

First Friday Fraud Facts+

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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+ (F4+). This issue will discuss grant fraud and abuse.

Each year the United States Government awards nearly \$450 billion in federal assistance, mostly in the form of grants. The grants are used to fund many programs that include: infrastructure, homeland security, criminal justice, agriculture, human health, the environment, and many others¹.

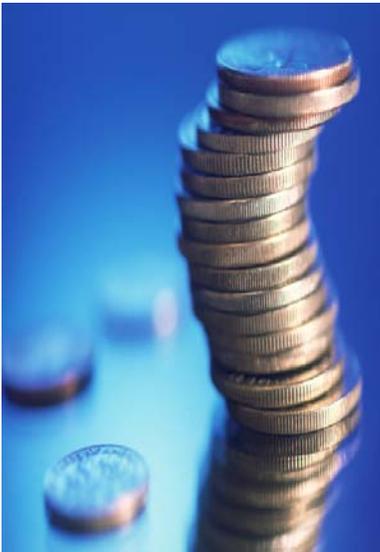
Fraud, waste, and abuse within grant programs costs everyone. It results in ineffective use of taxpayer dollars, lost revenues to governmental entities, lowers an organization's employee morale level, and creates an environment of distrust of government by the public at hand.

Governments see the second highest frequencies in the occurrence of fraud, only after the banking and financial services industry. Fraud within governments lasted a median of 18 months before being detected and had a median loss of \$81,000².

ORGANIZATIONAL CONTRIBUTING FACTORS TO FRAUD AND SUGGESTED CONTROLS

Some organizational contributors to fraud are a lack of internal controls, lack of management oversight or review, and overriding internal controls that are currently in place. The aforementioned risks can be mitigated by implementing good internal controls. Internal controls that have proven to be the most effective at reducing the cost of fraud are management review, employee support programs, fraud reporting hotlines, and fraud training for managers².

Ensure your organization considers the potential for misuse of funds and takes steps to make sure adequate fraud prevention controls are in place. Preventative controls are especially important in grant programs. 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. 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
- Train staff on fraud awareness

TYPES OF GRANT FRAUD AND THEIR PERPETRATORS

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 warnings of fraud. Some of these include the appearance of conflicts of interest; funds which are unaccounted for; lack of segregation of duties; and altered, inadequate, or missing documentation¹.

HOW TO PROTECT YOUR ORGANIZATION

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
- Safeguard assets appropriately

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

The federal government awarded approximately 500 grants to a university in New England for work to be performed by two of the university's specialized service facilities. The grant awards were made by numerous federal agencies including the Department of Defense, the Environmental Protection Agency, the National Science Foundation, and the National Aeronautics and Space Administration.

The federal government specifically alleged that the university submitted grant applications containing incorrect or overstated information about anticipated expenses. The university charged certain expenses that were not properly chargeable and submitted invoices to the government for three types of grant expenses. First, the government alleged that the university did not utilize a proper basis for setting and regularly updating its billing rate structure, as required by federal law. The university's failure to revise and appropriately set its billing rate structure resulted in numerous false claims being submitted for payment to the federal government. Second, the government alleged that the university failed to follow federal law for calculating how extra compensation should be paid to university faculty members for additional work on grant supported research activity and that improper excess charges were therefore charged to the grants. Finally, the government alleged that certain grants required cost sharing or matching by the university and that the university failed to provide the requisite cost sharing or matching.

The university agreed to pay \$2.5 million in damages and penalties to settle civil allegations that the university submitted false claims³.

¹ *Grant Fraud—A Message From the National Procurement Fraud Task Force*. Retrieved from <http://www.grants.gov/assets/GrantFraud.pdf> on July 12, 2013.

² *Report to the Nations on Occupational Fraud and Abuse—2012 Global Fraud Study*. Association of Certified Fraud Examiners (ACFE) (2012). Retrieved from http://www.acfe.com/uploadedFiles/ACFE_Website/Content/rtn/2012-report-to-nations.pdf on July 12, 2013.

³ *When Good Money Goes Bad—True Stories of Grant Fraud at the EPA*. U.S. Environmental Protection Agency—Office of the Inspector General. Retrieved from http://www.epa.gov/oig/reports/ARRA/EPA_OIG_Grant_Fraud_Brochure.pdf on July 12, 2013.

