



**GARY ZEUNE & ASSOCIATES**

Training, Writing and Consulting in:  
Fraud and Audit Failures  
Leadership Skills and Strategies  
Productivity Performance Measures

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# Government and Nonprofit Fraud

# 13

## Things You Need to Know For 2007



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## TRAINING AND CONSULTING

Using 35 years of experience in auditing, corporate finance, and investment banking, Gary D. Zeune, CPA, provides CPAs, attorneys and executives with hands-on experience in fraud and corporate strategy performance improvement. Mr. Zeune instructs courses for:

- ❑ FBI National Training Academy
- ❑ Office of the U.S. Attorney
- ❑ The SEC Institute
- ❑ National Association of Securities Dealers
- ❑ North American Securities Administrators Association
- ❑ American Society for Industrial Security
- ❑ Over 35 state CPA societies and bar associations
- ❑ American Institute of CPAs
- ❑ American Management Association
- ❑ Institute of Management Accountants
- ❑ Entrepreneurship Institute
- ❑ Treasury Management Association
- ❑ Private classes for numerous companies and accounting firms.

Mr. Zeune has instructed Strategy Formulation and Implementation in the Executive MBA Program and Accounting and Honors Finance at The Ohio State University. He is also a member of the Education Executive Council and is past chairman of the Education Marketing and Public Relations Committees of The Ohio Society of CPAs. His other memberships include: the American Institute of CPAs, and the Regulation of Public Offerings Committee of the Ohio Division of Securities.

Prior to forming his consulting practice in 1986, Mr. Zeune was an Assistant Vice President of Corporate Finance at The Ohio Company, a Columbus, Ohio investment banking firm. He also spent more than five years in Treasury and Finance at Wendy's International, where he was responsible for mergers and acquisitions, financial and SEC reporting, and corporate finance. He was on the audit staff of Ernst & Ernst from 1973 to 1977; and taught accounting at Ohio University from 1970 to 1973, where he received his bachelors in mathematics and masters in accounting, with honors.

## ARTICLES AND BOOKS

Mr. Zeune is also widely published. He has published more than 40 professional articles and is the author of *The CEO's Complete Guide to Committing Fraud* and *Outside the Box Performance*. He has been a member of the Editorial Advisory Boards of the *Journal of Working Capital Management* and *The Ohio CPA Journal*.

For Deloitte & Touche, he authored *Financing Business Growth* and has completed the first draft of *The Complete Guide to Buying or Selling a Closely Held Business*, two books in the firm's Entrepreneurial Series. He has authored chapters for two books published by Warren Gorham Lamont, the world's largest financial publisher: *Accessing the Capital Markets* and *Options for Raising Capital*.

## WHITE COLLAR CRIMINALS

Mr. Zeune has the ONLY speaker's bureau in the country specializing in white-collar criminals — The Pros & The Cons. Mr. Zeune's speakers tell their stories of how and they committed their crimes. Their frauds range from \$18,000 to \$350 million. Speakers include CPAs, attorneys, and business people. The frauds include:

- ❑ Mark Morze created 10,000 phony documents to steal \$100 million in the infamous ZZZZ Best Carpet Cleaning fraud (86% of the revenue was fake and no one found it)
- ❑ Fred Shapiro defrauded nearly every major financial institution in the City of Philadelphia to the tune of \$8.6M. He is a former attorney, accountant, educator and inmate. Fred worked undercover with the U.S. attorney's office and the FBI in a drug and money laundering operation in an effort to minimize his sentence.
- ❑ Nick Wallace committed a \$350 million fraud as the President of ESM Government Securities resulting in the collapse of the Ohio Saving & Loan Guarantee Fund, and the bankruptcy of 69 Ohio S&Ls
- ❑ Dunlap Cannon was the largest real estate closing attorney in Memphis. He went to prison for 32 months for stealing \$5 million from his clients.
- ❑ Suffering from medical expenses and family deaths, bookkeeper Teri Lynn Norwood stole \$18,000, promising to pay it back. She ran out of time.

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**ACTION STEPS FROM GARY'S CLASS**

**#     Action Item**

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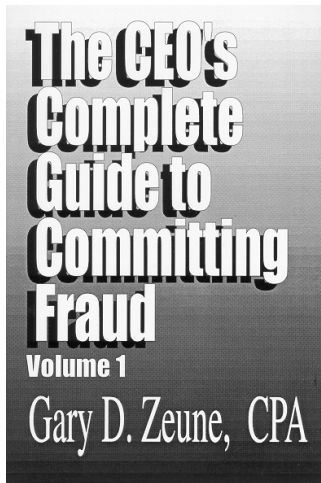
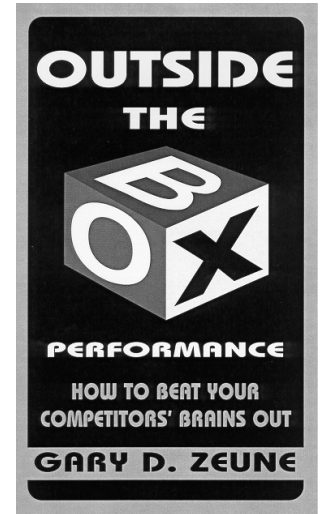


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***Thanks for attending. Don't hesitate to call or email if you have questions. . . .gdz***

# Want More Info? Order the Book!

**Outside the Box Performance: How to Beat Your Competitors' Brains Out** is packed with the techniques small and mid-size world-class companies use to become and stay competitive, and make a ton of money. Learn the secrets to unlock the multitude of new techniques which "drive" your profitability. This book compliments the class and provides new ideas to incorporate in your business. For example, do you know what the basis of competition will be in the next 10 years? It's around you ALL the time. You expect it everyday as a customer. Or, how to beat your competitors by asking your customers two simple questions? If not, sit back and learn how to "beat your competitors' brains out!"



Don't you want to know how Barry Minkow and Mark Morze stole \$100 million from investors in the ZZZZ Best Carpet Cleaning fraud, right under the noses of auditors, underwriters and lawyers? The first chapter of 100 pages in *The CEO's Complete Guide to Committing Fraud* tells you. It also has 8 chapters on other frauds: computer, real estate, fake financial statements, public company frauds, and a chapter by an auditor who became the target of a fraud investigation, just 4 weeks after becoming the engagement partner.

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**FRAUD PREVENTION SECRETS**  
From Behind the Bars..

**Mark Morze**  
Morze created 10,000+ phony documents, and no one caught it. He teaches his course Fraud: Taught by the Perpetrator many times each year for the Federal Reserve, bar associations, Institute of.....→

Featured Speaker

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Gary Zeune on Fraudsters Speaking Out on Fraud The Corporate Counsel - Podcast

OU alumnus examines corporate crime, criminals - By Ashley Ferguson

Ex-cons tout ethics through corporate speakers bureau - By Sarah Anderson

Man's Lifestyle Sold Investors - By Jim Woods

"The Pros of Cons" - By Michael Goldstein

Legal Audits: Does Your Borrower Need A Checkup? - Schottenstein, Zox & Dunn.

An Ex-Con Tells How to Avoid Being Conned. - By Fred Shapiro, in White-Collar Crime Fighter. December, 2004.

Does your compensation system encourage illegal activity? - By Gary D. Zeune, CPA, Published in White Color Crime Fighter in November 2004

Speaker explains how corporate con men get away with it - By Jim Phillips [Athens NEWS Senior Writer] in The Athens News in October 2004

How to Foster Fraud : Forget Ethics - By Gary D. Zeune in White Color Crime Fighter in August 2004

Your Auditors Can Stop Fraud , If they know what to look for - By Stephen Pedneault published in White Color Crime Fighter in August 2004

After Serving Time, Executives Now Serve Up Advice - by CHRISTOPHER S. STEWART in The New York Times

Local CPA, ex-cons attempt to spread word that crime doesn't pay - by SEAN CASEY [Daily Reporter Staff Writer] in Central Ohio Source " The Daily Reporter"

The costs of not securing personally identifiable Data - By Benjamin Wright "The Information Systems Audit and Control Assn." Site : [www.isaca.org](http://www.isaca.org)

Ex-Cons find peace and paycheck on the Burgeoning lecture circuit - By Joshua Harris Prager published in Wall Street Journal May 25th, 2004

Felons become educators for Business - By Mitch Moxley [ Financial Post ] Published in National Post July 17, 2004

A new regard for ethics on the job - By MEREDITH COHN [ SUN STAFF ] Originally Published JULY 9, 2004

The pros of preventing cons - White-collar criminals help companies avoid fraud in their midst By Chiree McCain, For Business First - June 25, 2004

Are You Teaching Your Employees to Steal? - By Founder Gary D. Zeune, CPA in Strategic Finance

When it's one of your own a first-person account of Fraud Inside A Bank - by ex-con Dave London in RMA Journal

FRAUD HAPPENS : How an honest employee crossed the line - by Teri lyn Norwood Published in White - Collar Crime Fighter Magazine , November 2003

Internal theft can destroy years of small business owner's work - by Jane Applegate

Fraud and Theft Start Small - by Founder Gary Zeune in NJ CPA Society Journal

How to Predict When People Will Embezzle - by Founder Gary Zeune in White Collar Crime Fighter

Hubbell details life of fraud - September, 2000 in San Antonio Express

Speaking with Conviction - from Report on Fraud

Corporate crooks hit lecture circuit - from Denver Post

Ex-Con Tells How Auditors Failed to Help Clients Guard Against Fraud - by Mark Morze in White Collar Crime Fighter

Preventing Your Firm's "Enron" - by Founder Gary Zeune in Ohio CPA Journal

SAS 99 17 Ways to Protect Yourself From Malpractice - by Founder Gary Zeune in 7 CPA journals

Regulation SAS 99 Aimed at Curbing Company Fraud - from Bizjournals , March 2004

Business First Auditors' Alert: How NOT to Get Sued Under Fraud Auditing Standards - by Founder Gary Zeune in White Collar Crime Fighter

SAS 99 Friend or Foe - by Founder Gary Zeune in two publications

(SAS 99 RMA) Look Out! New fraud auditing standard holds worrisome implications for financial statement reliability : interview with Gary Zeune in RMA Journal (for banking industry)

Like an article.....Email Gary Zeune at [gzfraud@bigfoot.com](mailto:gzfraud@bigfoot.com) for reprint permission.

# Government and Non-profit Frauds: 13 Things You Need to Know for 2007



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**NEW.....Manuals on the web site have all the  
blanks filled in.**

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many items that you refer to me that are helpful."

. . .Mike McGlynn

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## Agenda

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1. Overview and information sources
2. How to perform due diligence on non-profits that are merging
3. An entire segment of a non-profit business model that's illegal
4. How one city/non-profit partnership changed the measurement system to dramatically reduce new born deaths, and the risk to the entity and its auditors
5. How development economists are up-ending conventional wisdom in what works and what doesn't work
6. How one state agency misspent \$1 BILLION dollars despite years of audits
7. The one simple sentence NYC FD uses to minimize bribery of it's inspectors
8. A day-care owner bilked the federal government out of \$4.5 million

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## Agenda

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9. Universities are getting billions in grants, creating opportunities for abuse
10. How the evolving nature and pattern of donations is changing risk analysis
11. How schools are manipulating their 'metrics' to obtain funding, and the audit implications
12. How several Boy Scout Councils illegally obtained funding
13. How a national religious organization CFO manipulated the audit process

Bonus info – if we have time

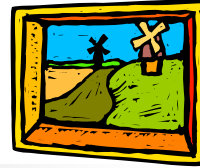
- ACFE 2006 Report to the Nation of Occupational Fraud
- Grant Thornton Governance Survey

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## Are You Protected?



- Question: If you miss a material fraud, get sued, and can show with a parade of experts that you performed a GAAS audit, that you put all the check marks in all the right boxes, is the jury bound to find you not liable?

Yes  No

- Why?

GAAP and GAAS do  
NOT have the weight of law.



## Interesting Fraud Information Sources

- National Association of State Charity Officials  
[www.nasconet.org](http://www.nasconet.org)
- Encyclopedia of Ethical Failure, Pentagon Attorney Stephen Epstein, financial misdeeds and shockingly bad judgment [www.dod.mil/dodgc/defense\\_ethics/dod\\_oge](http://www.dod.mil/dodgc/defense_ethics/dod_oge)



## Ford Family's Cash Faucet Goes Dry

- Suspension of dividend cuts off a strong annuity for auto maker's founders
- \$28 million
- \$.50/share in 2000
- Charity causes

Tip: **Are you verifying multiple year donations?**



Alabama state officials announced in February that they had identified more than \$438,000 in abuses of the financial aid program at Bishop State Community College in Mobile, including \$87,000 in athletic scholarships awarded to 42 relatives of employees (and others) who played no sports. Included was one employee's 67-year-old disabled grandmother, who received scholarships in three sports (but was unable to use them, in that she **died** shortly after the paperwork came through).  
Birmingham News, 2-19-07



## Atlanta Boy Scouts



- Claimed 10,000 members
- Audit revised to 5,300
- 5,000 were former Scouts and informational meetings
- Operation First Class paid for registration fees, books, uniforms and scholarships
- Scout Executive resigned
- Supposed actual count is 500



## Gary Urban Enterprise Association

- 20+ years old
- Formed to revitalize small area of downtown
- Funded \$3 - \$4 million per year by local businesses in lieu of property taxes
- Exec. Dir., CFO, and two board members pleaded guilty to embezzling \$1 million from 2000 – 2004
- Exec. Dir. and CFO did not report bonuses as income
- Both paid for 80 hrs work + 80 hrs of vacation
- \$550,000 to JIL, Inc.



## Gary Urban Enterprise Association

- \$260,000 personal expenses on GUEA \_\_\_\_\_
- Groceries, clothing, home furnishings, used car, Chicago home, casket and funeral expenses
- Exec. Dir. will name two others for leniency
- Exec Dir father and CFO's boyfriend indicted for tax evasion
- GUEA dissolved March 2007
- Board resigned and Indiana may seek restitution



## Schools Get Tough on Tardy Students

- High school principals report absences a serious problem increased from 25% to 32% and elementary principals increased from 18.5% to 27.1%
- Available technology
- Overworked parents
- Traffic
- No Child Left Behind



## Schools Get Tough on Tardy Students

- Why get tough....because attendance counts in measuring performance and funding
- Ice cream and movies, bicycles, computer games, popcorn, watches
- Tardy tanks, letter from principal
- Teachers in hallways instead of alarm bells
- Principals buy students \_\_\_\_\_
- Tardy students can't play sports that day



Fraud Tip: What control mechanism does the school have in place to correctly report attendance

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## A Rainbow House



- Sandra J. Pritchett-Guidry owned 13 day care centers including Indianapolis Government Center (downtown)
- 1984 to 2003
- Indy Housing Agency Board member
- Stole from Child and Adult Care Food Program, the Child Care Developmental Funds Voucher Program and Title XX Social Service Block Grant Program
- DOJ...Created and submitted hundreds of false names and charged for food not served
- What names former students and non-existent children

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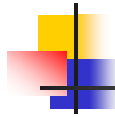


## A Rainbow House



- 1997 to 2003
- Bought dozens of pieces of real estate including one for \$1.9 million
- Transferred gov't money to separate acct to buy property resulted in money laundering charge
- 50 months + \$4.5 million

Fraud Tip: Just because the invoice went out, and the money came in, does NOT mean it was legally earned



## Universities Abuse Research Grants

Medical science's dirty little secret.....Survey of 3,300 research scientists by HealthPartners Research Foundation, more than 50% of established grant-getting scientists admitted using money designated for one project on another, often for undisclosed research that might lead to future grants.

As Universities Get Billions in Grants, Some See Abuses



Dr. Kyriakie Sarafoglou  
Cornell Whistleblower





## Universities Abuse Grants



Until now, the government has essentially relied on the honor system to police its grants. The auditors who examine universities' books are hired by the universities themselves. However, the inspector general's office at the Department of Health and Human Services says it has started a pilot program in which its auditors are visiting universities to examine their books.

Fraud Tip: Are your work papers up to speed to be reviewed by HHS?



## Universities Settle Charges

U of Minn Med School	Early 1990s	Largest settlement to date	\$32
Mayo Clinic	2005	Charged gov't for research unrelated to NIH grants	\$6.5
U of Alabama	2005	Overstated research + billed Medicare for research funded elsewhere	\$3.4
Harvard	2004	Billed gov't for salaries and expenses unrelated to federal grants	\$2.4
Johns Hopkins	2004	Overcharge for faculty time and effort for NIH grants	\$2.6
Northwestern	2003	Overcharged time on NIH projects	\$5.5



## Cornell's Medical Research



- Dr. Kyriakie Sarafoglou pediatric endocrinologist
- Greek native with strong sense of right and wrong
- \$20 billion annual total NIH grants
- Returned to U.S. since wouldn't pay Greek docs kickbacks
- Cornell using \$23 million of NIH grant money for study of children's diseases for normal adult care
- Nurses paid to care for children instead caring for adults
- Superiors refused to investigate



## Cornell's Medical Research



- Prosecutors intervened based on Dr. Sarafoglou 's 35-page qui tam suit
- She was a research subject advocate which exposed her to many projects
- Phantom nurses led to phantom research projects
- NIH funded pediatric Hodgkin's study projected to use 100 hospital days.....actual NONE
- Patient care billed to NIH even though not in the study



## Cornell's Medical Research



- Prosecutors allege Cornell.....
  - Falsely projected use of clinical research center in 5 annual grant applications to keep money flowing
  - Manipulated research activity reports to cover up most money was controlled by 2 faculty members in violation of rule that limits any department to 30 %
  - 62.5% of 'children' in projects were adults
- Dr. Sarafoglou received \$877,000



## Cornell's Medical Research



- Stephen Immelt, Cornell's attorney, says disputes over NIH grants often involve accounting issues

Fraud Tip Fraud of any significance nearly always involves multiple people and cover up and someone always knows what's going on and will often try to warn you.



## Evaluating Non-Profit Programs



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*A new breed of  
development  
economists are using  
the tools of hard  
science to put poverty  
programs under the  
microscope – and  
upending a lot of  
conventional wisdom  
about what works.*

Forbes, June 19, 2006



**Esther Duflo**  
Professor of  
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and Development  
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## Evaluating Non-Profit Programs



Developed  
nations give  
poor nations  
\$100 Billion  
per year

Private U.S.  
charities give  
poor nations  
\$71 billion  
per year

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## Evaluating Non-Profit Programs

- Most programs are feel-good evaluations using glossy paper with color charts/graphs showing impressive statistics on micro-loans made, textbooks delivered, roads built, schools built, etc.
- But doesn't show cause/effect, i.e., if the money has been well spent
- Evaluate like drugs...randomized groups v. control group



## Evaluating Non-Profit Programs




- Rural Indian education program Seva Mandir
- Teachers showed up 60% and could be fired for excessive absences but remote locations made it hard to monitor.
- Hire another teacher which would double cost
- Not interested in more aid / less aid
- Interested in what works / what doesn't work



## Evaluating Non-Profit Programs

- ½ class rooms got 2<sup>nd</sup> teacher, ½ didn't
- Difference in student test scores NONE
- How to reduce teacher absenteeism
- Teachers in 60 schools got camera with tamper proof time/date stamp and took pictures of themselves at beginning / end of each day with bonuses and fines with pay from \$11 to \$29 per month
- Teachers in 60 schools existing system with sporadic monitoring with same standard salary of \$23 per month

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## Evaluating Non-Profit Programs

- Teacher absence rate in camera schools fell to 22%
- Test scores increased 43%
- Average teacher salary same in both programs
- BUT camera program cost \$6/student/year, 60% less than hiring extra teacher at \$23/month
- CONCLUSION: One teacher working with financial incentives is more effective than two teachers working for fixed pay with little oversight

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## Evaluating Non-Profit Programs

Fraud Risk: Donors will soon start demanding economic 'results' analysis for domestic non-profit programs as a condition of giving. What's the risk? Some NPOs will manipulate results, defrauding donors to obtain donations illegally.



## Corporate Model Saves Babies







## Corporate Model Saves Babies

- Cincinnati death rate same as Chile, Lithuania, Brunei
- Every Child Succeeds started by P&G CEO
- 1,800 mothers
- Continuous Quality Improvement
- Rather than lofty goals set narrow goals to produce specific results to reduce infant mortality
- Poor, usually single, troubled background
- Smoking: stopped or reduced 90%



## Corporate Model Saves Babies

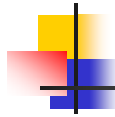
- Continuous Quality Improvement
- Tough, corporate practices
- "Do you smoke marijuana or short coke?"
- "Have you ever been physically or sexually abused?"
- "Is there a felon in your family?"
- 50 forms, some 10 pages, over 3 years, now on web
- 15 agencies willing to gather reams of data



## Corporate Model Saves Babies

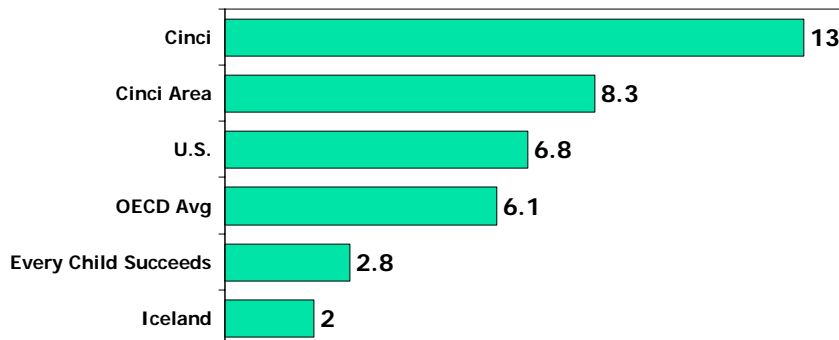
- Corp-type Red/Green chart lists 17 quality indicators
- Immunization rates, client satisfaction, breast feeding, depression, job training, etc.
- Red shames agencies into action

Fraud Tip: Because agencies are selected/funded based on their success, some will manipulate the data so funding has been obtained illegally in violation of SAS 54.



## Corporate Model Saves Babies

### Deaths/1000 births before 1st birthday





## 4 Audits Miss \$1.7 Billion



### ABOUT US: Overview



## 4 Audits Miss \$1.7 Billion

- Hamilton County Job & Family Services
- 1400 employees + \$1.3 billion budget
- Last audited 1993
- State and firm audit 2002 + 2003 no problems
- 2004 routine state audit of foster care
- "Auditing is a balance of resources and risks....we considered Hamilton County a lower-risk county," Jon Allen, Dept of Job and Family Services
- \$224 million recovery for charging child welfare to other programs and improperly obtaining funds not entitled to

## 4 Audits Miss \$1.7 Billion

- Funds lost identity when county transferred money between public assistance, child support and children services in violation of federal and state rules
- State may have to assume repayment
- <http://jfs.ohio.gov/releases/audit09142006.asp>

Fraud Tip: Auditors are required to know and comply with the laws that apply to clients.

## Ignorance of the Law Is Not a Defense



Louis Grumet  
ED, NYSSCPA



- Unknowingly violate the agreement.
- Get sued.
- Is "I didn't read the agreement," a valid defense?

YES NO

Source: Ignorance of the Law Is Not a Defense, Louis Grumet, Exec Dir, NYSSCPA, CPA Journal, June 2006, p. 7

## Ignorance of the Law Is Not a Defense



Louis Grumet  
ED, NYSSCPA

- Once you accept the agreement you are responsible
- Practicing in a state = you obey the laws even if you haven't **read them**
- You have a responsibility to know and uphold your state's and federal law regarding your practice AND your **clients' businesses**
- Required to know if any state law affects services
- "Law doesn't exist if you don't know about it" **WRONG**
- If conflict between professional standards and law which takes precedence      STD      **LAW**

## Ignorance of the Law Is Not a Defense



Louis Grumet  
ED, NYSSCPA

- Interpretation 501-3 of the Society's Code of Professional Conduct states, in part, "Engagements for audits of government grants, government units, or other recipients of government monies typically require that such audits be in compliance with government audit standards, guides, procedures, statutes, rules and regulations, in addition to generally accepted auditing standards," and members are obligated to follow such requirements.
- 501-3 goes on to say that failure to follow such requirements "is an act discreditable to the profession ... unless the member discloses in his or her report the fact that such requirements were not followed and the reasons therefore."

## Ignorance of the Law Is Not a Defense



Louis Grumet  
ED, NYSSCPA

Knowing and upholding the law is an essential part of professional competence and protecting the public interest. The profession, the state, and the public expect CPAs to know and uphold the law, and they deserve nothing less.

**Louis Grumet**  
Publisher, The CPA Journal  
Executive Director, NYSSCPA  
[lgrumet@nysscpa.org](mailto:lgrumet@nysscpa.org)

Ethics question: If you agree with the above, then is it OK to let clients, your boss or organization, take even insignificant tax deductions that they aren't legally entitled to? YES **NO**

## NYC Fire Department Permit Invoice

*WARNING.....You must not pay any money to, or offer any gift to an inspector at any time. An inspector may not demand, make suggestions, or take anything from you..... If an inspector asks for a bribe or gift, you must report this.*



"The notice is a corruption-prevention measure. It shows not that bribery is pervasive," Rose Gill Hearn, NYC Investigations Commissioner.

## College Financial Aid Under Scrutiny



Andrew Cuomo  
NY Atty Gen

- Student loans are \$ **85** Billion industry
- Higher Education Act
  - Prohibits colleges from requiring students to borrow from a specific bank or loan company
  - Allows "preferred lenders"
- Students choose recommended lender **90+%**
- Lenders fight like crazy to be **preferred**

## College Financial Aid Under Scrutiny



Andrew Cuomo  
NY Atty Gen

- NY Attorney General investigating 100+ lenders, including Ivy League
  - Sallie Mae – SLM Corp
  - Nelnet Inc
  - Education Finance Partners Inc.
  - EduCap Inc.
  - College Board
  - CIT Group Inc.
- Nationwide investigation because they recruit students from NY





## MyRichUncle.com



- Direct-to-student lending
- “You should know the truth about financial aid offices. They’re supposed to help you choose the best lenders. But in reality, they may steer you towards lenders that benefit them. Not you. Unless you check for yourself, how do YOU know you’re getting the best loan?” ad in *New York Times*.
- 1% below gov’t lenders, 2% below most for-profits
- Eliminate middleman and compete on price
- Guess who doesn’t like MyRichUncle.com \_\_\_\_\_

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lenders/fin aid officers

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## College Financial Aid Under Scrutiny



Andrew Cuomo  
NY Atty Gen

- 8 universities settled agreeing to stop revenue sharing with Citibank and accepting perks
- 5 universities refund \$3.27 million
- Citibank student-loan unit adopts a **Code of conduct**
- NYAG: revenue sharing is illegal since students aren’t getting the best financial terms on the theory prices are higher than otherwise would be
- Colleges signed code of conduct
  - Prohibits anything of value
  - Disclose criteria to select preferred lenders

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## College Financial Aid Under Scrutiny



Andrew Cuomo  
NY Atty Gen

- *Subpoenas turn spotlight on obstacles students face in finding best financing, WSJ, April 5, 2007*
- Financial aid officers at Columbia, USC and U TX hold stock in Student Loan Xpress, owned by CIT
- "We have worked with the Student Loan Xpress team for many years because they consistently meet the very high standards for service that our students and parents expect not only from our university, but also from our partners," David Charlow, Columbia FA officer, quoted on SLX web site

Ethics Q: Is selling FA officers SLX stock is ethical? Y N

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## Federal Official Holds Stock



Andrew Cuomo  
NY Atty Gen

- Matteo Fontana, GM of Office of Federal Student Aid
- Sold \$100,000 of stock in parent of Student Loan Xpress in 2003 when overseeing lenders
- "We need to fix the student loan program to take banks — which are just an expensive middleman — out of the process," Senator John Edwards.



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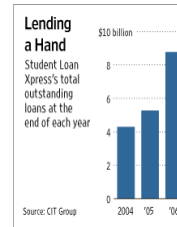
50

## Student Loan Xpress



Andrew Cuomo  
NY Atty Gen

- "We have ethics here," Ellen Frishberg, Dir of student financial aid, Johns Hopkins, who got \$65,000 in 'consulting' and other fees, from SLX + featured on SLX web site
  - Paid \$80,000 to Key West Higher Education Associates, Walter Cathie, Dir. of Fin Aid, Widener U.
  - Paid \$13,000 to Tim Hehmann, Dir of Fin Aid, Capella U and served on SLX advisory bd
- Fraud Question: How much less revenue have been if SLX was not "preferred"



## College Financial Aid Under Scrutiny



Andrew Cuomo  
NY Atty Gen

1. "These practices were either illegal or certainly unethical and deceptive and they needed to be stopped," Andrew Cuomo, NYAG
    - US Dept of Ed investigating whether colleges are violating the law
      - Require students to borrow from "preferred list"
      - How does Ed Dept know "tape recordings"
- Fraud Tip: Lenders are bribing financial aid officers
- Should these companies get clean opinions?



## Financial Aid Update



Andrew Cuomo  
NY Atty Gen

- CIT, parent of SLX, suspended 3 execs, Vice Chairman, CEO and Pres
- Task force of National Association of Student Financial Aid Administrators recommended publicly reporting of all gifts from lenders of \$50+ but the board rejected it.  
WHY Lenders provide lots money



## Financial Aid Update



Andrew Cuomo  
NY Atty Gen

- U of Texas used "treats" + fires Dir of Fin Aid
- Ohio AG investigating student-loan industry
- Student Loan Probe Widens to Alumni Groups
- Sallie Mae close student call centers
- Columbia and Johns Hopkins fire Fin Aid Dir



## Financial Aid Auditing Risk



Andrew Cuomo  
NY Atty Gen

Since colleges/universities have a legal fiduciary obligation to represent the best interest of the students in arranging financial aid, and don't do it, is the tuition for those students **illegally earned** \_\_\_\_\_?



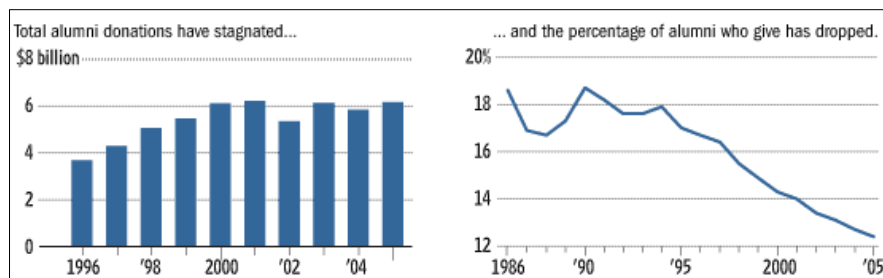
## Colleges Manipulate Donor Numbers

- **The Issue:** More colleges are manipulating their alumni-giving rates.
- **The Background:** High giving rates boost a school's status in U.S. News & World Report's annual college survey and with potential donors.
- **What It Means:** The statistic may not accurately reflect what it is intended to measure.





## Colleges Manipulate Donor Numbers



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## Colleges Manipulate Donor Numbers

- Alumni living longer
- More competition for donations
- Trustees set performance targets
- 5% of U.S. News score is alumni donor rate
- Trinity College Hartford Conn 2005 to 2006
  - 35 student volunteers door-to-door
  - Donations over 2 years 97% senior rate
  - Boosted overall rate 2005 of 45% to \_\_\_\_% in 2006
  - \$1 million

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## Colleges Manipulate Donor Numbers

- Harvard \$29 billion alumni giving rate 48% to 39%
- Senior's gifts different for tax purposes than for alumni-giving rate.....counted over multiple years
- Promise to seniors.....We won't solicit those years
- Colleges count donating seniors but not the senior class which raises the 'donation rate'
- Rationalizations
  - Everyone is is doing it
  - The methods are an 'industry standard'



## Colleges Manipulate Donor Numbers

Fraud Tip: If college management will knowingly manipulate donations, what makes you think they won't cook the books if needed.....think about management integrity (SAS 99).





## Nonprofit Mergers



- La Piana Associates says nonprofit mergers have doubled last two years
- 120 new nonprofits started every day
- Not enough funding
- For-profit executives moving to nonprofits
- Can be more complex than for-profit mergers
- Many more stakeholders with conflicting demands



## Nonprofit Mergers



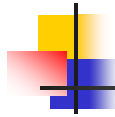
- Orchestra attendance down 13% from 2000 – 2004
- 9 symphonies Shut down
- How many does one city need 1 or ½
- Cleveland's two operas merged
- Philadelphia's symphony and pops
- Santa Fe and Aspen have joint dance company
- Arts groups giving up independence to survive



## Nonprofit Mergers Problems



- Incompatible accounting systems
- Passionate fans
- It's not a business, it's a treasured institution
- Foundations will give money when arts groups combine to save money
- Creative differences and large egos



## Nonprofit Mergers



- 3 usual methods
  1. Asset acquisition similar to corporate deal
  2. Asset grant to legal partner of another organization
  3. Gain control by reorganizing acquired nonprofit board

Fraud Tip: A merger of a client will expose your audit work papers to **intense scrutiny**



## CFO Manipulates Auditor Selection

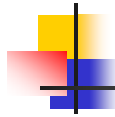


**Mr. Nagy L. Tawfik, CPA**

Business Manager  
Presbyterian Church

Mr. Tawfik has earned his undergraduate degree in Accounting, a Master degree in Computer Sciences, and was accredited the CPA (Certified Public Accountant) status. He is a member of the Kentucky Society of Public Accountants and the American Institute of Certified Public Accountants.

Mr. Tawfik brings to St. Patrick over 30 years of experience in the banking industry, the Public Accounting field, and the management of not-for-profit organization expertise.



## CFO Manipulates Auditor Selection



- Inflated the estimated hours in the bid specification
- Would give the incumbent firm an advantage knowing it wouldn't take that many hours so could underbid
- No evidence of missing money or other misconduct
- Church sent corrected information



## CFO Manipulates Auditor Selection

- “These errors in judgment.....jeopardized a fair and complete bidding process and therefore could not be tolerated,” John Detterick, Exec. Dir. General Assembly.
- “....concise explanations of intricate financial matters have helped those involved in the church’s budgetary process.....” Detterick.
- “wouldn’t even begin to speculate” on Tawfik’s reasons
- KPMG replaced by Crowe Chizek

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## CFO Manipulates Auditor Selection

- Judy Gollither replaced Tawfik
- Gollither fired for \$100,000 embezzlement
- How discovered routine bank reconciliation
- Church paid Tawfik \$390,000 to settle allegations that he was wrongfully terminated based on national origin
- Ellen Cooke embezzled \$1.5 million as treasurer of the Episcopal Church USA
- George Patrick embezzled \$800,000 as treasurer of the Evangelical Lutheran Church



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## Nonprofit Strings

Rich donors with big bucks want to give charities their two cents.



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## Nonprofit Strings



- Here's the money, but spend it the way I tell you
- New nonprofits most likely to agree because need \$\$\$\$
- Agree to management advice, business model, personnel changes, financial controls
- Sustainable organizations, not pet projects

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## Nonprofit Strings



- New Profit Inc., Cambridge Mass, helps NPOs expand
- Monitor Group, business strategy services
- REDF, San Fran, establish and manage for-profit orgs
- Blue Ridge Foundation, NYC, start up funds, support
- Edna McConnell Clark Foundation
- Heads Up
- Surdna Foundation



## Nonprofit Strings Venture Philanthropy Partners



Mario Morino  
Founder VPP

- Doesn't solicit funds
- Reduced 3000 NPOs to 12 "investment partners"
- See Forever foundation operates Maya Angelou Public Charter School for youth that failed in traditional schools run by David Domenici
- Fix governance + long-term strategy or won't exist
- 'What do business people know about poor kids'
- McKinsey & Co.
- High school graduation rate wasn't as good as thought



## Nonprofit Strings Venture Philanthropy Partners



Mario Morino  
Founder VPP

- 2003 \$2 million "investment"
- Domenici gave up teaching to focus on Exec
- Strategic initiatives
- Jack Davies, AOL founder for board
- Bank exec for financial, personnel, real-estate
- Vacant public school building for 2<sup>nd</sup> campus
- Alumni association for support
- Huge tensions and mistrust



## Nonprofit Strings



"If [venture philanthropy] attracts new donors and individuals who feel they can change the world, good for them. If they succeed, then more will do that," Diana Aviv, President, Independent Sector, coalition of 550 charitable organizations.



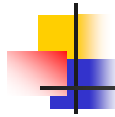


## Giving Circles



A member of Asheville, N.C., giving circle Women for Women visits a homeless shelter in Marion, N.C., to help determine if it will get a grant.

Even small donors want significant control over their money.



## Giving Circles



The Community Foundation of Western North Carolina

- Doubled 2004 – 2006 to 400
- \$100 million 2003 - 2006
- Small donors don't want their money swallowed up
- Efficient use
- Contractual obligation
- Problems.....
  - Where to keep the donations...host organization
    - Washington Area Women's Foundation
  - Turnover



## Giving Circles



- Forum of Regional Associations of Grantmakers
- Forum's New Ventures in Philanthropy
- Gather and Give: Let's Eat, Wash DC, \$75 - \$300
- Zawandi, New Orleans
- Women for Women, Asheville NC
- Women's Impact Fund, Charlotte, 360+, min \$5500 in 5 years, grant \$350k this year

Fraud Tip: Because giving circles stipulate how their donations will be spent, what \_\_\_\_\_.

**controls and audit tests do you have for compliance?**

## Down-Payment Assistance Charities





## Down-Payment Assistance Charities

- **The News:** The federal government has proposed prohibiting home buyers using FHA-insured loans from accepting certain down-payment gifts.
- **The Debate:** Federal officials say that some of these down-payment gifts can lead to higher foreclosures.
- **What It Means:** The federal proposal threatens nonprofit groups that dole out such gifts.



## Down-Payment Assistance Charities

- Nehemiah Corp of America and AmeriDream Inc.
- HUD proposed ban May 2007
- 14,600 (2%) in 2000 to 103,000 (33%) 'gifts' in 2006
- Average 'gift' \$3400, or 3%, in 2006
- "An Examination of Downpayment Gift Programs Administered By Non-Profit Organizations," HUD
- "Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance," GAO
- Foreclosure rate 200%+



## Down-Payment Assistance Charities

- Lender contacts down-payment assistance charity
- Charity 'gives' buyer the down-payment
- Sellers 'donate' the 'down-payment' + fee to the charity
- Sellers recover the 'gift' by Raising the price
- Primary recipients of 'gifts' are low-income buyers



## Down-Payment Assistance Charities

- 185 charities
- IRS revoked tax-exempt status Rev. Rul. 2006-27
- Seller-funded programs are not charities because
  - Funnel down-payments through self-serving, circular-financing arrangements
  - Direct correlation between seller's gift and amount of down-payment
  - Charity charges a fee
  - Seller makes 'gift' only IF the sale closes

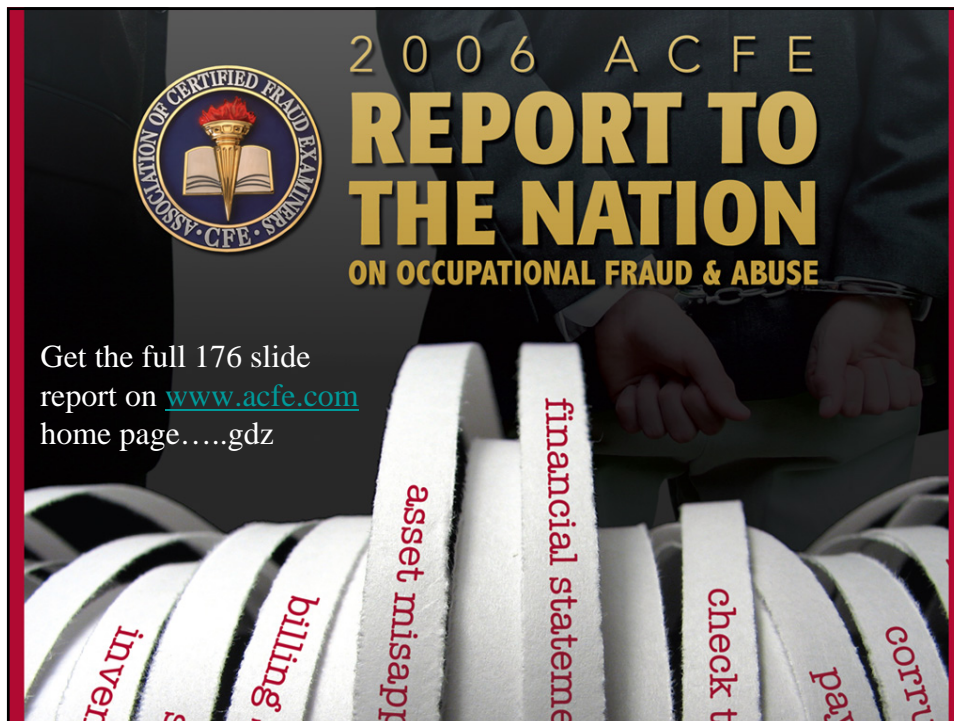


## Down-Payment Assistance Charities

U.S. rules bar sellers from giving direct assistance. To sell more houses, sellers make 'gifts' to charities that 'assist' home-buyers who can't afford the down-payment, thus circumventing the rules.

Fraud Tip: Anytime you change a system, people will always change their behavior to \_\_\_\_\_

**maximize the benefit to themselves.**



2006 ACFE  
**REPORT TO THE NATION**  
ON OCCUPATIONAL FRAUD & ABUSE

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asset misapp  
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inven

The image is a promotional graphic for the 2006 ACFE Report to the Nation. It features the ACFE logo on the left, which includes a torch and the text 'ASSOCIATION OF CERTIFIED FRAUD EXAMINERS'. The main title is '2006 ACFE REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE'. Below the title, there is a photograph of a person's hands holding a stack of white ribbons with various terms related to fraud and abuse, such as 'asset misapp', 'financial stateme', 'check t', 'pay', 'CORRU', 'billin', and 'inven'. The background is dark with a red border.



## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### About the ACFE

The ACFE is the world's premier provider of anti-fraud training and education. A leader in the community, the ACFE has over 37,000 members, sponsors more than 125 local chapters worldwide and provides anti-fraud educational materials to more than 300 universities. Certified Fraud Examiners (CFEs) on six continents have investigated more than two million suspected cases of fraud.

The ACFE would like to thank all of the Certified Fraud Examiners who made the 2006 Report to the Nation the most comprehensive fraud research available.

Your support and dedication in the fight against fraud and your efforts to establish prevention, deterrence and detection measures will help build integrity in your organization. Although fraud is widespread today, its potential impact on your organization can be reduced through appropriate anti-fraud programs.

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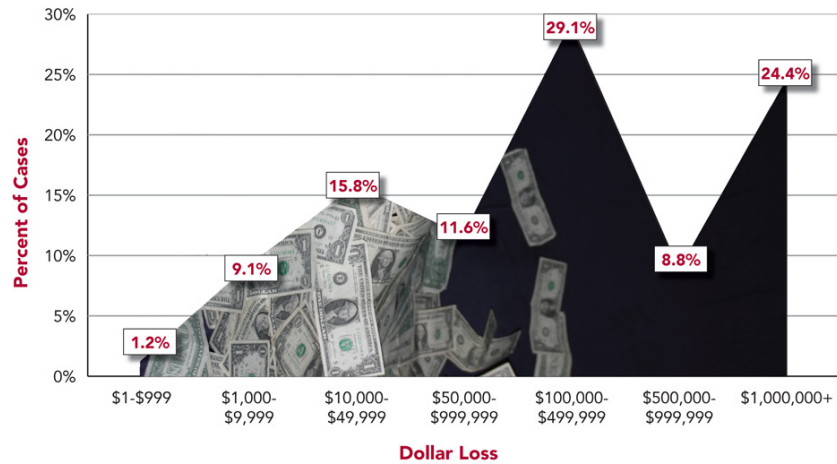
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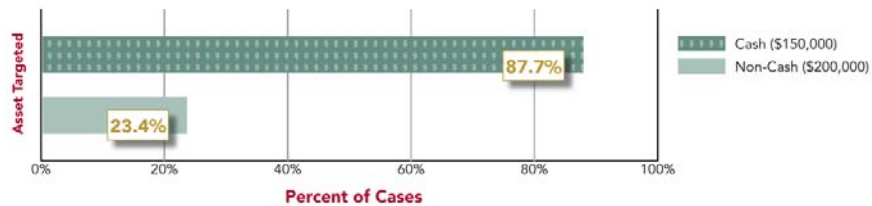
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### Distribution of Dollar Losses



## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Breakdown of Asset Misappropriations – Cash vs. Non-Cash<sup>4</sup>



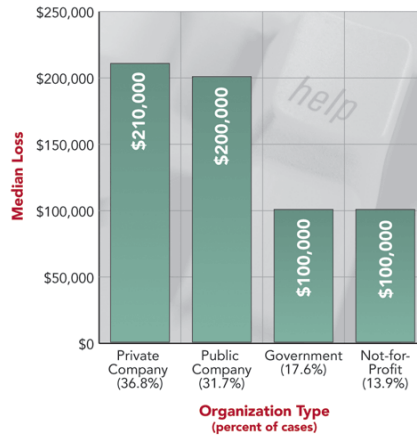
<sup>4</sup>The sum of percentages in this chart exceeds 100% because a number of cases involved the misappropriation of both cash and non-cash assets. In those cases, we were unable to subdivide the losses to determine exactly how much was attributable to cash vs. non-cash schemes.



## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

- The following chart shows the distribution of cases among the four organization types, and also illustrates the median loss for cases in each group. As we can see, privately held and publicly traded companies were not only the most heavily represented organization types, they also suffered the largest losses, at \$210,000 and \$200,000 respectively.

Frequency and Median Loss Based on Organization Type of Victims



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Size of Victim Organization Based on Number of Employees



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### Size of Victim Organization Based on Annual Revenues/Budget Median Loss and Frequency

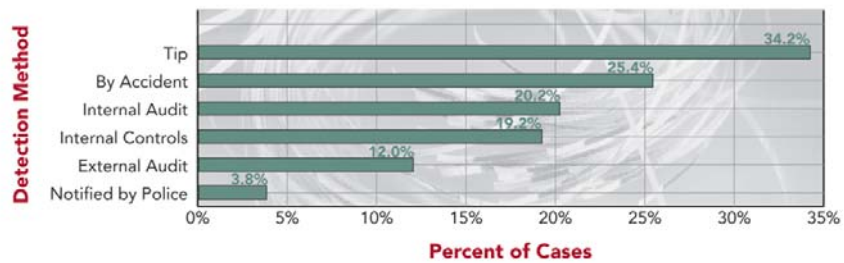


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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Initial Detection of Occupational Frauds<sup>10</sup>



<sup>10</sup>The sum of percentages in this chart exceeds 100% because in some cases respondents identified more than one detection method. The same is true for all charts in this Report showing how occupational frauds were detected.

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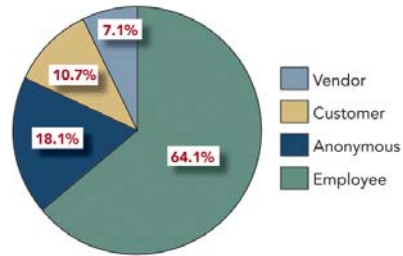


## Detecting Occupational Fraud

### Sources of Tips

- Tips were the most common means by which occupational fraud was detected in the cases we reviewed and the majority of tips — nearly two out of three — were received from employees.
- It is important to remember, though, that a significant number of tips came from outside sources such as customers and vendors. As we stated in our 2004 Report, an effective reporting system should be designed to reach out not only to employees, but also to these third-party sources.

Percent of Tips by Source

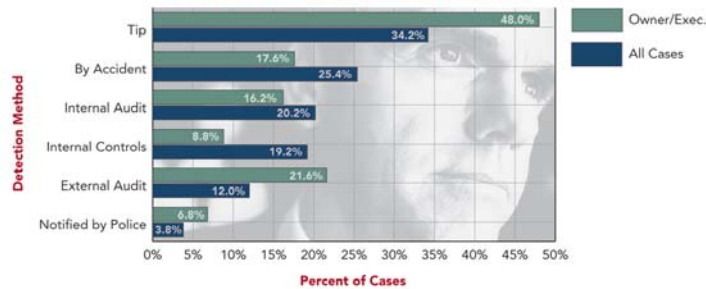


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- This data is important because losses associated with owner/exec schemes tend to be larger than for any other group, yet these schemes are much less likely to be detected through normal audits or control functions. This highlights the importance of establishing anonymous reporting mechanisms, conducting anti-fraud training and fostering open channels of communication as discussed earlier.

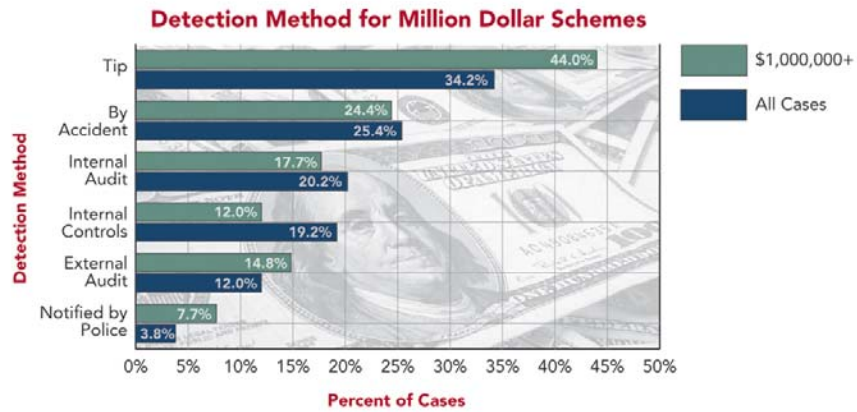
Detection of Frauds by Owner/Executives



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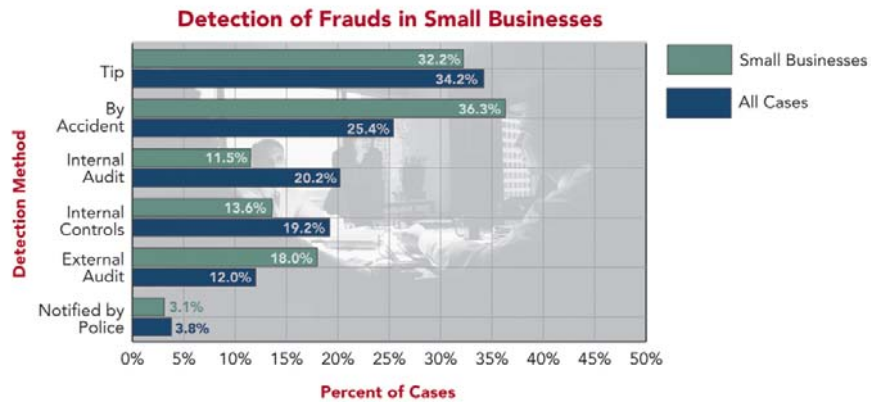
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### Detecting Fraud in Not-for-Profit Organizations

- The data for detection of fraud in not-for-profit organizations was largely consistent with the data resulting from all cases. Tips were again the most common detection method, followed by accidents.



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### Detecting Fraud in Government Agencies

- Generally speaking, government agencies were much less likely to rely on accidental detection of fraud, whereas their rates of detection through tips, external audits and notification by law enforcement each exceeded the rates for all cases.

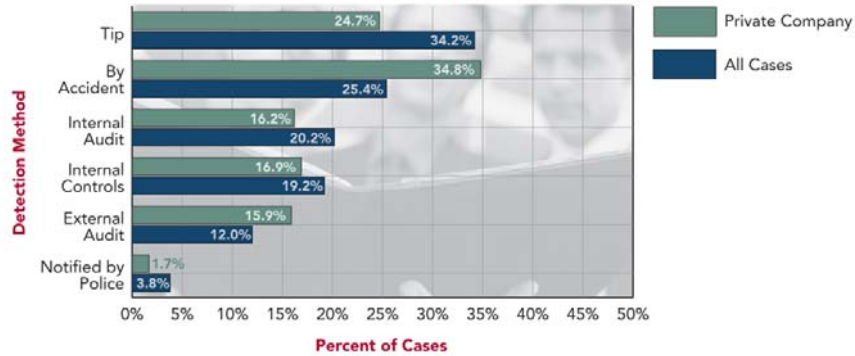


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### Detection of Frauds in Privately Held Companies

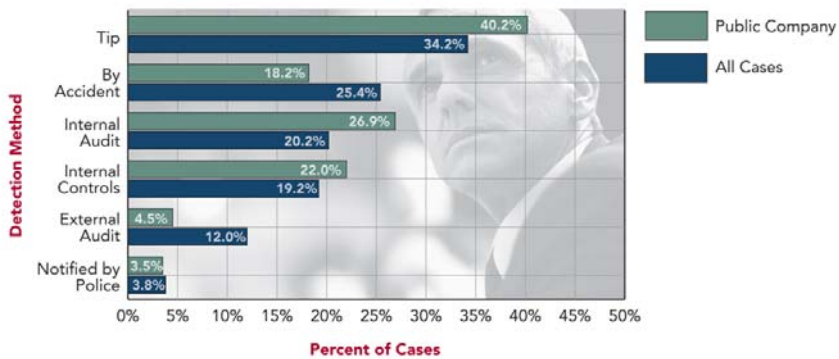


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### Detection of Frauds in Publicly Traded Companies

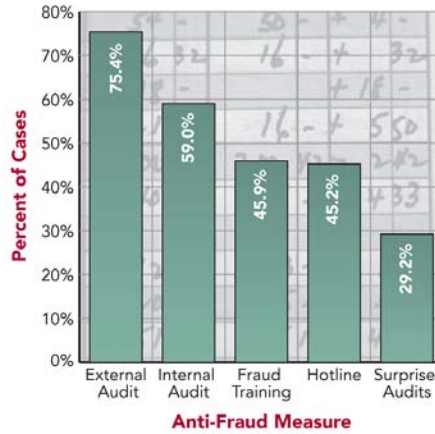


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### Frequency of Anti-Fraud Measures



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### Median Loss Based on Whether Organization had Hotline



### Median Number of Months to Detection Based on Whether Organization had Hotline



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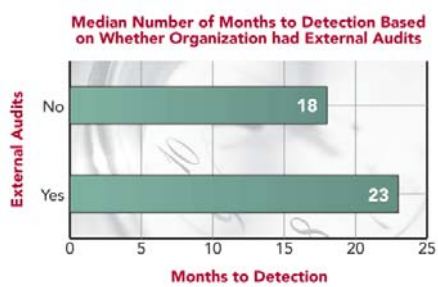
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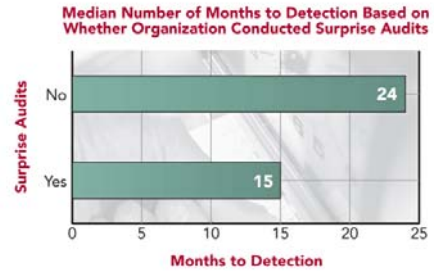
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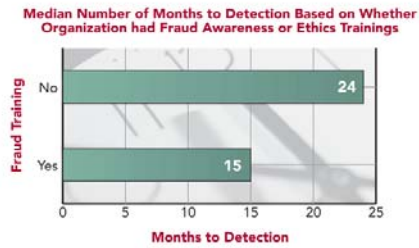
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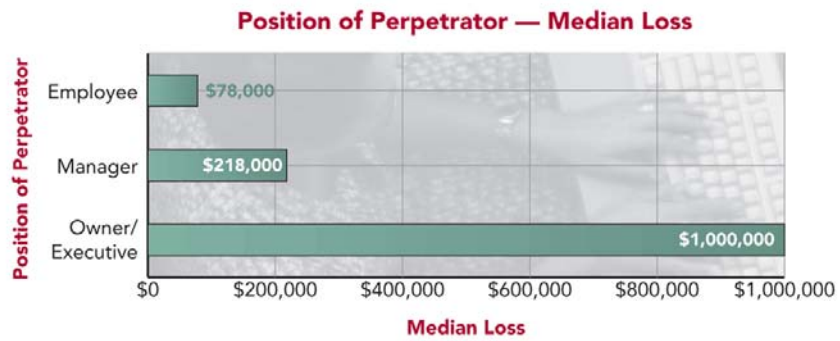
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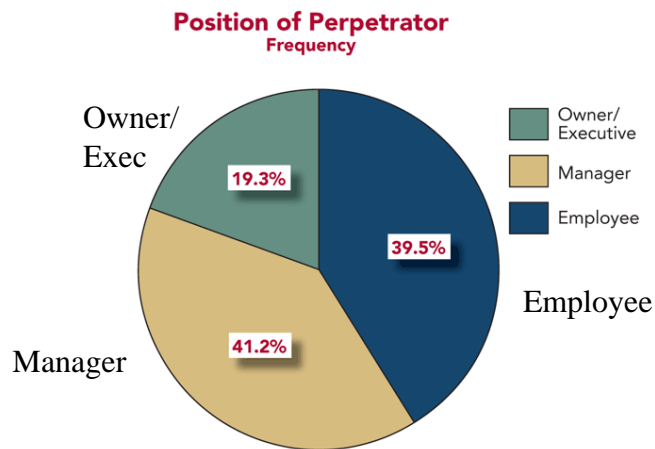
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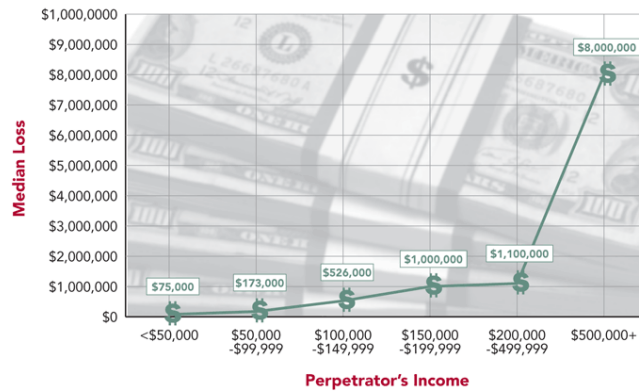
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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Median Loss Based on Perpetrator's Annual Income

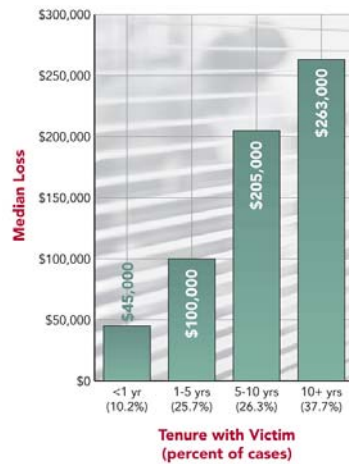


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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Tenure of Perpetrator

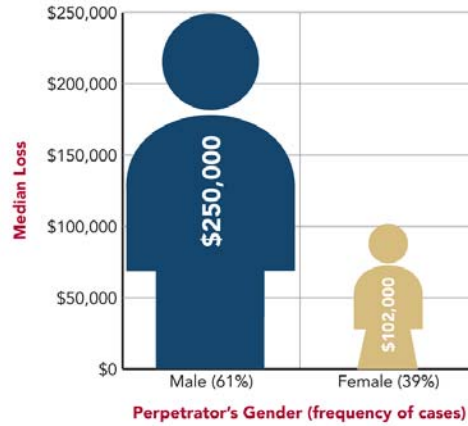


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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Gender of Perpetrator Frequency and Median Loss

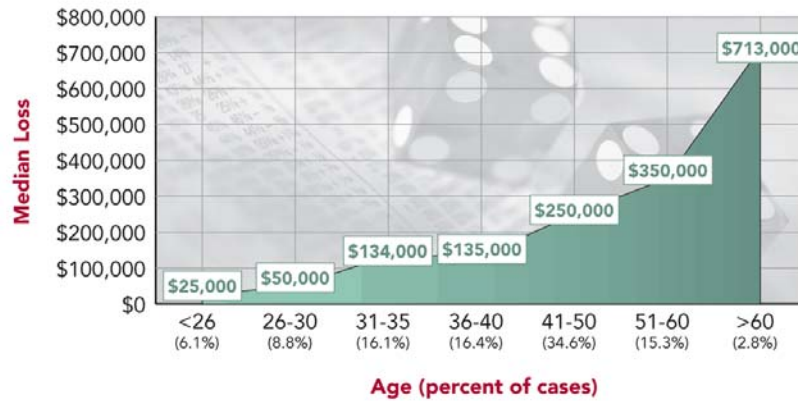


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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Age of the Perpetrator

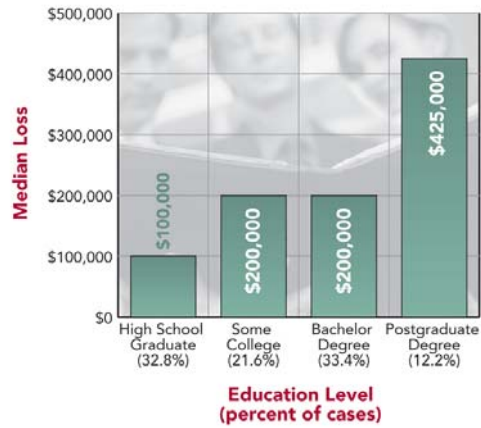


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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Education of Perpetrator Frequency and Median Loss



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### Median Loss Based on Perpetrator's Department



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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Number of Perpetrators

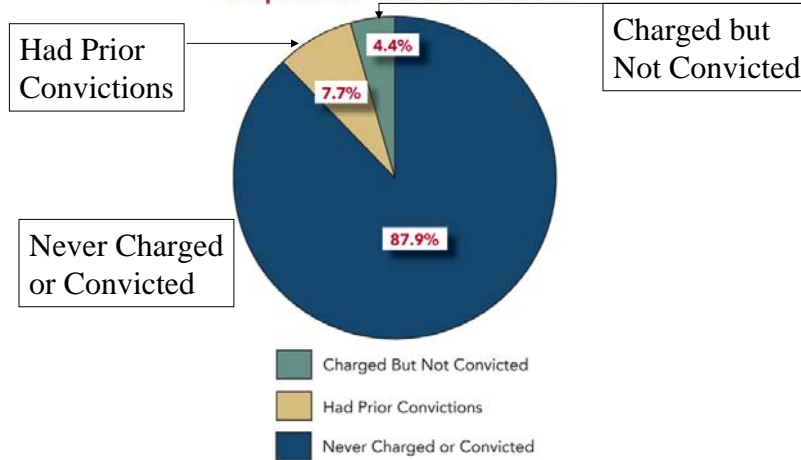


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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Perpetrators' Criminal Histories

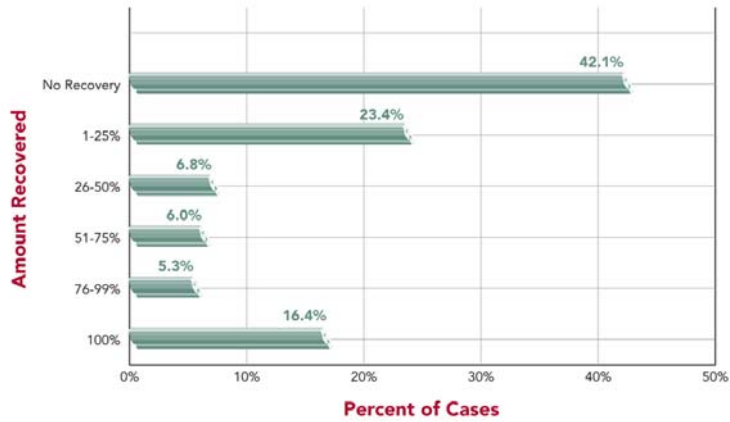


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## 2006 REPORT TO THE NATION ON OCCUPATIONAL FRAUD & ABUSE

### Recovery of Losses in Occupational Fraud Cases



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Grant Thornton



## Grant Thornton Non-Profit Survey

The 2006 Grant Thornton LLP  
National Board Governance Survey for  
Not-for-Profit Organizations

Grant Thornton



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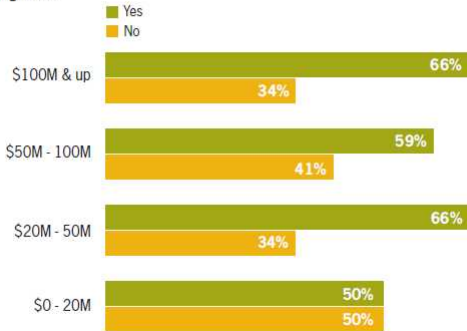
118



## Non-Profit Governance Policy Changes

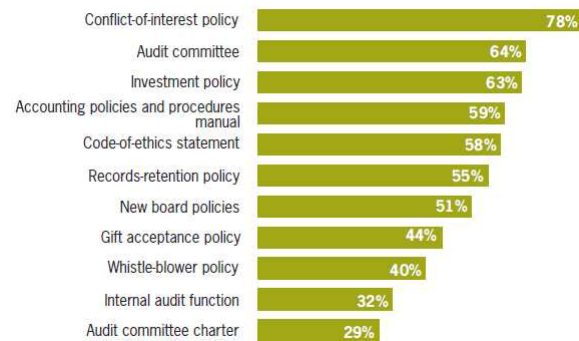
### Governance policy changes

By budget size



## Non-Profit Board Committees, Policies

### Board committees, policies

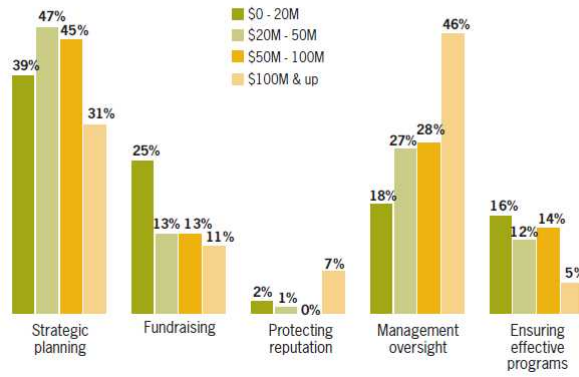




## Non-Profit Most Important Board Task

Most important board task

By budget size



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## Non-Profit Who Signs Conflict-of-Interest

Who signs the conflict-of-interest policy?



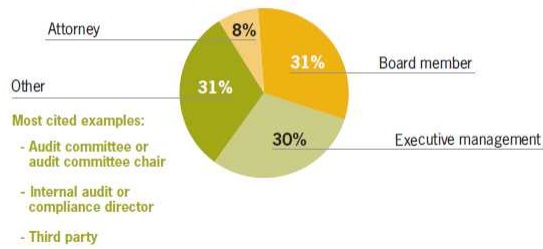
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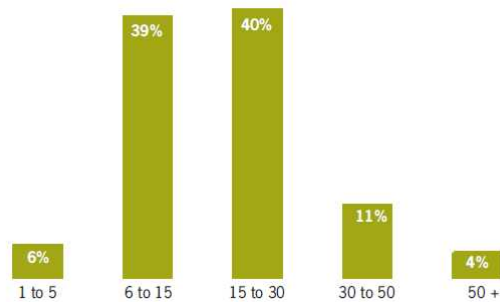
## Non-Profit Whistle-Blower Complaints

Who are whistle-blower complaints submitted to?



## Non-Profit Number of Directors/Trustees

Number of directors/trustees







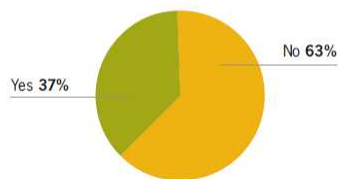
## Non-Profit Board Committees

### Board committees



## Non-Profit Board Assessment

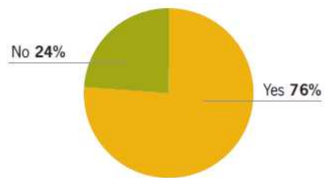
### Annual board self assessment





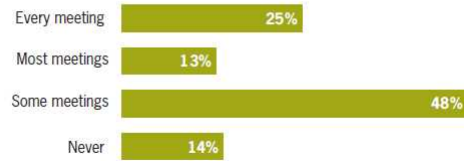
## Non-Profit Board Term Limits

Board member term limits



## Non-Profit Executive Session

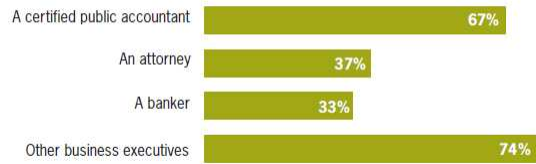
Executive session





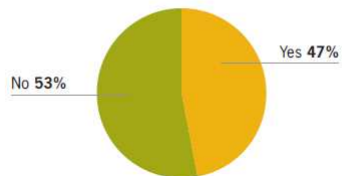
## Non-Profit Audit Committee Includes

If you have an audit committee, does it include...



## Non-Profit Do Auditor/Board Meet

Auditor meeting with the full board of directors/trustees

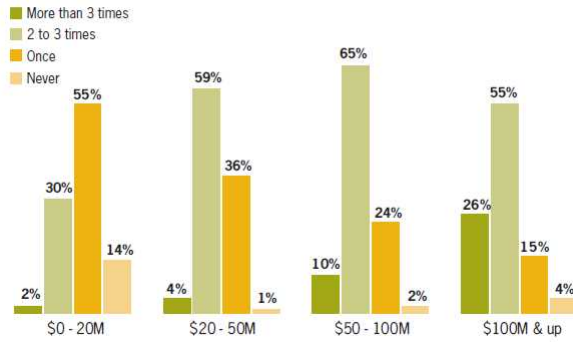




## Non-Profit Auditor/Board Meetings by Size

Frequency of auditor meeting with audit committee

Per year (by budget size)



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## Non-Profit Who Hires Auditors

Engaging the audit firm

By budget size

- Executive management
- Audit or appropriate committee
- Board



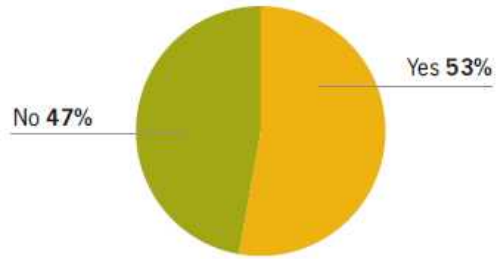
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## Non-Profit Special Project Pre-Approval

Special project pre-approval



## Public Perceptions in a "Post Enron" World

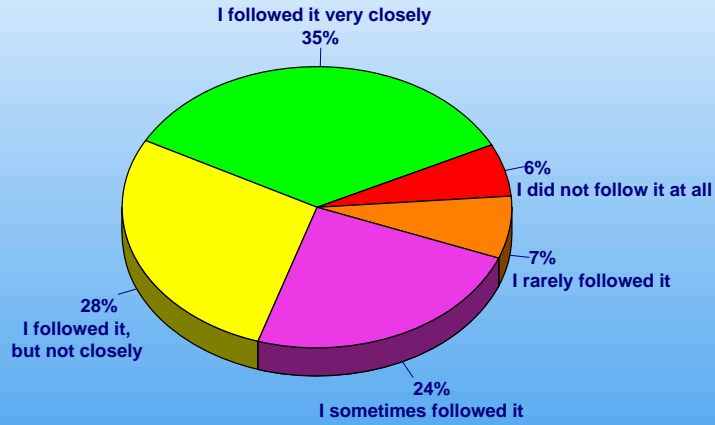


Results of Jury Research Conducted by  
CAMICO Mutual Insurance Co.

[www.camico.com](http://www.camico.com)



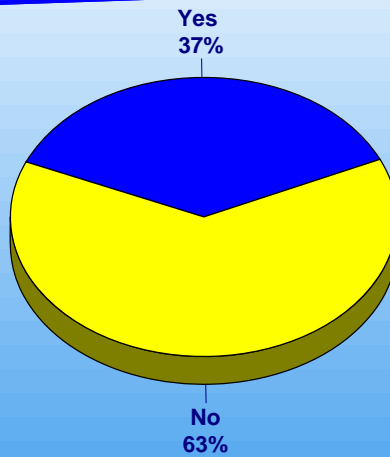
**How closely, if at all, have you followed the news about corporate scandals or wrongdoing?**



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1062tas 08/03

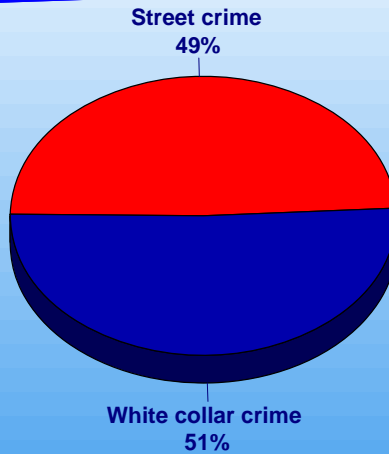
**Have you ever felt that you were misled about the financial health of a company?**



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Which type of crime poses a greater threat to society, street crime or white collar crime?

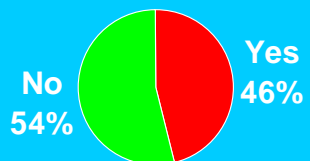


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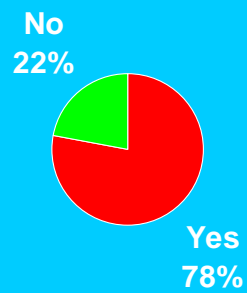
1062tas 08/03

Do you tend to believe the things you hear in the news about corporate wrongdoing?

Pre Enron



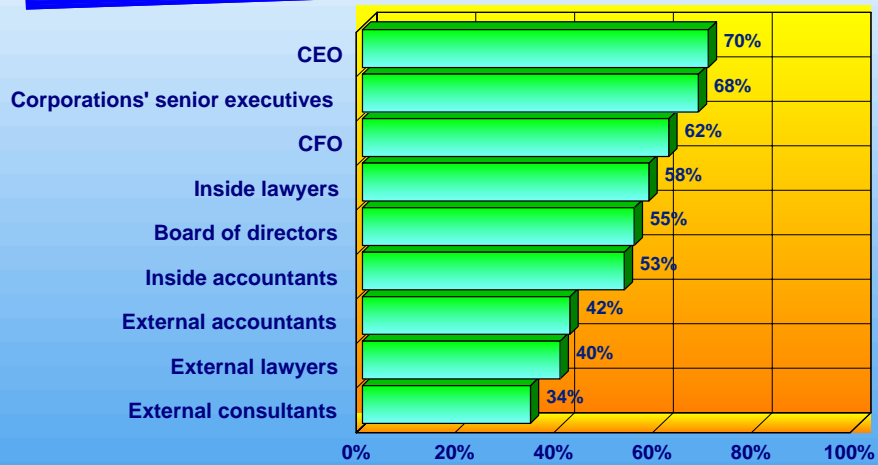
Post Enron



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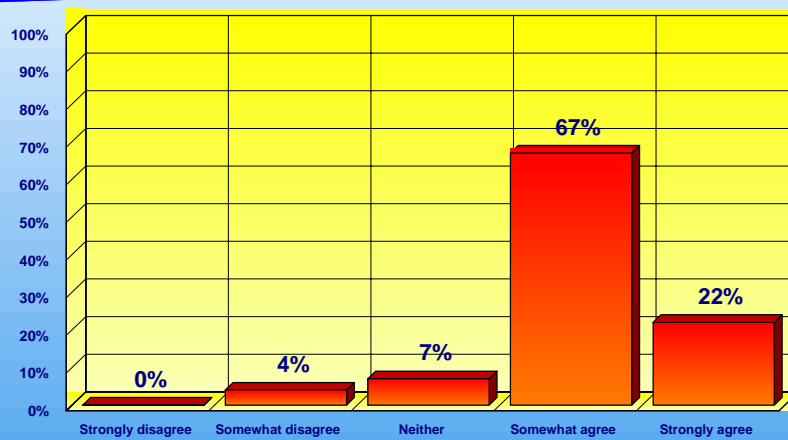
**Who, if anyone, do you blame for the legal and/or ethical problems facing Corporate America today?**



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**Accountants should know laws that relate to financial matters.**

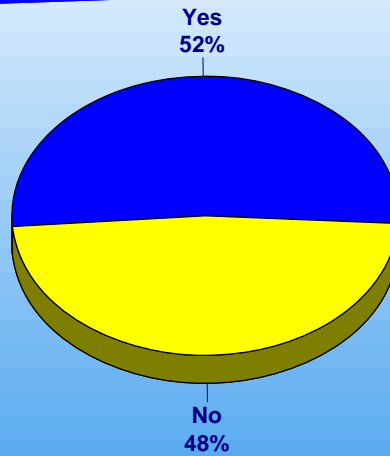


Feb. 2001  
Database February 2001

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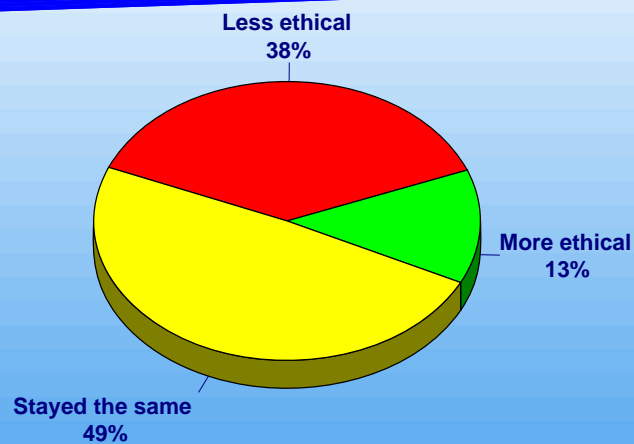
Over the last few years, has your opinion of accounting firms that audit corporations changed?



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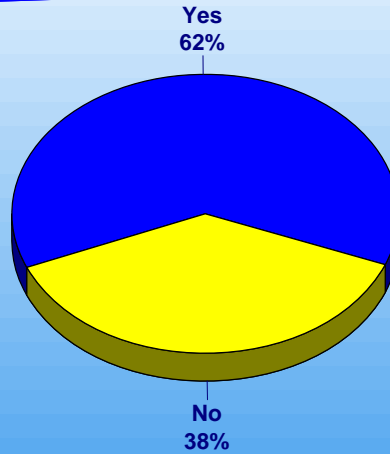
Do you think that accountants have become less ethical, more ethical, or stayed the same in the past five years?



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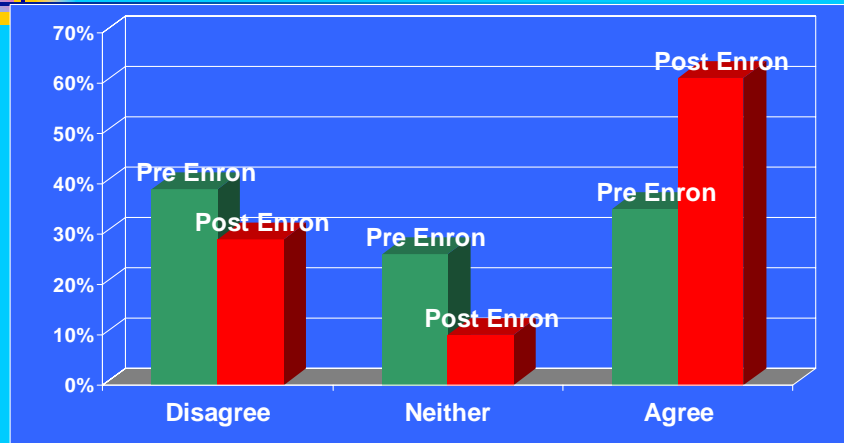
Do you think that a professional accounting firm would look the other way if a client violated the law in order to maintain its relationship with the client?



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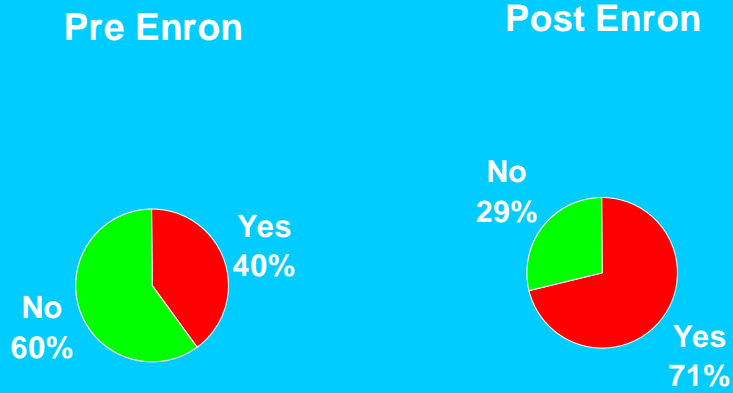
Accountants are responsible for making sure that companies stay honest...



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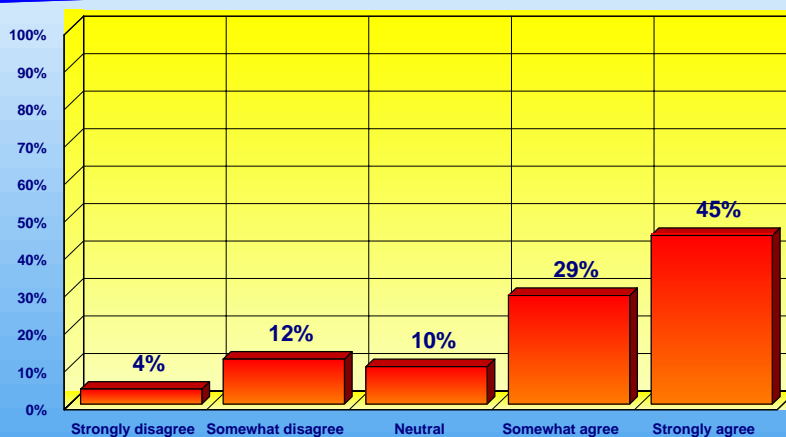
If an Accountant is hired by a company to review financial statements, but not retained to do an audit, would you expect the accountant to uncover fraud?



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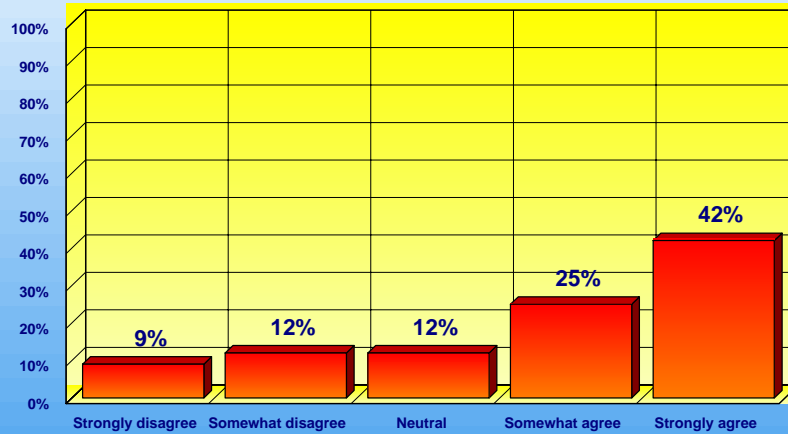
An auditor who works closely with a company's financial statements should easily detect any fraud.



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**A professional accounting firm that does not catch a company's fraud should pay a severe penalty.**



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## The Triangle of Fraud

Trigger

Need

Two kinds of need:

1. Direct
2. Indirect

Opportunity  
Low probability  
of getting caught

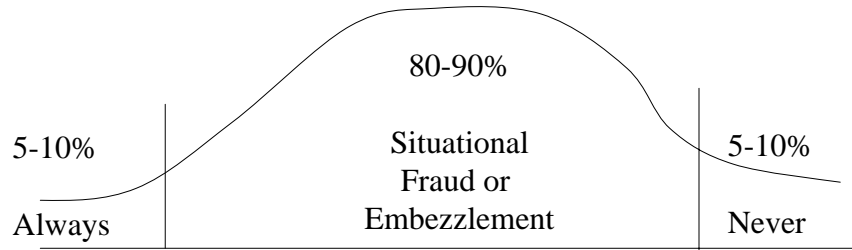
Rationalization  
Action fits  
inside code of  
conduct

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## Situational Fraud



## Dunlap Cannon



1. Real estate attorney
2. \$1 million income
3. Father
4. Life style issues
5. Bank accounts
6. Fraud lesson \_\_\_\_\_



## Jesse Oddi



1. Clerk of Courts
2. Financial stress
3. \$450,000 embezzlement
4. 5+ years
5. NM Municipal League
6. Fraud lesson \_\_\_\_\_



## SAS 99 Mark Morze



1. Pepperdine University
2. Toastmaster Speaking Champion
3. Fraud: Ex-Con Tells All Part II
4. CFO, ZZZZ Best Carpet Cleaning
5. 10,000 phony documents
6. \$50 million of revenue, 86% was \_\_\_\_\_
7. "If you were my auditor, \_\_\_\_\_"

## Embezzlement Walt Pavlo



1. Mid-level manager at MCI
2. \$6 million embezzlement
3. KPMG
4. Association of Certified Fraud Examiners
5. CNBC
6. Fraud lesson \_\_\_\_\_

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## Financial Reporting Fraud Nick Wallace




1. President ESM Government Securities
2. \$350 million fraud
3. Bankrupted 69 S&Ls
4. 2 suicides
5. Wallace serves 6½ years
6. Gomez goes to prison
7. Fraud lesson \_\_\_\_\_



Jose Gomez, Partner  
Alexander Grant  
A&A South Florida

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## Embezzlement TeriLyn Norwood



1. Accounts payable supervisor
2. \$18,000 embezzlement
3. Financial stress
4. Profiled in WSJ
5. Montel Williams Show
6. Fraud lesson \_\_\_\_\_



## Bank Fraud Dave London



1. Bank president
2. Gambling
3. Embezzlement
4. CFO figured it out
5. 33 months
6. Fraud lesson: If you're doing something wrong and someone figures it out you don't \_\_\_\_\_





## Barry Minkow

1. CEO ZZZZ Best
2. Senior Pastor
3. Fraud Discovery Instit
4. Fee \_\_\_\_\_

The screenshot shows a CBS News article from August 22, 2005. The article is titled "It Takes One To Know One" and is part of the "60 MINUTES" program. It features a "FILE VIDEO" section with a video titled "Teaching About Fraud" and a photo of Barry Minkow. The text describes Minkow as a former con artist who now exposes scams and discusses his past as a stock swindler and CEO of a \$300 million company.