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Part II

**Practical Considerations for
Managing the Business Risk
of Financial Fraud for
Higher Education Providers**

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April 23, 2010



Discussion Themes

I. Fraud – Why it Matters...

II. Fraud Schemes Specific to Higher Education

A. Not-for-Profit Entities

B. For Profit Entities

C. Other Higher Education Fraud Schemes

III. Practical Considerations for Managing Fraud Risk

“At any given moment, there is a certain percentage of the population that’s up to no good.”



J. Edgar Hoover

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Higher Education Frauds Making Headlines

University of Illinois' Trustees OK President's Resignation

Princeton Officials Hack Yale Admissions Website

Las Vegas Woman Scams Nearly \$1M in Student Aid

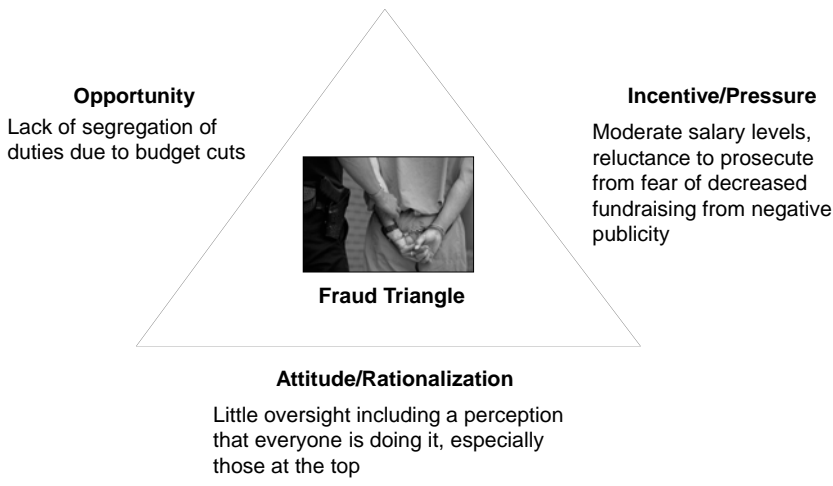
Student Visa Fraud

Clemson University Manipulates US News College Rankings

\$1M at University of North Carolina School of Arts Used for Non-Academic Purposes

Student Loan Kickbacks

The Fraud Triangle — Higher Education Organizations



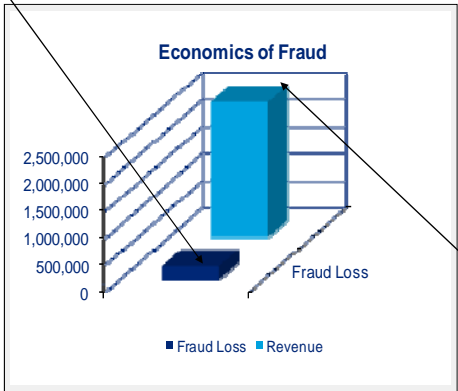
Source: Deloitte: *Helping to Prevent University Fraud* By: Ron Schwartz, Matthew Larson, and Mary-Jo Kranacher

Restoring Net Income After a Fraud Loss

A \$250,000 fraud loss . . .

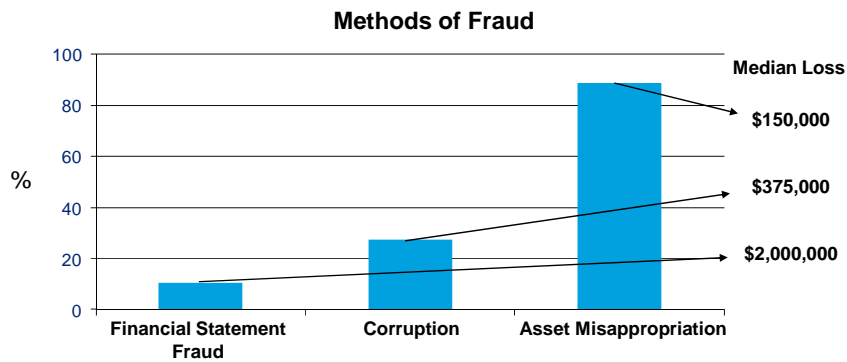
Fraud usually reduces net income on a dollar-for-dollar basis.

A company with a 10% profit margin that experiences a single \$250,000 vendor fraud would have to generate an additional \$2.5 million in revenue to restore its net income to pre-fraud levels.



. . . will require an additional \$2.5 million in revenue to maintain net income levels

The Fraud Environment (cont.)



Note: The sum of percentages in this chart exceed 100% because a number of cases involved multiple schemes that fell into more than one category.

Source: 2008 Report to the Nation on Occupational Fraud and Abuse © 2008 Association of Certified Fraud Examiners, Inc.

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Financial Fraud: Not-for-Profit Higher Education Entities

Financial Fraud Schemes:

Intentional misclassification:

- A manager intentionally creates inappropriate adjusting journal entries
- An employee intentionally misclassifies an expense as a program cost to hide excess service costs

Improperly reporting endowments, grants and restricted donations:

- An organization applies a full donation to a non-restricted account, when the donor stipulated that the proceeds should be used for a specific purpose

Overstating the value of non-cash gifts:

- Recording non-cash gifts at historical/inflated value vs. fair-value

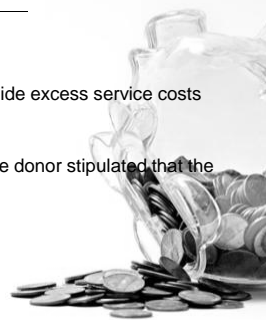
Compensation Incentives leading to falsification of results

Inappropriate use of discretionary funds

Netting results of fundraising events:

- An entity improperly accounts for a fundraising event by netting event 's costs with the event's proceeds, resulting in a gain of proceeds with no associate event costs
- Artificially inflates the program expense ratio and hides the true cost of raising the funds

Inaccurate application and disbursement of financial aid



Fraud Example – Notes of a CFO

Strong or... Go & B.L. so low?

① Co

- How explain?
- Co w/ no sale
- Planned to train Bill & D gets exposed anyway
- Will never have it all fixed in B.L. go to court unless anyway
- Look into #s of co going under anyway
- Once past audit probs vs court on fail?

② Ship

- Company exists but constantly dodging auditors
- Ship employed
- Why on 1st B.L. in 8-10 days of before 5/10/10
- Have stressed pressure of more one than
- Once past audit probs vs court on fail?

③ What if caught

- B.L. have the company & old systems & get fixed. Way is off + re clean

Audit

- ① Get to Florida - Ask the questions
- ② If Q on - Defend ourselves by the way, we agree JE
- ③ If Q on - Defend - what debit made sure R get
- ④ AR - Get what we owe AR
- ⑤ AR - accept if really criticize the whole story

Financial Fraud: For-Profit Higher Education Entities

Financial Fraud Schemes:

Revenue recognition

- Recording non-existent revenue
- Recording revenue when contingencies exist
- Recording revenue in an inappropriate period

Reserve manipulation

- Deferring the recognition of expenses that belong in the current period to future periods by capitalizing them
- Record lower expenses than actually incurred
- Hiding invoices

Improper capitalization leading to falsification of results

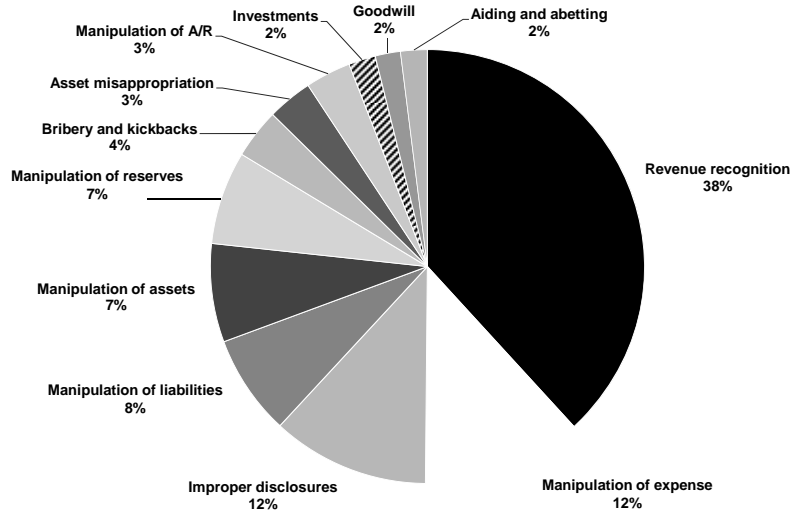
- Deferring the recognition of expenses that belong in the current period to future periods by capitalizing them
- Capitalizing costs that don't meet GAAP criteria

Intentional misclassification:

- A manager intentionally creates inappropriate adjusting journal entries



Most Common Financial Fraud Schemes in For-Profit Higher Education Providers



Source: Deloitte Forensic Center, Ten Things About Financial Statement Fraud — third edition, 2009

Fraud Example – Improper Accrual

OPERATIONS
ACCOUNT 243000 - ACCRUED BONUS (7120)
Period 7

PLANT	ACCOUNT NUMBER	2001 BALANCE	PAID IN 2002	2002 ACCRUAL	ADJ	BALANCE	
MSV	809000-0800	\$ (8,461.00)				\$ (8,461.00)	JE TO 243030
FARM PROD BON	4806990	\$ 81,265.40	\$ 523,919.83		\$ 211,305.23	\$ 616,490.46	JE TO 243030
RO PROD BON YRLY	8090	\$ 31,737.13		\$ (279,532.88)		\$ (247,795.75)	JE TO 243050
RO PROD BON QTR	8090	\$ (163,515.88)	\$ 116,651.23	\$ (138,489.23)		\$ (185,363.98)	JE TO 243040
Cookie Jar	281000	\$ -				\$ -	
Correct Bonus 2nd period	639000-0160				\$ 94,342.54	\$ 94,342.54	JE TO 243030
EXTRA BONUS-CJ ADJ	809000-6000				\$ (30,000.00)	\$ (30,000.00)	
EXTRA BONUS-CJ ADJ	709000-0700				\$ (20,000.00)	\$ (20,000.00)	
EXTRA BONUS-CJ ADJ	809800-0800				\$ (50,000.00)	\$ (50,000.00)	
EXTRA BONUS-CJ ADJ	809830-0800				\$ (31,000.00)	\$ (31,000.00)	
EXTRA BONUS-CJ ADJ	709830-0700				\$ (13,000.00)	\$ (13,000.00)	
EXTRA BONUS-CJ ADJ	809030-0800				\$ (16,000.00)	\$ (16,000.00)	
TOTAL		\$ (58,974.46)	\$ 446,571.06	\$ (418,032.11)	\$ 275,647.77	\$ 106,212.27	
G/L 243000						\$ 106,212.27	
DIFF						\$ 0.00	

Higher Education: Non-Financial Fraud Schemes

Fraud Schemes:

Payroll and Expense Schemes

- Inflated Overtime Reporting
- P-card and T&E fraudulent charges
- Paying family members from the university's payroll account

Theft of Personally Identifiable Information

Student Loan Kickbacks from Loan Providers

Manipulation of recruiting and placement data

Conflicts of Interest

Fictitious Vendors

- Setting up fake vendors to embezzle funds

Corruption (international expansion/partnerships)

Vendor Bid Rigging

- Fraudulently accepting bids from a predetermined vendor



Discussion Themes

I. Fraud – Why it Matters...

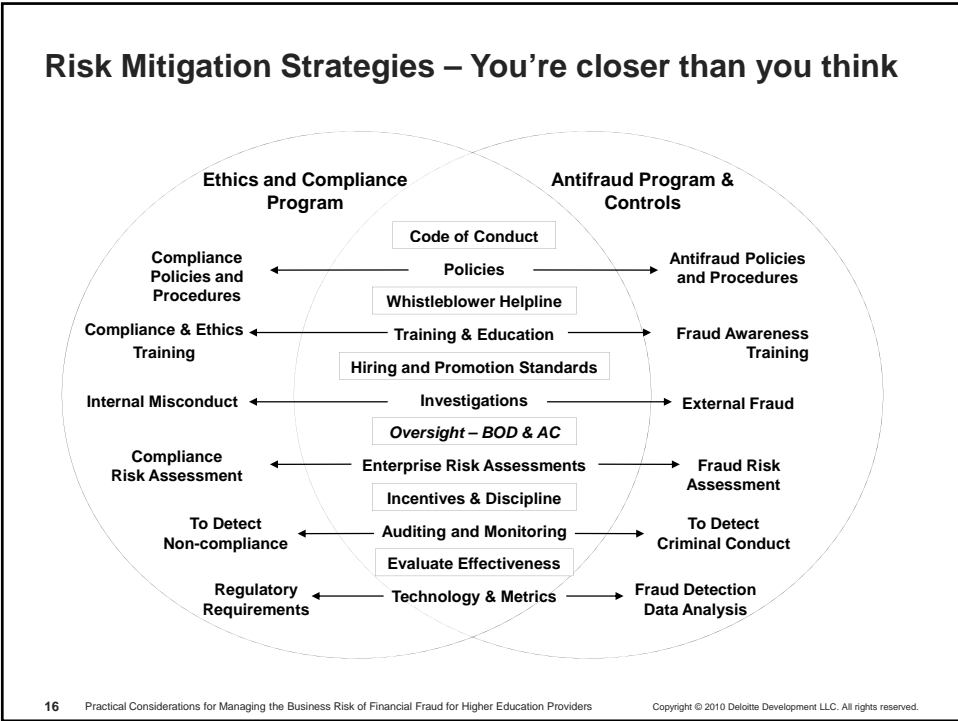
II. Financial Fraud Schemes Specific to Higher Education

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III. Practical Considerations for Managing Fraud Risk



An Approach to Fraud Risk Management – The Anti-fraud Roadmap

Evaluate	Identify	Action Plan	Mitigate	Monitor	Respond
Evaluate current status and effectiveness of an organization's approach to implementing antifraud programs and controls	Assess, define, and document fraud risks and control effectiveness Establish fraud risk profile by analysis of risk against controls	Develop a fraud action plan based on findings and identify activities that defines next steps to address an organization's antifraud program activities	Enhance, implement, and maintain preventative and detective control activities, which mitigate fraud risks identified during assessment	Enable continuous monitoring activities through technology and ongoing review activities to alert management of potential fraud Incorporate findings into annual fraud risk assessment process	Assist in responding to potential occurrences of fraud
Internal Survey	Fraud Risk Assessment	Fraud Risk Action Plan	Fraud Awareness Training	Continuous Monitoring Tools	Fraud Case Management Tools
Diagnosis of Current Position			Mitigate Deficiencies	Data Analytics	Fraud Response

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Approach – Evaluate

Evaluate	Identify	Action Plan	Mitigate	Monitor	Respond
Evaluate current status and effectiveness of an organization's approach to implementing antifraud programs and controls	Assess, define, and document fraud risks and control effectiveness Establish fraud risk profile by analysis of risk against controls	Develop a fraud action plan based on findings and identify activities that define next steps to address an organization's antifraud program activities	Enhance, implement, and maintain preventive and detective control activities, which mitigate fraud risks identified during assessment	Enable continuous monitoring activities through technology and ongoing review activities to alert management of potential fraud Incorporate findings into annual fraud risk assessment process	Respond in potential occurrences of fraud
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Diagnosis of Current Position			Mitigate Deficiencies	Data Analytics	Fraud Response

Objectives

- Evaluate the current status and effectiveness of a company's antifraud program and risk assessments

Tools/Technologies

- Survey Tools
- Diagnostic Tools

Activities

- Understand organizations' attitudes and tendencies toward fraudulent activity and reporting
- Gather intelligence on existing risk-based programs currently utilized and how they fit together
- Compare risk-based programs and conclusions to risk assessment tools and technology findings
- Identify process owners and subject matter experts that are most knowledgeable of risk, conduct interviews and evaluate against prevailing best practices in the industry

Deliverables


- Survey Analysis
- Diagnostic Report
- Antifraud Process Flow

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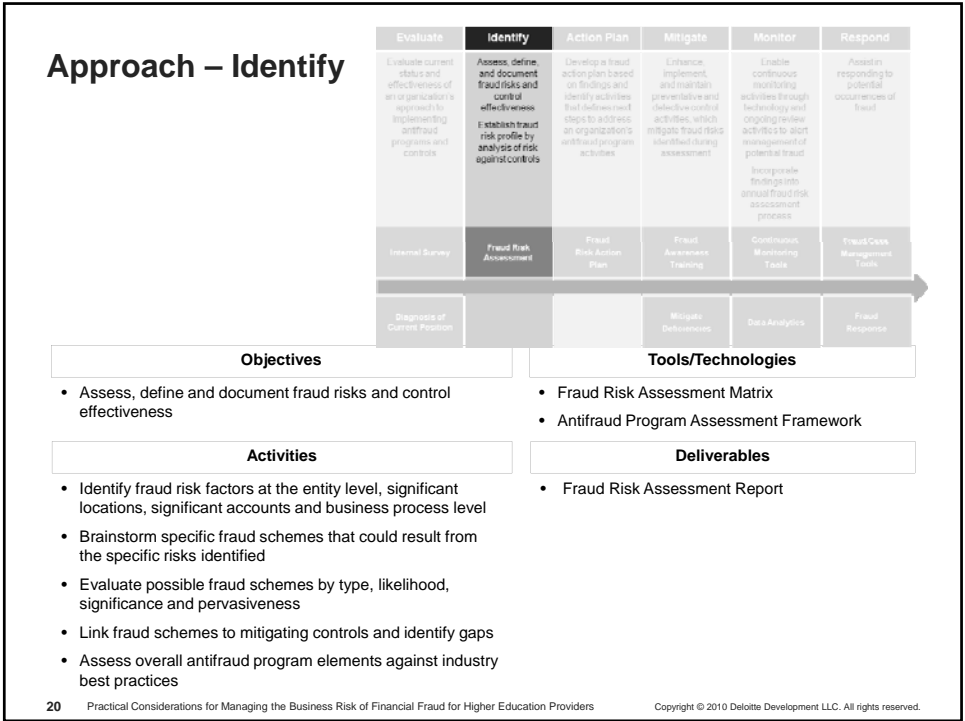
Evaluate: Key Components of Reducing Fraud Risk

Elements to Understand and Measure:

- **Code of Conduct/Ethics**
 - **Ethics Hotline/Whistleblower Program**
 - **Hiring and Promotion**
 - **Information and Communication**
 - **Monitoring**
 - **Oversight by Audit Committee and BOD**
 - **Investigation and Remediation**
 - **Fraud Risk Assessment**
 - **Control Activities**



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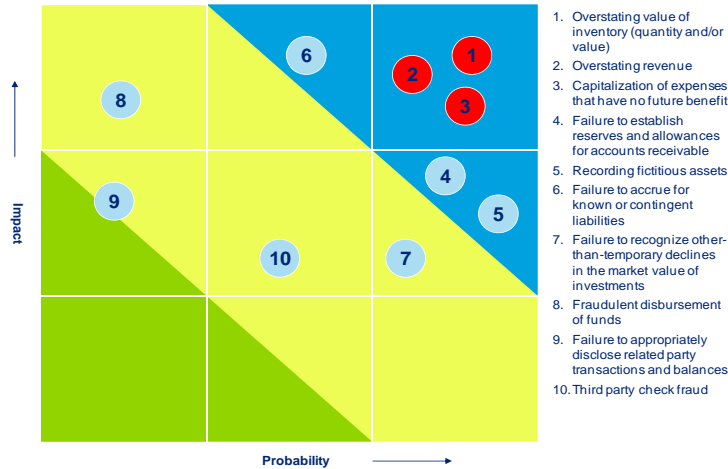
Identify — Conducting the Fraud Risk Assessment

Step	Step	Activities	Output
1	Identify and evaluate fraud risk factors	<ul style="list-style-type: none"> Identify fraud risk factors Identify account balances and potential errors related to each fraud risk 	<ul style="list-style-type: none"> Schedule of fraud risk factors Sound knowledge of fraud risk environment
2	Identify possible fraud risks, schemes & scenarios	<ul style="list-style-type: none"> Identify fraud risks Identify specific fraud schemes 	<ul style="list-style-type: none"> Fraud risk register Pervasive and specific fraud risks
3	Assess and prioritize identified fraud scenarios	<ul style="list-style-type: none"> Analyze the likelihood and significance of possible fraud schemes 	<ul style="list-style-type: none"> Inherent Risk Rating (IRR) for fraud schemes Catalog of existing controls
4	Evaluate whether existing controls exist/are effective	<ul style="list-style-type: none"> Map fraud schemes to mitigating controls and evaluate control design and effectiveness Evaluate residual risk of each fraud scheme 	<ul style="list-style-type: none"> Residual Risk Rating (RRR) Heat map/reporting of high risks Fraud control gap analysis
5	Develop risk treatment, mitigation and on-going monitoring strategies	<ul style="list-style-type: none"> Develop action plan to address identified gaps Develop and communicate on-going monitoring activities for high risk areas 	<ul style="list-style-type: none"> Fraud control action plan for high risk areas and/or for those with an identified gap

Source: Health Care Law Monthly July 2009, Key Compliance Concerns for the Generic Pharmaceutical Industry

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Distribution of Top Risk – Prioritization = Value



Identify — Do's and Don'ts of a Fraud Risk Assessment

Pitfalls	Recommendations
• Management does not take responsibility for the FRA	• Management should own and have significant input into the FRA; Educate the Board and external auditors on the FRA — get their support/buy-in
• The FRA is not risk-based	• The FRA should be risk-based
• The FRA is too broad	• Focus on high risk areas
• The planned approach is contrary to the organizational culture	• The planned approach should fit into the organizational culture — consider a mixed approach, e.g., interviews and group brainstorm
• The organization does not have the necessary skill sets to perform the FRA	• Hire in the necessary skill sets (employees/consultants)
• The FRA process does not include the appropriate people	• Consider who should be involved as part of the planning process — don't just involve a small group of senior management
• Not systematic and recurring	• The FRA should be an on-going process and recur on a periodic basis

Approach – Action Plan

Evaluate	Identify	Action Plan	Mitigate	Monitor	Respond
Evaluate current status and effectiveness of an organization's approach to implementing antifraud programs and controls.	Assess, define, and document fraud risks and control effectiveness. Establish fraud risk profile by analysis of risk against controls.	Develop a fraud action plan based on findings and identify activities that defines next steps to address an organization's antifraud program activities.	Enhance, implement, and maintain preventative and detective control activities, which mitigate fraud risks identified during assessment.	Enable continuous monitoring activities through technology and ongoing review activities to alert management of potential fraud.	Assist in responding to potential occurrences of fraud.
Internal Survey	Fraud Risk Assessment	Fraud Risk Action Plan	Fraud Awareness Training	Continuous Monitoring Tools	Fraud Case Management Tools
Diagnose of Current Position			Mitigate Deficiencies	Data Analytics	Fraud Response

Objectives

- Develop a fraud action plan based on findings noted during evaluation and identification activities that will define next steps to address antifraud program activities

Tools/Technologies

- N/A

Activities

- Consolidate key results obtained through evaluation and identification of fraud risks fit into overall initial perceptions
- Document strategic approach to respond to prioritized fraud risks on a global scale which will include a short-term, medium-term, and long-term action plan

Deliverables

- Fraud Risk Assessment Report

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Approach – Mitigate

Evaluate	Identify	Action Plan	Mitigate	Monitor	Respond
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Objectives

- Enhancing, implementing and maintaining **preventative and detective** control activities which mitigate fraud risks identified during the fraud risk assessment

Tools/Technologies

- N/A

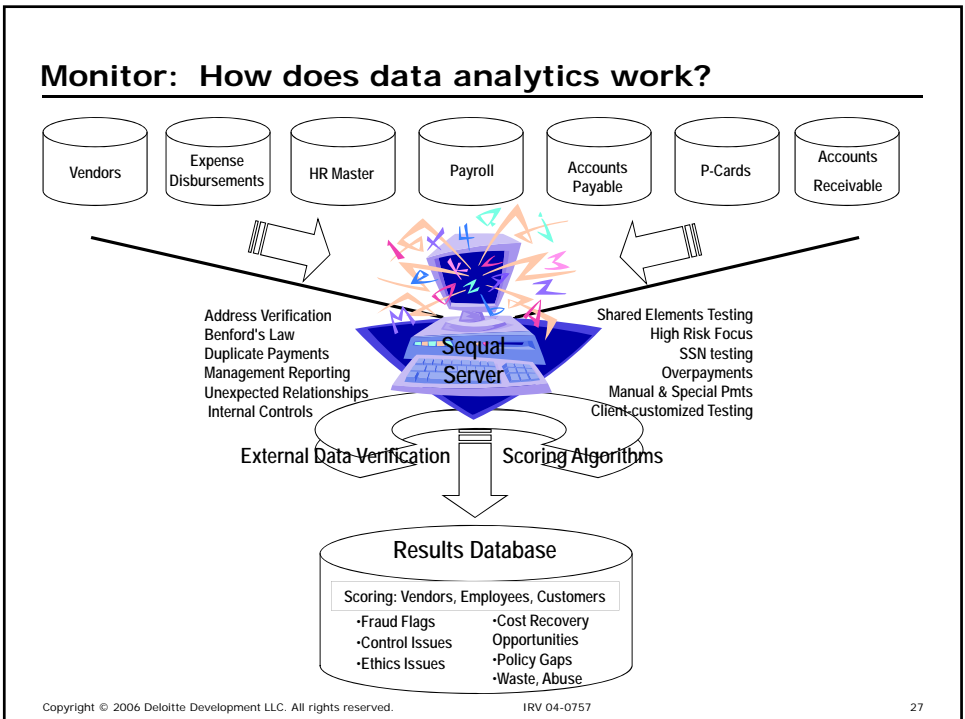
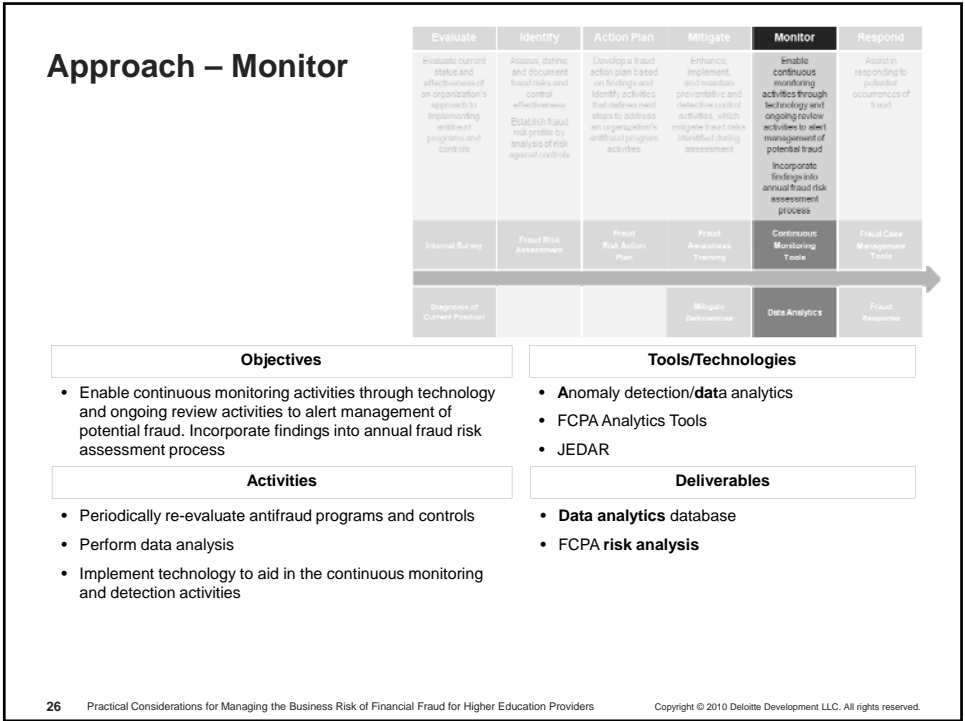
Activities

- Define and document controls to mitigate identified fraud risks
- Establish or enhance preventative and detective controls or antifraud programs
- Communicate programs/practices/policies to employees
- Develop and deliver tailored fraud training to employees

Deliverables

- Customized fraud training content
- Fraud training facilitation

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Approach – Respond

Evaluate	Identify	Action Plan	Mitigate	Monitor	Respond
Evaluate current status and effectiveness of an organization's approach to implementing anti-fraud programs and controls	Assess, define, and document fraud risks and control effectiveness Establish fraud risk profile by analysis of risk against controls	Develop a fraud action plan based on findings and identify activities that define next steps to address an organization's anti-fraud program activities	Enhance, implement, and maintain procedures and detective control activities, which mitigate fraud risks identified during assessment	Enable continuous monitoring activities through technology and ongoing review activities to meet management of potential fraud Incorporate findings into annual fraud risk assessment process	Assist in responding to potential occurrences of fraud
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Diagnosis of Current Process			Mitigate Deficiencies	Data Analytics	Fraud Response

Objectives

- Assist in responding to potential occurrences of fraud

Activities

- Evaluate responses to fraud and investigate anomalies and allegations with a timely and efficient methodology
- Report necessary fraudulent incidences
- Re-evaluate strategy and antifraud program design to respond to triggers in the operational environment

Tools/Technologies

- Fraud case management tools

Deliverables

- Situation dependant

Questions





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