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From worst to first

Learn from this city's fraud prevention mistakes as it remakes itself

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March/April 2013



Case in Point: Case history dissection



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graduated from college and wasn't a CPA.)

Elma Magkamit was a model employee for the City of West Linn, Ore. (population 25,109) She began working in the city's finance department as an accountant in 1994. She was promoted to acting finance director in March 2001 and appointed permanent finance director in September of that year. She wrote on her job application that she was a graduate of the University of the East in Manila, Philippines, and a CPA.

She was a member of the Oregon Municipal Finance Officers Association and the Government Finance Officers Association (GFOA). However, she was leading a secret double life. Magkamit was also a fraudster with a gambling problem and a desire for the finer things. (And she never

In early 2006, while catching up on the September 2004 monthly bank reconciliation, the city uncovered a discrepancy in a bank statement. Investigators pulled this thread, and a \$1.42 million embezzlement scheme unraveled.

Magkamt had forged and deposited 57 city checks into her personal account. The money supported her gambling habit — she dumped thousands into the slot machines at a local casino where everybody knew her name — and a lifestyle that included Ralph Lauren clothing, \$17,000 in jewelry, a Mercedes-Benz SUV and a nice home on a golf course.

In April 2006, a county grand jury indicted Magkamt on 114 felony counts: 52 counts of aggravated first-degree theft, five counts of first-degree theft and 57 counts of first-degree forgery.

In November of 2006, the Clackamas County Circuit Court sentenced Magkamt to eight years in prison and ordered her to repay the city. “We had a community that placed very limited resources in the hands of the defendant with the idea that she very carefully, with scrupulous integrity, manage those funds,” said Judge Steven Maurer. “That trust was violated over and over and over again. The impact of that can hardly be exaggerated.”

At the time of her sentencing, Magkamt's crimes were reported as the largest-ever Oregon city government embezzlement. Taxpayers lost money, the city's bond rating was suspended, and residents — shortly before Magkamt's sentencing — voted down a five-year levy to finance the police department to the tune of \$1.7 million annually probably because they just couldn't trust the city's management.

Before the city had discovered the fraud, it hadn't conducted an external audit for five years. (The City Council, which had gotten into a disagreement with the external auditors, fired them and didn't replace them.)

Obviously, the city had some fraud prevention and detection issues that allowed Magkamt to rob it blind.

The new city manager hired an interim CPA on contract, Andy Parks, between 2006 and 2008. I came into the situation in 2008 when the city hired me as the permanent finance director (The city later promoted me to chief financial officer). The city staff, including the finance team, has worked to be original and creative in surviving and recovering from the fraud with the ultimate goal of becoming a model of municipal responsibility and prudence.

This type of fraud can happen to your organization. Learn from this city's mistakes and improvements so you don't have to endure its pain from a former lack of integrated prevention and deterrence systems.

MORE THAN FIVE YEARS OF MONTHLY EMBEZZLEMENTS

Magkamt had complete control over the city's check stock, the bank reconciliation function and adjustment of entries to the general ledger. The city didn't have any oversight on what she was doing. From September 2000 through March 2005 Magkamt wrote monthly checks (except for the standard audit months of June and July, just in case the city hired new external auditors) averaging about \$30,000 on the city's accounts payable voided check stock. (See an example of one of her checks below.)



An example of one of Elma Magkamit's checks to herself.

She would retrieve checks from the accounts payable tractor-feed printer that hadn't been voided and destroyed, bring them home and type in her name or a fake consulting business as the beneficiaries. Magkamit didn't enter the checks into the general ledger; she would then alter the bank statements and reconcile around them. No one could tell funds were missing because the financial reporting adjustments and reports were convoluted, confusing and poorly formatted.

Oregon state law and the West Linn local charter required Magkamit to perform financial audits but, of course, for years she ignored those rules as well as the secretary of state's office when it asked for the audits. Finally, around 2004 the exasperated secretary of state told The Oregonian newspaper that Magkamit was ignoring her responsibilities. The city's books were a mess. Magkamit resigned in September of 2005.

The city hired a new finance director, Elizabeth Carlson, and new city manager, Chris Jordan, in 2006. Carlson began historical bank reconciliations to regain financial control over a lost department.

In early 2006, an internal accountant, when performing the September 2004 reconciliation, discovered that a check was missing from the city's copy of the bank statement; it was for \$36,884.70 and made payable to "Larry Magkamit, Magkamit Consulting." (External forensic auditors subsequently found the check on April 12, 2006.)

The accountant immediately told the finance director and Jordan about the discrepancy. Later that day, Jordan met with the city police chief; they then contacted the Oregon Department of Justice. In the meantime, the finance department had uncovered 24 checks totaling \$750,000 in embezzled funds.

Jordan engaged forensic and financial auditors who revealed the extent of the fraud. On April 19, the state justice department and the city police chief confronted Magkamit and later arrested her at her home on the golf course.

The external forensic and financial auditors then reviewed the city's bank statements, some of which were originals; others were copies. They found that the copies were altered to conceal suspect activity by using Wite Out®, cutting and pasting, and folding over (statements were folded over, which concealed suspect activity, and then copied).

Jordan consulted with attorneys and insurance companies for legal remedies. Carlson, who had spearheaded the initial investigation, moved on to another position in a different city. When I came on board in 2008, I hired another CPA, Casey Camors, to help me lead the new finance team. We completed all financial audits for 2003 through 2008, terminated some employees and hired new staff, revamped internal controls and implemented best-of-practice financial reporting. Some of the revamped internal controls included clear segregation of duties from the finance director, the bank reconciliation process, access to cash, and printing and control over check stock. Other new controls included documenting procedures, double reviewing, sign offs and rotating staff functions.

HIRING EXTERNAL (AND REPLACEMENT) EXPERTS

It was a good move to enlist experienced forensic auditors to help with the investigation. Hiring unconnected, dispassionate external experts — such as CFEs — to identify the extent of the damages in a devastating fraud is mandatory. We then retained external independent financial auditors with municipal government expertise to assist us in designing and implementing an internal control structure.

Hopefully, you won't find yourself in our situation. But if you do, take a deep breath and replace some of the finance department staff with competent, educated and experienced individuals who will move the organization forward.

The city has implemented a fraud hotline and holds regular audit committee meetings. It's paying off. We're refunding bonds, external auditors are giving us clean opinions, and credit rating agencies have restored and upgraded the city's credit ratings. West Linn is one of three Oregon cities to receive three annual GFOA awards for its comprehensive annual financial report, popular annual financial report and budget documents.

A NEW MISSION

We created a new mission statement:

Being good stewards of taxpayers' monies is the Finance Department's main focus, but that alone is not enough. We strive to develop healthy partnerships with the community; we strive to be transparent with the City finances; and we always look for cost efficiencies in all City operations.

"Transparency with City finances" is not just the latest buzz phrase. Only true transparency will help regain the community's trust. We produce quarterly newsletters mailed out with the utility bills and attend neighborhood and homeowner association meetings. The city has revamped its brand, logo, image and website.

The [West Linn Finance Department site](#) contains background and updates on the Magkamit embezzlement. The site also provides all financial reports, budgets and five-year plans. We preface each financial report with an executive summary explaining — in a narrative — understandable format, the significant financial topics for the quarter.

Citizens can also find web pages on ethics information with links to the state ethics commission, risk management with links to downloadable claim forms and the city's fraud hotline, among many other topics.

FINANCIAL AND REPUTATIONAL DAMAGE OFFSET BY HARD WORK AND FUNDS' RECOVERY

In addition to the embezzled \$1.4 million and the annual loss of \$1.7 million from the voters' rejection of the five-year police local option levy, the city had to pay \$200,000 for the cost of the forensic auditors plus special financial auditing services over the five-year recovery period.

The finance department budget has increased with the addition of two full-time CPA salaries. Printing and development costs of the financial reports run about \$25,000 per year. Other key aspects of progressive organizations — such as IT systems and e-commerce — went by the wayside.

The city recovered \$790,000 from the liquidation of Magkamit's personal residence, insurance companies and settlement with the city's former external auditing company and a former associate of the firm. (That firm had given city finances a clean bill of health with previous audits.) The city also recovered another \$200,000 after the closing out of Magkamit's state Public Employees Retirement System account balance.

The biggest cost to the city, of course, was the loss of citizen support, which is truly unquantifiable. However, it appears the community's trust has returned. City employees are again proud of where they work and what they do. Employee morale has greatly improved as shown by smiling and excited employees motivated to make a difference in their government duties, positive feedback received by management and a healthy pool of job applicants across the organization.

Respected community leaders are again giving up time from their professions to run for city council positions and serve on committees. Community surveys are returning positive feedback, the nasty news articles of the past have all but disappeared and leadership forums have a healthy turn out. Management's relationships with the two employee unions aren't contentious as they were during the dark years.

REGAIN COMMUNITY TRUST? DETER FRAUD

The previous iteration of the City of West Linn didn't share its financial situation with its citizens because its finance director was an embezzler. So we've found that we can regain citizens' trust by communicating that we're doing everything we can do to deter and prevent fraud of *any* kind. We do that, in part, by explaining that they can look at all of our financial records at any time on our website. We stress among our team members that we can never share "too much information" because the citizens are the major stakeholders. That helps tremendously in our fight to keep fraud from our door.

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