triangle (Trompeter et al., 2013). While no amount of internal controls, internal audits, audit committee work, or

preventative measures can guarantee that an organization will not have an employee at least attempt to commit financial embezzlement, effective internal controls can certainly reduce that risk.

Additional research is appropriate in the area of audit committees, including whether the audit committee is staffed by internal employees or outsourced to an outside entity (Coram et al., 2008). Cooperation between internal auditors and external auditors can be beneficial for improving the effectiveness of the audit function (O'Regan, 2013). Many municipal governments do not have an audit committee; one of the primary reasons for not creating an audit committee is that there has not been a financial scandal in the organization (Matkin, 2010). The municipality for the case study does not have an audit committee.

### **Sarbanes-Oxley Act of 2002**

The Sarbanes-Oxley Act of 2002 (SOX) was passed in Congress in July of 2002 in response to corporate scandals, with the Enron and WorldCom situations being the primary impetus (Nezhina & Brudney, 2012; Zhang, 2007). The SOX Act was also created out of perceived necessity at the time of its adoption and was enacted due to multiple corporate financial scandals and a lack of proper financial oversight of publically traded companies (Calderon, Wang, & Conrad, 2012; Dey, 2010). SOX is considered one of the most far-reaching securities legislation passed in Congress in the previous 80 years (Zhang, 2007), and the theory is that organizational stakeholders are helpless without accurate financial reporting information from which to make accurate judgments about the organization (Volonino, Gessner, & Kermis, 2004). The SOX legislation is the result of several bills put forward by Senator Sarbanes and

Representative Oxley. The various bills made their way through Congress more easily than they might have due to the WorldCom scandal in June of 2002 (Zhang, 2007). This legislation was designed to promote effective internal financial controls of publically traded companies on Wall Street in order to reduce the possibility of corporate fraud.

The basic premise of the SOX Act is to mandate company control systems and processes that will protect the public interests (Volonino, Gessner, & Kermis, 2004). The purpose of the act was to improve the accuracy and reliability of corporate disclosures (Jennings, 2012; Volonino et al., 2004; Wang, 2013), and one of the many new requirements was for publically traded companies to implement whistle-blowing programs (Reidy & Theobald, 2011). Whistleblowing programs within organizations will be discussed below in this literature review. Another significant responsibility put onto a company's CEO is the requirement for analyzing the internal control environment within the organization (Volonino et al., 2004). This might be important for municipal government operations because it is probable that senior managers of municipal organizations do not have the understanding, expertise, or desire to implement new internal controls, even if existing audit reports identify internal control material weaknesses.

The SOX Act of 2002 mandated that an audit firm hired by a publically traded company does not do any other work for that organization (Ahmed et al., 2010; Dey, 2010; Zhang, 2007). The act stipulated that an independent audit committee is required. This committee must be made up of members of the company's board of directors and, no audit committee member can have any close relatives working for company management (Dey, 2010; Jennings, 2012). The audit committee is responsible for the

hiring, compensation, and oversight of the public accounting firm conducting the company's audit and certifying the financial statements (Ahmed et al., 2010; Zhang, 2007).

SOX prohibits the firm from arranging executive loans, requires CEOs and CFOs to certify annual and quarterly reports to the SEC, and raises criminal penalties for corporate fraud and white-collar crime (Dey, 2010). Officers who certify financial statements either recklessly or knowingly are subject to criminal penalties (Dey, 2010). Company management is required to document and assess the effectiveness of internal controls (Zhang, 2007). If there is an accounting restatement as a result of material misconduct, the company's CEO and CFO are required to reimburse any incentive-based pay or profits from the sale of stock received within the 12 months following the misreporting (Dey, 2010; Zhang, 2007).

Despite the passage of the SOX Act, there have been several highly visible scandals in the nonprofit sector in recent years, and these scandals erode public confidence in these organizations (Mead, 2008). It is important for municipal governments to consider the benefits of adopting Sarbanes-Oxley type reforms that can help improve the internal control environment within an organization (Mead, 2008; Frank & Fink, 2008; Wang, 2013). Three specific Sarbanes-Oxley reforms that might be beneficial to implement at the municipal government level are requiring officers to certify financial statements, requiring independent audit committees, and mandating audits (Elson & Dinkins, 2009; Mead, 2008). Survey results from 42.2% of municipal finance officers from Florida and Ohio indicated that these officers support the adoption of certain aspects of the SOX Act for municipal governments (Frank & Fink, 2008).

Implementation of certain requirements of the SOX Act might create financial or other burdens on municipal governments that outweigh the benefits associated with their implementation (Frank & Fink, 2008). This is because there is evidence that governance and financial reporting are strongly linked (Hoitash et al., 2009). The SOX Act has many different components, and because each one imposes different requirements upon an organization, municipal governments considering adoption of any of those standards should carefully assess the standard before adoption (Matkin, 2010). Contrary to the goal of private companies, municipal governments generally do not have a goal to gain profit from their activities, given that their goal is instead to spend public funds wisely (Lehoczky & Simon, 2007). The Sarbanes-Oxley Act has proven benefits in that companies are showing significant declines in the number of reported material weaknesses between the years 2004 and 2010, indicating that more organizations are implementing effective internal controls (Calderon et al., 2012). Even if local governments do not implement SOX-style reforms, research has shown that some non-profit organizations proactively reexamined their own internal control systems and improved those systems because of SOX's requirements (Nezhina & Brudney, 2012). Municipal governments often have numerous city council (or board) members who are elected for staggered multi-year terms. These cities sometimes have professional managers, and these professional managers might not be fluent in financial reporting language. A challenge to implementation of SOX-type reforms will be the necessity to bring all council members of a municipal organization up-to-speed on financial reporting requirements. With council turnover, this would possibly be a daunting task.



Existing research has shown that there is little effort from local government officials to use comparative data for analysis of their own fiscal stability, and having increased information might prove beneficial for local government officials (Modlin, 2010). One of the possible interview questions to be used with this case study is whether the municipal government used comparative analysis data, at any point prior to the discovery of the embezzlement, in order to help determine whether fiscal stress factors existed in their organization, and if so, whether they were unique to that specific municipality. Knowing this information might have provided management with an indicator that something was amiss and that an investigation into the finances was appropriate. A study of the real-world experiences in a municipal government that experienced a high-dollar embezzlement from an employee of the organization over a multi-year period can add to the knowledge base of the possible costs and benefits of implementation of Sarbanes-Oxley requirements at the municipal government level. Even if SOX-type requirements are not appropriate, other research promulgates the possible benefits of state oversight of local government finances (Modlin, 2010).

### **Employee Whistleblowing**

According to Somers and Casal (2011), organizational whistle blowing is defined as “the disclosure by organization members (former or current) of illegal, immoral, or illegitimate practices under the control of their employers to persons or organizations that may be able to effect action” (p. 152). Another definition of whistle blowing is “the disclosure of organizational wrongdoing by internal or external parties either within the organization or publicly to outsiders who may be able to effect a positive change in action or activities” (Hargrove & Raiborn, p. 299). The researchers examined ways to

detect or deter organizational fraud, and the use of whistle blowing policies as part of an internal control system can be an effective organizational tool to helping detect fraud (Hargrove & Raiborn, 2013; Lee & Fargher, 2012; Noland & Metrejean, 2013). A comprehensive study of CEOs, CFOs, and chief compliance officers, listed whistle blowing as the most effective way to obtain information about illegal activities going on within an organization (Nielsen, 2013).

The effectiveness of whistle blowing policies at the municipal government level will depend in part on the organizational climate of the municipal government (Lee & Fargher, 2012). Existing research has revealed that if employees believe that organizational justice will occur when an employee is identified as having committed workplace violations; those employees are more likely to use whistleblowing as a means to reveal the other employee's acts (Trompeter et al., 2014). Research has also shown that employees are more likely to turn in other employees when there are positive incentives for whistleblowing (Trompeter et al., 2014). Understanding just how important whistle blowing can be is highlighted in a report by the Director of the National Whistleblower Center, who stated that whistle-blowers uncover far more cases of fraud than do paid corporate auditors or internal compliance personnel (Nielsen, 2013). Existing research has suggested that merely reporting a perceived fraud violation to one's supervisor is not necessarily considered whistle blowing and additional research is needed to further explore the types of whistle blowing mechanisms used in organizational settings (Miceli, Near, Regh, & Scotter, 2012).

The Sarbanes-Oxley Act is discussed in more detail in another section of this literature review; however, one of the requirements is that it requires publically traded

companies to establish whistleblowing programs (Dey, 2010; Jennings; 2012; Reidy & Theobald, 2011). The SOX Act states in part that the whistle blowing system established by organizations must allow people to submit anonymous information (Hargrove & Raiborn, 2013). One of the benefits of the SOX Act is that whistle blowing systems implemented by organizations cannot require that the employee report only to the organization. Employees can report directly to the SEC; yet, employers are still encouraged to set up robust self-reporting systems that promote internal reporting (Hargrove & Raiborn, 2013). In addition to the establishment of whistleblowing programs designed to promote employees letting management know when other employees are involved in company-related wrong-doing, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 made an additional requirement that the Securities and Exchange Commission (SEC) reward whistleblowers who report violations of securities law (Hargrove & Raiborn, 2013; Reidy & Theobald, 2011). In addition to the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act, the False Claims Act and the Tax Relief and Health Care Act provide additional requirements for organizations as they relate to whistle blowing (Hargrove & Raiborn, 2013).

The False Claims Act was put into place during the Civil War as an attempt to curtail defense contractor fraud (Hargrove & Raiborn, 2013). The law specified that people who knew of fraud against the United States government could prosecute fraudsters but the law was rarely used until the mid-1980s when a Senate report noted that there was rampant defense contractor fraud (Hargrove & Raiborn, 2013). That Senate report concluded that of the largest 100 defense contractors doing business with the

United States government, 45% of them were under investigation for fraud-related crimes (Hargrove & Raiborn, 2013).

The Tax Relief and Health Care Act made it a requirement for the government to pay whistle-blowers of Internal Revenue Service violations (Hargrove & Raiborn, 2013). This Act created what is a reward system so that the government pays people who inform on tax-law violators so long as the whistle blowing results in the information substantially contributing toward the actual collection of owed taxes (Hargrove & Raiborn, 2013). The amount of the whistle blowing reward can be anywhere from 10% to 30% of the amount of taxes ultimately collected, but the person who blows the whistle cannot have been a Treasury Department employee (Hargrove & Raiborn, 2013).

There were concerns by members of Congress that employees might be harmed due to their decision to blow the whistle on possible fraudsters within their own organization (Hargrove & Raiborn, 2013). Data from a 2011 business ethics survey found that 45% of respondents knew of work misconduct, nearly two-thirds of those people reported the misconduct, and just under a quarter of those people experienced retaliation from their employer as a result of them reporting the wrongdoing (Hargrove & Raiborn, 2013). Another study has shown significant evidence that whistle blowers are retaliated against and experience negative outcomes in a variety of ways because of their decision to blow the whistle on suspected wrongdoing within an organization (Nielsen, 2013). Because of this concern, Congress passed the Fraud Enforcement and Recovery Act of 2009. This Act prohibited employers from retaliating against whistle-blowers, and if an employee believes that they are being retaliated against, the Act provides a course of action for employees to take so that their concerns are addressed (Hargrove & Raiborn,

2013). In addition to these protections, the Dodd Frank Act and the Sarbanes-Oxley Act each provide certain employee protections against possible employer reprisals because of whistle blowing (Hargrove & Raiborn, 2013).

Research has suggested that whistle blowing mechanisms within an organization can lead to improved overall performance and governance; however, if the same employees who might otherwise utilize whistle blowing mechanisms lack confidence in management to do something about a claim of fraud, those employees are not likely to come forward (Trompeter et al., 2013). In addition to concern over management inaction from whistle blowing complaints, another concern is that regulatory agencies do not have the staff resources to process the volume of whistle-blower complaints that come in annually (Nielsen, 2013). Therefore, it is important for organizations to have good internal systems in place with ethical management to enforce workplace rules (Nielsen, 2013). This is no more important than with the Bernard Madoff Ponzi scheme in which a certain whistle-blower tried for years to blow the whistle on the scheme by contacting the U.S. Securities and Exchange Commission; however, that agency failed to do anything about the claim (Nielsen, 2013). Had the government SEC effectively responded to the whistle blowing claim in a timely manner, it is possible that an estimated \$50 billion fraud would have been averted (Miceli et al., 2012). Research has suggested that organizations that have observed employee wrongdoing show lower levels of perceived distributive and procedural justice amongst employees; however, stopping the wrongdoing can be equally as effective for employee morale as preventing it (Miceli et al., 2012).

In a study by Somers and Casal (2011), researchers learned that the most common reason for employees not to report a perceived unethical or illegal organizational activity was they believed that nothing would be done about the problem. That same research reveals that 67% of employees who witnessed embezzlement by another employee purposefully did not report the violation because they thought that company management would not effectively act upon the whistle blowing claim (Somers & Casal, 2011). In addition to employees failing to report an illegal or unethical act by other another employee because of the thought that nothing would be done about it, employees in this study also said that they observed wrongdoing but chose to do nothing because it was not important enough to them (Somers & Casal, 2011). Of all respondents who observed embezzlement, 10% said that they did not report it because it was not important.

A failure on the part of organizational stakeholders to think that embezzlement is not important provides insight into why employees choose not to report what they observe. This implication is significant because the researcher examined the reasons why a municipal government employee was able to commit a multi-year fraud of at least \$50,000. This new research is important because it might reveal important information related to the ethical climate in the organization before and after the discovery of the fraud event. The ethical climate within the municipal organization of the case study before the discovery of the known embezzlement will help answer the research question about the cause(s) of the municipal government not detecting the fraud sooner.

### **Local Government Financial Management**

There has been an increase in public sector financial management research, including research in the area of public accountability (Lapsley & Skaerbaek, 2012).

Since the 1970s, there have been frequent public sector financial disasters with taxpayers picking up the financial pieces of financial mismanagement (Raghavan, 2010). Public sector financial management is important for many reasons, including that a proper reporting of debt and equity helps municipal bond investors properly evaluate the solvency of the local government and their ability to repay debt (Doinea & Lapadat, 2010). Misstatements in financial reporting can happen in both the private and public sector; however, public sector financial management must be vigilant in protecting the accuracy of financial statements to avoid even an unintentional misreporting that leads to bond investor misinformation (Doinea & Lapadat, 2010). Lapsley and Skaerbaek (2012) attributed this additional research to a paradigm of new managerial cultures trying to coexist with traditional longstanding political influence over public finances and financial operations. Public sector financial management helps reduce the incidence of employee fraudulent events, and three top reasons for fraud stem from the following management inaction: poor management practices, people not held responsible for their actions and inadequate training for those responsible for fraud prevention (Huefner, 2010). The need for proper management does not rest solely with company management; local government governing boards have a responsibility to ensure proper oversight of financial operations (Huefner, 2010).

Research by Soltani (2014) revealed that poor senior management ethical climate, including the tone of executive leadership, poor control mechanisms, and executive personal interest were common factors in actual corporate fraud events. Two of those three reasons are applicable for municipal governments; however, it is rare for a senior public manager to be paid a bonus based on the local government's balance sheet results

for a fiscal year. Even though Soltani's research involved corporate organizations, the fact that common causes of fraud dealt with specific senior management actions (or inactions), makes the research applicable to the public sector and therefore important for this research.

Adhering to professional public sector financial reporting is a responsibility of public sector financial managers (Nistor, 2013). Financial management at the public sector is important not only to ensure proper management of limited financial resources, but also to ensure proper reporting in an often-complex rules environment for financial reporting (Nistor, 2013). Public sector financial managers in several states are losing money adhering to risky investment policies (Raghavan, 2010). According to Raghavan (2010), local governments have paid significant fees to exit poorly designed interest rate swap investments, and while many communities have put significant effort into risk management related to disasters or terrorist threats, not enough local governments put adequate effort into proper financial management. Specific examples of improper public sector financial management include a loss of over \$114 million by Cuyahoga County, CA from poorly designed repurchase agreement investments meant to offset low local government investment pool money market interest returns and a failure of San Diego, CA to disclose a funding shortfall of \$1.7 billion for retiree health liabilities (Raghavan, 2010). A public sector's stakeholders must understand their financial risk exposure and professional financial managers can help ensure this occurs (Raghavan, 2010). These examples highlight the importance of professional public sector financial management.

Public sector financial management involves more than just managing financial resources (Nistor, 2013). Public sector budgeting is the primary way in which a local



government legislative body keeps citizens informed about financial priorities and decisions of the governing body (Nistor, 2013). Nistor (2013) discussed the importance of the public sector developing programs that continue into the future. Any local government can budget year-to-year; however, developing long-term budgeting forecast methodologies helps provide an adequate review of finances years into the future so that public sector financial decision makers can make informed decisions. In addition to professional budgeting, it is important for public sector managers to bring accountability to the municipal underwriting process. Unlike their private sector counterparts, local government governing bodies and managers often do not have a good grasp of the nuances involved with providing accurate information in an official statement prior to the sale of a public bond (Raghavan, 2010).

One of the goals of a public sector organization is to provide goods or services and not to generate a profit (Nistor, 2013). Allowing taxpayers to keep as much money as possible while providing important public services is a goal for a professional local government sector financial manager. The importance of professional public sector financial management is revealed by data that show public citizens are “bearing the financial burden” of risky financial investments without understanding all of the associated risks (Raghavan, 2010). Understanding risky financial ventures is important for professional local government financial management; so is having an understanding that revenue from property and sales taxes often fall while expenditures for employee pensions and health-care costs rise (Raghavan, 2010). This new research is important because it was designed to provide information for public sector financial managers on ways they can improve their control environment and thus reduce the risk of employee

embezzlement. A reduced risk of embezzlement helps promote professional public sector financial management and its associated responsibility for managing taxpayer resources.

### **Local Government Bankruptcy and Bond Defaults**

According to Williams and Fadairo (2013), local governments are important for providing services that help citizens in their daily lives and for the overall good of the economy. In the year 2009, the cumulative expenditures of local governments in the United States were 8.7% of the gross domestic product (GDP) (Williams & Fadairo, 2013). This statistic is important because local governments are often reliant upon property taxes as their primary source of revenue, yet this reliance can lead to financial problems for the local government (Williams & Fadairo, 2013). The case study for this research involved a local government employee who stole over \$53 million over 20 years of employment, and it is likely that any local government that loses that much money will experience financial difficulties that result in either a loss of services or higher taxes for its citizens.

Fiscal stress is common at the local government level, and it often results in reduced services for residents (Fudge, 2014). Certain local government organizations are reducing the hours they are open for public services, some are eliminating important social programs (Fudge, 2014), and others are relying more heavily on borrowing (Williams & Fadairo, 2013). According to Williams and Fadairo (2013), evidence shows that local governments that experience financial stress are turning toward borrowing money in order to accomplish certain goals. Debt leads to interest payments and interest payments lead to more money the local citizenry owes to the local government to pay that debt. It is in part for this reason that this new research can provide important information

for local government leaders because effective internal controls can help the local government keep its valuable and limited financial resources for use to serve the public. When the financial situation for a local government causes extreme fiscal stress, it might lead to defaulting on bond payments or even bankruptcy (Fudge, 2014; Williams & Fadairo, 2013).

Municipal bankruptcy is rare in the United States (Scorsone & Padovani, 2014) and according to Williams and Fadairo (2013), there have only been 170 local government bankruptcies between 1988 and 2005. Fudge (2014) put the number of general-purpose local government bankruptcies at only 0.6% of all local governments since 2008. Some of the more high-profile municipal bankruptcy cases in recent years include Detroit, MI, Harrisburg, PA, Central Falls, RI, San Bernardino, CA, Stockton, CA, and Jefferson County, AL. According to Williams and Fadairo (2013), municipal fiscal stress is complex and often involves a variety of factors; this fiscal stress results in municipal government bankruptcy filings. In Orange County, CA, the local government filed bankruptcy in part due to poorly managed and highly leveraged investments based on too much speculation (Fudge, 2014). The city of Vallejo, CA and Central Falls, RI each filed for bankruptcy protection after realizing that financial resources were not able to keep up with required employee pension obligations (Fudge, 2014). Long-term budget forecasting and effective internal controls might have prevented the situation in Vallejo, CA and Central Falls, RI by providing local government finance officials with proper budget management tools so they can better understand the long-term consequences of their current financial decisions. Helping local government leaders to reduce the risk of

fiscal stress by implementing a sound system of internal controls to protect financial resources was one of the goals of this new research.

Defaults on bond payments are another predictor of municipal bankruptcy (Williams & Fadaïro, 2013). A default on a bond payment occurs when the local government does not make a scheduled principal or interest payment, or if it fails to comply with all bond agreement provisions (Williams & Fadaïro, 2013). A local government defaulting on a bond payment is very rare, and of 18,400 municipal bond issuers between 1970 and 2009, there were only 54 bond payment defaults (Williams & Fadaïro, 2013). Even though 54 out of 18,400 is not an alarming number in itself, in recent years the default dollar amount in recent years exceeds \$4 billion (Williams & Fadaïro, 2013). If there is a sudden loss of revenue, a municipality might find itself defaulting on a bond payment or even seeking bankruptcy protection (Williams & Fadaïro, 2013); it is in part for this reason that understanding why a municipal government does not implement effective internal controls that can help protect financial resources is important.

### **Local Government Ethics**

Recent scandals in various firms and organizations raised doubts about the ethical conduct of employees (Somers & Casal, 2011), and a goal of government ethics is to improve the public's trust in public officials (Wechsler, 2012). These public scandals related to malfeasance raise questions related to the very ethical reasoning employed by management, including questions about the values taught to them during their schooling (Somers & Casal, 2011). Organizations that want to reduce risk of employee unethical behavior must set the tone at the top--that includes ethical and honest behavioral

characteristics (Reidy & Theobald, 2011; Trompeter et al., 2014). Existing research has suggested that if an employee believes that management thinks ethics is important, those employees will rely more on their own positive ethical values when they make organizational decisions (Trompeter et al., 2014). A local government interested in helping move the organization forward in a positive ethical direction should understand that leadership and organizational change act as one concept (Burnes & By, 2012).

The importance of a leader in bringing about change is important for local government boards (or city councils) to consider because there are many municipal governments that do not employ a professional city manager. Burnes and By (2012) stated that leadership and change are two of the most important issues facing organizations with problematic environments. Research has shown that one of the best deterrents of employee embezzlement is for senior management to set a very strong, ethical tone that serves as an example for the entire organization (Reidy & Theobald, 2011). According to Bruhn (2009), ethics comes in black, white, and many shades of grey. For local governments, it is important for management ethics to be more black and white because projecting a potential unethical persona can possibly lead employees to believe that management does not care about ethics in the workplace. According to Caldwell, Hayes, and Long (2010), there is a correlation between effective leadership and interpersonal trustworthiness and ethical stewardship. There is a clear connection from prior research (Caldwell et al., 2010) that a municipal government organization can promote positive ethics in all its employees by promulgating strong ethical beliefs in both words and actions from its senior managers. The concept of “service over self” (Caldwell

et al., 2010, p. 508) is one that can help promote a positive ethical climate within an organization.

An ethical collapse in the workplace can occur when the organization is unable to see that clear line between right and wrong (Bruhn, 2009). An empirical study revealed that a leader's moral development and actions would likely affect the organization's ethical climate (Otken & Cenkei, 2012). Every organization forms its own moral identity, whether on purpose or inadvertently, by establishing boundaries of amoral and moral behavior (Bruhn, 2009). It is all too easy for employees in an organization to rationalize unethical behavior (Bruhn, 2009), but fortunately, there are many cities across the country that recently created or improved their own ethics training and programs (Weschler, 2012). These programs, while often unknown to outsiders, are designed to provide training, enforcement, and advice for employees as they face various conflict-of-interest situations (Wechsler, 2012). One of the challenges for local government managers is establishing a strong ethical foundation for the entire organization, because according to Drucker (1981), someone who steals is both immoral and a criminal; however, ethics is not quite as clear-cut. There are other organizations that are not as clear about expectations for ethical behavior, and vague rules for proper ethical employee actions can encourage employees to supplement their own beliefs in the absence of strong ethical belief promulgated by management (Bruhn, 2009).

While Reidy and Theobald (2011) identified a strong ethical tone as the most important element to fraud risk reduction, they also identified the importance of cultivating a questioning mindset that makes it acceptable to question what someone else is doing while being highly communicative with organizational stakeholders about the

real fraud risks that exist. Research has suggested that the ethical culture within an organization as espoused by senior management can have a direct effect on an employee's rationalization for committing a fraudulent act (Trompeter et al., 2013). This same research suggested that if someone were unethical in his or her personal life, that person would tend to be unethical in his or her work life (Trompeter et al., 2013). The ethical responsibilities inherent to leadership state that a leader has to resist any temptation to put self-interest above the moral duty to provide a fiduciary responsibility to the organization (Caldwell, Hayes, & Long, 2010). This research is important because it implies that doing thorough background checks on local government senior managers before hiring can benefit the organization by not hiring someone with a known unethical history. This research is also important because local government tax revenue has declined by 15% (Nielsen, 2010), and any financial loss from municipal government employee embezzlement will only exacerbate the already dwindling revenues for local governments. This research also examined why local governments failed to detect or deter the fraud and whether they implemented internal control or ethics changes after the discovery of the embezzlement. Although scandals are often a driving force for implementing ethics-related changes within an organization, a scandal is not the most effective way to bring about true ethical changes in an organization (Wechsler, 2012).

### **Current Cases and Consequences of Local Government Employee Embezzlement**

The negative effects of municipal government employee embezzlement are widespread. There were 26 municipal government bankruptcies between January 2011 and June 2012, and the problem of municipal government employee embezzlement will only contribute to this number (Maciag, 2012). Additionally, research has shown that

organizations that fail to remediate known internal control material weaknesses suffer consequences of higher audit fees, a greater likelihood of auditor resignation, and worsening credit ratings (Hammersley et al., 2012). A municipal organization with a capital improvement plan that includes borrowing will best serve its citizens by obtaining the best possible credit rating in order to reduce the overall cost of borrowing from otherwise higher interest rates.

Although there is little research into the specific consequences of local government scandals, existing research has shown that misusing government resources can hinder government's performance for citizens, can take away from community pride, and can hinder a community's ability to promote a positive business climate (Wechsler, 2012). Companies that fail to remediate previously disclosed material weaknesses have higher audit fees, a higher likelihood of auditor resignation, a higher rate of failing to meet reporting deadlines, and as a result, they receive poorer credit ratings (Hammersley et al., 2012). Preventing scandals and the misuse of government resources is important for meeting the goal of having the community be an attractive place for business (Wechsler, 2012). There are many ways to improve government financial ethics and controls, but the one too often used is because of a scandal (Wechsler, 2012).

Municipal governments frequently operate with a small number of personnel in order to reduce the tax burden to the community (Maciag, 2012); however, not having an adequate number of personnel for effective implementation of internal control procedures over financial operations provides an opportunity for employees of the municipal government to embezzle funds (Elson & Dinkins, 2009). This new research took an in-depth look at the number of staff within the municipal organization that experienced the



multi-year, high-dollar fraud event to help answer the research question about why the organization did not detect or deter the embezzlement sooner.

Fraud is a major cause of poverty in certain parts of the world, and any fraud by the government can lead to poorer economies (Agarwal & Medury, 2014). For these very reasons, a case study of a known incident of multi-year, high-dollar employee embezzlement within a municipal organization is important for a better understanding of the causes and consequences of the fraud. It is probable that the municipal government had a report from its external auditor that listed certain internal control material weaknesses before the discovery of the fraud event and that these internal control material weaknesses were not corrected in a timely manner, thus allowing the fraud to continue for several years. Once material weaknesses within the internal control environment are identified, it is very important to remediate those weaknesses to improve financial reporting reliability and public confidence in the organization (Hammersley et al., 2012).

Effective internal controls can detect or deter expense account fraud (Noland & Metrejean, 2013). In a report sponsored by the Association of Certified Public Fraud Examiners, the median duration of expense account fraud is 24 months, and the average dollar loss from that embezzlement is \$33,000 (Noland & Metrejean, 2013). The level of complexity was not great for an expense account fraud at the Blue Grass, Kentucky Airport in which the chief executive officer and two others employees embezzled more than \$500,000 of public funds (Noland & Metrejean, 2013). The problem with the Blue Grass, Kentucky Airport case is that the control environment and control activities were ineffective; in fact, an almost complete lack of internal controls allowed employees to

commit undetected expense account fraud for years (Noland & Metrejean, 2013). An analysis of publically traded companies that announced employee embezzlement revealed their failure to implement effective internal controls, resulting in significant loss of shareholder value (Murphy & Tibbs, 2010).

A case involving a municipal employee shows that from 2008 through 2011, Susan Duffy stole from the city of Westfield an amount exceeding \$110,000, primarily cash payments from property tax collections (LaBorde, 2012). Another local government case from the Roslyn School District revealed \$609,000 in poorly documented purchases from two different Home Depot stores for items that likely were not for use at any public school facility (Huefner, 2010). A very important detail with many of these cases is that the fraud incidence occurred over several years. The Roslyn School District case occurred from 1995 through 2003 (Huefner, 2010). A reasonable person might inquire as to why someone did not implement proper internal controls sooner to have discovered this fraud before eight years had passed. The aim of this new research was to help answer such a question for another local government that experienced a high dollar fraud event over several years' time.

In another example of municipal government employee embezzlement, a Dixon, IL city treasurer stole over \$53 million of public funds, primarily because the city did not have proper internal control safeguards in place to prevent or detect the fraud (McDermott, 2012). The federal indictment of Crundwell alleges that she stole the \$53 million over a period of 20 years and that the amount embezzled equated to \$3,300 for every person who lived in the city of Dixon (Verschoor, 2012). Crundwell allegedly used the embezzled money from the City of Dixon to pay her own personal expenses,

including costs for a new motor home, a Kenworth tractor truck, and over \$2.5 million on her personal credit cards (Verschoor, 2012). The researcher delved into this particular case as a case study, and one of the three research questions was to examine the consequences of municipal, multi-year embezzlement. It is possible that municipal employee fraud leads to a loss of public confidence; when a government is accountable, it is more likely to meet citizen expectations (Elmore, 2013). According to Trompeter et al. (2013), consequences for certain employee fraud events include employees being indicted for criminal acts, a loss of stock value for publically traded companies, and regulatory action against the organization including fines. Even though municipal governments do not operate as for-profit and publically-traded businesses, and therefore they do not sell stock in their operations, they are still subject to regulatory action; and certainly a loss of public confidence might hinder the community's ability to enhance its economic develop efforts. These cases highlight the importance of improving municipal government financial accountability, and oversight is one way to combat fraud, especially because poor oversight of financial transactions can result in cases of fraud and embezzlement (Elson & Dinkins, 2009). Trompeter et al. (2013) recommended additional research that examines the consequences of organizational fraud and the steps needed to correct those consequences after it is detected.

Another case from Illinois is that of Linda Heyde, who was accused of stealing more than \$500,000 over 15 years from the City of Marion, IL as she worked as a water department manager (FBI.gov, 2013). In her indictment, Heyde was accused of having control over water billing accounts, but her daily bank deposits did not contain cash. A covert operation was launched, and cameras caught her stealing cash deposits. A forensic

audit revealed that she stole over \$500,000 between 1996 and 2012 while falsifying billing adjustments (FBI.gov, 2013).

In a recent case in California, employees from the City of Pasadena were accused of embezzling over \$6.4 million from a city hall slush fund (Favot, 2015). Government officials were quoted in the local media for reporting there was a complete breakdown of the internal controls, which had they existed, could have prevented fraud (Favot, 2015, p.1) The employee embezzlement is reported to have occurred in the city's water and power electricity fund as the employees created bogus vendors and funded false accounts over the period of 11 years (Favot, 2015). An Internet search reveals dozens of recent cases of municipal government employee embezzlement.

According to Miceli et al. (2012), an organization that experiences fraud but fails to effectively stop that fraud in a timely manner, or fails to quickly act on whistle blowing claims, will likely experience demoralized employees. A case from 2012 reported by the Berkshire Eagle (2013) describes how a town's municipal credit union had an employee who opened up fraudulent loan accounts in the names of actual credit union members and then deposited the loan proceeds into her personal account. This fraud event occurred over several years (Berkshire Eagle, 2013). One of the more challenging questions that the public asks is how can multi-year scandals be allowed to continue without having effective internal control policies in place that could have prevented the fraud (Somers & Casal, 2011). Public questioning of the ethical nature of government officials, including questioning ethics training, is bound to occur when multi-year fraud events are finally discovered (Somers & Casal, 2011).

## Summary

In summary, there has been extensive research on the relationship between a lack of effective internal controls and the existence of employee fraud (Trompeter et al., 2014), and so this study, in part, was designed to help others better understand why a municipal government with a known incident of multi-year employee embezzlement of at least \$50,000 did not put effective internal controls in place prior to the discovery of the embezzlement. This study was intended to contribute to FTT and BMT via an investigation of municipal government financial management. Companies that fail to remediate previously disclosed material weaknesses have higher audit fees, a higher likelihood of auditor resignation, fail to meet reporting deadlines more often, and receive poorer credit ratings (Hammersley et al., 2012). Preventing scandals and the misuse of government resources is important when hoping to meet the goal of having a community be an attractive place for business (Wechsler, 2012). There are many ways to improve government financial ethics and controls, but too often changes occur because of a scandal (Wechsler, 2012). Effective internal controls in municipal government financial management should not be the result of a scandal after years of apathy on the part of the municipal governing body (Wechsler, 2012).

Municipal government employee embezzlement occurs in states all across the United States (Maciag, 2012). Even though policies might exist in municipal government entities to prevent embezzlement, there are few legal requirements for financial internal controls at the municipal government level (Governmental Accounting Standards Board, 2013). Given the significant effect on municipal government financial management and municipal government budgeting, there is a need to research how a lack of financial

internal controls within municipal governments affects that municipal government's risk of employee fraud (Huefner, 2011). In this single instrumental case study research project, the researcher examined municipal government employee embezzlement from the perspective of a municipal government that experienced a multi-year employee embezzlement of at least \$50,000. This study added to theory and filled a needed gap in existing scholarly research.

Previous research has suggested that poor management practices, economic pressure, weak social values, people not being held accountable for their actions, and inadequate training for those responsible for fraud detection and prevention contribute to employee embezzlement (Huefner, 2010). However, other factors may be at play within embezzlement situations in municipal governments. Knowledge gained in this topic area can enable others to create policies or laws for municipal government internal financial controls similar to laws implemented in the private sector with the implementation of the SOX Act of 2002 (Elson & Dinkins, 2009).

## Chapter 3: Research Method

### Research Method and Design

This researcher used a qualitative single-case study approach. Qualitative methods help facilitate an in-depth and detailed study of issues by producing a wealth of information without needing to obtain a large sample size, as would be the case with quantitative analyses (Patton, 2002). A case study approach also allows the researcher to have identifiable boundaries in which to operate, with the results providing an in-depth understanding of the case under examination (Meriam, 1998). As Eisenhardt and Graebner (2007) noted, the use of a case study approach allows a researcher to build an explanatory framework for a phenomenon in question via the use of one or more cases to create theoretical constructions and propositions based on empirical evidence. Yin (2014) suggested that a case study design is useful when the researcher wants to provide a comprehensive understanding of the case. Yin (2014) also noted that a case study design is appropriate when the incident under investigation is unusual but of general interest to the public, especially when the phenomenon in question is relevant in terms of policy or practical outcomes. Finally, Yin (2014) noted that case studies are an excellent way of providing a rich, empirically based description of the instances of a given phenomenon, provided that a researcher uses a variety of data sources when describing the phenomenon in question.

An explanatory case study design approach was the best option for this proposed study because the study required the process of qualitatively analyzing a specific way of collecting, organizing, and analyzing data throughout a process (Butin, 2010). Case studies are conducted to explore real-life problems and situations (Yin, 2014). A case

study research is perfectly suited to analyze in-depth responses from qualitative interviews to support and expand the propositions of a particular situation in a group of people, and will extend a current underlying theory (Merriam, 2009). This case study was designed to help expand and refine existing theories on bureaucratic management theory, organizational theory, and fraud triangle theory. An objective of a qualitative dissertation is to inform or expand on an existing theory (Dooley, 2002; Eisenhardt, 1989). The current project on high-dollar multi-year municipal employee embezzlement met these criteria. The qualitative analysis for this study was intended to help develop new theoretical insights on the phenomenon being investigated in the study.

According to Creswell (2014), the goal of case study research is to rely on participants' views of the situation being studied. In order to capture the views of participants, this research will use a single instrumental case study, a strategy that is used to investigate situations in which what is evaluated does not have a clear, single set of outcomes (Patton, 2002; Yin, 2014). The purpose of choosing a single instrumental case study approach for this research project was to understand the phenomenon of municipal government employee embezzlement from not only the perspective of stakeholders who experienced the event (excluding the person who committed the embezzlement), but also from data obtained via archival review of previous audit reports, bond rating reports, fund balances, internal control policies, news articles, and news editorials. An instrumental case study is conducted when the case is used to understand more than what is obvious to the observer (Stake, 1995). This was the specific type of case study used for the proposed study.



Other possible designs that could have been used for this project include a quasi-experimental, nonequivalent control group, posttest-only design, a single-group posttest-only design, or an experimental design. A nonequivalent, control group, posttest-only design would have revealed useful information about which specific internal controls can detect or deter employee embezzlement, but it is unlikely that this design would have been as effective as a case study design for answering the research questions for this study. The reason a nonequivalent, control group, posttest-only design was not used as a research method for this study is that a case study design was more effective at exploring the nature of the research questions, as a case study design delves deeper into the specifics of what happened in the municipal government employee embezzlement case (Yin, 2014).

A weakness of the non-equivalent, control group, posttest-only design is that because groups are not equivalent, the researcher cannot say the treatment is responsible for observed changes (Cozby & Bates, 2012; Jackson, 2012; Leedy & Ormrod, 2010). Another problem with using a nonequivalent control group design is that it is possible that the control group has employee embezzlement occurring, but it has not yet been discovered. If that is the case, the internal controls used by that municipal government that might be interpreted as being effective, would in fact be ineffective. Another problem is that a municipal government might have very weak internal controls but not have any incidents of employee embezzlement due to the moral character and ethical makeup of each employee of the organization. Because of these reasons, a non-equivalent control group design was rejected as a possibility for this current research project.

A single-group, posttest-only design is another design choice that could have been used by this project; however, this approach does not have a control group, and therefore will not yield a result as effective as using a control-group (Cozby & Bates, 2012; Jackson, 2012; Trochim & Donnelly, 2008). Experimental designs include the manipulation of a variable (Jackson, 2012; Trochim & Donnelly, 2008). In the case of this research study, it was inappropriate to use an experimental design, because it is unethical to allow a municipal government to allow employee embezzlement to occur for the purpose of a research study.

A qualitative single instrumental case study design was an ideal research method to explain how internal controls could have detected or deterred a multi-year municipal government employee embezzlement of at least \$50,000, to explain the consequences to the municipal government for its failure to detect or deter the employee embezzlement, and to explain the reasons why effective internal controls were not implemented prior to the discovery of the embezzlement. As Yin (2014) noted, there are several rationales for the use of a single case study design. These include when the phenomenon under investigation represents a *critical* case (i.e., a case that is used to test a well-formulated theory), an *extreme* case (i.e., a case that is unique or rare), a *representative* case (i.e., a case that is typical), a *revelatory* case (i.e., a case that was previously inaccessible or uninvestigated), or a *longitudinal* case (i.e., a case that is studied at two or more time periods). The researcher sought to gain knowledge of a phenomenon that has been investigated in the past via other representative cases of an event that is relatively rare. For example, an investigation by Snyder and Hersberger (1997) used a case study approach to investigate embezzlement on the part of public librarians in the state of

Indiana. A later investigation by Singh, Best, and Mula (2013) used a single case study approach with respect to the detection of fraud in enterprise system audits. These previous studies underscore that the use of a single case study is appropriate to gain a better understanding for an incident (such as embezzlement or fraud) that is relatively rare yet will offer information that might be essential for effecting organizational change (Padgett, 2004). Nevertheless, these previous studies have not addressed the problem of how municipal governments deal with multi-year employee embezzlement of at least \$50,000. An investigation of this phenomenon will therefore add to the body of knowledge on the phenomenon of embezzlement.

As previously noted, because the researcher wanted to explain a phenomenon that is not well understood, and because of the scarcity of cases where a municipal employee has embezzled more than \$50,000, a single instrumental case study method was selected. As Yin (2014) noted, a single instrumental case study design is often preferred when one is dealing with the “unusual or rare case, the critical case, and the revelatory case” (p. 53). Such was the situation in the current project, as multi-year municipal government employee embezzlement of \$50,000 or greater is rare. Even though a single instrumental case study design was selected, the results of this case study will help to provide other municipal government managers and elected officials a broader knowledge of the consequences of multi-year employee embezzlement and how they can effectively prevent a similar embezzlement incident in their own organization. This single instrumental case study will add to the body of theoretical knowledge, as well as permit additional testing through future qualitative or quantitative research. This is because a single instrumental case study approach is appropriate when the researcher identifies the

context of a case so that others can draw conclusions that allow them to determine if the findings are generalizable to their situation or event (Leedy & Ormrod, 2010).

Other qualitative designs that could have been used but were ultimately rejected include narrative research, ethnographic research, phenomenological research, and a grounded theory approach. As Neuman (2000) noted, narrative research is more suited when investigating a biographical or autobiographical research question. In other words, narrative research is based on the principle of collecting information from research subjects with the intent of weaving the data into a story that articulates the biography of the research subjects (Trochim, 2008). Capturing biographical information is beyond the scope of this project; as such, it was rejected. An ethnographic research approach was also rejected because it, too, primarily relies on the principle of capturing biographical information, albeit from a larger cultural group (Berg & Lune, 2012). As Creswell (2014) pointed out, a grounded theory approach is most often used to generate a new theoretical understanding of a given topic or create an analytical schema of a previously uninvestigated process. Although the current project may contribute to the body of knowledge on fraud theory and organizational theory, the primary purpose of the current project was to extend the theory on the topic of embezzlement. Case study approaches provide research driven “outcomes” or generalizations that can inform such theory development.

Finally, a phenomenological approach was considered for the current project. As Yin (2014) noted, phenomenological research and case study research share some similarities. However, phenomenological research typically focuses on the meaning an *individual* gives to his or her unique circumstances (Patton, 2002), whereas a case study

tends to examine the parameters of a *bounded system* (Yin, 2014) as a way of understanding the nature of the bounded system. For these reasons, a phenomenological approach was rejected in favor of a case study approach.

### **Population**

There are 89,386 municipal or special purpose governments in the United States (National League of Cities, 2013), and this study provided for a single-case study of one of those municipal governments that experienced a known incident of high-dollar, multi-year employee embezzlement. A municipality will have regular external audits, and those audits result in the auditor preparing a Comprehensive Annual Financial Report (CAFR). Information in these CAFRs will be used to help answer one or more of the research questions. Additionally, it is common practice to obtain a bond rating before a municipality sells bonds (often used to finance public capital improvement projects). By obtaining a bond rating, a municipality might be able to obtain lower interest rates for a particular borrowing. The city used for this study did not have a bond rating prior to or after the discovery of the embezzlement.

### **Case Selection**

The case study selection criteria outlined by Yin (2014) was used to identify the municipality that will serve as the case for this single case study. As Yin (2014) noted, in a single case study design, it is acceptable to forgo the normal case study screening process because the case to be investigated is one where the researcher has “some special arrangement or access” (p. 91) to the case in question. In the current investigation, the researcher has established a preliminary relationship with the municipal government of Dixon, Illinois, a city that was home to one of the largest multi-year municipal employee

embezzlement cases in America. The municipality of Dixon, IL was selected as an ideal case study community after an Internet search for municipal government employee embezzlement.

As part of the selection of this municipality for study, a review of the municipality's external audit report in the year before the discovery of the embezzlement confirmed the presence of internal control material weaknesses that might have detected or deterred the embezzlement. This was possible because these external audit reports are public records. In order to examine the reasons why municipal officials did not implement effective internal controls in time to detect or deter the embezzlement, it is important that the community selected mentioned internal control material weaknesses in a prior audit report. The use of these procedures is in alignment with the recommendations of Yin (2014), who notes that before collecting data, the researcher should have defined a set of "operational criteria" (p. 91), whereby the case is likely to yield optimal data.

### **Materials/Instruments**

To obtain in-depth information about what can be a complex situation or event, it is best that a case study methodology uses multiple data sources (Yin, 2014). The data collection methods for this single instrumental case study included semi-structured interviews from multiple stakeholders and a review of archival data from the following sources for each of the four years prior to and the two years after the discovery of the embezzlement: the community's bond rating from each of the three major local government rating agencies (Moody's, Standard & Poors, and Fitch); the unencumbered general fund balance; the city's property tax rate; the city's total outstanding debt;

external annual audit reports; and any city policy on internal controls. In order to answer the research questions, in-depth, semi-structured interviews were conducted with the following stakeholders of the municipality: appointed officials, elected officials, external auditors, members of the local news media, and business owners. Appendix A identifies the semi-structured interview questions for each stakeholder group. The preferred method for completing the interviews was face-to-face; however, if that was not possible based on the unique situation for each interviewee, phone, or e-mail interviews were used. Additional archival data came from news articles and news editorials available within the public domain. As stated, the information included the community's bond rating from each of the three major local government rating agencies: the unencumbered general fund balance; the city's property tax rate; the city's total outstanding debt; external annual audit reports; and any city policy on internal controls during the two timeframes of the period of the four years prior to discovery of the embezzlement and the two years after the discovery of the embezzlement.

### **Data Collection, Processing, and Analysis**

A good research study is conducted in a systematic, ethical, and rigorous manner (Merriam, 2002). According to Berg and Lune (2012), there are many perspectives regarding establishing validity with qualitative research. Credibility, transferability, dependability, and confirmability are each important for establishing the validity of a qualitative research design (Jackson, 2012). To establish credibility, specific individuals within the municipal government were interviewed to obtain useful data to answer each research question. The mayor, city manager, finance director, auditor, certain local business owners, and news media are professionals that should ensure the responses

provided by officials are credible. Transferability is enhanced by describing assumptions that are central to the research (Cozy & Bates, 2012). By describing these assumptions, another person wishing to replicate the research can decide if the replication is appropriate.

Dependability is enhanced by learning as much as possible about the context in which the research occurs (Yin, 2014). There will probably be changes that were made within the municipal government because of the discovery of known employee embezzlement. This research was designed to gather information about changes made in the internal control environment because of the discovery of the employee fraud event. A description of the changing research context is important to improve the study's dependability (Trochim & Donnelly, 2014).

To improve confirmability, it is important to compare responses from the participants from each of the multiple stakeholders of the municipal government. If the observations and experiences from these officials differ greatly, confirmability is weakened. By seeking out potential bias or distortion in the interview questions or responses, confirmability is improved (Yin, 2014). Conducting interviews after the employee fraud occurred is an unobtrusive method and can reduce the possibility of bias.

Transferability, dependability, and confirmability of the data are also enhanced via triangulation of data (Yin, 2014). Triangulation with case study research involves using multiple data and multiple methods to confirm findings (Yin, 2014). Sources of data included in-depth, semi-structured interviews with several individuals, as well as archival data from several document sources. A case study does not provide much basis for scientific generalization (Yin, 2014). Generalizability refers to whether the research



study can be extrapolated to cases beyond the scope of this study (Merriam, 2002). In lieu of generalizability, most qualitative research instead focuses on external validity (Cozby & Bates, 2012). In order for this research study to provide external validity, it is important that the results provide a thorough and rich description of the case so that readers can determine how closely the case matches their own situation so they can determine whether the findings are transferable (Neuman, 2000). By conducting semi-structured interviews with multiple stakeholders of the municipality, data can be collected to thoroughly describe the case being studied.

Major bond-rating agencies such as Moody's, Standard & Poor's, and Fitch routinely provide a rating for municipal governments during the process immediately before the municipal government sells bonds. A local government will commonly sell bonds on the primary market in order to raise money for capital projects that the local government cannot, or chooses not to, pay cash for from reserve funds. These bond ratings provided the external stakeholders an independent review of the municipality's financial condition so the municipality can sell bonds on the primary market. Generally, the better the bond rating, the less risk of default, and thus the municipality pays less in interest costs. These bond ratings are public record and were used to analyze whether any of the major rating agencies lowered the municipality's bond rating post-discovery of the embezzlement.

A city's unencumbered general fund balance is an indicator of the city's financial health. The general fund balance, when unencumbered, represents cash available for any legal purpose. According to the Government Finance Officers Association (2015), a city should always maintain at least a two-month unencumbered cash reserve in its general

fund. A safer rule is to maintain 20% to 25% unencumbered general fund reserves to represent up to a three-month cash reserve. Because property tax and other revenues do not always come in throughout the year at equal rates, this reserve allows the local government flexibility in meeting accounts payable and payroll obligations during times of the year in which revenues are flat. The purpose of comparing unencumbered general fund balances before and after the discovery of the embezzlement is to analyze possible cash reserve consequences because of the embezzlement or its announcement to the public. When the public realizes the financial loss to taxpayers, it is possible that economic development will suffer. Fewer people moving to the community, fewer homes being built, or fewer businesses opening up shop can result in lower city cash balances.

The city's property tax rate and total outstanding debt are factors for analysis. The property tax rate might be expressed in dollars per hundred dollars of assessed property value or in some other format; however, so long as the researcher describes the way the city determines its property tax rate, other researchers can replicate the study even if additional community's studied use a different method to determine property taxes by using a simple mathematical formula to compare tax rates. There are numerous possible reasons for property taxes to increase; however, understanding if taxes increased after the discovery of the embezzlement is important. The city's total outstanding debt is determined by adding together all outstanding principal bond payments still due over the life of the bonds. Generally, a city borrows to complete needed capital projects when there is not enough cash to pay for the projects without borrowing.

External annual audit reports are publically available and were completed by an external auditor for meeting state law requirements that municipal organizations have an

annual external audit. An external auditor will ensure that within the audit report there is information related to the city's internal control material weaknesses. An analysis of the listed internal control material weaknesses and any other comments related to internal controls in the audit reports prior to the discovery of the embezzlement might reveal useful information. It is possible the audit reports list internal control material weaknesses for several years before the discovery of the embezzlement, but the city failed to correct those weaknesses. It is important to analyze steps taken by the city after the discovery of the embezzlement to determine if those steps would have detected or deterred the embezzlement had they been taken beforehand.

The data on audit reports, bond-rating reports, fund balances, internal control policies in place before and after the discovery of the embezzlement, internal e-mails, news articles, and news editorials were obtained from archives. The information came from a reputable database. The archival data came from news articles and news editorials available within the public domain. The archival data covered the period of four years before and two years after the discovery of the embezzlement. Relevant information was taken from the archives and was analyzed together with the themes generated from the interview responses. The archival data illustrated and supported the qualitative data obtained from interviews. These archival data were summarized in an Excel spreadsheet.

These data collection methods provided answers to each research question by explaining how financial internal controls could have detected or deterred the embezzlement, by explaining the consequences to the municipal government from the embezzlement event, and by explaining the reasons why the municipal government did

not implement effective internal controls to detect or deter employee embezzlement before the discovery of the fraud event.

In order to ensure that all semi-structured interviews are conducted in a systematic and consistent manner, an interview protocol was used. As Jacob and Ferguson (2012) noted, an interview protocol is more than just a list of interview questions; rather, it is a script of what will be said before the start of the interview, the prompts used during the interview to solicit information, and a procedural guide for directing the researcher through the interview process. In order to achieve these goals, an interview protocol was developed for use with research subjects (see Appendix A).

For the recruitment of interview participants, an invitation was sent to the appointed officials, elected officials, external auditors, members of the local news media, and business owners of the municipality. Typically, a qualitative study includes a sample size of five to 25 samples (Polkinghorne, 2005). Participant recruitment began in August 2015 with an invitation letter sent to the relevant city administrators, auditors, media, and business owners. The different stakeholders of the municipality were invited to be part of the study as respondents by e-mailing or hand delivering them an invitation letter. They were sent out to officials, including a mayor, city manager, finance director, auditor, certain local business owners, and news media professionals.

The invitation letter included a discussion of the purpose of the study, benefits of results brought by the study, and the process the sample respondents would undergo during their participation in the study. The stakeholders invited to participate in the study were given a maximum of one month to provide feedback about participating in the study. Stakeholders who did not respond to the invitation after two weeks received a

follow-up invitation. Those stakeholders who positively responded to the invitation were included as respondents in the interview.

After agreeing to participate in the interview, the stakeholders of the municipality were asked to sign an informed consent form. The informed consent form was proof that the respondents had agreed to be part of the study. An informed consent form included a brief discussion of the purpose of the study and the methodology process the respondents would undergo in the study. The informed consent form mentioned that the interview sessions would be audio-recorded. The respondents were asked to bring the signed informed consent forms in their scheduled interview session. The informed consent form identified that the privacy and security of respondent identities would be kept confidential. The participants would not be allowed to undergo the interview if they did not sign the informed consent forms and give them to the researcher during the meeting between the two parties.

The responses resulted in a sample size of nine and the completion of nine interviews. The researcher initially planned to collect at least ten interview subjects for the study. However, due to the lower number of received responses, the researcher decided that the collected interviews contained a satisfactory amount of information for the required data saturation. In the end, seven participants completed face-to-face audio interviews, and the researcher received permission to complete two of the interviews by email.

The interview respondents were contacted via telephone or e-mail to arrange the scheduled date, time, and location of the individual interview sessions. Each individual interview lasted about 30 minutes. Each interview session was audio-recorded to be able to

record all the verbatim responses of the respondents in order to create a transcript of the interview responses. However, in line with ethical considerations, gaining permission from the respondents was necessary. Permission is necessary before any audio recording. The audio-recorded interviews were transcribed and coded in the data analysis. Responses were numerically coded to maintain anonymity and to preserve the confidentiality of the respondents.

Member checking of the interview responses was conducted to verify the accuracy of each of the responses to ensure credibility of the data collected. Member checking is conducted by double-checking if the interview responses that will be transcribed and written are the same responses as provided by the respondents in the interview (Thomas & Magilvy, 2011). In member checking, the respondents were asked to review the interview transcript created by the researcher and were asked for their feedback about the transcript accuracy after the interview session.

To analyze the interview data, this study used an open-coding system to analyze participants' interview responses line-by-line, phrase-by-phrase, and word-by-word. Open coding was conducted to create themes and eliminate interviewees' personal bias from the interview responses. Coding was conducted on the interview responses to create categories or to group together similar topics (Saldaña, 2013). The codes that emerged from each interview responses were arranged and grouped by similar ideas, phrases, or relevant information into categories of themes. The codes, which can be words, statements, or phrases, that emerged from each interview responses were sorted and categorized together when they had similar ideas. These categories became the themes of the interview responses. Themes of responses were generated for each of the three

interview questions. Each of the interview questions had different themes of responses obtained from the interview. Then, the findings from interviews, which were the themes that emerged, were triangulated with the archival data. The findings obtained from the archives were used to support the findings from the interview responses. The researcher reviewed the archival data from the different sources of community's bond rating from each of the three major local government-rating agencies; the unencumbered general fund balance; the city's property tax rate; the city's total outstanding debt; external annual audit reports; and any city policy on internal controls. The coverage of the review was in periods of four years before and the two years after the discovery of the embezzlement. In addition, the responses of the interviews can be validated by comparing it with the key information obtained from the archives. The themes generated for each of the interview responses were supported or compared with a news article or the numerical figures obtained from the archival reports in order to provide a more concrete picture of the occurrence of the incidence of high-dollar, multi-year employee embezzlement.

### **Assumptions**

Leedy and Ormrod (2010) posited, "Assumptions are so basic that, without them, the research problem itself could not exist" (p. 62). With any research study, assumptions must be made about certain data being collected. For the purpose of this research study, an assumption is that all people participating in the semi-structured interview process would be truthful with their responses and that they would provide information that adequately reflects their views and opinions on the questions. To help realize this assumption, interviewees were told that their responses would be included in the aggregate of all other participant responses so as to reduce the possibility that any one

person's answers would be attributable back to them. Additionally, it was assumed that accurate data was originally provided to the bond rating companies so they could correctly assess the financial condition of the municipality in order to provide a bond rating. It was assumed that the external auditors were provided with accurate information and thus the data in the Comprehensive Annual Financial Report (CAFR) was accurate (excluding the deception related to the specific multi-year embezzlement that this study is investigating). It was also assumed that the municipality's fund balances in each of their various funds was accurate (excluding the deception related to the specific multi-year embezzlement that this study is investigating).

### **Limitations**

Because of its subjective nature, qualitative research studies have limitations (Berg & Lune, 2012). For example, the honesty and openness of participants during their interviews can affect the quality of the study's findings. A weakness of any case study design is that it is limited by the integrity and sensitivity of the researcher (Yin, 2014), and it can be subjective because the primary instrument for collection of data is the researcher (Merriam, 2002). To reduce the possibility of these limitations from affecting the research results, interview participants were informed that their answers to the interview questions would be anonymous. Additionally, the researcher strived for continuous objectivity during the investigation. In order to protect against limitations, this research involved a comfortable research environment, and all participants understand the intent of the interview. Interviewees were provided with the researcher's phone number and email address in case any of them had additional information to share after completion of the formal interview.



Because this study relied on participants' self-report in order to gather data, bias may have been encountered in the form of untruthfulness on the part of the interview participants. This is the reason the researcher ensured that all participants were aware of the rights to confidentiality and anonymity that all participants enjoy so that they were not tempted to misrepresent facts. Despite such measures, however, self-report data is susceptible to errors in the memory of participants. To mitigate this, the researcher interviewed multiple stakeholders and used an adequate sample size in the interview based on the minimum sample size that a qualitative study needs to evenly distribute and take into account possible errors and threats to the validity of the data and analyses. The multiple stakeholders included a mayor, city manager, finance director, auditor, certain local business owners, and news media professionals to ensure that the responses provided by officials were credible. Different perspectives can be obtained when interviewing of different samples.

Another key limitation is the study's generalizability. The findings of the study will only be true for only the municipal governments in the United States that experienced a known incident of high-dollar multi-year employee embezzlement.

### **Delimitations**

As Simon (2011) noted, a research project's delimitations are the characteristics of a project that limit the scope of the project and define the boundaries of the project. The topic of interest for this project was delimited to municipal government financial management and employee embezzlement. This topic was selected because there are 89,386 municipal or special purpose governments in the United States (National League of Cities, 2013), and employee embezzlement is a serious issue for communities (Aikins,

2011; Aikins, 2012; Berkshire Eagle, 2013; Camilli, 2013; Elson & Dinkins, 2009; Hammersley et al., 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrjean, 2013; Raghavan, 2011; Verschoor, 2012; Wechsler, 2012; Zecheru, 2012).

With the time constraints associated with a PhD study and knowing that a single case study is a viable method to obtain useful data (Patton, 2002; Yin, 2014), delimiting the project to a specific a municipal government with a known incident of a high-dollar multi-year embezzlement was essential. An Internet search revealed several possible municipalities for study; however, there were two communities in Illinois with significant financial loss from an employee embezzling from them over several years. Dixon, Illinois was the ideal community to use for this study because it is currently where the highest financial loss has ever occurred due to a known incident of multi-year employee embezzlement.

The embezzlement in Dixon, Illinois by a city employee was over \$53 million and spanned approximately 20 years. Marion, Illinois is another municipality that experienced a known incident of high-dollar, multi-year embezzlement, and although the utility billing department employee did not embezzle nearly the amount of money as did the employee in Dixon, IL, she still embezzled over \$500,000 over 15 years. Either of these cases should provide very useful data to answer this study's research questions. As previously noted, even though qualitative research was limited in terms of its generalizability due to the nature of its subjectivity (Creswell, 2014), it nevertheless stands to reason that the findings within the aforementioned communities should shed light on the topic of employee embezzlement such that any accrued knowledge in this study will be of utility to future researchers who conduct work in this area.

### **Ethical Assurances**

With qualitative research, ethical dilemmas can be problematic, and a researcher must protect the quality of the research process (Merriam, 2002). This study involved collecting data and information based on events that already occurred, and therefore there were fewer ethical considerations than had it been conducted as an experimental design with human subjects (Trochim & Donnelly, 2008). It was probable that the subjects who were interviewed were in their positions during the time that the employee embezzlement took place. Because of this, it was possible that those people would have felt personally judged if asked questions about the incident. Even though no study can predict all possible ethical dilemmas, there are several methods to employ to help protect the rights of study participants (Cozy & Bates, 2012). This study complied with these recommendations by making sure that participants understood the purpose of the research, by obtaining written permission from participants after approval from the Institutional Review Board, by informing participants of all data collection methods, by providing a transcription for each participant interview, and by allowing participant anonymity if requested (Trochim & Donnelly, 2008).

In addition, the researcher also practiced the three principles of the Belmont Report: respect for persons, beneficence, and justice (The Belmont Report, 1978). The researcher helped ensure the anonymity of the participants by only including them in the study as a respondent if they voluntarily participated in the study and by providing individual responses in aggregate form. Beneficence was practiced by not harming the participants of the study. Lastly, treating each of the participants fairly contributed toward justice. Equal care and security was given to all of the respondents. There was no special

treatment of any of the respondents. Their rights were considered in the study, and they were always well protected.

### **Summary**

In summary, there are numerous examples of internal control material weaknesses in municipal governments that contributed to employee embezzlement (Aikins, 2011; Aikins, 2012; Berkshire Eagle, 2013; Camilli, 2013; Elson & Dinkins, 2009; Hammersley et al., 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrjean, 2013; Verschoor, 2012; Wechsler, 2012; Zecheru, 2012). The literature on the topic of internal controls in municipal government financial management reveals that there is a need for additional research in the area of municipal government internal control effectiveness (Coram et al., 2008; Cosmin, 2011; Dorminey et al., 2012; Elmore, 2013; Hermanson et al., 2012; Jones & Bowrey, 2013; Murphy & Dacin, 2011). The study filled an identified gap in existing scholarly research on the topic of municipal government financial management and internal control effectiveness, and it also contributed to fraud theory, organizational theory, and theoretical perspectives on the topic of municipal government employee embezzlement.

With existing research showing that the phenomenon of municipal government employee financial embezzlement is a serious issue for many communities across the country (Aikins, 2011; Aikins, 2012; Berkshire Eagle, 2013; Camilli, 2013; Elson & Dinkins, 2009; Hammersley et al., 2012; Huefner, 2010; LaBorde, 2012; Matkin, 2010; Noland & Metrjean, 2013; Raghavan, 2011; Verschoor, 2012; Wechsler, 2012; Zecheru, 2012) and with 89,386 municipal or special purpose governments in the United States (National League of Cities, 2013), there is a need for financial managers and municipal

public officials to understand the barriers to financial internal control implementation to detect or deter municipal government employee embezzlement, to understand why effective internal controls are not implemented, and to understand the consequences to the municipal government from a known incident of employee embezzlement.

This chapter provided a synopsis of the researcher methods that were used to collect and analyze interview and archival data, to ensure that this qualitative exploratory single instrumental case study design had both internal validity and external validity. This qualitative exploratory single instrumental case study was the best research method to achieve the study's results. The study incorporated detailed interviews with officials from a U.S. municipal government having experienced a known multi-year employee embezzlement of at least \$50,000. The semi-structured interviews and archival data review were meant to provide in-depth information about the internal control environment in each of those municipal government organizations, to learn about the effects of failing to detect or deter employee fraud, and to explain the barriers to implementing effective municipal government internal controls.

## Chapter 4: Results

The purpose of this qualitative single instrumental case study was to fill an identified gap in existing scholarly research on fraud triangle theory, bureaucratic management theory, and organizational theory by studying a municipal government with a known incident of multi-year employee embezzlement of at least \$50,000. This chapter reports the results by laying out the findings in a logical manner in order to answer the study's three main research questions. The researcher examined how a municipal government's financial internal controls should and could identify or deter a fraud event. The researcher also asked how the embezzlement affected the government, and why city administrators did not implement the proper internal controls to monitor the municipality's finances. The chapter also provides a rich and detailed summary examination of the collected data around the embezzlement incident.

### Results

**Setting.** The case study took place in the municipality of Dixon, Illinois. Dixon experienced one of the country's largest historical cases of multi-year embezzlement, making it an ideal case for this study (Smith, 2012). The fraud event occurred over a period of 22 years, with Rita Crundwell, the former appointed comptroller, responsible for the embezzlement (U.S. Attorney's Office, 2012). The Comptroller began stealing funds in 1988 (Smith, 2012). She opened two separate accounts in 1990 in order to carry out the embezzlement scheme (U.S. Attorney's Office, 2012). The first account resembled a city account, RSCDA (Reserve Sewer Capital Development Account), and as comptroller, she was the only person with access to the money (IGFOA, 2015).

She deposited money into the second account, the Capital Development Fund, and created false invoices and wrote checks out to herself as the treasurer (Smith, 2012). She then placed these funds into the RSCDA (Smith, 2012). Throughout the scheme, the comptroller stole an average of around five million dollars a year from the city (U.S. Attorney's Office, 2012). She covered up the embezzlement by blaming the State of Illinois for not paying the city's tax revenue on time (Smith, 2012). The city was also under regular financial strain as the scheme resulted in sweeping service cuts to several city departments, including the police department and city maintenance (Jenco & Grimm, 2012).

Crundwell was a well-known resident who was trusted by most of the city's residents even amidst the economic situation during her time of service (Smith, 2012). No one questioned her wealthy lifestyle, but toward the end of her tenure in the late 2000s, the city's economic instability came under question (Smith, 2012). At this point, an economic recession and poor city maintenance led to suspicions of fraud within the city administration and council (Smith, 2012). The comptroller's scheme was uncovered beginning in 2011, when a deputy clerk served as acting comptroller while Crundwell was on vacation (U.S. Attorney's Office, 2012). The clerk uncovered the two accounts and turned over the information to the FBI (U.S. Attorney's Office, 2012).

The FBI arrested Crundwell in 2012 and charged her with embezzling \$53 million dollars (Becker & Barichello, 2013). After her removal, the city saw a three-million-dollar rise in revenue, but the damage inflicted by the scheme left a deficit of \$16.6 million with some \$30 million in operating funds lost over the previous ten years (U.S. Attorney's Office, 2012). The city sued the outside auditors and the city's main banker

for not recognizing the many signs over the past two decades of the corruption displayed by the former comptroller (Becker & Barichello, 2013). City employees all came forward to discuss the ways in which the Comptroller had manipulated the situation in order to force drastic cuts in spending, making it almost impossible for the city to pay for its most basic needs (Becker & Barichello, 2013). The whole incident hurt public trust in the municipal government and instituted the need for massive local government reform and internal and external auditing policies (Mencarini, 2014).

**Demographics.** As of 2015, the municipal government in Dixon, IL consisted of a combination of administrative and elected officials (City of Dixon, 2015). These included the Mayor, four City council members, a City Manager, a Finance Director, City Clerk, Deputy City Clerk, Building Official, Police Chief, Fire Chief, Superintendent Public Property, Superintendent of Waste Water Department, City Attorney, Airport Manager, Library Director, and the Public Works Director (City of Dixon, 2015). The local government oversees the police department, fire department, building and zoning, public works, and an airport (Dixon, Illinois, n.d.). This was a community of about 15,941 people, according to the 2000 census (Dixon, Illinois, n.d.). The largest industries were government and healthcare, with the Department of Transportation employing over 600 individuals (Dixon, Illinois, n.d.).

The racial makeup of the city was 86% White, 10% African American, and less than five percent of other races with a median age of 37 (City-Data, 2015). The median income was \$35,720, and the median income for a family was \$45,088 (City-Data, 2015). Males had a median income of \$32,511 versus \$21,777 for females (City-Data, 2015). The per capita income for the city was \$16,630 (City-Data, 2015). Approximately 5.7%



of families and 10.1% of the population were below the poverty line, including 10.7% of those under age 18 and 12.0% of those aged 65 or over (City-Data, 2015).

Interview participants ranged in age and background. Their demographic data included their job title and time in their particular job. The interview participants included internal and external auditors, government officials, media writers, and business people. Participants needed to maintain their privacy because of the sensitivity of their positions and the controversy around the case. They shared their experiences and thoughts with the acknowledgement that their participation is anonymous to the extent possible by reporting interview results taken together. The small number of participants allowed their identities to be more easily identifiable if the researcher shared specific demographics. Due to privacy concerns, the researcher suppressed specific details about the participants. As previously noted, the researcher shared the confidentiality agreement and the procedures for handling the participant information. Interviews with external auditors took place without informing them of the case study under investigation; external auditors answered questions in general terms.

**Data collection.** Participant interviews and analysis of town financial documents made up the data collection method for this study. Participant recruitment began in August 2015 with an invitation letter sent to the relevant city administrators, auditors, media, and business owners. The responses resulted in a sample size of nine and the completion of nine interviews. The researcher initially planned to collect at least ten interview subjects for the study. However, due to the lower number of received responses, the researcher decided that the collected interviews contained a satisfactory amount of information for the required data saturation. The researcher also proposed to

complete all interviews in person, but the researcher adjusted this method based upon the needs of the study. Seven participants completed face-to-face audio interviews, and the researcher received permission to complete two of the interviews by email.

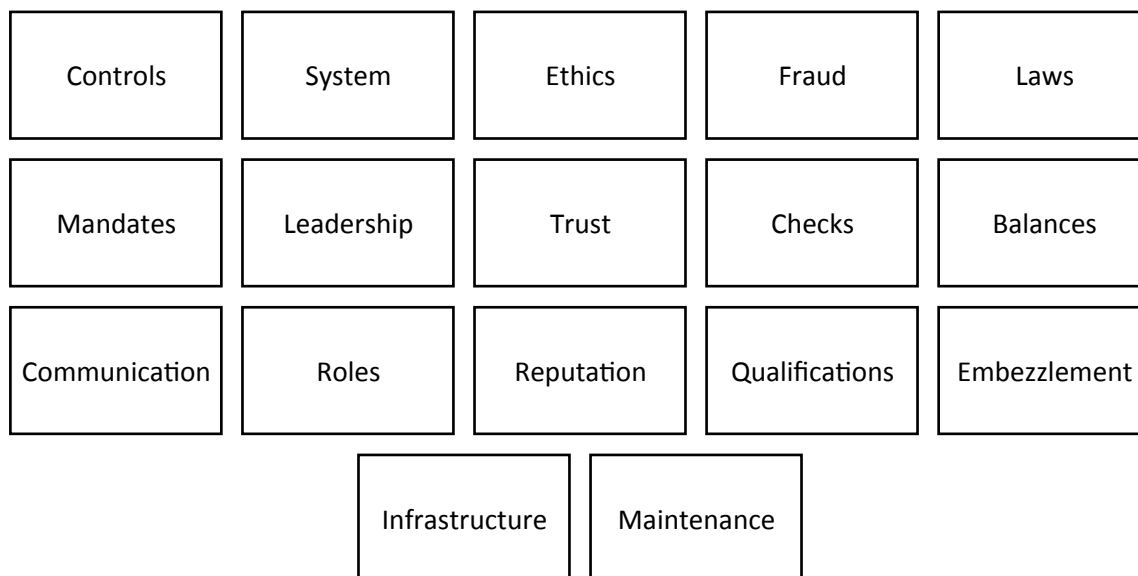
Interview participants finished interviews by telephone and email; the seven face-to-face interviews took approximately 30 minutes to conduct. The audio-recorded interviews took place at a discreet location, and the researcher transcribed the interviews at home for privacy purposes. Each participant signed a consent form before the beginning of the interview, and the researcher reminded participants of the study's purpose and the study methodology. The researcher verified the accuracy of interviewee responses by having the participants check their responses and confirm the correctness of the information.

The interviews were semi-structured and in a conversational style. The interview protocol helped to answer the study's main research questions about the financial internal controls used to detect or deter multi-year municipal government employee embezzlement, how the incident affected the municipal government, and why the government did not implement effective internal controls to help detect or stop the embezzlement. Public records provided other relevant data used in the study. One encountered problem involved some missing financial data, but other collected financial and media records supplemented this missing information. These records included news articles and archival data, such as the unencumbered general fund balance, the city's property tax rate, the city's total outstanding debt, external annual audit reports, and any city internal control policy. Data collection revealed that the City of Dixon did not have a rating from any of the three major bond-rating agencies.

**Data Analysis.** The researcher transcribed the interviews into written transcripts. Transcribing the interviews onto paper started the overall analytical process. Transcripts for each interview received a thorough read through in order to gain a sense of the interviews as a whole. This study consulted the Saldaña coding system. This system acted as a type of qualitative inquiry that uses short phrases or words in order to give meaning to a selection of language-based data, including interview transcripts (Saldaña, 2013). It also utilized a first and second cycle coding process, which included review of either a single word or paragraph during the first cycle (Saldaña, 2013). The second cycle allowed for coding the same units and longer parts of the interview transcripts, and the researcher reconfigured some of the codes collected during the first cycle to develop the main themes discussed in the analysis (Saldaña, 2013). Open-coding classification guided the analysis of the interview data going by each line, phrase, and word. This part of the analytical process involved looking for patterns in the interview data including word and phrase repetition by participants.

During the first review of the interview data, each word, line, and phrase received several reviews. These reviews revealed general words and phrases written down and separated into categories (also written as nodes). The researcher again read these words several times and started grouping the words together to generalize about how these words formed patterns. Each transcript contained handwritten notes on any thoughts that came up during the first review of the transcribed interviews. This acted as an integral part of the coding process. The notes showed several word repetitions and phrases, which the researcher collected onto a separate memo, compared to each other, and grouped together into three thematic categories creating a coherent framework for the data. Figure

1 below depicts some of the most common categories and words uncovered during the first phase of analysis.



*Figure 1. Categories/nodes from interview data.*

Each of the interviews was color-coded by a main category (node) during the first phase of review. The following figures briefly summarize the color-coding to depict the percentage of each interview, as it corresponded to a certain node/category.

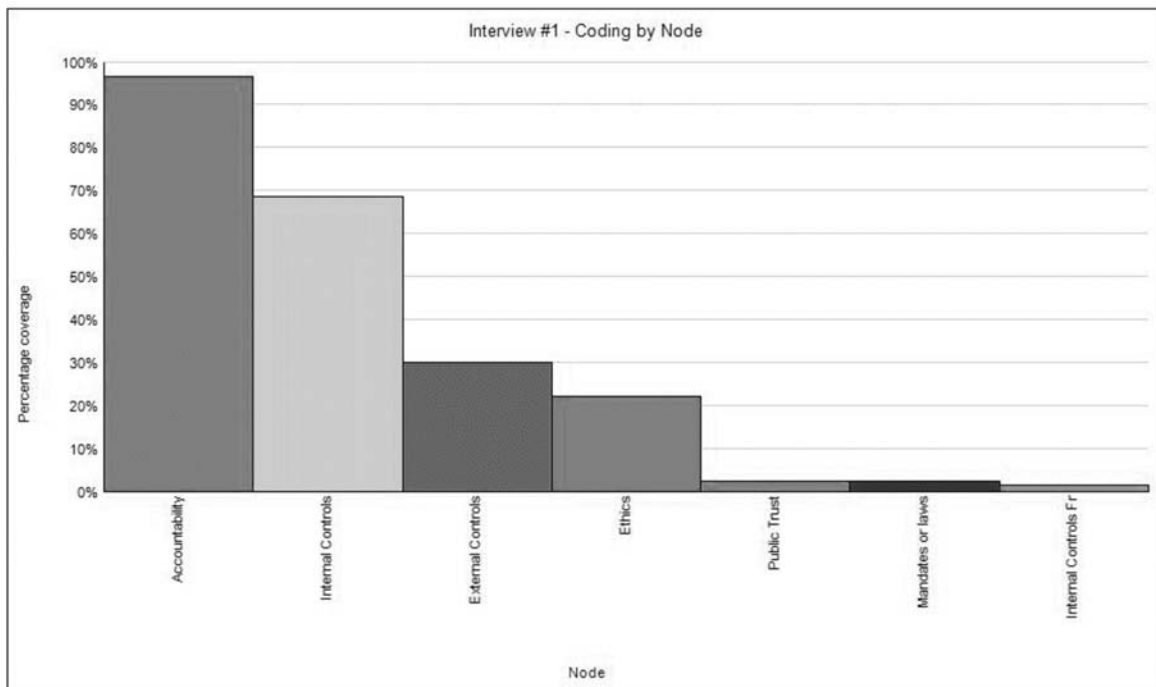


Figure 2. Interview 1 color coding by node.

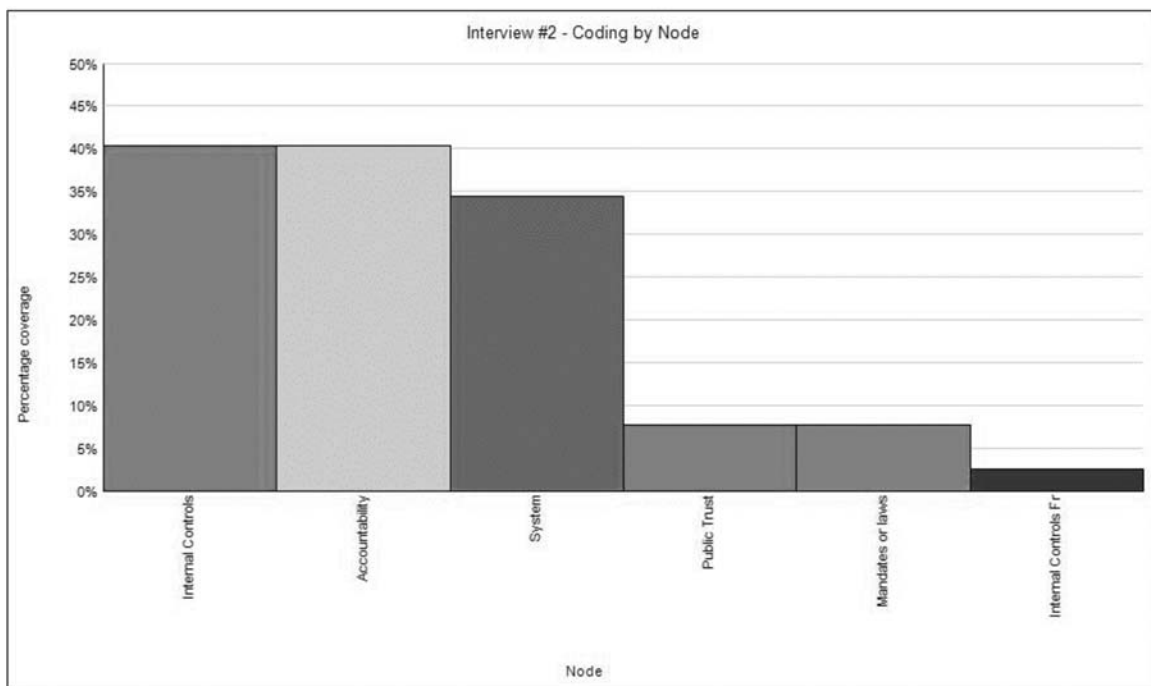


Figure 3. Interview 2 color coding by node.

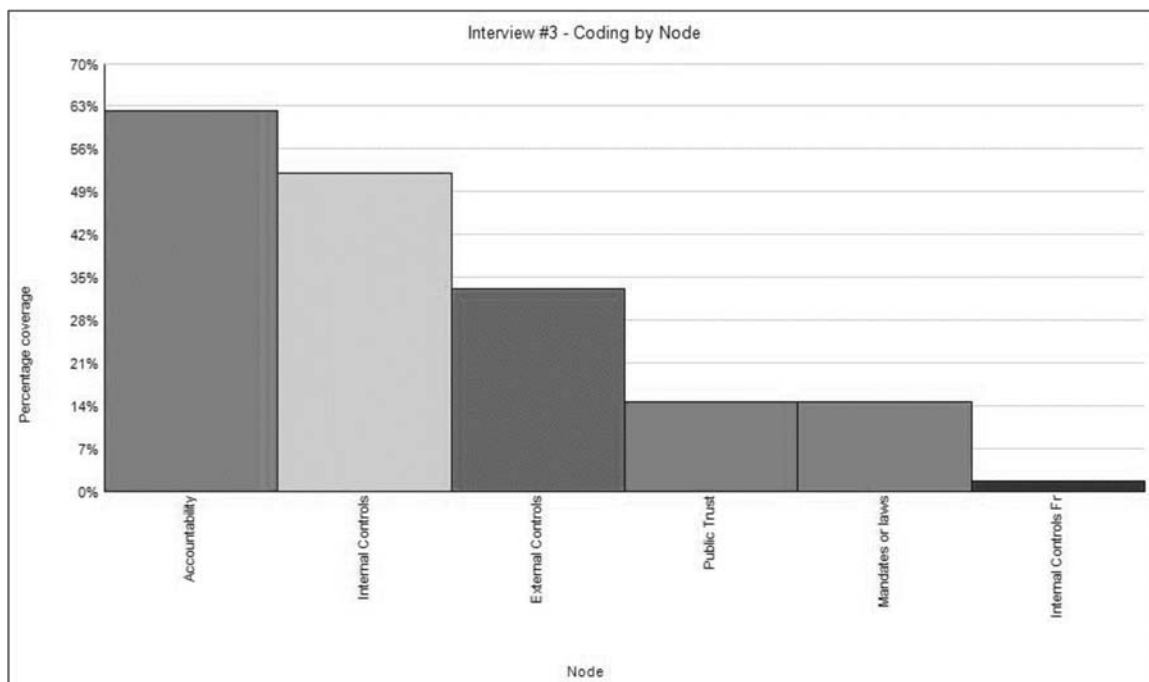


Figure 4. Interview 3 color coding by node.

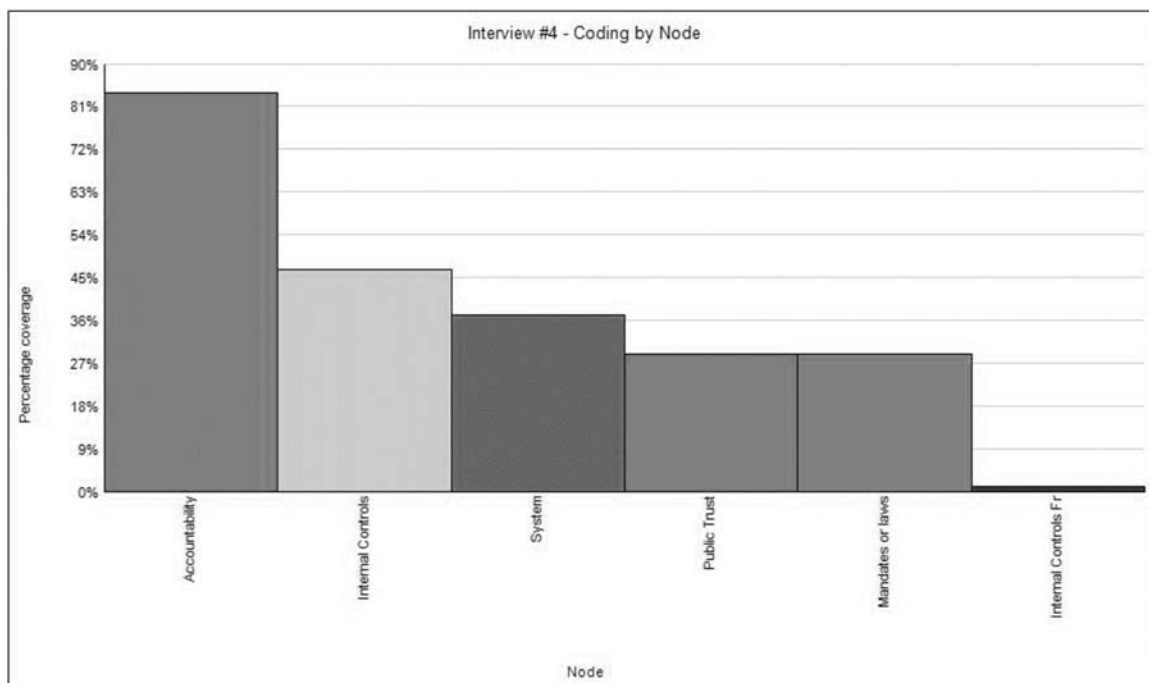


Figure 5. Interview 4 color coding by node.

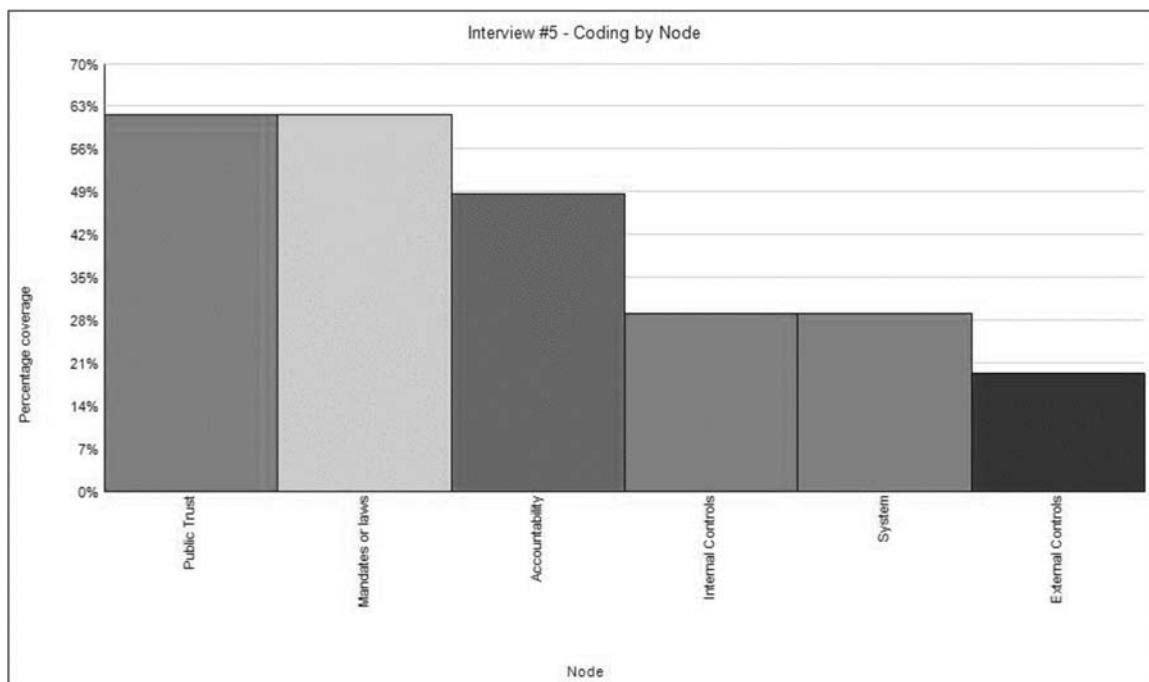


Figure 6. Interview 5 color coding by node.

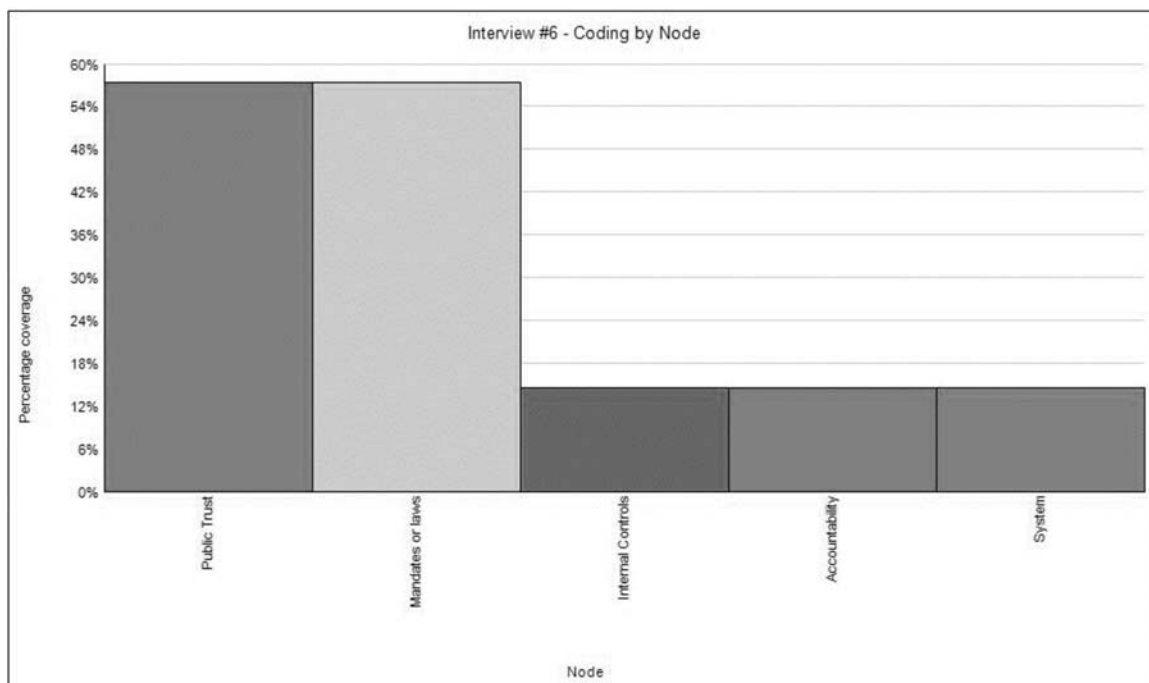


Figure 7. Interview 6 color coding by node.

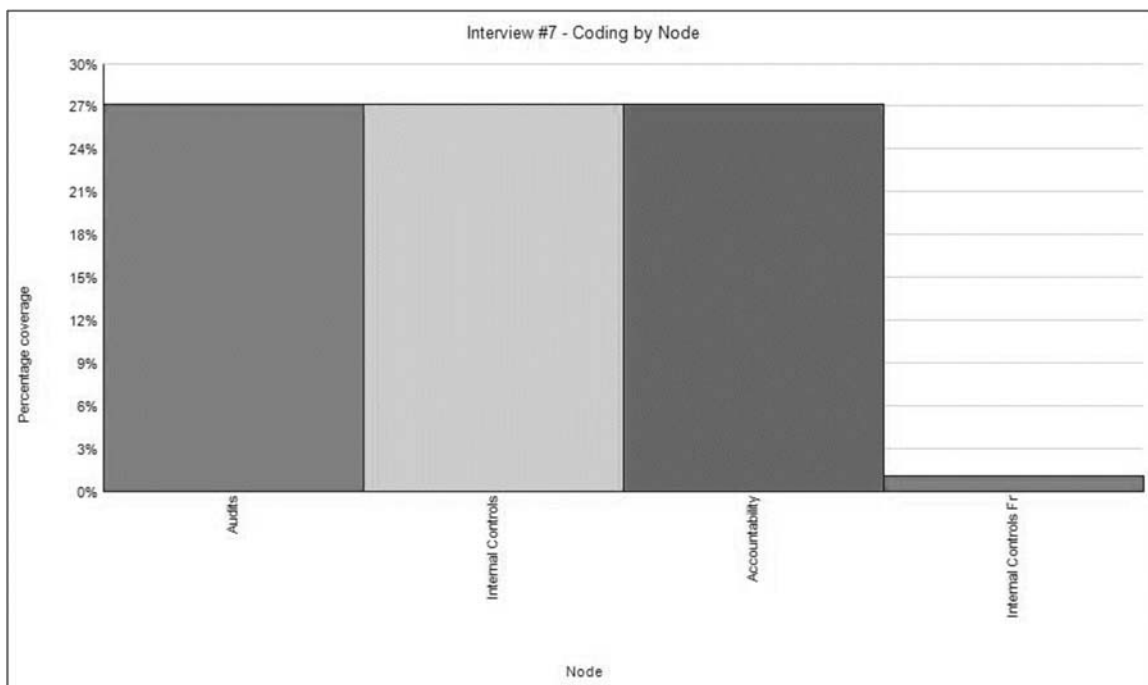


Figure 8. Interview 7 color coding by node.

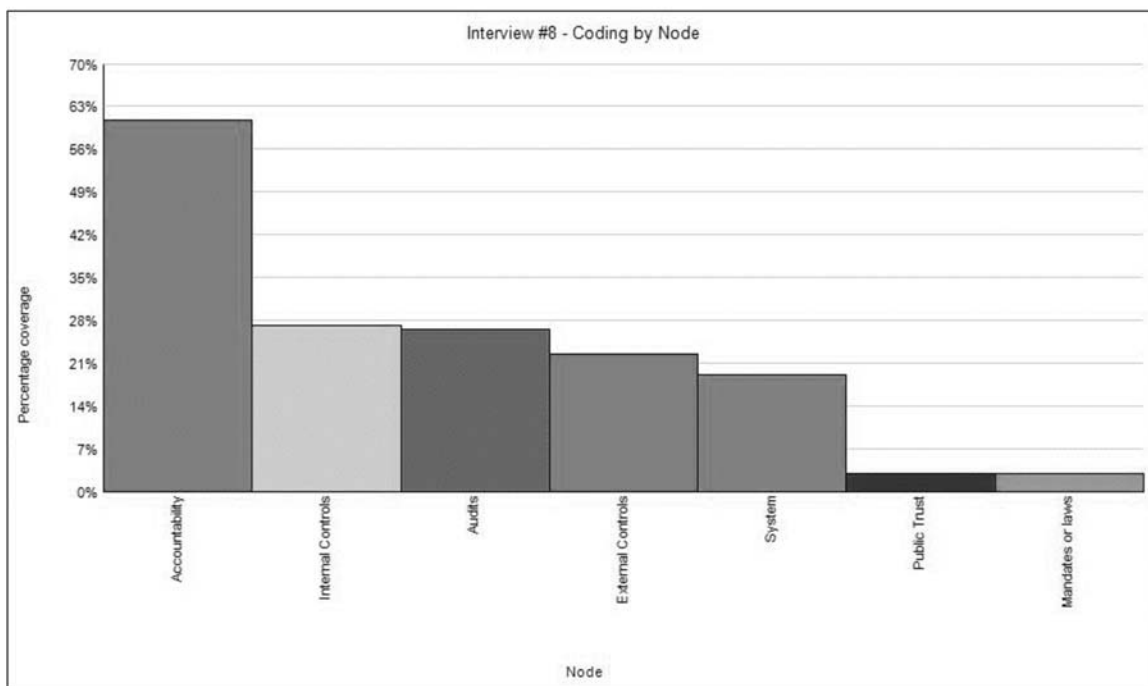


Figure 9. Interview 8 color coding by node.



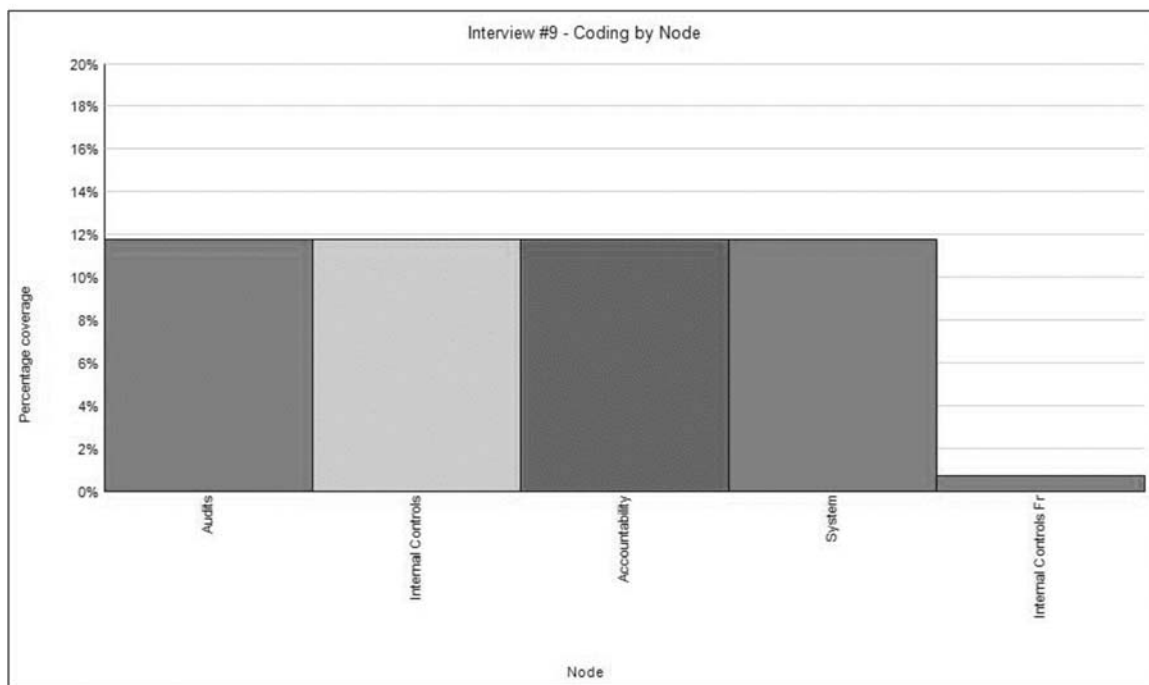


Figure 10. Interview 9 color coding by node.

The second phase of the coding analysis outlined three thematic categories used to frame the results of the data later in the chapter. These categories emerged from the line-coded data where the categories of accountability, trust, and system issues (internal controls, audits, accountability) all reoccurred frequently throughout the interviews. Table 1 below shows the categories that emerged from the second phase and the related key phrases from the interviews that initially helped to form the categories and themes.

Table 1

*Thematic Categories and Related Key Phrases*

| Thematic Phrases   | Accountability  | Public Trust   | System   |
|--------------------|---|--|--|
| <u>Key Phrases</u> | Segregation of duties<br>A/R system financials<br>fraud detection<br>qualifications<br>accounting practices<br>internal controls<br>external controls<br>management<br>embezzlement<br>laws<br>checks<br>balances | Public confidence<br>trust<br>fraud deterrence<br>duties<br>internal controls<br>complacency<br>embezzlement<br>mandates<br>leadership<br>laws<br>checks<br>balances | A/R system<br>fraud deterrence<br>segregation of duties<br>management<br>internal controls<br>qualifications<br>maintenance<br>embezzlement<br>roles |

Accountability, public trust, and system all appeared as the best way to answer questions regarding the history behind the case study, how the embezzlement took place, and the effects or consequences that resulted once authorities uncovered the incident. The results section used extracts from the individual interviews in order to provide a richer description of the case study. The open coding system created the themes and comparisons that eliminated potential bias from the interview responses by uncovering the reoccurring frequency of the most used phrases. Archival data retrieved from publicly available records and news media accounts, combined with the coded interviews, allowed for triangulation of the data. The resulting narrative revealed a rich and thorough description of the case results stemming from the embezzlement.

**Evidence of Trustworthiness.** The study revealed evidence of trustworthiness in credibility, transferability, dependability, and confirmability through its systematic and

ethical analysis and methods design. The establishment of credibility occurred through the recruitment and interview of important government, business, and media professionals who provided credible and pertinent responses to the interview questions. Individual responses provided similar versions of the events and matched with the collected archival data and news accounts about the embezzlement scandal.

Assumptions about the case enhanced transferability of the study to future research as well. The interviewees participated in semi-structured interviews revealing similar opinions and accounts about the embezzlement. These views matched the triangulated data and other outcomes related to the event. The provided archival data also matched back to information shared in the media and responses provided by the participants. This supported the assumption about the data's accuracy including the financial condition of the Comprehensive Annual Financial Report (CAFR), and the municipality's account balances.

Confirmation about the study's dependability occurred with the enhanced description of the research context. Changes occurred within the municipal government after the discovery of the embezzlement. The study shared a rich description of the changes and improvements made to the internal controls following the discovery of the fraud event.

Confirmability of the study happened after comparison of the participant responses to the interview questions. Their observations and accounting of the events leading up to the embezzlement matched one another. The amount of time between the fraud event and completion of the research study reduced some of the bias from the

participants. Consequences for the embezzlement and new municipal management were already in place.

Triangulation of the overall data also enhanced the above categories by comparing and contrasting multiple sources of data that includes the interview and archival data. Points made throughout the analysis usually received confirmation from more than one source of data including the missing internal controls that allowed the fraud event to take place. The thorough description of the case in the results section should allow for the generalizability of the results to other future research.

The results section outlines answers to the study's three research questions by providing a narrative of the incident and by using triangulation of the collected data. This section relies heavily upon interview data and news media accounts of the embezzlement events. The archival data provided the opportunity to triangulate the information and confirm the reliability and validity of different aspects of the information. In addition, the interview participants provided their answers under conditions of anonymity (to the extent possible) and have labels such as Interview 1, Interview 2, etc. This system provided a way to share valuable excerpts from individual interviews that enhanced the narrative without compromising the interviewer's identity. The coding of the data revealed three main, but overlapping categories. These categories included accountability, public trust, and system. The research questions contained elements of each category and the narrative discussion outlines how the categories overlap. Given the overlap of each theme and the part that they have in answering the research questions, this section was organized and ordered according to those research questions.

**RQ1.** How can financial internal controls be used to detect or deter multi-year municipal government employee embezzlement of at least \$50,000?

The first question in the study asked how municipal government could use financial internal controls to stop embezzlement from happening. One of the changes that took place (the reader will find the full discussion captured by research question 2) was the improved attention paid to internal controls. Each of the interviewed participants appeared to be familiar with standards of internal control policy and the prior lack of these policies in Dixon's government and accounting system. This knowledge could be due to the demographics presented by the interview participants. Each interview mentioned the importance of internal controls and that their proper use offered the opportunity to deter future fraud. Figure 11 depicts the percentage of the interviews coded as they linked to internal controls.

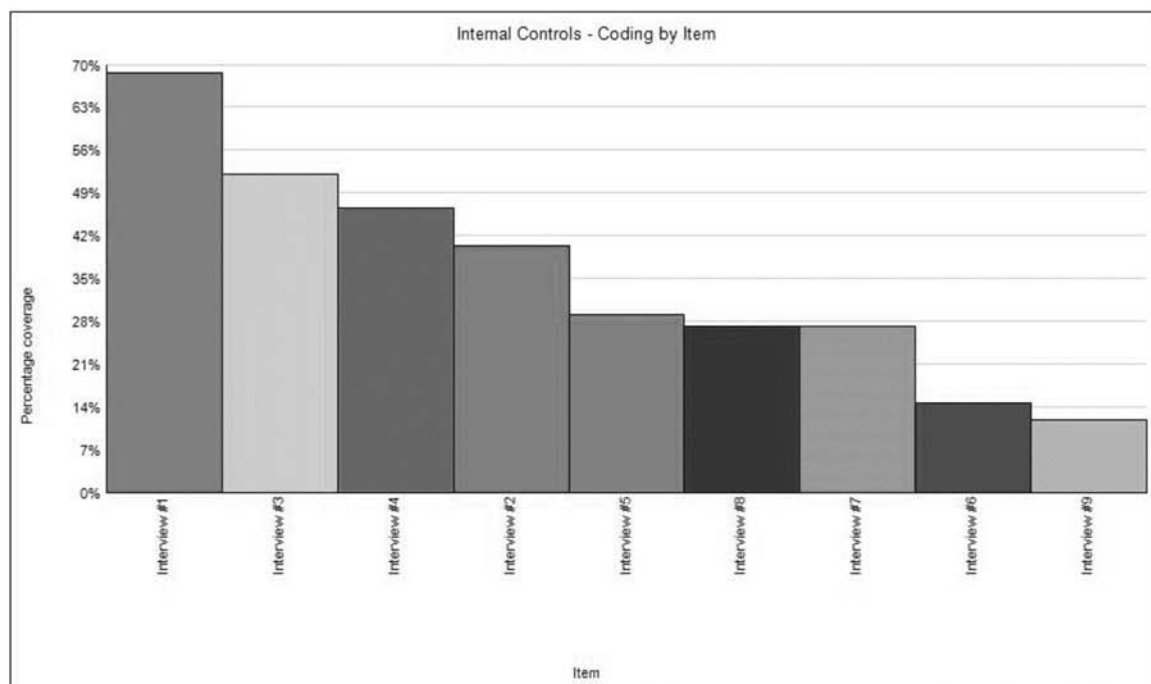


Figure 11. Percentage of interviews coded by internal controls category.

Because almost half of the interviews showed language coding of close to 40 percent in this category, this strengthened the suggestion about knowledge of the importance of such financial controls. However, this did not match with the existing accounting system within the city. The city had an annual budget that consisted of approximately \$32 million, with \$9 million in general operating funds and \$23 million for all other funds (City of Dixon, 2013b). The Dixon accounting system, which did not have many existing financial internal controls, aided the ability of the comptroller to embezzle funds (Association of Certified Fraud Examiners, 2014). The Association of Certified Fraud Examiners (2014) noted that any financial system with effective internal controls and a sound system required the following: antifraud training including actions to promote prevention, detection, and deterrence of the fraud. According to archival records and interview statements, these internal controls did not exist in Dixon. The city had 50 existing accounts with which to handle the city's finances (City of Dixon, 2012b). According to news media and interview statements, before the fraud was uncovered, the comptroller handled the majority of the accounts receivable for these accounts (Smith, 2012). No formal structure existed to monitor her actions. Whereas common internal controls practice involved activities such as segregation of duties and oversight, this did not occur in Dixon (U.S. Attorney's Office, 2012; Jenco & Grimm, 2012). Multiple accounts reported the serious lack of internal controls in the city. Individual department heads and commissioners held responsibility for one area, and people did not share duties (Jenco & Grimm, 2012). One person had access to one account or completed a transaction alone without oversight (U.S. Attorney's Office, 2012; Jenco & Grimm,

2012). No one completed separate reviews of any reconciliations or tracked receipts (Jenco & Grimm, 2012).

The comptroller controlled over 30 city checking accounts, which allowed her to create a secret account in 1990 that she used to deposit the stolen money (U.S. Attorney's Office, 2012). Her mode of theft consisted of two methods, skimming and fictitious billing of construction invoices. She regularly created fake construction invoices for the Dixon Water Department and IDOT from the State of Illinois (Becker & Barichello, 2013). The existing system enabled her to constantly reconcile and balance statements and find ways to account for missing money (Becker & Barichello, 2013). Interview accounts verified these events.

She had about 35 city checking accounts and 1 the city didn't know about. She skimmed at first 22 years ago is where it started, then it got into billing fraud, she would make up a fake invoice for a construction project, we would get money in from the State, she transferred that money into multiple different checking accounts then she would make a check out to "treasurer" and deposit it into the account nobody knew about. She then made a fake invoice to account for that money. She did this hundreds of times over the years. (Interview 1)

During her time in office, she wrote checks from accounts where she was the only signatory (Interview 1; Interview 2; Interview 3). "Rita wrote a manual check with only one signatory" (Interview 1). "She made checks out to "treasurer" rather than to the City of Dixon" (Interview 2). According to interview participants, a regular audit of the books might have detected the fraud (Interview 3; Interview 7).

Having an external audit, having an internal audit department can help quite a bit depending on the size of the organization. An internal audit committee can help determining and monitoring fraud risks, control risks, and follow up to ensure auditor recommendations are acted upon. (Interview 7)

Regular accounting practices took place externally, and no internal payroll or accounts payable system existed (Interviews 1; Interview 2; Interview 4). “A/R was not in the system and it was done by hand internally” (Interview 2). The system only employed one outside firm to complete all of the books for the city, and they carried out the yearly audit (Becker & Barichello, 2012).

They should have noticed the discrepancies. The invoices lacked key information, such as the agency’s emblem or logo and a contact name and number of an employee who could be reached for questions. While those and other examples should have raised suspicion, no evaluation or investigation was made of the phony documents by one of the two firms that have conducted the annual audits for the past 21 years, the city government says in its lawsuit. (Becker & Barichello, 2012, p.1)

This firm did not question the Comptroller, and they regularly signed off on her routine annual reports, which the basic financial statements also confirmed. Transparency of documentation remained a problem for several years. A transparency audit offered by the Local Transparency Audit found that the Dixon City website ranked in the bottom of local government agencies with their information transparency scoring only about 17 out of 100 points (Costin, 2012). The failure existed, because they did not post full budgets, financial audits, government expenditures, and contracts (Costin, 2012). The



transparency offered the opportunity to deter the embezzlement. Posting of financial information provided opportunities for multiple individuals, ranging from employees to city officials, to review the finances and to ask critical questions about any suspicious details.

The Dixon government enacted or used few of these types of internal controls. One interviewee shared certain internal controls that the interviewee thought would help to deter fraud if implemented.

Segregation of duties is huge, background checks on employees, have a robust interview process, set a good tone at the top, management must set a good tone, require vacations and rotating job duties, having an external audit, and having an internal audit department can help quite a bit depending on the size of the organization. An internal audit committee can help determining and monitoring fraud risks, control risks, and following up to ensure auditor recommendations are acted upon. (Interview 7)

Other interview participants also cited the most commonly reported missing internal controls as no oversight, separation of duties, independent checks, lack of fraud education, controlled finances, in-house bookkeeping, background checks, and required holidays for employees, external and internal audit systems, and regular fraud risk detection. External auditors also recommended that a good accounting system with internal controls that detect fraud needed tailoring specifically to the city's design.

The recommendations matched recommended internal control guidelines outlined by the U.S. Government Accountability Office Standards (2005). The guidelines state that internal control provided the key component to keeping assurances in place within a

management structure (U.S. Government Accountability Office, 2005). These controls contributed to an organization achieving efficient operations, reliable financial statements, and the correct compliance with any existing financial laws (U.S. Government Accountability Office, 2005). The America Institute of Certified Public Accountants (AICPA) in Statement of Auditing Standard No. 55 (2015) also noted the importance of these standards for good management and fraud deterrence and detection. They noted that a controlled environment, proper risk assessment, controlled policies and procedures, strong communication and information sharing mechanism, and constant monitoring created an environment that stops embezzlement (American Institute of Certified Public Accountants, 2015). The failure of the system to employ proper internal controls directly related to why the embezzlement occurred.

**RQ2.** How is a municipal government affected by a known multi-year incident of municipal government employee embezzlement of at least \$50,000?

The embezzlement incident's effect completely changed the municipal government as the town knew it. The interview accounts and the archival data provided answers to the question of these effects within the main themes of accountability, public trust, and system. The trust in the comptroller and the system of government in place allowed the embezzlement to take place. Once uncovered, the damage from the fraud destroyed the public confidence in every aspect of the government. The public lost confidence in the city council, resulting in a complete switch in the make-up of the government (Smith, 2012). This included all new council members, new financial controls, and an entirely new way of choosing city employees (Smith, 2012). Excerpts from the interview data outlined the overwhelming effect of the incident on how the city

experienced future management. “Everyone was shaken by it. It changed the Dixon form of government and that referendum passed with a 76% approval. It also included a very thorough vetting of new top level employees” (Interview 4).

Without a shadow of a doubt. A great example is people can be untrusting of government and in a rural conservative area that goes up even more. There is a preconception in Illinois that corruption is common. Public trust bottoms out. I think that was demonstrated in the vote to change the form of government and with the elections where voters got to express their concerns. (Interview 3)

Change of government, people lost confidence in city official leadership. People felt the city was a closed shop—insular. It was a bunker mentality. The city lost credibility. A clean sweep of the council and mayor. A change of government. (Interview 5)

The failure of the public trust leading to the loss in credibility and the vote for the new government was really a major change for the city. There was only one other time in the city’s history, back in 1918, when it tried to change from the commission form of government into a management style, but the referendum failed during the vote (City of Dixon, 2013a). This major change was reiterated in a news article from November 4, 2014, which reintroduced the government change referendum; it recommended a change in government from the former commission style to the current managerial style (Mencarini). Mencarini (2014) wrote that

Of the 3,893 votes cast, 2,977 – 76.47 percent – favored the change. Only 916 voters, or 23.53 percent, voted to keep the current form. The change is one that doesn't happen often. Only two northern Illinois cities in the past 25 years have

changed their government – Rochelle in 1994 and Sycamore in 2003 – and both to the managerial form.

Municipal government changed drastically as result of the scandal and the loss of public trust in the existing system. It also brought about a stronger focus on the need for internal controls and a sound accounting system.

The Association of Certified Fraud Examiners' *2014 Report to the Nations on Occupational Fraud and Abuse* recommended the change in system and the institution of a new set of controls to help manage future fraud detection in Dixon. The city felt the pain and embarrassment of the embezzlement. Interview 4 said, "there was really bad employee morale at the time and a lot of infrastructure projects were cancelled. Staffing was bare bones and there wasn't any money. The concept of internal controls never crossed anyone's minds [at the time]." The incident motivated the city to push for continued work and revision on creating new policies and procedures. Interview 3 noted, "morale was affected since employees probably felt that people were looking at them with suspicion. Many employees became frustrated with the sacrifices they needed to make. It had to impact morale." The first step to boosting morale was the change in system to a managerial style of government, the result led to the creation of a strengthened accounting system with better internal financial controls and accountability. Interview statements outlined the strengths of the new system.

We set up the accounting system utilizing the IT manager so the system itself will allow you to separate things. If someone has the right to input the invoice, that person cannot cut the checks. The IT guy gives access to people...Was that in place before? Absolutely not—not even close. We've tried really hard to

implement internal controls since the discovery. (Interview 1)

The city also hired completely new management and eliminated the former role of comptroller by switching to a finance director role (Smith, 2012).

After the change in form of government, the role of mayor changed. [The] role is to be involved in all major policy decisions and to ensure reviews are done on decisions. Keeping council informed while working with staff. We are recovering from municipal fraud. We are redoing so many policies. (Interview 3)

The new finance director did not have complete control over the city's finances, but now answered to a city manager enlisted to set up a set of checks and balances on every aspect of the new financial system (Interview 1, Interview 3, Interview 4, Interview 8). The city manager position did not exist before, because of the commission form of government (Mencarini, 2014). Another referendum in the early 1980s proposed to have a manager in place, but the measure did not pass (Interview 4, City of Dixon website). This spoke to the intensity with which the city adapted to making changes to the system and the much more elaborate system put into place to manage the city's finances.

Another major change to the government following the embezzlement scheme required employees to have proper qualifications. This was a major flaw in the system, because before the reforms, anyone could be in a particular role. Internal controls went unimplemented because of the lack of qualifications and training on better accounting practices and how to do fraud detection. The comptroller did not have any education related to her role. She did not have an accounting or related degree. Interview 2 stated it was common that

Many of the employees didn't have college degrees. Rita started as a seasonal and

grew into the position. It's always been done that way and nobody knew better. I don't know if the auditor emphasized our weaknesses to the council? I don't know.

Interview 4 also noted, "most of the department heads don't have college degrees or any real background—they just got hired out of high school." Smith (2012) mentioned that in the City of Dixon, the commissioned governors earned a wage, but because of the minimal amount, many of them maintained other full time employment. Financial documents from the city's Budget-Fiscal Year Ending April 30, 2007 general fund budget corroborated the statements (City of Dixon, 2012a). According to the record, a commissioner made \$2,700 in 2004 to 2005, the comptroller/treasurer made \$53,197.17, and the personnel manager made \$4455.49 (City of Dixon, 2012a, p. 4). This added to the suggestion that some of them did not have the necessary qualifications or background required to function in an effective manner (Smith, 2012). Having the training, time, and incentive to detect fraud only comes with training.

Knowing what could go wrong so if things are not in place, there is a heightened risk. Compensating controls are probably not going to be implemented if council members don't know where the weaknesses exist. Council doesn't see the severity until it is too late. (Interview 7)

Following the government style change and the boost in transparency, it appeared that the town worked to address this issue as well. The Budget-Fiscal Year Ending April 30, 2015 showed that the town government finally remedied this problem following the scandal, by instituting full time salaries for positions within the new city government

(City of Dixon, 2014). This added another layer of protection to the internal control system, but was a major change from the previous way of doing business.

A review of archival data revealed general fund cash decreased from \$3,503,752 to \$594,169, or 83.04% between 2009 and 2011. During the same time, the city's investment account decreased from \$5,376,081 to \$284,067, or a decrease of 94.72%. Between 2010 and 2012 the city's general fund property tax rate increased by 68.4%. Once the city recovered the majority of the embezzled money from a settlement, net assets increased by 30.24% from 2009-2014 and debt decreased by 37.15%.

**RQ3.** Why did a municipal government with a known multi-year employee embezzlement of at least \$50,000 fail to implement effective internal controls to help detect or deter municipal government employee embezzlement?

The interviews and archival data revealed several issues that made it possible for the comptroller to embezzle several million dollars from the city's finances. The first issue was a matter of trust. It was typically some trusted employee who carried out an embezzlement scheme; even the definition of embezzlement necessitates that the embezzler be in a trusted role (American Institute of Certified Public Accountants, 2015). Dixon's comptroller built up public and individual trust by starting work for the city early; she started through a high school work-study program back in 1970 (Smith, 2012; Interview 3; Interview 4).

She then advanced through the city government, and the city appointed her comptroller in 1983 (Smith, 2012). Within five years of her appointment, she started embezzling money (Smith, 2012). Her length of time with the city contributed to her ability to cover up this fraud (Interview 3; Interview 4). During her tenure as comptroller,

she continued to develop a certain level of trust within the city government and the community by reinforcing her reputation and congenial demeanor through subtle bribery and favors. “Her reputation [was] that she was very smart and very knowledgeable with finances. She got along well with people and some of it was using taxpayer funds to get along with people” (Interview 3). There was little to question about her abilities to handle finances or use city funds. “She had been with the city longer than elected officials or staff members and she knew more than anyone else. She used that position to steal funds and cover her tracks” (Interview 3). Financial statements reiterated the major trust placed in the comptroller as obvious drops in city cash flow occurred and went undetected, including a significant drop in cash flow and investments in September 2011 (City of Dixon, 2012c).

As a trusted city official, the comptroller received the autonomy to by-pass many procedures and internal controls, which would have denied her the chance to commit the long running fraud scheme (Association of Certified Fraud Examiners, 2014). The level of trust developed during her time in office allowed her to operate alone without the typical regulation or oversight (Association of Certified Fraud Examiners, 2014). This related to the point that she had a level of trust such that the town auditor regularly signed off on her books (Interview 3). However, once someone started questioning the state of the city’s finances, the scheme revealed itself quickly (Smith, 2012). Complaints came in regularly from community members and department heads about the city being broke and in disrepair, but no one questioned why for a long time (Interview 4; Smith, 2012). It is often typical for embezzlement schemes to be revealed easily, because no one previously looked for them. The trust in the comptroller was based on coworkers’ and communities’



usual propensity to trust, facilitating the opportunity to carry out such a crime over multiple years.

Besides the trust placed in the comptroller, the city was also complacent in creating an accounting system that implemented proper internal controls. Individual commissioners had control over one particular area, and they only had an interest in dealing with their one area of responsibility (Mencarini, 2014; Interview 3; Interview 4). Given the trust placed in the comptroller, there was no interest in questioning anyone else's action (Interview 3; Interview 4). That also opened the door for the comptroller to commit fraud. Because she was responsible for handling a majority of the accounting practices for the city, the lack of internal controls and the level of trust placed in her abilities allowed the crime to take place (U.S. Attorney's Office, 2012). Interview 4 noted "she had like 30 some checking accounts and I don't think any of the elected officials were interested since they wanted to do things that people saw and liked—not to "fix" the mundane things." Compounding of responsibilities violated basic internal control policies, but this was a small city with limited staff. In such a system, a trusted individual had total financial control and the council reportedly lacked either initiative or authority to question her practices.

In the 90s the populous didn't see a need to change the form of government since an effort back then to do it failed. The push was never there until this happened. If people trust what's there and the people trust the system and the people within it, then there is no impetus for change. (Interview 3)

The complacency and tendency not to ask questions reinforced the failure to enact proper internal controls necessary to deter the embezzlement.

## **Evaluation of Findings**

The findings of the study, based primarily on the interview responses of the participants were in line with the findings of previous literature. Three significant themes emerged, respectively answering the three research questions. First is that the lack of financial internal controls are a central issue to the embezzlement scandal. Second is that embezzlement can lead to a complete changeover in the accounting system of a municipal government. The third is that the trust in the comptroller and the city government without proper oversight procedures allowed the embezzlement to happen.

The finding that the lack of financial controls in Dixon, Illinois served as the enabler of fraud is supported by existing literature. The findings revealed that participants were familiar with the appropriate standards of internal control policy but did not have the chance to apply such policies because they did not exist. From the responses of the participants, it is observable that they are aware that if the government used certain controls properly, the fraud would not have taken place or it would have been detected sooner. Similar to the present findings, Kopic (2013) found that internal control is a risk management instrument. To ensure a sound system of internal controls is critical and should be in place even before a scandal takes place. Internal controls include the control environment, control activities, information and monitoring, risk assessment, and monitoring (North Carolina Department of the Treasurer, 2011). If internal financial controls are effective, researchers found that they could most likely prevent fraud and correct weaknesses once a problem is discovered (Dorminey et al., 2012; Miller, 2012). Financial controls in Dixon, Illinois were limited, enabling the comptroller to embezzle money easily.

The second theme, which states major embezzlement incident can change the municipal government completely and significantly, is also supported by existing literature. Both the interview responses and archival data led to the conclusion that embezzlement significantly affected the trust of the public. After the fraud was uncovered, public confidence in every aspect of the government lowered. Transparency started to be desirable. The hiring of staff became even more stringent. The findings of the study contributed are in line existing literature that showed weak governance is associated with a greater likelihood of someone committing organizational fraud (Trompeter et al., 2013; 2014). Trompeter et al., (2013) claimed that unethical senior managers might continue to be unethical if not given reprimands or other more severe punishments. Existing literature emphasized fraud and embezzlement should not be taken lightly because they can have serious consequences for the municipality (Elson & Dinkins, 2009; Elmore, 2013; Ference, 2014; Simona & Elisabeta, 2014). Existing studies support this finding as well. According to Maciag (2012), 26 municipal government bankruptcies between January 2011 and June 2012, mainly because of municipal government employee embezzlement (Maciag, 2012). Municipal governments are not that different from organizations, which can suffer significantly after fraud took place. Hammersley et al. (2012) found that organizations after fraud weaknesses suffer consequences of higher audit fees, a greater likelihood of auditor resignation, and worsening credit ratings (Hammersley et al., 2012).

One more important finding was that trust is a key factor why the government failed to prevent fraud. Because the person who carried out the embezzlement was in a position of trust and nobody thought she could ever think of committing fraud, she was

able to get away with committing this. This is supported by the literature, which claimed that most embezzlers are able to engage in fraudulent activities because they have trusted roles (American Institute of Certified Public Accountants, 2015). Moreover, the findings of the study revealed that fraud detection could not be done by a person or one organization alone. This is why most researchers end their studies with a recommendation that proper modern public accounting practices entail having different aspects of finances to be handled by multiple people or that there be segregation of duties, so that no one person in an organization can receive, spend, transfer, or otherwise control money without the participation of others in the organization (Kapic, 2013; McDermott, 2012). Reidy and Theobald (2011) also claimed organizational embezzlement is much more than just a concern of company management. Various organizational stakeholders including the board, internal auditors, an audit committee, and the organization's external auditor share the concern (Reidy & Theobald, 2011).

The researcher's credibility, the full narrative description of the case, and the triangulation of information determined the reliability and coherence of the data collected in the study. The richness of the narrative in the results allowed for the reader to determine the validity, reliability, and applicability of this research to their own purposes, including for academic research efforts. Readers can also find the triangulation of the data interspersed throughout the results section, and may use this information to determine the usefulness of the findings.

Overall, the collected interview data demonstrated consistency among the nine respondents. Some of the questions differed slightly, depending on the participants' occupation and background. However, there was general agreement on what happened

and what would ensure that the embezzlement does not happen again. These responses also corresponded with the categories and themes that emerged from the first and second coding analysis of the interview data. The thematic categories that emerged as a result of the research interviews were accountability, public trust, and system. Each of these thematic categories explain the case study's history, explain how the embezzlement occurred, and explain the consequences that resulted from the discovery of the financial fraud.

Some weakness existed between the triangulation of the interview data and archival documents, but this depended upon the theme or question answered. Archival data had some limits, but the information already existed in media accounts and within the interview statements. Because the themes overlapped the available information from multiple questions, the study did not need support from multiple archival data sources in order to strengthen the analysis.

### **Summary**

The results in this section answered the study's three main research questions: (1) how can financial internal controls be used to detect or deter multi-year municipal government employee embezzlement of at least \$50,000; (2) how is a municipal government affected by a known multi-year incident of municipal government employee embezzlement of at least \$50,000; and (3) why did a municipal government with a known multi-year employee embezzlement of at least \$50,000 fail to implement effective internal controls to help detect or deter municipal government employee embezzlement? It answered these questions by uncovering overarching themes presented by the interview data and linking those back to the collected archival and media data. The themes of

accountability, public trust, and system played a part in answering the above questions and outlined the case study narrative.

Financial internal controls revealed themselves as a central issue to the embezzlement scandal. Internal controls did not really exist in Dixon's accounting system and practices. The absence of these controls allowed for the Comptroller to continue committing fraud for over two decades. The missing oversight and transparency caused the embezzlement to go on for a long time.

Another major finding is that the city underwent major changes because of the embezzlement. The government consisted of a small commission of part-time elected members who each carried out separate and unmonitored activities. At different points during the city's history, the city tried to change from a commission style to a managerial style of government, but voters always overturned the proposal. However, once the city uncovered Rita Crundwell's fraud, the government finally admitted to the flaws in the old commission style system. A sweeping referendum took place in November 2014 introducing a new management and accounting system for the city. A complete changeover in the accounting system took place, and staff adjusted accordingly. Whereas the former government had no internal controls in place, the new government required full transparency, accountability, and qualified personnel.

The findings also showed that the trust in the comptroller and the city government allowed the embezzlement to happen. A main problem in a small city such as this one is that there was fewer outside audits conducted and limited attention paid to the city's accounts. Local accountants and the external auditors dismissed concerns, trusting the comptroller's background and annual financial statements. These existing processes made

it simple for Crundwell to do whatever she wanted with the finances. Without internal controls, transparency, and questioning of trust, a sort of complacency grew within the city government. People complained about the state of the city's finances, but it took twenty years before they questioned anything.

In summary, the analysis of the data showed that the embezzlement resulted in significant changes to the city government's style and management structure. The incident destroyed public trust and hurt government employee morale for a period following the incident. The old system facilitated the embezzlement due to complacency and a closed culture of communication and trust. While economic development did not appear to suffer, the incident damaged the city's reputation, and it acted as the catalyst for the previously discussed reforms.

This case study fully describes the implications of such a massive embezzlement scheme and the effects on the financial controls of a city government. The goal of the study was to help inspire others interested in this topic to carry out their research into bettering financial controls for a city or institution. The next chapter provides the summary and conclusions made because of the results. It contains a short summary of the research, insights for policy and procedures, and potential for future research into similar case studies. The chapter also includes discussion of the findings, how these results relate to previous studies outlined in the literature review, and any conclusions resulting from the discussion.

## Chapter 5: Implications, Recommendations, and Conclusions

The phenomenon of municipal government employee financial embezzlement in communities across the United States is well documented (Aikins, 2012; Camilli, 2013; Hammersley et al., 2012). Existing scholarly research on municipal government internal controls has revealed that these illegal activities are widespread (Laborde, 2012; Noland & Metrjean, 2013; Verschoor, 2012). These illegal activities have led to adverse effects such as municipal government corruption and scandals, making a higher level of accountability and oversight desirable (Elmore, 2013; Ference, 2014; Simona & Elisabeta, 2014). These studies revealed a need to understand more comprehensively how municipal government employee embezzlement occurs in these localities and what practices should government finance managers engage in to detect or deter illegal activity (Aikins, 2011; Agarwal & Medury, 2014; Gabriel, 2014). The effects of a multi-year incident of employee embezzlement on the municipal government's setup and operations are unknown. The current study was designed to close this gap.

The purpose of this qualitative single instrumental case study was to understand the value of municipal government financial internal controls in detecting and deterring a multi-year employee embezzlement of at least \$50,000. The objectives of the study included understanding the perspectives of stakeholders on the role that financial internal controls can play in preventing employee embezzlement, the ways in which governments without adequate financial internal controls can change after employee embezzlement, and the reasons why a municipal government can fail to implement effective internal controls in the first place. To achieve the purpose of the study, the researcher used the



single instrumental case study approach, aided by fraud triangle theory, bureaucratic management theory, and organizational theory.

The purpose of this qualitative single instrumental case study was to use fraud triangle theory, bureaucratic management theory, and organizational theory in examining municipal government with a known incident of multi-year employee embezzlement of at least \$50,000. The main objective was to ascertain how certain municipal government financial internal controls detect or deter multi-year employee embezzlement of at least \$50,000. The goals were to understand how municipal governments can be affected by a known incident of multi-year employee embezzlement of at least \$50,000 and understand why municipal government officials fail to implement effective internal controls to help detect or deter employee embezzlements.

To achieve the purpose of the study, in-depth semi-structured interviews with stakeholders of the municipality of Dixon, Illinois, who experienced one of the country's largest cases of multi-year embezzlement, were conducted. The stakeholders included appointed officials, elected officials, external auditors, members of the local news media, and business owners who had firsthand experience of being affected by the aftermath of the embezzlement case. Additionally, data were obtained from an archival review of previous audit reports, bond rating reports, internal control policies in place before and after the discovery of the embezzlement, internal e-mails, news articles, and news editorials from the locality where the municipal embezzlement took place. The collected data were part of the single instrumental case study design to answer the three primary research questions of this investigation.

Because of its subjective nature, this qualitative study, like most qualitative research studies, experienced limitations. One limitation is that the researcher needed to assume that participants exhibited honesty and openness during their interviews. Moreover, because this study relied on participants' self-reports of their experiences, bias was a possible limitation. Although the researcher made sure that participants knew how important it is to be honest, participants' honesty can only be assumed. In addition, self-report data is susceptible to errors in the memory of participants. The researcher mitigated these limitations by interviewing multiple stakeholders. The sample size used for the study is the best number that takes into account possible errors and threats to the validity of the data and analyses.

Another key limitation is the study's generalizability. The findings of the study may only be applicable to Dixon, Illinois, which experienced a known incident of high-dollar, multi-year employee embezzlement and cannot be generalized to all 89,386 municipalities of the nation, even if fraud and embezzlement is a widespread problem. Dixon, Illinois was the ideal community to use for this study because it is one of the areas where significant financial losses were incurred from a very well-known incident of multi-year employee embezzlement. However, even though some findings may be relevant for other municipalities, claiming the same findings for all municipalities or fraud cases is not possible. Still, even with these limitations, the findings within the Dixon, Illinois could shed light on the topic of employee embezzlement such that any accrued knowledge in this study will be of utility to future researchers.

Before summarizing and presenting the findings, it is also best to understand what ethical considerations were made for this study. For qualitative research studies, ethical

dilemmas can be problematic, and a researcher must protect the quality of the research process (Merriam, 2002). Fortunately, this study involved collecting data and information from past events, and therefore, there were fewer ethical considerations compared to a study involving experimental design with human subjects (Trochim & Donnelly, 2008). Because the topic was sensitive in nature, wherein participants may feel like they were being judged if they answered certain questions, several ethical considerations were made. First, the researcher made sure participants understood the purpose of the research, by obtaining written permission from participants after approval from the Institutional Review Board, by informing participants of all data collection methods, by providing a transcription for each participant interview, and by allowing participant anonymity (Trochim & Donnelly, 2008).

In addition, the researcher adhered to the three principles of the Belmont Report: respect for persons, beneficence, and justice (The Belmont Report, 1978). In particular, the researcher helped ensure the anonymity of the participants by making sure no identifying information were presented on the study, by ensuring they participated willingly and knowingly, and by presenting individual responses in aggregate form. Beneficence was practiced by assuring participants that no harm would be associated with their participation. Justice was observed by treating each of the participants fairly. Equal care and security were provided to each respondent. There was no special treatment toward any of the respondents.

The current chapter discusses the implications, recommendations, and conclusions of the current study. The section on implications presents the findings according to their corresponding research questions and hypotheses. Logical conclusions based on these

findings will be drawn by examining if these findings are supported or contradicted by existing literature. The section on recommendations includes all recommendations for practical applications of the study. All recommendations stem from the research findings. Recommendations for future research are given. The last section is the conclusion, which summarizes all key points in Chapter 5.

### **Implications**

**Research Question 1.** How can financial internal controls be used to detect or deter multi-year municipal government employee embezzlement of at least \$50,000?

The first question raised for this study is how municipal government could use financial internal controls to stop embezzlement from happening. The participants revealed that they believe financial internal controls are very important for stopping embezzlement from happening. Their responses were based on their observations and experiences over the fraud that taken place in Dixon, Illinois. Archival data supported the interview responses.

The responses to the interviews showed that participants were familiar with the appropriate standards of internal control policy. However, they were also aware that in the Dixon's government and accounting system, these policies were non-existent. All the participants cited the importance of internal controls. According to the participants, if used properly, these controls can offer the opportunity to deter future fraud. However, financial controls in Dixon, Illinois were found to be severely lacking. In particular, the Dixon accounting system, which did not have many existing financial internal controls, generated the ability of the comptroller to embezzle funds. The findings for this particular question are supported by archival data from governmental institutions. For instance, the

Association of Certified Fraud Examiners (2014) stated that for any financial system to be considered having adequate and effective internal controls, it should at least require antifraud training that can promote prevention, detection, and deterrence of the fraud. However, such controls were apparently not present in Dixon; based on archival records and interview statements, these internal controls did not exist in Dixon. Archival data also showed that Dixon actually had 50 existing accounts with which to handle the city's finances (City of Dixon, 2012). News media and interview statements showed that the comptroller was given the main responsibility over the accounts receivable for these accounts before the fraud was discovered (Smith, 2012). With no formal structure in place to provide monitoring function over the comptroller's actions, it was easy for fraud to occur. In addition, common internal controls such as segregation of duties and oversight were not present in Dixon (Jenco & Grimm, 2012). To allow only one person to have the access to one account without a structure in place to provide oversight, fraud was tempting and easy to carry out (Jenco & Grimm, 2012). No one completed separate reviews of any reconciliations or tracked receipts, aggravating the situation (Jenco & Grimm, 2012).

Evidence was also gathered from the US Attorney's Office (2012), which showed that because the comptroller controlled over 30 city checking accounts, a secret account in 1990 was easily created, which Crundwell used to store the stolen money (U.S. Attorney's Office, 2012). Skimming and fictitious billing of construction invoices were also made easy for her because of these insufficient or lacking financial controls. The comptroller found it easy to regularly create fake construction invoices for the Dixon Water Department and IDOT from the State of Illinois (Becker & Barichello, 2013). The

ineffective system in place at the time enabled her to regularly reconcile and balance statements and find ways to account for missing money (Becker & Barichello, 2013). Interview responses also shared these perceptions and experiences, claiming that they did not know the comptroller had 35 checking accounts, skimmed and faked invoices, adding that the system in place made it easier for her. They stated that if there had been either an external audit system or internal audit system in place, fraud would have been preventable. The participants added that Dixon city often failed with transparency of documentation. Had the city been diligent in being transparent regarding the disclosure of their budgets and expenditures, embezzlement could have been deterred.

The findings of the study showed that from the perspectives of the participants, certain internal controls might have been helpful. In particular, they cited segregation of duties, background checks, external audit, internal audit, and follow-up procedures as being helpful in preventing embezzlement. Provisions of fraud education, in-house bookkeeping, and mandatory holidays for employees, coupled with regular fraud risk detection were all considered helpful. External auditors also recommended that a good accounting system with internal controls that detect fraud must be in place, especially one that is tailored according to Dixon city's design.

The findings for research question one contributed to existing literature highlighting the importance of financial controls. Studies have emphasized that the main function of financial controls is to manage and reduce risks (Huefner, 2011; Kapic, 2013). Moreover, effective internal controls are those that cannot only manage risks, but can also prevent fraud, detect fraud if it occurs, and correct weaknesses once a problem is discovered (Dorminey et al., 2012; Miller, 2012). The responses of the interviewees

showed that Dixon municipal government could certainly use effective internal controls to prevent fraud from taking place. However, because it already did, Dixon can also use effective internal controls from preventing such fraud from ever taking place again.

**Research Question 2.** How is a municipal government affected by a known multi-year incident of municipal government employee embezzlement of at least \$50,000?

The second research question raised was how the municipal government was affected by the known multi-year incident of municipal government employee embezzlement of at least \$50,000. Interview responses and archival data showed that the major embezzlement incident affected the municipal government completely and changed it significantly. Both the interview responses and archival data revealed three main themes of accountability, public trust, and system. The embezzlement significantly affected the trust of the public. After the fraud was uncovered, public confidence in every aspect of the government was damaged. Accountability was questioned. The public lost confidence in the city council's ability to regulate these matters, resulting in a complete switch in the make-up of the government (Smith, 2012). Council members and financial controls were all replaced. Recruitment processes for choosing city employees were changed (Smith, 2012). Excerpts from the interview data showed that everyone within the municipality was so shaken by the embezzlement that the Dixon form of government was overhauled, after a referendum was passed with a 76% approval. The city lost its credibility, and it was not easy to restore without drastic changes, which Dixon city was compelled to carry out. In fact, the drastic changes were only comparable to suggested prior suggested changes, when the city tried to change from the commission form of government into a management style, but the referendum failed because there were not

enough votes for these changes (City of Dixon, 2013). News reports all supported how drastic the changes were. One lesson learned from the scandal was that there is a greater need for internal controls and a sounder accounting system.

Residents were very concerned about the effects the embezzlement would have on the city. According to interviewees, government employees felt demoralized and many infrastructure projects had to be cancelled. Even though these negative effects and changes were being felt, the concept of internal controls did not immediately become reality. Employees continued to feel as if they were being judged and they became frustrated. To respond to the low employee morale, management style needed to change, which led to better internal financial controls and accountability. Interviewees said the new system helped, especially because an accounting system allowing for segregation of tasks was made possible. The interviewees emphasized that the fraud occurred in part because nothing was in place before the discovery. Apart from a new accounting system, the former role of the comptroller was scrapped and replaced with that of a finance director role. The form of the government and the role of mayor also changed. The interviewees claimed that to recover from the large-scale municipal role, major policy decisions had to be carried out.

One more significant change that took place because of the fraud was that transparency started to be prioritized. The finance director who replaced the comptroller now has to answer to a city manager, which was also a new position. Unlike the comptroller, the finance director was not given control over the city's finances anymore. This led to a system of checks and balances on every aspect of the new financial system. According to an interviewee, there was already a referendum in the early 1980s that



proposed to have a manager in place, but the majority voted against the proposal. The fact that there is a manager now in place shows how intense the fraud was that such a significant change was approved.

Another major change to the government following the embezzlement scheme is that employees to be hired should now have proper qualifications. This was one of the uncovered key flaws in the past system. Applicants were able to take on a role or a job even if they were not qualified. These insufficient qualifications of those recruited before were one of the main reasons why internal controls were not present or not implemented. The people employed simply did not have the qualifications to carry out better accounting practices and to detect fraud. The comptroller did not have any education related to her role. She did not have an accounting or related degree.

Smith (2012) also cited that commissioned governors were maintaining other full time employment because they were earning minimum wage in the government. Their minimum wage salaries implied that most of them did not have the necessary qualifications or background required to function in an effective manner (Smith, 2012). Having the training, time, and incentive to detect fraud only comes with an education that the past commissioners did not have, as the interviewees and archival data revealed. Following the government style change and the boost in transparency because of the fraud, it appeared that the town became more prepared to prevent such from ever happening again.

The findings of the study contributed positively to existing literature that showed weak governance is associated with a greater likelihood of someone committing organizational fraud (Trompeter et al., 2013; 2014). Trompeter et al., (2013) claimed that

unethical senior managers might continue to be unethical if not reprimanded or replaced. Moreover, the findings also contributed to literature that emphasized fraud and embezzlement should not be taken lightly because they can have serious consequences for the municipality (Elson & Dinkins, 2009; Elmore, 2013; Ference, 2014; Simona & Elisabeta, 2014).

The findings revealed general fund cash decreased from \$3,503,752 to \$594,169, or 83.04% between 2009 and 2011. During the same time, the city's investment account decreased from \$5,376,081 to \$284,067, or a decrease of 94.72%. Between 2010 and 2012 the city's general fund property tax rate increased by 68.4%. Once the city recovered the majority of the embezzled money from a settlement, net assets increased by 30.24% from 2009-2014 and debt decreased by 37.15%. This data shows how much the city's cash and investments decreased in the final years before discovery of the embezzlement, how much property taxes increased during that same time of cash reduction, and how the city benefited once some of the cash was returned to the city from a court case settlement.

**Research Question 3.** Why did a municipal government with a known multi-year employee embezzlement of at least \$50,000 fail to implement effective internal controls to help detect or deter municipal government employee embezzlement?

The third question raised was why a municipal government with a known multi-year employee embezzlement of at least \$50,000 failed to implement effective internal controls to help detect or deter municipal government employee embezzlement. Interviewees and archival data showed that there were several barriers facing the municipal government at the time, preventing them from detecting fraud or doing

something to prevent embezzlement. The lack of internal controls is just one of these factors.

According to most interviewees and the supporting archival data, trust was a key factor why the government failed to prevent fraud. The very person who carried out the embezzlement was in a position of trust. No one suspected that she could engage in such an illegal action. This is supported by the literature, which claimed that most embezzlers are able to engage in fraudulent activities because they have trusted roles (American Institute of Certified Public Accountants, 2015). Dixon's comptroller had a high level of public and individual trust because she was already employed for so long. She started through a high school work-study program back in 1970, interviewees detailed. Five years into her comptrollership starting in 1983, she already started to embezzle. Because she worked several years for the city before she became a comptroller, she was already able to gain the trust of the public as well as within the city government, interviewees asserted. Her congenial demeanor helped her attain a certain level of trust from those around her. The number of years she worked in the city helped her understand the operations of the city more than it helped anyone else, so she was able to cover her tracks well. This is evident in the archival data gathered from financial statements. Even though there were obvious drops in city cash flow, nobody thought to ask why or investigate further (City of Dixon, 2012). Because she was a trusted figure, she was also given the autonomy to bypass most procedures and internal controls (Association of Certified Fraud Examiners, 2014). Trust in her enabled her to carry out fraud without being detected for so long because there was no oversight (Association of Certified Fraud Examiners, 2014). The town auditor trusted her so much that all her books were just

signed off, the interviewees revealed. According to Smith (2012), it took only one person to be suspicious, to not trust the comptroller, to start the fraud discovery process. The scheme revealed itself quickly when one person started to question and investigate (Smith, 2012). When complaints came in regularly, from community members and department heads about the city, being broke and in disrepair, interviewees claimed that no one immediately tried to investigate or ask why. Trust in the comptroller made it difficult to think there was something illegal going on.

Another theme that emerged about what led to embezzlement to take place is the lack of accountability within the system. Dixon, Illinois was complacent in creating an accounting system, so proper internal controls did not exist. According to the interviewees, there was a lack of solidarity among individual commissioners in making sure that fraud will not take place. Individual commissioners had control over one particular area, and they only paid attention to their one area of responsibility. This is supported by the archival data (Mencarini, 2014). No one was interested in what other commissioners were doing, especially what the comptroller was doing. Because the comptroller was the one mainly responsible for handling a majority of the accounting practices for the city, the lack of internal controls and the level of trust placed in her abilities made her think she could commit fraud without getting caught. For quite a while, this was precisely what happened. She was able to commit fraud without anyone growing suspicious of her. Interviewees claimed that most elected officials simply were uninterested in interfering with others or in providing check and balance, especially since the comptroller was trusted.

The small city had a limited staff, which made them individually more concerned about their own responsibilities and not about what others might be doing wrong. Dixon, Illinois had a system wherein a trusted individual had total financial control, and the council reportedly lacked either initiative or authority to question her practices, which provided the impetus for fraud to happen or barred the municipal government from preventing fraud. The complacency and tendency not to ask investigate or interfere served as significant reasons why the municipality failed to enact proper internal controls necessary to deter the embezzlement.

The findings for the third research question contributed to the literature that highlighted how fraud detection and prevention is not a one man's job. According to studies, organizational embezzlement is much more than just a concern of company management. Rather, various organizational stakeholders including the board, internal auditors, an audit committee, and the organization's external auditor (Reidy & Theobald, 2011) share this concern.

### **Recommendations**

The findings of the study lead to both recommendations for actual practice and recommendations for future research. These will be presented in this section.

**Recommendations for actual practice.** The findings of the study led to the recommendation that municipal governments should have internal control guidelines as outlined by the U.S. Government Accountability Office Standards (2005). According to these guidelines, controls can lead to efficient operations, reliable financial statements, and the correct compliance with any existing financial laws (U.S. Government Accountability Office, 2005). Having a controlled environment wherein there are proper

risk assessment, controlled policies and procedures, strong communication and information sharing mechanism, and constant monitoring created could prevent embezzlement (American Institute of Certified Public Accountants, 2015). Interview responses already showed that without these controls, embezzlement occurred easily and detection took a long time, leading to significantly negative effects.

**Recommendations for future research.** The case study of Dixon, Illinois has already led to significant findings. However, more research can be done. For example, instead of taking the views of the appointed officials, elected officials, external auditors, members of the local news media, and business owners, future researchers can take in the views of the embezzlers themselves. This can certainly shed light on why they carried out the fraud and if they can still engage in fraud if financial controls are in place. Another recommendation is for future researchers to take into account the role of leadership. Apart from the existence of financial controls, how did leadership factor into the high potential for fraud in such a weak system? In addition, it is recommended that future researchers use focus groups instead of one-on-one interviews. Even though the interviews led to comprehensive findings, the use of focus groups can lead to consensus or debate so that disparate views can be discerned (Gibbs, 2012). Not only that, the use of focus groups can generate chances for point-counterpoint discussion and resolution to take place. Focus groups can also be used as mechanism for helping participants generate and share their ideas, especially if the topic is sensitive. Focus groups can illuminate a topic and draw out latent issues (Gibbs, 2012).

## Conclusions

The main objective of the study was to ascertain how important municipal government financial internal controls detect or deter multi-year employee embezzlement of at least \$50,000. The study was designed to mainly answer three main research questions: (1) how can financial internal controls be used to detect or deter multi-year municipal government employee embezzlement of at least \$50,000; (2) how is a municipal government affected by a known multi-year incident of municipal government employee embezzlement of at least \$50,000; and (3) why did a municipal government with a known multi-year employee embezzlement of at least \$50,000 fail to implement effective internal controls to help detect or deter municipal government employee embezzlement?

The questions were answered through interviews and the use of archival and media data gathered from Dixon, Illinois. Overarching themes of accountability, public trust, and system were revealed.

In particular, the findings of the study highlighted how important financial internal controls are for municipal government to avoid fraud and embezzlement from taking place. Because these controls were nearly non-existent in Dixon, Illinois, the comptroller easily carried out fraud without being caught for a long time. When news of the fraud broke, the fraud was already on such a scale that the municipal government needed a complete overhaul just to get back on its feet. Not only has the municipal government lost large sums of money, it also lost public confidence and trust. Several measures were taken to recover, and many significant changes ensued.

Understanding why these controls should exist helped to answer the first research

question. Shared lessons regarding the effect of missing internal controls also highlighted which internal financial controls should exist in order to deter future fraud attempts. Interview statements, financial documents, and media accounts all linked together to demonstrate how the existence of internal controls could have prevented fraud and at the same time, provided assurance of a sound organizational financial system that future fraudulent activities can be deterred.

The city suffered major changes because of the embezzlement. The interview data, media data, and archival reports showed that Dixon, Illinois' government consisted of a small commission of part-time elected members who each carried out separated and unmonitored activities. Moreover, there were several points during the city's history when there were referendums about whether the government should change from a commission style to a managerial style of government, but the votes often led to the proposals being overturned. However, once the city uncovered the comptroller Rita Crundwell's fraud, these proposals resurfaced, and this time, the government did not reject them anymore. The government recognized how large scale the fraud is and how weak the old commission style system is, making it more amenable to transformation. A sweeping referendum took place in November 2014 introducing a new management and accounting system for the city.

More important, the municipal government lost public confidence. Government employees experienced low confidence and morale during this time, and a complete changeover in the accounting system had to be carried out and staff had to be replaced with more qualified ones. The new government now necessitated full transparency, accountability, and qualified personnel, which were lessons the government gained from



the fraud that took place. The embezzlement scheme completely overturned the old system and introduced a much stronger one that should be able to deter similar crimes.

The effects of the fraud can be simply described as unprecedented and remarkable.

Answering the third question led to the finding that both the blind trust in the comptroller and the city government enabled the embezzlement to happen. Complacency was observed, especially because few outside audits were conducted and limited attention paid to the city's accounts. Local accountants and the external auditors did not grow suspicious even though danger signs started flashing, trusting instead in the comptroller's background and annual financial statements. In addition, the comptroller was provided with almost the sole control of the city's finances because there were very few checks on accountability by other city employees, and transparency was not even required. Because of the significant lack in an accountability system, it took twenty years before anyone questioned anything and for fraud to be detected. Embezzlement was largely propelled not only by the comptroller's greed and lack of integrity, but because the system was weak, making fraud easy and initially undetectable.

From these findings, this case study thoroughly described the implications of such a massive embezzlement scheme and the effects on the financial controls of a city government. Most municipal governments can gain insights and learn lessons from the experience of Dixon, Illinois. Although the findings cannot be generalized to all municipalities, even to those that experienced fraud and embezzlement, the findings can help in showing why financial controls can help detect and/or deter fraud.

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Appendixes

## Appendix A: Semi-Structured Interview Protocol/Questions

Hi! My name is Dave Ross and I have asked you here today because you have been identified as someone who might be able to help answer three important research questions designed to help local government leaders with their internal control environment in an effort to detect or deter employee embezzlement. Your knowledge of certain aspects of the Rita Crundwell embezzlement case is important to this research project. The research focuses on how municipal governments deal with employee embezzlement of at least \$50,000. The study will examine how certain municipal government financial internal controls detect or deter multi-year employee embezzlement of at least \$50,000, it is meant to help others understand how municipal governments are affected by a known incident of multi-year employee embezzlement of at least \$50,000, and it is designed to help local government leaders better understand why municipal government officials fail to timely implement effective internal controls that could have helped detect or deter employee embezzlements.

As part of the research project, I would like to audio record your answers. This will be done so that I can have an accurate record of your answers to the questions I will be asking as part of this interview. Your responses will be grouped with other responses so it is very unlikely anyone can trace your responses back to you. The audio recording and your responses will be kept in a locked cabinet and will not be accessible to anyone other than me. Once my project is complete, I will destroy the audiotape. Prior to starting the audio recording, I would like to have you review and sign an informed consent form for this project. Please review the informed consent form and please feel free to ask me any questions that you have.

(WAIT FOR SIGNED FORM, START RECORDER, THEN BEGIN QUESTIONING)

As you may know, internal controls are safeguards put into place that can help an organization ensure employees adhere to policies, including the ability to detect or deter fraud. An example is an organization that requires bi-weekly payroll hours to be entered into the system by a person who does not have physical access to change someone's rate of pay. Another example is requiring vendor approval forms so that the organization cannot do business with a company without that company providing their tax ID number, identifying themselves, and having someone from the municipal government verify it is a legitimate business. The person who verifies the business cannot be the person who also sends payments through for that business. These "segregation of duties" examples for payroll and accounts payable are two examples of "internal controls" that might help reduce the risk of organizational fraud.

### **Basic Demographic Information asked prior to actual interview**

1. What is your position?
2. What is the length of time in your current job?
3. Were you employed at the time of the embezzlement or not? If yes, how long after the embezzlement?
4. What is your their education level?
5. How long have you been an official of the municipality?



6. What are your previous positions as officials of the municipality in the past?

### Questions for Elected officials and Staff

1. Please tell me whether you were employed with the city at the time of the discovery of the embezzlement and if so, how long you had been with the City. What is your level of education? What is your current position title?
2. How do you view your role as it relates to ensuring proper checks and balances are in place to detect or deter fraud within the workplace?
3. From your knowledge, how did the embezzlement occur? Please provide as many specific details as possible.
4. Do you know if the organization implemented any internal controls prior to the discovery of the embezzlement?
  - a. (If yes) Describe those controls.
  - b. (If no) As best as you understand, why do you think internal controls were not implemented?
5. Do you know if the auditor listed in any prior audit report any Internal Control Material Weakness (ICMW) prior to the discovery of the embezzlement?
  - a. (If yes) Were those weaknesses addressed in any manner? – If (no) why do you think they were not addressed? Be specific.
  - b. (If yes) Can you describe the ways in which the ICs should have detected the embezzlement?
  - c. (If no) Based on what you know about the way the embezzlement happened, what types of controls do you think could have been implemented that could have detected or deterred the embezzlement?
6. Did an auditor ever mention that it is common for an organization of your size to have ICMW's listed in an audit report?
  - a. (If yes) Did you rely on the auditor's judgment and thus choose not to implement certain controls?
7. If the auditor had basically demanded that the organization implement effective controls prior to the discovery of the embezzlement, do you think the organization would have implemented them? What about the potential cost to segregate functions (i.e. whoever takes in money for a water account payment cannot be the same person to post to the account and cannot be the same person to reconcile the account's checkbook)? There is a cost to those functions and it might mean hiring more personnel. Would the cost of say \$40,000 a year to hire someone else to perform some of these functions be worth the risk of embezzlement?
8. Did the embezzlement affect your municipality's bond rating? Please describe in detail.
9. Did the embezzlement affect public confidence, and if so, in what way(s)?
10. Did the embezzlement affect the careers of employees or elected officials? Please describe in detail.
11. Please describe any additional expenses that came about as a result of the embezzlement.
12. Did the municipality have to borrow any money to cover the costs of the embezzlement?
  - (If yes) How much, from where, and at what rate of interest?
13. Were any capital projects scrapped or delayed as a result of the embezzlement?

- a. (If yes) Can you describe the projects?
  - b. (If no) How was the city able to continue with the slated projects after having lost so much money over the years from the embezzlement?
14. Did the embezzlement have any effect on the community's ability to attract residential or commercial development? Explain.
  15. Did the embezzlement have any effect on the morale of other municipal employees?
  16. What else can you tell me about the embezzlement that might help answer any of the three research questions? (Repeat the questions as necessary)

### **Questions for External Auditors**

1. Your company was not the auditor during the time the embezzlement occurred. Please tell me of right now, how long you have been employed as a public sector auditor. What is your level of education and degree certification? What is your current position title?
2. From your knowledge, how did the embezzlement occur? Please provide as many specific details as possible.
3. Do you know if the organization implemented any internal controls prior to the discovery of the embezzlement?
  - a. (If yes) Describe those controls.
  - b. (If no) As best as you understand, why do you think internal controls were not implemented?
4. Do you know if the auditor listed in any prior audit report any Internal Control Material Weakness (ICMW) prior to the discovery of the embezzlement?
  - a. (If yes) Were those weaknesses addressed in any manner? – If (no) why do you think they were not addressed? Be specific.
  - b. (If yes) Can you describe the ways in which the ICs should have detected the embezzlement?
  - c. (If no) Based on what you know about the way the embezzlement happened, what types of controls do you think could have been implemented that could have detected or deterred the embezzlement?
5. Have you ever mentioned weaknesses in the internal control environment in a local government audit report?
  - a. (If yes) Does your company require follow up with the local government to ensure they implemented changes?
  - b. (If yes) Do you think it is a good idea to mandate local governments implement all recommended changes to their internal control environment, some of them, or none of them? Why?
  - c. (If no) Do you believe it is a good idea to mandate local governments implement auditor recommended changes to their internal control environment?
6. Please describe any additional expenses that came about as a result of the embezzlement (including additional audit-related costs).
7. Were any capital projects scrapped or delayed as a result of the embezzlement?
  - a. (If yes) Can you describe the projects?
  - b. (If no) How was the city able to continue with the slated projects after having lost so much money over the years from the embezzlement?

8. What else can you tell me about the embezzlement that might help answer any of the three research questions? (Repeat the questions as necessary)

#### **Questions for Local Business Officials**

1. Please tell me whether you were working in Dixon at the time of the discovery of the embezzlement and if so, how long you had been working here. What is your level of education? What is your current position title?
2. From your knowledge, how did the embezzlement occur? Please provide as many specific details as possible.
3. Did the embezzlement affect public confidence, and if so, in what way(s)?
4. Did the embezzlement affect the careers of employees or elected officials? Please describe in detail.
5. Please describe any additional expenses that came about as a result of the embezzlement.
6. Were any capital projects scrapped or delayed as a result of the embezzlement?
  - a. (If yes) Can you describe the projects?
  - b. (If no) How was the city able to continue with the slated projects after having lost so much money over the years from the embezzlement?
7. Did the embezzlement have any effect on the community's ability to attract residential or commercial development? Explain.
8. Did the embezzlement have any effect on the morale of other municipal employees?
9. When you first heard about the embezzlement, what was your reaction?
10. Do you believe the embezzlement affected this business in any way?
11. What else can you tell me about the embezzlement that might help answer any of the three research questions? (Repeat the questions as necessary)

#### **Questions for Local News Media**

1. Please tell me whether you were employed within the news media field at the time of the discovery of the embezzlement and if so, how long you had been so employed. What is your level of education? What is your current position title?
2. From your knowledge, how did the embezzlement occur? Please provide as many specific details as possible.
3. Do you know if the organization implemented any internal controls prior to the discovery of the embezzlement?
  - a. (If yes) Describe those controls.
  - b. (If no) As best as you understand, why do you think internal controls were not implemented?
4. Do you know if the auditor listed in any prior audit report any Internal Control Material Weakness (ICMW) prior to the discovery of the embezzlement?
  - a. (If yes) Were those weaknesses addressed in any manner? – If (no) why do you think they were not addressed? Be specific.
  - b. (If yes) Can you describe the ways in which the ICs should have detected the embezzlement?
  - c. (If no) Based on what you know about the way the embezzlement happened, what types of controls do you think could have been implemented that could have detected or deterred the embezzlement?

5. Did the embezzlement affect your municipality's bond rating? Please describe in detail.
6. Did the embezzlement affect public confidence, and if so, in what way(s)?
7. Did the embezzlement affect the careers of employees or elected officials? Please describe in detail.
8. Please describe any additional expenses that came about as a result of the embezzlement.
9. Did the municipality have to borrow any money to cover the costs of the embezzlement?  
(If yes) How much, from where, and at what rate of interest?
10. Were any capital projects scrapped or delayed as a result of the embezzlement?
  - a. (If yes) Can you describe the projects?
  - b. (If no) How was the city able to continue with the slated projects after having lost so much money over the years from the embezzlement?
11. Did the embezzlement have any effect on the community's ability to attract residential or commercial development? Explain.
12. Did the embezzlement have any effect on the morale of other municipal employees?
13. Do you believe the embezzlement had an effect on local business?
14. When you first heard about the embezzlement, what was your reaction?
15. What else can you tell me about the embezzlement that might help answer any of the three research questions? (Repeat the questions as necessary)