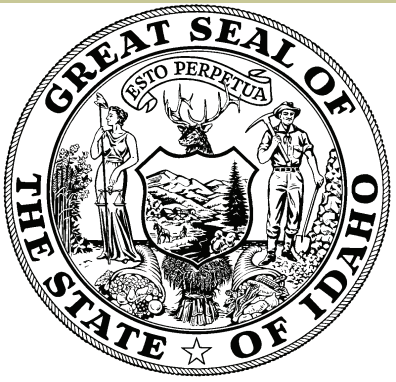
# First Friday Fraud Facts+

April 6, 2012

*The Idaho State Controller's Office distributes this newsletter as a cost-effective method of increasing awareness about ways to detect and prevent fraud, waste, and abuse in government.*





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Welcome to First Friday Fraud Facts+ ($F^{4+}$). This edition will cover billing schemes, fraudulent Medicaid reimbursements, and how to verify vendors are legitimate.

## Billing Schemes

Billing schemes follow the typical form of creating invoices for fictitious goods or services, inflated invoices, or invoices for personal expenses. In a billing scheme, the perpetrator submits a false invoice or alters a valid invoice that induces the buyer to make a payment that should not be made. Billing schemes are very common and costly. The three most prevalent types of billing schemes are those that 1) entail making personal purchases with organizational funds, 2) rely upon the alteration or double payment of a vendor's invoice, or 3) involve shell companies:

1) Employees sometimes make personal purchases using company funds. The fraudulent purchases are often made using the organization's credit card, so that payment appears to be nothing more than the proper settlement of organizational debt.

2) Fraudulent disbursements can be affected by using what are or were legitimate vendor invoices. The amount of the original invoice is increased or the original invoice is paid twice. Alternatively, a payment can be intentionally sent to the wrong vendor. When the vendor returns the overpayment, the employee intercepts it and keeps the money.

3) A shell or dummy company is a fictitious entity, generally created by an employee, which has been established exclusively to perpetrate a fraud. A shell company often consists of little more than a post office box and a bank account. The employee submits what appears to be legitimate invoices from the dummy company for services or goods that would be of the type normally purchased. When these invoices are paid, the perpetrator, unbeknownst to the buyer, keeps the payment.

Most billing schemes charge for services, rather than goods, because it is easier to conceal services that are not performed than goods that are not received.

## Red Flags

Several potential red flags may exist when a billing scheme is taking place. Some of these include:

- Invoices cannot be traced to shipments
- Multiple payments to a single vendor on the same date
- Pattern of purchases with amounts just below review level
- Unusually quick turnaround of invoices
- Payment to multiple vendors for same product
- Unexplained rise in cost of goods sold
- Unexplained decrease in gross/net profits

## Best Practices

- Invoices, purchase orders, and receiving reports should be matched before payment is issued
- Purchasing department should be independent of receiving, shipping, and accounting
- Purchases should have management approval
- Maintain a current approved vendor list
- Cross-check each vendor's address, phone number, and zip code against those of employees
- The person who maintains the vendor list should not have the ability to receive or pay bills
- Use competitive bids for major purchases

## Fraud Case

This case involves a billing scheme lasting several years where more than $3.8 million in fraudulent invoices were exchanged between a school district's transportation department and a vendor used to supply school bus and automotive parts.

Four employees from the school district's transportation department and three employees from the vendor were involved in the scheme. The transportation director had been authorized to approve invoices under $2,500. Therefore, the vendor sent fake invoices to the transportation department in amounts small enough to require only the transportation director's signature. Even though the vendor never filled the phony orders, the school district paid the invoices. The four transportation department employees received kickbacks from the three vendor employees. The money was used by those involved to buy luxury items such as homes, vehicles, jet skis, golf carts, large-screen TVs, and $600,000 in department store gift cards. $500,000 was also deposited into a personal bank account.

The scheme was discovered during an internal view conducted by the school district which found irregularities in their purchasing of goods. Numerous red flags went unnoticed:

- Payments to the vendor increased 342% from one year to the next (more than $3.7 million).
- 2/3 of the vendor invoices were under the $2,500 bid limit, and did not have a corresponding purchase order.
- On 24 occasions, there were 50 or more invoices from the vendor with the same invoice date, and a majority of these invoices had consecutive invoice numbers.
- On one particular day close to the fiscal year end, the vendor submitted 466 invoices totaling $909,266.

Originally, the school district had only one internal auditor. Since the fraud was discovered, the school district has set up a fraud hotline and hired additional internal auditors and other fiscal administrators to monitor each department's spending. Surprise internal audits and more substantive reviews of invoices and payment requests are also being conducted.

Most of the money stolen has been recovered. All involved were convicted and sentenced to prison terms ranging from 20 months (for helping cover up the fraud) to 15 years (for facilitating many of the purchases and being the only person to plead not guilty). The vendor was ordered to pay a $2.5 million fine to the school district.

## Fiscal Focus—Is the Vendor for Real?

When an accounts payable clerk at a State of Idaho agency is ready to pay an invoice, and the vendor is already in the statewide vendor table, what are the assurances that the vendor is a legitimate vendor? First of all, when a vendor completes and signs an IRS Form W9, he is certifying under penalties of perjury the following:

- The number entered on the form is the correct taxpayer identification number (TIN).
- The vendor is not subject to backup withholding.
- The vendor is a U.S. citizen or other U. S. person.

In addition, the Idaho State Controller's Office (SCO) conducts the following independent verifications before adding new, or updating existing vendor records:

- IRS TIN Matching - verifies that the vendor name/number combination matches either IRS or SSA information
- Federal Excluded Parties List System (EPLS) found at https://www.epls.gov/
- IRS Publication 78 is used to verify a vendor's non-profit status

Being on the statewide vendor table does not provide any assurance that the invoice is legitimate or that the invoice should be paid. Those assurances must come from the agency's purchasing and accounts payable policies and procedures.

Before paying any invoice, the clerk should conduct additional verifications before entering a transaction to pay the bill:

- Has the invoice received all of the necessary prior approvals? If not, route the invoice back through the approval stream as defined by the agency.
- If the invoice is for goods or supplies, has receipt of the goods or supplies been verified and documented? If not, obtain verification and documentation goods or services were received before paying the invoice.
- Does the name/number combination on the invoice match the information on the statewide vendor table? If not, then a new Substitute Form W9 should be obtained from the vendor and the invoice should not be paid until a new vendor record has been successfully added to the statewide vendor table.
- Does the remittance address on the invoice match the address on the vendor record? If not, then request either an address change or an additional vendor record for that name/number combination. The invoice should not be paid until a new vendor record has been successfully added to the statewide vendor table.

By working together and being diligent in their respective roles and responsibilities, agency accounts payable clerks and SCO personnel can lessen the possibility of paying vendors or invoices in error.