



Where Is The Line Between Fraud And Abuse?

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What is Fraud?

- A false representation of a matter of fact—whether by words or by conduct, by false or misleading allegations, or by concealment of what should have been disclosed—that deceives and is intended to deceive another so that the individual will act upon it to his or her legal injury.

What is Abuse?

- The wrongful or improper use or destruction of resources or seriously improper practice where the intent to deceive is not present. Abuse can include the excessive or improper use of an employee's position in a manner other than its rightful or legal use.

Where is the Line?

Waste

Abuse

Fraud

Intent to Deceive

Three Most Common Types of Fraud

- Financial Statement Fraud
 - Least Common – Less than 10% of Cases
 - Largest \$\$ - Median Loss \$975,000
- Corruption
- Asset Misappropriation
 - Most Common – 83% of Cases
 - Smallest \$\$ – Median Loss \$125,000

Financial Statement Fraud

- Financial statement fraud is the deliberate misrepresentation of the financial condition of an enterprise accomplished through the intentional misstatement or omission of amounts or disclosures in the financial statements to deceive financial statement users.
- Majority of frauds committed fall into one of the following two categories:
 - 1) Manipulation of Timing
 - 2) Falsifying Entries

Corruption

- Employees or officials wrongfully using their influence in a business transaction to procure some benefit for themselves or another person, contrary to their duty to their employer or the rights of another.
- Examples:
 - Accepting kickbacks
 - Engaging in conflicts of interest
 - Bid rigging
 - Economic extortion
 - Illegal gratuities

Misappropriation of Assets

- Asset misappropriation schemes include those frauds in which a perpetrator employs trickery or deceit to steal or misuse an organization's resources.
- Individuals committing asset misappropriation-type crimes may be:
 - Employees of an organization
 - Customers or vendors of an organization
 - Individuals unrelated to the victim organization
- Asset misappropriation frauds generally divided into:
 - 1) Theft of cash (85%)
 - 2) Theft of non-cash assets (15%)

Michigan Schools in the News

- Ecorse Public Schools (2009) – Former assistant superintendent was charged with steering contracts to a company that he controlled, and required to repay over \$1 million in restitution for fraudulent conduct related to the district's e-rate program.
- Montcalm Area Intermediate School District (2009) – Similar to Ecorse, former superintendent indicted for engaging in a conspiracy to accept a bribe from a vendor to ensure vendor's company was selected for e-rate service contract.

Michigan Schools in the News

- Sand Creek Schools (2016) - The former president of the High School music program booster club entered a plea deal in exchange for reduced charges related to his theft of \$13,000 from the club and was sentenced to 30 days in jail instead of the five-year prison term he might have received.
- Royal Oak (2011) - High School principal was sentenced to 2 years probation after embezzling thousands of dollars from student activity accounts.

Michigan Schools in the News

- Mona Shores Public Schools (2016) – The district has recovered about a third of the \$3.7 million it lost in a Ponzi Scheme operated by the district's former financial advisor. The advisor never purchased bank certificates of deposit that his clients had given him money for. Instead, he used the money to pay off other investments, gamble, buy personal items and real estate and make loans.
- Jackson Public Schools (2017) – Former middle school principal pled guilty to embezzling school funds. She fraudulently wrote checks out of the school's Principal Fund for personal use in excess of \$97,362.

Detroit Public Schools

- Employee received \$50,000 in salary overpayments
- \$2,500 of field trip collections disappeared
- Employee manipulated a lottery process to benefit his tutoring company in an estimated \$1.3 million contract
- \$59,000 of falsified overtime paid out to an employee
- Vendor received payment for services not rendered
- \$1.275 million over seven years of grant billings for tutoring services never delivered
- Vendor fraud for textbooks and other supplies that cost the District an estimated \$2.7 million

Non-Publicized Fraud Examples

- Fictitious vendors
- Theft of athletic receipts
- Use of food service supplies for personal catering business
- Phantom employees
- Skimming payroll taxes
- Purchasing construction supplies for residence from bond money
- Falsification of records by third party service provider

Fraud vs. Abuse

- CEO uses the company credit card to pay to have her nails done. When asked about it, she said it was a necessary business expense to keep up her professional appearance.
- Soccer coach put on a soccer camp outside of the district and used district equipment to run it. The district received no compensation for the wear and tear on its equipment or facilities.

Fraud vs. Abuse

- Mechanic makes purchases with district dollars to buy their parts at a discount for a side business repairing vehicles. He pays the invoices directly, but the District's name is used to gain more favorable pricing.
- Authorizing a purchase above authorization limits by splitting the purchase into several smaller invoices.
- An employee pays for everything on their personal credit card and submits for reimbursement to get promotional benefits through their card instead of using District's payment policies and procedures.

Fraud vs. Abuse

- Unspent grant dollars used on unnecessary items at the end of a grant period so that the District did not “leave money on the table”.
- Unreasonable PDO benefits for management or individuals outside of bargaining agreements
- Lack of due diligence on service organization contracts to ensure the District is not paying inflated prices for products.

Preventing Fraud & Minimizing Abuse

- Most organizations take a reactive approach to fraud and abuse.
- “Pay and chase” – Pay first, notice an error later (whether fraudulent or not), and then try to recover funds.
- Prevention is much more cost-effective than after-the-fact recovery.

Preventing Fraud & Minimizing Abuse

- Perform Surprise Audits
 - Call local banks to determine if there are accounts you are not aware of being used by your District.
 - Verify addresses on new vendor invoices to ensure it is a legitimate company.
 - Review cleared checks for a break in sequences.
 - Perform an unplanned audit of petty cash, inventory, etc.
 - Observe cash collections at a sporting event or lunch service.

Preventing Fraud & Minimizing Abuse

- Train Employees

- Train employees as to what constitutes fraud and abuse, and how it impacts the District (publicity, job loss, morale, etc.)
- Ensure employees understand where to seek advice when they are faced with uncertain ethical decisions.
- Communicate a policy of zero-tolerance through words and actions.
- Provide employees a confidential outlet to report suspicious or fraudulent activity.
- Instruct employees on how to recognize red flags and early warning signs.

Preventing Fraud & Minimizing Abuse

- Solid internal controls, implemented and followed correctly, are the BEST deterrent to fraud.
- Policies and procedures designed to provide reasonable assurance that assets are safeguarded against unauthorized use and disposition.
- Think Like an Auditor
 - Set a strong tone at the top
 - Enforce internal controls
 - Evaluate segregation of duties
 - Know your employees
 - Don't allow exceptions
 - Trust, but verify!



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