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Should Government Agencies Be Subject to Sarbanes-Oxley?

In spite of some disagreements, most surveys of investors, regulators, the general public, and even some business executives show agreement that the Sarbanes-Oxley Act of 2002 (SOX) has helped restore confidence in the reliability of corporate financial reporting. The need for trust in a capitalistic marketplace is significant. Combined with the U.S. Federal Sentencing Guidelines' emphasis on organizations maintaining an ethical culture, SOX is believed to be responsible for at least slowing the growth of fraudulent activities in asset misappropriation. From the perspective of society as a whole, the missing link is any meaningful reduction of scandals in government, particularly at the state and local levels.

The most recent significant fraud to receive media coverage is the nearly $50 million allegedly embezzled from the District of Columbia (D.C.) over the past 20 or so years by individuals in the D.C. Office of Tax and Revenue (OTR), which *The Washington Post* wrote about in a series of articles. Local law enforcement sources said they consider this to be the largest public corruption case in local history. A February 24, 2008, *Post* article noted, "Every day was Christmas" in the OTR. "One employee got $35,000 to remodel her house; two others got $15,000 to help pay off credit card bills. Breakfast and lunch were often on the boss, as were high-end shopping sprees." The *Post* continued: "D.C. officials trying to figure out how a multimillion-dollar embezzlement scheme went undetected for years need look no further than a government culture in which goodies were taken for granted."

Coincidentally, at the same time the *Post* was breaking its story of the massive embezzlement in the D.C. city administration, a former top official in the D.C. Public Schools system was sentenced for embezzlement. Brenda Belton, who was responsible for charter school oversight, was sentenced to 35 months of incarceration. Through her corrupt scheme, Belton allegedly embezzled hundreds of thousands of dollars from D.C. public charter schools serving predominantly low-income, African-American students.

In the OTR case, 15 employees have been dismissed or put on administrative leave, more than 10 people have been arrested, and the chief suspect, Harriette Walters, a mid-level OTR manager with a salary of $81,000 a year, was reported to be negotiating a guilty plea agreement on criminal charges while remaining in jail without bond. Among other charges, Walters is accused of signing off on six-figure refund checks to sham companies and then using the proceeds to enrich herself and others, depositing $8 million in her checking account and personally spending more than $1.4 million at Neiman Marcus in a six-year period. Over 160 questionable "refunds" of property tax "overpayments" were made in a period believed to have begun in 1989.

The FBI found jewelry, designer handbags, a luxury Bentley automobile, and high-fashion clothing, including a mink coat, at Walters's D.C. home and in the home of her brother. Witnesses say Walters paid for her goddaughter's college tuition, a New Jersey home for $855,000, and gambling trips to New Jersey and Nevada. Her brother and sister own two vacation homes on St. Thomas, Virgin Islands. According to the charges, Walters's niece, Jayrece Turnbull, was accused of establishing dummy corporations to receive the refunds and then cashing the refund checks and spreading the money to other bank accounts. Turnbull owns a home in the Dominican Republic, and the FBI reported finding 28 Chanel purses, 41 Louis Vuitton handbags, and 76 pairs of shoes in her basement and bedroom closets, including some from Prada, Ferragamo, Gucci, Chanel, Jimmy Choo, Armani, and Kate Spade. A nephew and a friend have also been arrested.

Under OTR policy, four people in Walters's unit had to sign off on refund applications before the city would issue a computer-generated check. Thus, it appears that manual checks that required fewer approvals were used for the fraudulent disbursements. Investigators noticed that, for many refund applications, the supporting materials were identical to the documentation provided in previous sham applications, and someone reading carefully could have easily spotted them as frauds. The approving employees acknowledged to investigators that they received gifts and sometimes money from Walters and that they never looked very closely at the refund applications. She was always available for a "loan" that never had to be repaid. Walters was quoted as telling a few other friends about how they could get free city money through bogus tax refund checks. She said there was no backup computer system to notice the manipulated checks.

Since the average amount of the refund checks was nearly a staggering $400,000, someone might wonder if additional approval by higher-level authorities might have been required. D.C. Chief Financial Officer Natwar Ghandi testified that only the approval of the manager of the Adjustment unit had been required, a direct violation of his explicit directive that refunds in excess of $250,000 be approved by the director of OTR. Further, "after a check was cut, it was not mailed, but held for pickup by the manager of the Adjustment unit," who also happened to be the sole approving individual. Ghandi said, "This criminal enterprise was able to thrive because of a profound failure of internal management controls at OTR." Ghandi served in the OTR prior to becoming CFO.

An interesting twist to this otherwise straightforward litany of embezzlement and fraud is a defense counsel's comment that "The government says they got things, and my response is: 'Who didn't?'" This appears to suggest that the culture of spreading gifts and cash was so prevalent in the 600-person D.C. tax office that it was, in effect, condoned by management. Therefore, "getting your share" of the goodies was considered to be acceptable behavior.

Perhaps the most telling part of this story deals with the *Post*'s conclusions. The paper believes that it was the easygoing culture of the office that was most responsible for allowing the fraud to continue without detection for so many years, concluding, "The bureaucracy in which [Walters] toiled was either corrupt or dumb as dirt." She was generous to many in the office, undoubtedly to buy silence. At least two of her supervisors ordered her to stop providing gifts to her employees, but apparently they never were suspicious of how a person of her income level could afford the shopping sprees at luxury stores, frequent gifts, and other cash she lavishly dispensed like a modern Robin Hood.

Apparently there were normal internal controls in place, but they were largely ignored. The red flag of wrongdoing was waved by a D.C. internal auditor, who reportedly noted a spike in the amount of refunds made in 2004 and suggested that tax revenues be closely monitored. But there doesn't appear to have been any follow-up. BDO Seidman, the external audit firm for the city's financial statements, ostensibly made no internal control management letter recommendations pertaining to the OTR. The city also has an Inspector General, but no information has been reported about this office's participation in either the detection or investigation of the massive fraud.

The District of Columbia's government has a code of conduct, and CFO Ghandi instituted a tax fraud hotline that allows city workers to report suspicions of wrongdoing without identifying themselves. Unfortunately, hardly anyone uses it. Great resentment was reported when he insisted upon ethics training. Prosecutors say Walters and her associates blithely kept ripping off taxpayers in full confidence that not a single person would live up to the moral and legal obligation to alert the authorities rather than protect the job of a friend or relative.

According to the *Post*, "Looking out for your fellow man has been redefined in the District as 'snitching.'" In the end, it fell to a teller at Sun Trust Bank to begin to unravel the fraud. When asked to cash a large refund check *continued on page 61*

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for Turnbull, he questioned whether she really was an authorized agent of a local firm of attorneys who prepared many tax assessment appeals.

Lessons to be learned from this experience:

- SOX provisions requiring an audit committee to oversee controls and place management emphasis on internal controls could have been helpful in preventing this scandal.
- Merely having an ethics code or a confidential reporting system isn't enough. These processes must be an integral part of an ethical culture.
- Executives aware of suspicious circumstances should investigate them thoroughly.

Questions:

- Is this culture a reflection of the moral/ethical climate across America?
- Whose responsibility is it to change this unethical mentality?
- Why were so many people content to participate in this totally unethical episode without anyone speaking up?
- Can the cost control disciplines inherent in a for-profit organization be introduced into the governmental sector?
- Could there be similar situations in your city or state? ■

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