

Webinar Transcript for "Evaluating Subrecipient Fraud Risk"

A Vander Weele Group Webinar

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Presenter: Elizabeth Mackay, Maribeth Vander Weele

With introduction by: Jessica Gay

Facilitator: Sydnie Long

INTRODUCTION

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Jessica Gay: Good afternoon, everyone, and thank y'all for joining us today. My name is Jessica, and I'll be your facilitator for today's presentation. Let's go over some quick housekeeping rules. The presentation will last approximately 30 minutes, followed by a question segment.

Once the recording is ready, we will email everyone with a copy of the recording, as well as the slide deck.

Please be sure to keep your microphones muted. If you have any questions throughout the presentation, please use the QA feature found at the bottom of your Zoom window. The QA feature is different from the Chat feature, so please use the QA feature to post your questions. We'll take about 5 minutes or so at the end to answer your questions. In regards to the Chat feature, I will post a few resources there for you to reference.

Today's presenter is Attorney Liz McKay, who, before joining the Vander Weele Group to spearhead our utilities and other initiatives, Liz managed compliance, procurement, and contracts for more than \$10 billion of grants for the State of New Jersey.

Before our QA session, our CEO and President, Maribeth Vander Weele, will be offering some teasers about our upcoming webinar. Now, with all of that, I turn it over to you, Liz!

PRESENTATION

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Elizabeth Mackay: Thank you, Jessica, and again, good afternoon, and thank you all for joining us. We'll be covering a very specific topic today, "Evaluating Subrecipient Fraud Risk." But it's one that's raised some

questions with respect to implementation, and that's concerning this revision in October to the Uniform Guidance. Which, of course, as we all know, is not guidance, but a body of requirements with respect to Federal grants.

The goal of our webinars at the Vander Weele Group is always to give you information that you can use, that you can implement in your practice, and I hope that you feel that way, feel that we've accomplished that when you walk away today.

In terms of our agenda. . . Again, we'll specifically talk about these requirements for pass-through entities per the Uniform Guidance, which actually dovetails with the new administration's focus on waste, fraud, and abuse in Federal grant programs.

We'll talk about the framework for assessing that risk of fraud for your subrecipients. You know, how can you actually implement that process. And then, once we've finished talking about assessing the risk of fraud, our President, Maribeth Vander Weele, will talk about recommendations for managing that subrecipient fraud risk.

Okay, I'd like to just start with this overview slide, and this was from a study that the Association of Certified Fraud Examiners conducted in 2024, looking at 1,921 cases in 138 countries. And they found that 18 common anti-fraud controls were effective. Right? In other words, better than doing nothing, right? They were effective in... with respect to faster detection of fraud and fewer losses. But there were actually four controls that were outstanding. They were associated with at least a 50% reduction in fraud, loss, and duration. And that was the surprise audit, financial statement audits, hotlines, and proactive data analysis.

However, two of those four highly successful controls, surprise audits and proactive data analysis, were among the least commonly implemented anti-fraud controls in the study.

So I take away two points from this slide. One is that we have much more to do, and I say "we" as *practitioners*, much more to do with respect to knowledge about preventing fraud, and actually implementing what works. And then secondly, our goal is really to manage fraud risk. It's not realistic to expect that we'll eliminate fraud, rather, to manage fraud risk.

Okay, so looking at the Uniform Guidance. Now, the pass-through entity is required to monitor the activities of a subrecipient to ensure that their grant is being used for the authorized purposes, that it's in compliance with Federal and programmatic requirements, and that the program is actually achieving its goals. It's doing what it's supposed to be doing.

Now, on October 1st of last year, the Uniform Guidance was revised. And they revised this one section for requirements for pass-through entities to also include "evaluate each subrecipient's fraud risk." That's along with the risk of noncompliance with regulations, etc.

The Uniform Guidance also lists certain considerations when you're evaluating subrecipient fraud risk, and we would say these are factors in a risk assessment, right? How much experience does the subrecipient have with this type of a program? What were the results of prior audits or monitoring visits? And were there any changes in program management or personnel?

And I have to say that HUD actually follows these rules. Because I had worked at New Jersey, as Jessica mentioned, in New Jersey, and we managed HUD recovery funds for Hurricane Sandy, and I know I have some former colleagues from the state of New Jersey on the call today. But HUD typically would come for a twice-a-year visit. Monitoring visit. And we were doing well, so HUD said, "Okay, we'll make that once a year." So they changed their monitoring with respect to our risk.

Well, we had an election for governor. And when the new governor came in, they changed the commissioner who was running our department, which is the Department of Community Affairs. So HUD came back and said, "Well, you've had changes in the responsible party here of the grantee. So we're going to go back to our twice-a-year monitoring, and we'll see how that plays out." And we did eventually go back to once a year, but my point is, HUD is actually practicing what it preaches with respect to following these rules. Which is, of course, another reason why we all need to be following these rules.

The Uniform Guidance was ahead of its time, at least by maybe six months, because the new administration has been intently focused on waste, fraud, and abuse in the Federal grant space. As an example, this was an executive order that was issued on August 7th, entitled, "Improving Oversight of Federal Grantmaking." And specifically, it was, the purpose was to improve the process of Federal grantmaking while ending offensive waste of tax dollars.

So, with that theme, we've seen, in some cases experienced, that the administration is not hesitant about terminating funding for grant programs, canceling the programs outright, or even clawing back awards that have been allocated. So, again, this is all the more reason to take very seriously, your responsibility as a pass-through entity, with respect to monitoring your subrecipient, and as a subrecipient, with respect to having your fraud controls in place.

And I should note, this particular executive order required certain reviews, certain due diligence for discretionary grants. And discretionary grants are those that are created by the agency itself. Allocated by the agency. Those are not legislatively allocated grants. So this does not apply to block grants, or formula grants, or disaster recovery grants, for example.

And what are some of these scenarios where fraud is not discouraged, or where there may be opportunities for fraud? And, the first bullet is self-explanatory: "Insufficient checks of databases and over-reliance on manual

checks." These days, with the use of AI and the ease of using artificial intelligence, hopefully, we can incorporate this more regularly into our programs with respect to Federal grants.

We all know, if you've worked in disaster recovery especially, that you can have a tremendous amount of volume, a tremendous amount of applications, and there's a lot of pressure to get the money out the door. These people need help. They need your assistance. They don't have roofs over their head. That can create a lot of pressure that results in corners being cut.

And one thing that's very basic in terms of a control, simple control, would be your intake staff is different from the staff that reviews the applications, say, for eligibility. And then their determinations are then reviewed by a third entity, third person, who is outside that operational process. So you have independent determinations along the way. It should not really slow the process down, but it's a control, and if you have appeals with respect to your eligibility criteria, you can show that you've had a process where it was somewhat independent in terms of these determinations.

And then poor fraud awareness among supervisors and application reviewers. Well, that sounds a lot like what we saw in that slide with respect to the Association of Certified Fraud Examiners. We seem to have a sense, maybe, of denial here, that, "Well, fraud occurs in other programs, but not ours." And it's kind of surprising that even for entities that have controls, there isn't an escalation process. You say, well, what happens if you detect fraud? You get kind of a blank stare. So, you need to have in place: Where do we go? If we suspect fraud, do we go to in-house counsel? Do we report it to the internal audit staff? Who would be doing the investigations? It should not be someone, obviously, connected with the operations. Is it an outside entity?

And I would add here that, actually, Medicaid requires its managed care companies, and they're contractors, they're not subrecipients, so you don't have this flow down with respect to compliance. But they require the managed care companies to have a process for suspected fraud and an escalation process. So again, that's something we should think about right at the beginning, implementing a program, along with, what kind of frauds would this program be susceptible to?

Which brings us to the key elements of the fraud risk assessment process. This was put together, this framework, by the GAO, the General Accounting Office. And I think it's really, it's not a cumbersome process, but something that you can use to fulfill this responsibility now with respect to assessing subrecipient risk. And I'll leave this up for a few seconds, because we're going to go one by one and talk about each one of these elements in more detail.

Okay, so the first element is "Identify inherent fraud risks affecting the program." So, inherent risks are risks that are basically involved in the nature of the program.

If you had no controls whatsoever, what type of fraud would the program be vulnerable to?

And, if you had watched, participated, or read the article from What The Watchdogs Say, that Maribeth, had conducted, oh, I guess around six months ago or so. Most of these mistakes with respect to financial reporting were just that. They were mistakes. They were, you know, these irregularities were an oversight, not fraud, which is intentional.

And I would say probably for most of the programs and with the Federal grants, it would be more a falsification of documents issue, rather than a financial reporting fraud.

Misappropriation of assets. Corruption, probably not so much. And I added conflicts of interest here, because this is an important waste and abuse element. In the spectrum of fraud, waste, and abuse, this would be more the waste and abuse side of it, because conflict of interest is something that the Uniform Guidance took pains to point out, right? The Uniform Guidance specifically says, if you have a procurement and you hire someone to put together the engineering specs for a project, well, that firm cannot then go on and bid for the project, for the construction. The Uniform Guidance says you can have conflicts of interest on an evaluation committee, right? If you're evaluating proposals that come in, you have to sign a certification that says you have no conflict of interest. Your father-in-law doesn't own one of the companies that's bidding for this project. So I think we need to see those policies for subrecipients with respect to conflict of interest, in particular.

Applicants using false identities, I think, is more of a problem if you've got a big program with many applicants.

And as COVID began to take its toll, the U.S. Treasury decided to help homeowners who were falling behind in their mortgage payments, with the HAF program. That's Homeowner Assistance Fund. And we worked with an agency that was administering a HAF program totaling \$325 million. So that was a huge program, assisting applicants with their mortgages, and the cap on each award was \$75,000. So that's a lot of applications, a lot of potential input there. So, on its face, you say, well, that could be an opportunity for fraud.

And since Federal programs do not finance second homes, because the taxpayers in Kansas should not be paying for the second homes of New Yorkers and New Jerseyans. Primary residence was immediately identified as a problem with Hurricane Sandy recovery. Because the epicenter for Hurricane Sandy was the Jersey Shore. And the Jersey Shore is populated with vacation homes, you know, second homes. So, we anticipated right off the bat that there could be a problem with homeowners trying to get assistance to rebuild or repair their second home by putting it forth as their primary residence. That is actually what happened.

You need to, once you've identified the potential fraud, what is the likelihood and the impact of that potential fraud? I already talked about in these two examples, that, yeah, for those particular situations, these would be potential opportunities if someone had a fraudulent inclination.

And obviously the impacts are... well, first of all, with respect to compliance, you don't want a Federal agency sensing that you are not doing your best to prevent fraud. That's number one. And number two, we all know the impact of fraud is that there are less dollars for applicants who really do need the funding, who do need the assistance, and deserve the assistance.

Okay, so then we want to look at the fraud tolerance. Which is really, it's an interesting almost balancing, of sorts. Because... In our example, with the Homeowner Assistance Fund, there were certain requirements with respect to income and assets, you know, certain ceilings. So, when state agencies would really delve into false identity: Is this the person who they say they are? What is their link to COVID? You know, were they laid off? As they state, what are their assets, the value of assets, and so forth. But... and this was taking... This could take months.

So, the U.S. Treasury said, you're not getting the money out the door quickly enough. Remember that the chances for risk, the risk factors, that was one of those, well, you're not getting the money out quickly enough.

So... Accept, homeowner certifications with respect to assets, and the link to COVID. Don't investigate. And so it wasn't even, you may accept, certifications. It was Accept them. Do not do this due diligence.

In 9/11, we had the anniversary last week, of course. And many agencies, like the American Red Cross, the Salvation Army, there was, you know, city and state agencies, immediately stepped up to help families and workers, because obviously this was a very unexpected development. And if you think about a maintenance worker in Tower 1, well, Tower 1 was rubble after September 11th. So, you lost your occupation, right? So, the city, you know, NYPD, were concerned about getting some relief to these folks. So they said, we're gonna get the support, give these applicants support. But, if you see any kind of evidence, documentation presented that looks a little odd, something that you really haven't seen before, set it aside and we'll follow up. And they actually did. They set up, it was the DA, District Attorney's, detective squad. It was some of the most highly thought of detectives joined this squad to follow up on these documentation.

And one piece of documentation was a Guyanese birth certificate. Which, you know, was unusual, and this American Red Cross wasn't used to seeing that. So, I actually was the second seat on a trial at the Manhattan DA's office for this man who invented a son who was born in Guyana. That was the guy in his birth certificate, and he had been killed in 9/11. He went for an interview at the Twin Towers. So he wouldn't be found in any of the employment roles from employers at the World Trade Center, because he was just there for an interview. So he said, well, that's... that sounds kind of

clever. But what was noted about the Guyanese birth certificate is, if you've traveled outside the United States or were born outside the United States, you know that we are unique in the way that we date documents. We have a month, a day, and a year. Outside the United States, everywhere else in the world, it's the day is first, the month, and then the year.

Well, the Guyanese birth certificate had the month, the day, and the year, just as we would do that in the United States. So that was just one part of this scheme that went awry. And in fact, this father, alleged father, did receive a sentence of 20 years to life for taking almost \$300,000 from the American Red Cross. So the follow-up at the back end did occur, but safe to say, it's easier to have the controls at the front end.

Okay, so examine the suitability of your fraud controls. Are the fraud controls actually addressing the potential fraud? Gonna go back to my example again, with the HAF, Homeowner Assistance Fund. So, a lot of pressure, get money out the door, endorsed by the U.S. Treasury. But the program decided to implement other controls if they couldn't have them right at the front.

So what they decided to do was to pay the mortgage company or the lender directly. So the homeowner did not receive funds. They were skipped, the money went to the lender. So, if I'm a fraudster, why would I try to fill out an application, because I couldn't get the funds? What would be the point of that? So I think that was a very effective fraud control.

HUD had suggested, with respect to Sandy, that we require utility bills as proof of primary residence, but most people don't disconnect the utilities every winter. They have a minimal utility bill, so that didn't really prove anything. So we thought, well, a driver license, or voter registration, initially, that would be a better indication of where you actually live. And elections certainly don't occur in the summer, so that would tend to be near your primary residence.

And actually, in both of these examples, mortgage assistance and disaster recovery assistance, to receive Federal funds, the homeowners had to agree, in the case of disaster recovery, to have a Declaration of Restrictive Covenant placed on their properties. In other words, the state's name would be in the deed. And that was done in case homeowners decided to not fulfill their side of the bargain. They had to elevate their homes. They had to complete construction and live it for a certain amount of time, and then the Declaration would be released.

But, if the homeowner tried to sell the property prematurely, tried to get out of their responsibilities, a title company would right away see that New Jersey was on that in that title, and they would not be successful.

Similarly, with the HAF program, a secondary lien was placed on that property. So that, again, if a homeowner didn't fulfill their requirements, which in this case was a three-year residency after the assistance was received, if they didn't comply with that, they did have

this lien. And once they did comply, the three years in the home, the primary residence, then the loan was forgiven.

So, you may want to think about that, if you have a program related to housing recovery, to attach, in some way, the property to ensure compliance.

Okay, so we've provided you with some of these key steps, and putting them all together. You're looking at the type of fraud. What are the chances that this would impact the program? What kind of risk tolerance do we have? What is the most cost-effective way to implement these controls? And then how effective are these controls?

And the GAO has a scale for these. They present a continuum. What is the likelihood of risk? What is the impact of the risk? The inherent risk significance. So you have this continuum, which really would fit neatly into your existing risk assessment, because you already have a risk assessment for your subrecipient. And we worked with New Jersey, we're in their integrity monitoring pool. They use a risk assessment with three steps: Low risk, medium risk, high risk. So obviously, a fraud risk profile would fit very neatly into risk assessment categories like that. So I think this is a reasonable approach. This framework is something that you can use that's not cumbersome to meet your obligation as a pass-through entity.

All right, so now that we've talked about evaluating or assessing the risk for fraud, I'd like to turn this over to Maribeth Vander Weele, who's going to talk about managing subrecipient fraud risk.

NEXT WEBINAR SNEAK PEAK

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Maribeth Vander Weele: Good afternoon, and this is really a preview of our next webinar that will give very practical suggestions on how to integrate fraud controls in your subrecipient programs. Some of them are very familiar to you. Require fraud awareness training tailored to the grant program. We talked about the escalation procedures. The fraud posters. *Every Student Succeed Acts* requires every subrecipient and recipient to have fraud-reporting posters. That can be integrated into a monitoring program. Check the school. Do they have the posters? Or check the central office.

Segregating the monitoring function from the program management is something we'll talk a lot about in the next webinar, which will be on October 22 at the same time. And, you know, this is a controversial one, but we did have you know, one of the biggest frauds in American history in a grant program occurred in Minnesota called Feeding Our Future. I believe

it's up to about 75 people who have been indicted or convicted in this fraud, where they created fictitious feeding programs. And there were a lot of lessons learned that came out of that program. But one of the things is that the very entity that was responsible for establishing all these programs across the area was also being tasked with investigating complaints. Was also being tasked with some of the monitoring functions, from what we understand. Segregating the monitoring function from program management prevents a conflict of interest occurring.

Deploy monitoring in the first year of the program. We know that if the fraud is going to occur, it usually starts in the first year. Of course, I don't have a statistic to back that up necessarily, but I have a friend who's gone to over 80 countries to do investigations. And, inevitably, the bribery, occurs in the first year, and you'll get to see the early warning signs that way.

We talked about conducting existing testing through site visits.

Next slide, please. Okay, during monitoring, engage subrecipients in two-way conversations to identify program strengths and weaknesses. I can't tell you how powerful this is. Just saying, how's it going? Do you have any concerns? We have things that have surfaced that you'll never see in the documentation and the data. Things have surfaced that are very critical. Weaknesses in the program and fraud vulnerabilities.

Designing the software correctly, the data fields to not only report financial data, but also to provide data analytics that will detect fraud.

Using human-vetted data analytics. And the reason I say human-vetted is it's frustrating for a recipient, or I should say a pass-through entity to receive a big binder of, well, here are the red flags in your program. What you really want is actionable leads.

And beneficiary programs, we talked about brainstorming checks and balances specific to the program. And then we talked about the importance of creating those effective escalation procedures. Recently, there was a child who died in daycare, and the monitoring program had highlighted a number of problems with that particular daycare center. The child was not given the seizure medicine that he needed when he went into an epileptic seizure. But we wonder what could have happened if there had been immediate follow-up to this daycare center and created an escalated kind of SWAT team going in and saying, we want to see what's actually going on.

So that's a little quick preview for our next webinar, and I'll turn it over to Jessica.

QUESTIONS AND ANSWERS

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Jessica Gay: All right, well, thank y'all for a wonderful presentation. Very, very informative. So this will bring us to our question and answer session. Like I said, look below, you'll see the QA box. If you have any questions, please feel free to drop them in there.

It looks like we have one. It's directed at Liz. Liz, can you please elaborate on what residual risk is?

Elizabeth Mackay: Okay, and thank you, because I should have mentioned that during the presentation.

So, inherent risk, as I mentioned, is the risk, if no controls, what would happen? What is the nature of the program that would invite risk?

But if you've controlled all that you can, you've controlled your inherent risks, there still is risk. And that's called a residual risk. So it's more of an external risk, and it may be something that's very difficult for you to control. And an example of this would be, if you receive Section 8 housing vouchers, you would then be eligible for this program that I am running. Well, I'm not responsible for the intake for the Section 8 housing, so I didn't have any fraud controls over that part of the process. So that would be a residual risk. So you have to see, is a residual risk significant? If it's significant, is it a low probability? Is it a high probability, but not significant? And then, you would do your similar kind of analysis to the inherent risk, if you think that is something that could be a problem.

Jessica Gay: Excellent. We did get one question during the webinar. Yes, this presentation will be available to y'all via email in a couple days' time.

All right, are there any other questions for today?

CONCLUSION

00:33:51.510 --> 00:34:56.190

Jessica Gay: Well, all right. Well, if there's no other questions, that'll conclude today's webinar. Once again, thank you, Liz. Thank you, Maribeth, for this wonderful presentation. If you would like to watch this webinar again, like I stated, it will be available in a couple of days' time in your email inbox.

We would really appreciate your feedback using our post-webinar survey as well. If you would like to receive invitations for future webinars, you can sign up using our mailing list on our website.

If you have any additional questions regarding the upcoming changes to the Uniform Guidance, our contact information can be found both on the slide and in the chat.

Furthermore, we encourage you to visit our Resource Library to discover a wealth of grants oversight resources to help you in managing your grants program. Our Resource Library can be found at our website, vanderweelegroup.com/resources.

Please join us for our next webinar entitled, "Fraud Guardrails for Your Grant Program," which will be held on October 22nd at noon Central Time.

Thank you all once again for attending our webinar, and we hope that y'all have a lovely rest of your day.

Elizabeth Mackay: Thank you.

END OF TRANSCRIPT