

First Friday Fraud Facts

February 4, 2011

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



QUESTIONS OR COMMENTS:

Matt McBride, CGFM
Financial Specialist
P.O. Box 83720
Boise, ID 83720-0011

Phone: (208) 332-8805
Fax: (208) 334-3415

E-mail: mmcbride@sco.idaho.gov

Inside this issue:

Welcome	1
Contributing Factors to Fraud	1
ARRA	1
Grant Fraud Uncovered	2
What You Can Do	3
Fraud Case Overview	3
Announcements	4

Welcome to First Friday Fraud Facts (F⁴). This edition will look at the impact of fraud in the public sector. In addition, as government entities have dealt with the American Recovery and Reinvestment Act of 2009 (ARRA), many opportunities for new and increased grants have become available. As such, we will address grants and the potential for fraud, waste, and abuse within the grant process.

Fraud, waste, and abuse within the government sector costs everyone. It results in costs to taxpayers, government entities suffer lost revenues, co-workers lose trust, and there is an overall loss of public trust. Government/public administration entities see the third highest reported rate of fraud, after the banking/financial services and manufacturing sectors. Nationwide, governments lost over \$18 billion according to a 2010 report of the Association of Certified Fraud Examiners (ACFE).

CONTRIBUTING FACTORS TO FRAUD

Fraud within government organizations, on average, is carried out for 18 months or longer and typically leads to an approximate \$100,000 loss. In general, the most commonly cited contributor to fraud is an overall lack of internal controls, followed by a lack of management review, and an override of existing controls. Internal controls are a key component of mitigating, detecting, and limiting fraud. Internal audits, surprise audits, and management review of internal controls are thought to be three of the most common controls that help in mitigating fraud.

THE AMERICAN RECOVERY & REINVESTMENT ACT (ARRA)

The passage of the ARRA could lead to an increased potential for fraud, waste, and abuse. It is important to ensure that your



organization considers the potential for misuse of funds and takes steps to ensure adequate fraud prevention controls are in place. In grant programs it is especially important to consider preventive controls. Once grant dollars have been disbursed fraudulently or improperly, the government is likely to recover only a few pennies on the dollar. In the context of grant programs, preventive controls are mechanisms that keep ineligible individuals and questionable organizations from gaining access to grant funds in the first place. The Government Accountability Office (GAO) recommends some of the following controls be considered: validate data used in decision making against other government or third party sources, inspect information to confirm its validity prior to payment, conduct system edit checks to identify problems before payments are made, and train staff on fraud awareness.

The ARRA provides for extraordinary levels of transparency, and as such, a great deal of scrutiny is focused on the way funds are expended. It is increasingly important to ensure your programs are operating effectively and efficiently. For more information about the ARRA and it's progress visit www.recovery.gov.

GRANT FRAUD UNCOVERED

Grant dollars are susceptible to several forms of financial abuse. Some of the most common forms are embezzlement, theft or bribery concerning programs receiving grant funds, false statements, false claims, and mail or wire fraud. Some of the more common scenarios: charging personal expenses as business expenses against a grant; charging for costs which have not been incurred or are not attributable to a grant; and charging for inflated labor costs or hours, or categories of labor which have not been incurred (i.e. fictitious employees, contractors, or consultants). Several areas of grant programs are particularly susceptible to abuse. Some of these include processes that involve large expenditures or appropriations of cash, sub-recipient pass-through, documentation for and review of payment, management review prior to payment, and review of grant outcomes.

Grant fraud is most commonly committed by grant recipients (company officers, business partners, board members, and managers), employees working on or within the grant process (bookkeepers, financial staff, and other involved employees), and individuals engaged with the grant recipient (contractors, subcontractors and consultants). Several "red flags" exist

that can potentially serve as a warning of fraud. Some of these include the appearance of conflicts of interest; unaccountable funds; lack of segregation of duties; and altered, inadequate, or missing documentation.

WHAT YOU CAN DO

Ensure your organization has a firm foundation established with basic internal controls by implementing the following:

- Maintain proper documentation with approvals and authorizations
- Verify transactions are appropriately reported and recorded
- Maintain adequate segregation of duties
- Assets are appropriately safeguarded
- Accountability within the organization can be traced

Be aware of some of the areas of potential risk and weaknesses within the organization. Some common areas include insufficient resources for segregation of duties, management override of controls, unqualified accounting personnel, and inadequate control of information technology. Operations can be strengthened by staying alert to the possibility of fraud, monitoring operational activities, considering audit findings, and awareness of internal control weaknesses.

FRAUD CASE OVERVIEW

This case involves a former school administrator. The individual was the administrator for a grant program that was designed to distribute federal grant monies through the state to local schools and school districts. The money was designated to assist disadvantaged children within the schools and to provide services such as counseling and assistance with test taking.

Over the course of seven years the program received over \$900,000 in federal grant funds. The grant administrator was responsible for certifying to state officials the number of qualified students enrolled in the schools and to whom services were being provided. In addition, the individual was responsible for providing certification to the granting authority showing that the funds had been properly applied. An audit later concluded that the number of students had been grossly inflated to allow the receipt of additional funds. Furthermore, the report concluded that virtually none of the services for which the funds were intended were being provided to the students.



The grant administrator had enough autonomy, lack of oversight, and lack of segregation of duties to falsify these records and go unnoticed. The individual was charged with, and found guilty of, three counts of mail fraud. He was sentenced to 30 months in prison and ordered to pay \$900,000 in restitution.

ANNOUNCEMENTS FROM THE IDAHO STATE CONTROLLER'S OFFICE

- 1) STARS FYE Comprehensive Training will be on Wednesday, March 16, from 9:00 a.m. – 11:00 a.m. To register, please contact Patti by email at peverill@sco.idaho.gov, or by phone at 332-8799.

- 2) Mark your calendars to attend one of the following annual internal control training sessions:
 - a) Wednesday, May 4, from 8:15 a.m. – 10:15 a.m.

 - OR

 - b) Thursday, May 12, from 1:15 p.m. – 3:15 p.m.

More details and registration information to come...