Report No. 2007-11

April 13, 2007

Secretary of State Audit Report

Bill Bradbury, Secretary of State

Charles A. Hibner, Director, Audits Division

Oregon Department of Transportation: Loss of Funds – Coos Bay Sign Crew

Summary

PURPOSE

The purposes of this audit were to assist the Oregon State Police in quantifying a loss of funds at the Oregon Department of Transportation and to evaluate the department's purchasing and inventory controls intended to prevent or detect fraudulent transactions.

In April 2005, the Oregon State Police (OSP) asked us to quantify the loss of funds the Oregon Department of Transportation (department) sustained as a result of potentially fraudulent billings initiated by Dick Ekblad, a partial owner of Oregon Pacific Company and Edward Goodrich, a former sign crew employee at the department's Coos Bay location.

RESULTS IN BRIEF

From August 2000 through September 2005, the department experienced losses totaling approximately $47,000 in product costs and freight charges from billings that Mr. Ekblad submitted to the department for items it never received. Mr. Goodrich used his purchasing authority to approve most of those billings.

Mr. Goodrich resigned from state service on April 25, 2006. On February 2, 2007, the two men pled guilty to one count of aggravated theft in the first degree and were sentenced in Coos County Circuit Court to 90 days in jail and 36 months of probation. In addition, they were ordered to pay the department approximately $56,000 in restitution. That amount consisted of $47,000 in fraudulent billings, reduced by approximately $6,000 of recovered property, and a $15,000 compensatory fine.

Although internal controls cannot always prevent fraud from occurring, especially when there is collusion, the risk of losses from fraud can be mitigated if controls are in place and working. The department, however, had not implemented some key controls that could have prevented or detected the activities that led to the losses. Specifically, the department had not separated responsibilities for initiating, receiving, and approving purchases and controlling inventory.

In addition to the $47,000 loss, the department experienced losses estimated at approximately $42,000 because state purchasing rules were not enforced. The department did not enforce compliance with state purchasing rules that require agencies to obtain competitive pricing when purchasing goods.

RECOMMENDATIONS

We recommend department management implement controls to strengthen its fraud prevention efforts and improve its purchasing activities. Specifically, department management should:

- separate the responsibilities for initiating, receiving, and approving purchases and controlling inventory of goods at the Coos Bay sign crew location; and
- ensure compliance with state purchasing rules to obtain goods at competitive prices.

AGENCY'S RESPONSE

The Oregon Department of Transportation generally agrees with the recommendations.

Background/Allegations

The Oregon Department of Transportation's (department) Coos Bay Sign Crew was one of 18 sign crews located throughout the state. The staff, which consisted of two crew members located in Coos Bay, Oregon, and a manager headquartered in Roseburg, Oregon, performed installation and maintenance of highway signs in Curry, Coos and Douglas counties.

In April 2005, the Oregon State Police (OSP) asked us to quantify losses the department sustained from potentially fraudulent billings initiated by Dick Ekblad, a partial owner of Oregon Pacific Company, and Edward Goodrich, a department sign crew employee in Coos Bay, Oregon.

According to allegations the OSP received, the two men had entered into an arrangement for their mutual benefit whereby Mr. Ekblad would bill the department and receive payment for products his company did not deliver, and Mr. Goodrich would use his purchasing authority to approve the billings for payment. In exchange for his participation, Mr. Goodrich allegedly received goods for his personal use at no cost from Oregon Pacific Company.

Audit Results

We determined that the department sustained losses of approximately $47,000 from fraudulent billings submitted by Mr. Ekblad from August 2000 through September 2005. Although internal controls cannot always prevent fraud from occurring, especially when there is collusion, the department had not implemented some key controls that could have prevented or detected activities that led to the losses.

Additionally, the department also experienced losses estimated at approximately $42,000 because the department did not enforce compliance with state purchasing rules.

Mr. Goodrich resigned from state service on April 25, 2006. On February 2, 2007, the two men pled guilty to one count of aggravated theft in the first degree and were sentenced in Coos County Circuit Court to 90 days in jail and 36 months of probation. In addition, they were ordered to pay the department approximately $56,000 in restitution. That amount consisted of approximately $47,000 in fraudulent billings, reduced by approximately $6,000 of recovered property, and a $15,000 compensatory fine.

Losses from Fraudulent Billings Totaled Approximately $47,000

We substantiated the allegations that Mr. Ekblad submitted fraudulent billings to the department and Mr. Goodrich approved them for payment. As a result of those billings, from August 2000 through September 2005, the department sustained losses totaling approximately $47,000 in product costs and freight charges for items the department never received.

Effective controls over purchasing and inventory include segregation of responsibilities for authorization, record keeping, and custody of the related assets to reduce the opportunities for any individual to be in a position to both perpetrate and conceal errors or fraud in the normal course of duties. Particularly, responsibilities for initiating purchases, receiving goods, authorizing payments, and maintaining inventory should be separated.

We found that the department had not adequately separated responsibilities for the Coos Bay sign crew's purchasing and inventory activities. For example, goods were received by Mr. Goodrich, who also initiated and approved the purchases. Additionally, Mr. Goodrich was responsible for controlling the inventory of the products he purchased. These control weaknesses created an opportunity for Mr. Goodrich and Mr. Ekblad to initiate the fraudulent billings and not be detected.

We recommend department management separate the responsibilities for initiating, receiving, and approving purchases and controlling inventory of goods at the Coos Bay sign crew location to strengthen its fraud prevention efforts.

Agency's Response:

The department agrees. "Financial Standard 1.0 Management's Responsibilities" requires placing key duties with different individuals to detect errors and prevent wrongful acts. This standard outlines to department employees that no single person should cross the three responsibilities of authorizing, recording, and maintaining custody. Region 3 Management has worked with the Coos Bay sign crew to ensure proper segregation of duties.

Noncompliance with Purchasing Rules Resulted in Estimated Losses of Approximately $42,000

The department experienced losses estimated at approximately $42,000 because it did not enforce compliance with state purchasing rules that require agencies to obtain competitive pricing when purchasing goods. To estimate the losses, we compared prices the department paid Oregon Pacific Company for products it received to the prices Oregon Pacific Company paid its distributor. We recognize that the department might not have received the same price Oregon Pacific Company did in all instances, but we based our conclusion on the premise that products cost less if purchased directly from the distributor. We confirmed other department sign crews purchased directly from the distributor during the audit period.

Open and fair competition in the procurement process provides many benefits to the public, including acquiring goods of the requisite quality within the time frame needed and at the lowest reasonable cost. Competitive pricing also helps to guard against favoritism, extravagance, fraud, and corruption.

Oregon's purchasing rules require agencies to obtain competitive pricing for purchases over $5,000. The rules become more stringent as the purchase price increases, requiring formal quotes or bids and contracts above certain thresholds. The rules also prohibit artificially dividing or fragmenting purchases to avoid the more stringent purchasing requirements.

Based on authentic invoices we reviewed relating to the Coos Bay sign crew purchases, the department did not spend less than $7,000 for sign posts and related accessories in each of the five fiscal years that spanned the audit period. In at least two of those years, purchases of those products exceeded $40,000.

Department management, however, had not acquired a contract or pricing agreement for those products during the audit period. Furthermore, the Coos Bay sign crew's manager confirmed that he did not require staff to obtain competitive quotes for items over $5,000, contrary to state purchasing requirements.

We recommend department management ensure compliance with state purchasing rules to obtain goods at competitive prices.

Agency's Response:

The department agrees. In August 2006, the department revised the "Financial Standard 1.0 Management's Responsibilities" requiring those employees delegated expenditure decision authority to attend the Fiscal and Procurement Responsibilities training class within 90 days of receiving such authority. Financial Services monitors those individuals delegated expenditure decision authority for the completion of training and forwards to Appointing Authorities this information each March and September. Appointing Authorities ensure those individuals under their management control attend training.

Objectives, Scope and Methodology

The purposes of this audit were to assist Oregon State Police (OSP) in quantifying a loss of funds at the Oregon Department of Transportation (department) and to evaluate the department's purchasing and inventory controls intended to prevent or detect fraudulent transactions.

To meet the first objective of this audit, we examined documentation from the department, Oregon Pacific Company, and a distributor of the products purchased by Oregon Pacific Company for resale to the department. The documentation related to transactions that occurred between August 2000 and September 2005.

To evaluate the department's purchasing and inventory controls, we interviewed department personnel, reviewed applicable policies, rules, and laws, and reviewed related documentation. We limited our examination of purchasing and inventory controls to those related to the department's Coos Bay sign crew.

We conducted our fieldwork from May 2005 through October 2006. Legal proceedings progressed through February 2, 2007.

We performed this audit in accordance with generally accepted government auditing standards.

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Courtesies and cooperation extended by officials and staff of the Oregon Department of Transportation were commendable and much appreciated.

This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained:

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