Horseplay in Dixon: Lessons Learned from the Rita Crundwell Fraud

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A Horse of a Different Color¹

While assuming the responsibilities of the vacationing City Comptroller, City Clerk Ms. Kathe Swanson made what she thought to be a routine request for bank statements for all of the Dixon, Illinois municipal bank accounts. The City of Dixon had been banking with the Fifth Third Bank since 1967,² and the request was met promptly. As she reviewed the statements, it became apparent that one of the accounts was one with which she was not familiar. She quickly alerted Mayor James G. Burke, who requested assistance from the Rockford, Illinois office of the FBI. The ensuing months were agonizing for Mayor Burke and the small circle of insiders as the FBI conducted its investigation even as the Comptroller returned from vacation, resumed her duties, and continued to siphon millions of municipal dollars into the previously unknown bank account. Ms. Swanson's simple request accidentally uncovered the largest municipal fraud in U.S. history.

Rita Crundwell was born in 1953 and raised on a farm near the City of Dixon. She and her family were well-known in the local community. Perceived as a bright student, she obtained a work-study position with the City of Dixon while still in high school, and started working as a secretary upon graduation. By 1983, at the age of 30 and with no more than a high school diploma, she was appointed as Comptroller, a position she held until April 17, 2012. She was so

¹ The Rita Crundwell case has been widely reported in a range of media. We rely on the legal documents, depositions, U.S. Justice Department, and FBI reports for the presentation of the case facts. These resources appear in the reference list. When a different resource is used, we provide a specific footnote.

² Fifth Third Bank and its predecessors provided banking and financial services to Dixon since 1967. The name of the bank changed during that time.
good at her job and had such strong knowledge of municipal issues, that she earned the trust and confidence of her colleagues, community, Mayor Burke, and the elected Commissioners. Indeed, according to one observer, Rita Crundwell was "...as trusted and efficient as a church tithe collector."\(^3\) As she settled into the routine of comptrollership with ease, she pursued her first passion of raising and showing quarter horses.

Quarter horses are an honored breed known for a fast sprint and powerful body. They are expensive to obtain and maintain, but are popular in racing, exhibitions, rodeos, and other riding events.\(^4\) Rita Crundwell's quarter horse operation developed into one of the most prestigious in the world. She amassed two farms, over 400 quarter horses, a 1967 Corvette, a Lexus, a Hummer, late-model trucks, a 20-foot boat, a $259,000 horse trailer, a $2.1 million motor home, a Florida home, significant quantities of custom jewelry and fur coats, leather and wooden furniture befitting a queen, and over 50 champion trophies. The local community trusted Rita. The quarter horse community trusted Rita. They had no reason not to until City Clerk Kathe Swanson made a simple request to Fifth Third Bank in the fall of 2011.

Dixon, Illinois is the county seat of Lee County, Illinois, with a population slightly less than 16,000 and a median household income of $35,720. The city was founded by John Dixon in 1828. Of note, the city was the boyhood home of Ronald Reagan, the 40th U.S. President. Reagan lived in Dixon from the age of 9 to 22, and the "Ronald Reagan Boyhood Home" is a local tourist attraction complete with a Visitor's Center. Dixon is governed by a part-time mayor (salary of less than $10,000) and four elected part-time Commissioners (annual salaries under $3,000 per year): (1) Accounts & Finance, (2) Public Property, (3) Public Health & Safety, and

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\(^4\) http://www.aqha.com/
(4) Streets & Public Improvements. All had come to rely on Rita's competent handling and presentation of the financial affairs of the City of Dixon. A timeline of the events in Rita Crundwell's life is presented in Exhibit 1.

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 10, 1953</td>
<td>Rita Humphrey's birthday.</td>
</tr>
<tr>
<td>1970</td>
<td>Employed as intern in the City of Dixon municipal government while in high school.</td>
</tr>
<tr>
<td>1974-1986</td>
<td>Married to and divorced from Jerry L. Crundwell (retained married name). No children.</td>
</tr>
<tr>
<td>1971-1983</td>
<td>Secretary for the City of Dixon Mayor.</td>
</tr>
<tr>
<td>1983-2012</td>
<td>Served as the City of Dixon's Comptroller and Treasurer on full-time basis.</td>
</tr>
<tr>
<td>December 18, 1990</td>
<td>Opened RSCDA account at Fifth Third Bank.</td>
</tr>
<tr>
<td>January 1991</td>
<td>Transferred funds out of RSCDA for the first time for personal use.</td>
</tr>
<tr>
<td>October 2011</td>
<td>Kathe Swanson discovers RSCDA account and informs Mayor Burke. FBI is contacted.</td>
</tr>
<tr>
<td>April 17, 2012</td>
<td>Arrested at work in the City of Dixon on a one-count indictment of wire fraud.</td>
</tr>
<tr>
<td>November 14, 2012</td>
<td>Pleads guilty to wire fraud and admits to money laundering. Her assets, including over 400 horses, were seized.</td>
</tr>
<tr>
<td>February 13, 2013</td>
<td>Sentenced to 19 years, 7 months (maximum possible was 20 years).</td>
</tr>
<tr>
<td>February 18, 2013</td>
<td>Receives full suspension from the American Quarter Horse Association.</td>
</tr>
<tr>
<td>October 16, 2013</td>
<td>City of Dixon settled a lawsuit against Fifth Third Bank and the auditors.</td>
</tr>
<tr>
<td>March 5, 2030</td>
<td>Expected release date from prison. She is incarcerated at the Federal Correctional Institution at Waseca, MN.</td>
</tr>
</tbody>
</table>

5 http://www.discoverdixon.org/city-of-dixon-administration/-officals/
6 http://www.aqha.com/About/Content-Pages/AQHA-Membership/AQHA-Suspensions.aspx
Letting Go of the Reins

The City of Dixon had six authentic bank accounts established for general and special purposes plus a seventh fraudulent account created by Rita Crundwell as presented in Exhibit 2.

<table>
<thead>
<tr>
<th>Account name</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Corporate fund</td>
<td>2563</td>
</tr>
<tr>
<td>2. Sales tax fund</td>
<td>8373</td>
</tr>
<tr>
<td>3. Capital projects fund</td>
<td>0066</td>
</tr>
<tr>
<td>4. Motor fuel fund</td>
<td>3675</td>
</tr>
<tr>
<td>5. US Bank money market account</td>
<td>1128</td>
</tr>
<tr>
<td>6. Capital development fund</td>
<td>7503</td>
</tr>
<tr>
<td>7. RSCDA account</td>
<td>9530</td>
</tr>
</tbody>
</table>

The fraud was genius in its simplicity. Rita Crundwell picked up the daily mail, made all the deposits, updated the journals and ledgers, prepared and signed checks, moved investment monies, and reconciled the bank accounts. In 1990 she opened a checking account at Fifth Third Bank as "City of Dixon and RSCDA" with the checks imprinted with "RSCDA c/o Rita Crundwell." RSCDA was short for "Reserve Sewer Capital Development Account." She routinely transferred funds from the first five accounts into the legitimate capital development fund account (7503). The next step was that she created fictitious capital projects and fabricated a total of 179 invoices for those projects. Transfers from the legitimate account (7503) to the fraudulent account (9530) were documented as payments of the fictitious invoices.

Notably she supported these transfers to the 9530 account with 179 fabricated invoices for nonexistent capital projects in the event the auditors would ask for documentation. She then drafted checks from the 7503 account payable to "Treasurer" that she signed and deposited into the RSCDA (9530) account. She then wrote checks from the RSCDA account for personal expenses to the tune of more than $29 million during the period July 2006 to March 2012.

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7 Crundwell's family members were assigned to pick up the Dixon mail when she was on vacation.
($153,745 of legitimate City of Dixon expenses were paid from these funds during the same time frame). When the FBI completed its investigation tracing back to the origin of the RSCDA account in 1990, the total embezzlement exceeded $53.7 million. According to the FBI, the theft was $181,000 in 1991 and a high of $5.8 million in 2008 for an average of $2.5 million per year during the period of the fraud.\(^8\)

The impact of the fraud on the City of Dixon was devastating. Roads were in disrepair, ambulances and police radios needed to be replaced, and the infrastructure was in shambles. The cash flow problems caused by the fraud were attributed to a slowdown in tax collections as a result of the economical downfall. Unlike a commercial enterprise that generates cash flow from selling a product or service, a typical municipal government depends upon tax collections from citizens as the primary source of cash flow. The mayor and council members believed Rita Crundwell's explanation.

As evidence of the magnitude of the impact, the FBI computed how City of Dixon monies were spent prior to her arrest during the five months ending in February 2012 per Exhibit 3:\(^9\)

<table>
<thead>
<tr>
<th>Where the Monies Went</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public affairs</td>
<td>$192,000</td>
</tr>
<tr>
<td>Public works and property, building, traffic</td>
<td>$241,000</td>
</tr>
<tr>
<td>Streets</td>
<td>$263,000</td>
</tr>
<tr>
<td>Fire</td>
<td>$560,000</td>
</tr>
<tr>
<td>Accounts and finance</td>
<td>$589,000</td>
</tr>
<tr>
<td>Police</td>
<td>$1.3 million</td>
</tr>
<tr>
<td><strong>Crundwell's pocket</strong></td>
<td><strong>$3.2 million</strong></td>
</tr>
</tbody>
</table>


Hold Your Horses\textsuperscript{10}

Arrangements with the CPA firms and the accountants who worked for them muddied the waters of the City of Dixon situation. CliftonLarsonAllen (hereafter, Clifton) or its predecessor firm conducted audits of the City of Dixon from 1993 to 2005. Effective for the 2006 audit, the City of Dixon met the threshold for a Single Audit, which also requires an opinion on internal control effectiveness. An historical timeline of the CPA firms associated with the City of Dixon audits is presented in Exhibit 4:

<table>
<thead>
<tr>
<th>Dates</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-2005</td>
<td>CliftonLarsonAllen\textsuperscript{11} (Clifton) audits City of Dixon and provides unqualified opinions each year</td>
</tr>
<tr>
<td>2006-2011</td>
<td>Samuel S. Card, CPA participates in arrangement with Clifton to audit City of Dixon\textsuperscript{12} and renders unqualified opinions each year</td>
</tr>
<tr>
<td>2011-2012</td>
<td>FBI initiated investigation leading to April 17, 2012 arrest of Rita Crundwell</td>
</tr>
<tr>
<td>2012 to present</td>
<td>Wipfli LLP retained to audit Dixon after the fraud</td>
</tr>
</tbody>
</table>

Declaring itself to no longer be independent (without disclosing the reasons), Clifton entered into an arrangement with Sam Card, CPA to work in concert to provide audits wherein Clifton would perform the audit work and Card would sign off. Clifton asserts that it switched to performing an annual compilation and that no such arrangement was made. However, several communications between Clifton and the City of Dixon from 2006-2011 refer explicitly to the "audit fee" and scheduling "audit field work."

\textsuperscript{10} http://www.scribd.com/doc/121026135/Crundwell-case-Dixon-suit-against-three-auditing-firms#fullscreen
\textsuperscript{11} The firm name has evolved through mergers over time and was previously known as Clifton Gunderson LLP.
\textsuperscript{12} Associated with Janis Card Company LLC. and Samuel S. Card, CPA, P.C. during this time.
Further, Sam Card, CPA admitted that Clifton created an arrangement for him to sign off on the audits, while it continued to perform the audit work for fees exceeding $30,000 in the years they claim were compilation services. Card billed $6,000-$7,000 annually for his services.

One of the Clifton staff accountants testified: "We would see [Sam] once maybe for a couple of hours..." during the two-week audit. The following is from the Sam Card deposition: 13

Q. [City of Dixon attorney] "All right. My question to you is: Based upon your years of working in the accounting firm, why do you believe that Clifton came to you and initiated and suggested the venture that was ultimately entered into?"

A. [Sam Card] "In my opinion they did not want to lose the client...and that revenue stream."

Clifton prepared the financial statements for the City of Dixon using general ledger software. The software also cut the checks based on appropriate accounts payable documentation and then presented them to the City Council for approval. However, Clifton also was aware that Rita Crundwell prepared handwritten checks that bypassed the general ledger system maintained by Clifton. These checks were not scrutinized, mentioned to the Council, or subjected to audit scrutiny.

Clifton also prepared Rita Crundwell's personal tax returns that revealed expenses not justified by her $83,000 annual salary. In spite of the audit relationship that existed between Clifton and the City of Dixon, the Clifton partners and associates never considered that a Comptroller spending beyond her means should be investigated or viewed as fraud risk. Mr. Ronald Blaine, a Clifton partner who is now retired, admitted at deposition that he sought dates with Rita Crundwell, had dinner at her house, and even still remembered the recipes. He also enjoyed calling her "Reetz" as a nickname. Rita played softball on the Clifton team. Mr. Blaine

denied knowledge of professional standards that might prohibit an intimate or personal relationship with a client.\textsuperscript{14}

Q. [City of Dixon attorney] "Have you ever read any accounting standards or been taught in any continuing accounting education classes about the potential for problems to develop if an accountant has an intimate personal relationship with a client?"

A. [Ronald Blaine, retired Clifton partner] "I don't remember ever having anything in any education classes about that subject, no."

Megan Shank, CPA started working for Clifton in June of 2002 and was assigned to the City of Dixon engagement until the fraud was uncovered in 2011. Referring to Exhibit 4, Megan Shank asserts that she performed an audit through 2005 and a compilation thereafter. However, she also admitted to conducting audit procedures (e.g., bank confirmations) after 2005 and referencing the "audit work" in correspondence with the client after 2005. During her deposition she asserted that it was not the auditor's duty to detect fraudulent misstatement:

Q. [City of Dixon attorney] "Is it your claim as you sit here today as a certified public accountant in the state of Illinois that part of an auditor's duty is not to identify fraud or misstatement when performing an audit of a client?"

A. [Megan Shank] "That is not the reason for an audit, no."\textsuperscript{15}

For Want of a Horse the Woman was Lost

The financial statements of the City of Dixon were audited annually throughout the course of Rita's tenure as Comptroller and the escalating fraud. Setting aside the sketchy relationship between the Clifton partners and Rita Crundwell (plus the unusual arrangement with Sam Card during 2006-2011), Clifton admittedly served as the auditor from 1990-2005. The auditors failed on several counts.

\textsuperscript{14} http://www.scribd.com/doc/121026135/Crundwell-case-Dixon-suit-against-three-auditing-firms#fullscreen
\textsuperscript{15} http://www.scribd.com/doc/121026135/Crundwell-case-Dixon-suit-against-three-auditing-firms#fullscreen
Internal Controls over Financial Reporting (ICFR)

Rita Crundwell had no supervisor and had earned the complete trust of the Mayor, Council members, and colleagues. The auditors noted the absence of segregation of duties and the risk of management override regularly since 1993, but made no attempt to address these material weaknesses with enhanced audit procedures. Furthermore, no audit report on ICFR reported these material weaknesses, noting instead that ICFR was effective.

The fraud was uncovered by Kathe Swanson by happenstance. Rita Crundwell earned four weeks of vacation per year, but in 2011 decided to take an additional 12 weeks without pay. Her colleagues were impressed that she was honest enough to turn down her pay for the extended leave and still be available for any phone calls or matters that required her attention. An effective system of ICFR requires vacations for individuals with responsibility over assets, but the control is only operating when someone else performs the work in the vacationer's absence. After two decades, that finally occurred.

Stealing the Cash

The first step was the secret bank account. The second step was to design a way to transfer City monies into that account for personal use. Rita Crundwell accomplished this by creating fake projects, fabricating invoices to be paid in support of those projects, then writing checks from the legitimate Capital Development Fund (7503) to the RSCDA (9530) account that she controlled. It is a wonder that the auditors missed it.

Fifth Third Bank included the RSCDA account on a bank confirmation that Clifton received as recently as 2011. One of the staff associates documented that this was an account for the "Reagan Statue Committee Fund" based on an inquiry of Rita Crundwell. No further investigation was made. A reconciliation of the account was not requested.
Rita Crundwell maintained records in her office of her fictitious capital projects and created phony invoices from the Illinois Department of Transportation (IDOT) to support these fraudulent diversions of cash from the City of Dixon for her own use. Refer to Exhibit 5 for actual evidence from the FBI investigation. An actual IDOT invoice for the City of Dixon is shown on the left. One of Rita Crundwell's fake invoices is on the right. Notable differences include: (1) no logo, (2) SECTION is misspelled as SECTON on the fake invoice, (3) contact information does not appear on the bogus invoice, and (4) the fonts and stylistic features are different. Not one of the 179 fake invoices was noted during any audit, in spite of material amounts and what appear to be obvious features to heighten the auditor's skepticism.

Some of the fraudulent invoices were included in Clifton's work papers in the years that audit work was performed by Megan Shank. She had examined them and failed to notice the difference between an authentic invoice and one created by Rita Crundwell. Megan Shank agreed with the City of Dixon counsel that if she had made a "two-minute call to the State of Illinois" during the audit that it would have revealed the fraud:

Q. [City of Dixon attorney] "Ma'am, did they teach you in accounting school that if there are multiple invoices from the same vendor and they look different, that that's something that you should ask about and make further inquiry?"

A. [Megan Shank] "Yes, I suppose."16

The transfers to the RSCDA account represented bogus payments for nonexistent projects. At no time did an auditor do a site visit or otherwise verify that the projects were ongoing. What makes this failure more vivid is that the City of Dixon's infrastructure was collapsing as a result of the funds funneled out of the coffers to Rita Crundwell. Even a cursory glance around a city of 16,000 residents should reveal that multimillion dollar projects were not underway.

Rita Crundwell prepared manual checks drawn from the authentic Capital Development Fund (7503) payable to "Treasurer" and deposited in the RSCDA Account. One example of a fraudulent check is #604 dated 3/26/12, which is written on the legitimate Capital Development Fund account (Exhibit 6). The endorsement is what the auditor missed 179 times. It is payable to an account at Fifth Third Bank. If it were an authentic payment to Treasurer, State of Illinois, it

17 http://www.scribd.com/doc/125376365/Crundwell-Checks
would have been deposited into an account at the State's bank with its official endorsement.

Further, no reference appears on the Memo line of the check to tie it to a specific vendor invoice.

**Exhibit 6. Example of a Rita Crundwell Fraudulent Transfer**

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**My Kingdom for a Horse**

The City of Dixon prevailed in its civil lawsuit against Fifth Third Bank and the auditors with a settlement of $40,000,000 in October of 2012. The settlement of the Lee County lawsuit called for payments of $35.15 million from accounting firm CliftonLarsonAllen, $3.85 million from Fifth Third Bank, and $1 million from the accounting firm of Janis Card Associates and owner Samuel Card, CPA. The City of Dixon incurred in excess of $10 million in legal fees to be paid from liquidated assets, which amounted to $12.38 million.\(^{18}\) On dissolution of those assets

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in 2012, world champion quarter horse *Good I Will Be* sold at auction for $775,000 to a Canadian breeder only to be euthanized in November 2013 due to kidney stones.\textsuperscript{19}

Changes in internal controls were made. The City of Dixon switched from several bank accounts to a single account. Paper checks are no longer allowed. Duties are properly segregated, and those with responsibilities over cash require supervision by a City Administrator. Rita Crundwell's position of Comptroller was replaced by a Finance Director position. The Council appointed an independent panel to oversee financial reporting that consists of a CPA, banker, and attorney. As a direct result of the Rita Crundwell fraud, the State of Illinois passed into law a requirement that the annual audited financial statements be presented to each member of the city council or county board in a public meeting; the municipality also must post the audited information on its website.\textsuperscript{20} Other laws have been introduced by state representative Tom Demmer, a Dixon native, to require tougher penalties for municipal embezzlement.\textsuperscript{21}

In summary, the Rita Crundwell case provides a rich context for appreciating standards of professional conduct, audit processes, and the importance of internal controls over financial reporting.

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\textsuperscript{19} One of the difficult aspects of the case was to dispose of the assets as quickly as possible because eight of the more than 400 horses died prior to auction and any delays could reduce amounts recovered. Many of the horses were due to foal at the time of the seizure of the Crundwell assets as well (http://www.saukvalley.com/2013/11/12/prized-crundwell-horse-euthanized/aqofbq9/).


\textsuperscript{21} The proposed legislation is available at http://www.tomdemmer.org/p/legislation.html as HB1561 (5/10/13), HB1562 (4/10/13), and HB1563 (3/22/13).
Discussion Questions

1. Who is responsible for the Rita Crundwell fraud going undetected for over two decades? What traits or behaviors of the various individuals involved impact the outcome?

2. An auditor is required to be independent. The American Institute of Certified Public Accountants (AICPA) requires that auditors follow a four-step process or conceptual framework in which they (1) identify threats to independence, (2) evaluate the threats, (3) identify safeguards against the threats, and then (4) evaluate safeguards to ensure that they reduce threats to independence to an acceptable level. Use this process to reflect upon whether the Clifton auditors or Sam Card were independent. Refer to the AICPA’s Code of Professional Conduct, Conceptual Framework for Independence (§1.210)\textsuperscript{22,23}

3. Statement on Auditing Standards (SAS) No. 122, AU§240, Consideration of Fraud in a Financial Statement Audit (AICPA, 2014a), describes the auditor’s responsibility related to material misstatements caused by fraud. Much of the guidance in AU§240 is relevant to the Rita Crundwell case, but consider specifically the following issues:

   a. Professional skepticism. Define and explain how it was or was not maintained.

   b. Risk assessment procedures. Define and consider where the auditors may have failed to properly consider and respond to fraud risk. What industry considerations may have been a factor? What do you think that auditor should have done with respect to risk assessment?

4. Fraud is generally conceived as consisting of three elements (often called the fraud risk triangle): (1) incentive or pressure to commit fraud, (2) perceived or actual opportunity to do so, and (3) an attitude that permits the perpetrator to rationalize the behavior. According to AU§240, auditors are required to consider these elements and the corresponding impact on fraud risk. Given the facts of the case, identify the presence or absence of each element. Do you think that the auditors properly applied the fraud risk triangle? What specific risk factors can you identify as belonging to each of the three elements? Explain your answer.

5. The City of Dixon was subject to a governmental audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) published by the U.S. Government Accountability Office (http://www.gao.gov/yellowbook/overview). The City of Dixon became obligated to have a Single Audit in 2006 because its Federal financial assistance exceeded a new threshold, which ostensibly led to the shenanigans with Clifton and Card as described in the case. Identify how the auditor's responsibility changed in 2006.

\textsuperscript{22} The AICPA Code of Professional Conduct may be found at http://pub.aicpa.org/codeofconduct/Ethics.aspx#.
\textsuperscript{23} The following article may be helpful in understanding the AICPA’s conceptual framework for independence: Goria, E. (2014). "Revised AICPA Code of Ethics...What's the Fuss?" Journal of Accountancy (February) available at http://www.journalofaccountancy.com/Issues/2014/Feb/20139229.htm
6. What recommendations would you make to improve the internal controls over financial reporting? Do you think that the City of Dixon has reacted strongly enough? Explain your answer.
References


