STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

# Fraud Alert

The Auditor General is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.

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## Conflict of Interest

A public official creates a job for a relative, or pays that relative a higher salary than warranted, or commits the agency to do business with an entity in which he or she has a personal interest. In each case, the official's decisions are influenced by his or her personal interests—a conflict of interest.

More specifically, a conflict of interest occurs when a public official participates in an official action that could result in a financial benefit to himself or herself, a family member, or a business with which either is associated and fails to disclose that interest in a public record. In Arizona, the laws concerning conflicts of interest are contained in Arizona Revised Statutes §38-501-38-511.

Most of the conflict-of-interest cases that we investigate involve officials in management positions who abuse their authority and override established internal controls. The most common of these fraud schemes involve officials inappropriately hiring relatives or awarding contracts to businesses in which they have a personal interest.

For example, a state agency director may have violated conflict-of-interest laws by authorizing his son's employment at the agency and later created another position for his son through an interagency service agreement. He also created a position within the agency for his wife, directed her hiring, and later authorized a 35 percent increase in her salary. His wife submitted a falsified employment application to support her hiring. The director attempted to conceal his actions by failing to disclose his son's employment status and falsifying the circumstances of his wife's hiring. Payments to his son and wife totaled over $330,000. This individual was indicted on four counts of conflict of interest.

In another example, a county school superintendent violated conflict-of-interest laws by authorizing four consulting contracts totaling $116,500 to a business in which she had a substantial interest. Without these contracts, the business would have incurred a loss of $69,000. The contracts also allowed the business to pay her approximately $17,000. She did not disclose her substantial interest in the business and awarded the contracts by circumventing procurement rules. This individual pled guilty to one count of felony conflict of interest.

## What You Can Do to Protect Your Entity

No system of internal controls can identify all conflicts of interest, or completely prevent management override of controls. However, a few well-designed controls can help mitigate the risk of override.

- Establish procedures to ensure that all employees comply with conflict-of-interest statutes. All employees who have, or whose relative has, a substantial interest in any contract, sale, purchase, service, or decision must file a conflict-of-interest statement and refrain from voting upon or otherwise participating in any manner as an employee in that contract, purchase, or service. In addition, if an employee supervises a relative, the employee's conflict-of-interest statement should describe the relationship, and the supervisor must refrain from participating in decisions or contracts relating to that relative, such as hiring and approving pay increases.
- Maintain a separate file of all known conflicts of interest for public inspection and periodically monitor it.
- Institute policies and procedures to effectively oversee management and address the risk of management override. For example, governing board members and all members of management should strengthen their understanding of the business and control climates, brainstorm potential fraud risks, cultivate a strong whistle-blower system, and maintain an appropriate level of independence and skepticism.