

FINANCIAL AID FRAUD IN A NONPROFIT UNIVERSITY: WHERE WERE THE INTERNAL CONTROLS?

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CASE DESCRIPTION

The primary subject matter of this case concerns ethical decision making. The case has a difficulty level of four, appropriate for senior level. The case is designed to be taught in one class period of approximately 50 -75 minutes and is expected to require 2-3 hours of outside preparation by students.

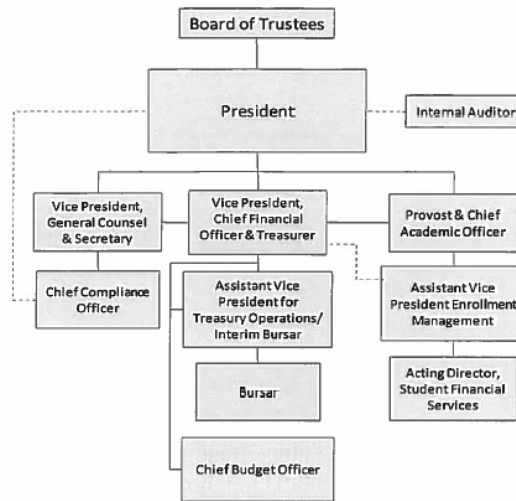
CASE SYNOPSIS

Internal control failures within a nonprofit university's financial aid office resulted in the misappropriation of approximately \$1 million in grants over a ten-year period. These grants were earmarked for needs-based students but were diverted by office employees to their own accounts and used for personal expenses. Although the problem was identified and reported to the university's president, no action or public disclosure was made for at least two years. A whistleblower notified an online newspaper of the fraud, and it was subsequently reported to university constituents. The university created an action plan to prevent such an incident from occurring in the future and terminated all employees involved in the fraud. The events described in this case are based on a real-world situation as reported in various newspaper and online sources.

INTRODUCTION

Howard University (the university) was established in 1867 to provide newly emancipated African Americans a space to develop their spiritual and intellectual acumen. Today, the university has an enrollment of approximately 10,300 undergraduate, graduate, and professional students representing all 50 U.S. states, the District of Columbia, and nearly 70 countries. Students pursue more than 120 academic disciplines within the university's 13 schools and colleges. The estimated cost of attendance for an undergraduate living on campus for the 2018-19 academic year was \$44,951. The university, a privately-operated non-profit, is governed by a 28-member board of trustees and managed daily by the university president. A partial view of the organizational structure showing the Office of Student Financial Services, which is the focus of this case study, is provided in Figure 1.

Figure 1: Organization Chart (Partial View)



The university is one of five that is congressionally chartered due to its location in the federal district. This means that a portion of the university’s annual revenue is generated through funds received from the federal government (Lama, 2017). For the 2017 fiscal year, the university reported unrestricted revenue of \$741 million of which 29.5% was from federal appropriations (See Figure 2). These funds are provided to partially support construction, development, improvement, endowment, and maintenance related activities, and for operating the university hospital.

The university’s mission is to provide an exceptional educational experience and to attract and employ faculty who are, through their teaching, research and service, committed to the development of distinguished, historically aware, and compassionate graduates and to the discovery of solutions to human problems in the United States and throughout the world (Anonymous, 2018.). It achieves this mission through the four core values of excellence, leadership, service, and truth.

Figure 2: Statement of Activities from the 2017 Single Audit Report

| Statements of Activities For Fiscal Years Ended June 30, 2017 (with summarized comparative information for fiscal years ended June 30, 2016 and 2015) (in thousands) | Unrestricted | Temporarily Restricted | Permanently Restricted | June 30, 2017 | Summarized June 30, 2016 | Summarized June 30, 2015 |
|---|----------------|------------------------|------------------------|----------------|-----------------------------|-----------------------------|
| Operating | | | | | | |
| Revenues and reclassifications: | | | | | | |
| Academic services: | | | | | | |
| Tuition and fees, net | \$ 147,867 | \$ - | \$ - | \$ 147,867 | \$ 155,453 | \$ 154,088 |
| Grants and contracts | 53,763 | - | - | 53,763 | 56,379 | 64,450 |
| Auxiliary services | 40,960 | - | - | 40,960 | 52,481 | 53,988 |
| Clinical services: | | | | | | |
| Patient service - Hospital, net | 231,499 | - | - | 231,499 | 228,075 | 230,915 |
| Patient service - Faculty medical practice, net | 12,854 | - | - | 12,854 | 27,012 | 25,401 |
| Patient service - Dental clinic, net | 1,972 | - | - | 1,972 | 1,594 | 2,450 |
| Public support: | | | | | | |
| Federal appropriation | 218,416 | 3,405 | - | 221,821 | 221,821 | 212,035 |
| Contributions | 5,265 | 7,578 | 2,896 | 15,739 | 10,555 | 12,442 |
| Endowment transfer | 6,954 | 7,665 | 509 | 15,128 | 14,274 | 13,718 |
| Operating investment income (loss) | 5,270 | - | - | 5,270 | (1,015) | 966 |
| Other income | 16,290 | - | - | 16,290 | 16,447 | 16,505 |
| Total revenues | 741,110 | 18,648 | 3,405 | 763,163 | 783,076 | 786,948 |

Source: <https://www2.howard.edu/sites/default/files/HU%20Single%20Audit%20Report%20%28A133%29%20FY2017.pdf>

FRAUD WITHIN THE UNIVERSITY

There are past instances in which those associated with the university have experienced lapses in judgment causing them to stray from the stated mission and core values. For example, during the period 2010-2015, an employee benefit plan manager embezzled \$420,128 by diverting funds due to retired or retired and deceased employees to a personal bank account. The manager was convicted in 2017, received a one-year prison term, and was required to repay \$420,128 in restitution and an additional \$420,128 in forfeiture (ABC7, 2017).

Another incident occurred during the 2010-2011 academic year in which a university accountant embezzled \$105,000. This involved the accountant submitting thirteen forms that authorized payment from the university to various vendors (Department, 2016). However, the payees were disguised, and the funds were deposited into the accountant's personal bank account and the bank account of an accomplice. The accountant was convicted in 2016, received a one-year prison term with three years of supervised release, and was ordered to pay \$57,586 in restitution (ABC7, n.d.).

FINANCIAL AID FRAUD AND ITS AFTERMATH

Yet another example of fraudulent activity occurred within the Office of Financial Aid between the years 2007-2016 and was disclosed to the public in March 2018. A timeline of the events is provided in Figure 3. The university receives grants that are classified as unrestricted funds in its financial report. As noted in Figure 2, this ranges from approximately \$53-\$65 million for the 2015-17 academic or fiscal years. A portion of these funds provides need-based assistance to low-income students. The need-based assistance equates to an average of \$3,000 per student each semester (Harriot, 2018).

The problem was that some Financial Aid Office employees, who were also taking classes at the university, received both a tuition remission and other institutional aid in the form of a need-based university grant. A benefit of working at the University is receiving a substantially discounted rate of tuition, or tuition remission, should an employee choose to enroll in classes. However, some employees were also adding university grants to their personal student accounts. This caused the funds in excess of the tuition expenses to either be deposited into the student employee's bank account or to be paid to them in the form of a check (Howard Newsroom, 2018).

The individuals involved in the scheme worked in either the Office of Student Financial Aid or the Office of the Bursar and were successful in carrying out the fraud for an extended period. The Financial Aid Office management and staff were granted authority to provide financial aid awards to any student account, including their personal student accounts, without any additional approval (Howard Newsroom, 2018). As a result, they were able to make inappropriate aid awards without proper documentation and oversight. Typical of most universities, the Financial Aid Office can provide information relating to scholarships, tuition remissions, university grants, and fellowships, while the Bursar's Office can assist students with refunds, payment due dates, and the removal of financial holds.

The following are two examples of the types of unauthorized benefits received by employees.

- The Associate Director of Financial Aid received a tuition remission to cover all tuition related expenses for the 2014-2015 academic year and received an additional \$68,712 in need-based university grants. The highest potential salary for the university's associate

director position is \$69,253, which means that this employee almost doubled his income as a result of the grant (Harriot, 2018).

- During 2014-2017, a student-employee in the Financial Aid Office allegedly embezzled \$429,612, which is an average of over \$100,000 per year. This amount includes an annual receipt of a \$65,000 need-based university grant. While not attending school and working at the Financial Aid Office, this individual worked on his fashion blog and posted pictures of himself wearing \$2,600 fur coats, other expensive outfits, and touting name brand designer bags (Harriot, 2018). The individual stated that he lost a job, which he expected to begin after his law school graduation, due to the public disclosure of the alleged embezzlement. He is currently suing the University, its President, and the whistleblower, for \$10 million for breach of a duty and negligence, intentional infliction of emotional distress, and defamation (Elamroussi, 2018).

The Fraud Uncovered

During the 2015-2016 academic year, the President asked the Office of the Controller to review transactions within the university's financial reporting software and to perform procedures to determine if internal controls were effective within the Office of Financial Aid. The Controller's Office noted fraudulent financial aid transactions at the end of 2016 and became concerned about specific control activities related to the awarding and disbursement of university-provided financial aid funds. The university President was notified of these findings and subsequently informed the Board of Trustees (Howard Newsroom, 2018).

An external auditor was hired by the university to determine the extent of the scheme. While testing this transaction, the auditor discovered the fraudulent activity of a student-employee receiving both a tuition remission and a university grant. After further analysis and the completion of testing, it was determined that out of 131 employees or dependents of employees receiving tuition remission, university grants, and refunds, the top 5 most reimbursed individuals received \$689,375 in total refunds during a six-year time frame (Howard Newsroom, 2018). These five individuals were part of the group that would be terminated by the university later. Two months after the completion of the external audit, the President informed the Department of Education about the issue.

Then, six months later, a student employee in the Office of Financial Aid discovered the same fraudulent activity and reported the matter to the President. During the meeting, the employee provided supporting documents to substantiate the claim. However, the employee was not comfortable with the direction of the conversation and felt that the President either knew of the fraud or was personally involved. Failing to achieve satisfaction from the meeting with the President, the employee disclosed the fraud to an online newspaper on March 27, 2018. One day later, the President confirmed the embezzlement to the public. After another eleven days, the Office of the President released a report, titled the Preliminary Investigation Report, to the public that described the details of the embezzlement to provide transparency (Veritas, 2018).

A timeline of the financial aid fraud and related events is provided in Figure 3 (located on the following page).

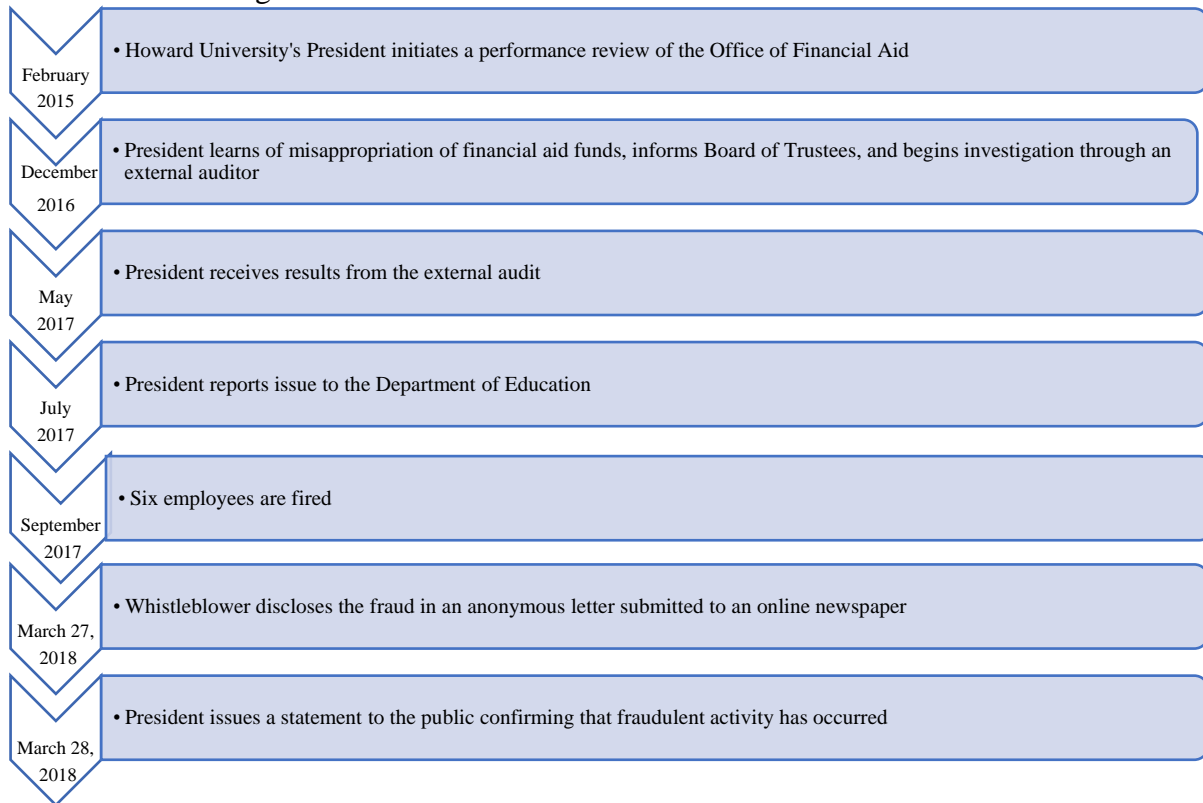
The University and Students' Response

The President has stated that the justification for not disclosing the fraud to the public at an earlier time is because the intention was to “report on its findings once all of its investigations were completed” (Howard Newsroom, 2018). Additionally, to prevent this type of malfeasance in the future, the university administration developed numerous measures that will strengthen internal controls. These include:

- Creation of an approval process in which unrestricted financial aid will be reviewed and approved by the University Budget Office (a unit within the Chief Financial Officer Division).
- Limiting access to the financial aid accounting software to a few specific individuals at the senior level of management, rather than to everyone working in the Office of Financial Aid.
- Performing an annual reconciliation between the awarded financial aid and the approved financial aid.

After being notified about the fraud from the anonymous online post, the students of the university were unhappy about the administration's lack of transparency and communication. To protest the situation and other grievances such as an increase in tuition fees and a lack of campus housing, 400 students occupied the administration building for nine days in order to meet with upper management and to make their voices heard (Vera, 2018). This sit-in is also a part of Howard University's history in that students in 1968 and 1989 used the same tactic in order to force the administration to create solutions for the problems the students had with the university's management. Meanwhile, the investigation is ongoing.

Figure 3: Financial Aid Fraud Timeline and Related Events



THE CHALLENGE

Assume you are the President of Howard University, and that you are preparing to meet with your leadership team at Howard to discuss with them your thoughts on the following two issues:

1. Why has Howard University experienced the sorts of frauds which have been uncovered?
2. What steps should be taken to reduce the likelihood that additional frauds will occur in the future?

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