



# Fraudcast: stories of tricks & treachery



## Episode 3: Rules for thee, not rules for me

### Jazz Clemente

Hello everyone and welcome to the KPMG Fraudcast where we unravel fraud cases in the news to uncover what happened and explore lessons learned. My name is Jazz Clemente.

### Frédéric LeBlond

And I'm Frederic LeBlond.

### Jazz Clemente

We are both senior consultants within the KPMG in Canada's Forensic practice.

### Frédéric LeBlond

The stories we will cover in this series are true events, but the names have been changed to aliases for the privacy of everyone involved. Although KPMG was not involved in these cases, we often work on cases similar to the ones of public knowledge we discuss.

### Jazz Clemente

In this episode, we will be discussing stories of rule bending and breaking, of tricksters believing themselves immune to scrutiny, and the fallout of their actions.

### Frédéric LeBlond

So the first story I'd like to discuss is that of a city counselor in Ontario who found a creative way to ensure she could keep paying the bills in times of struggle. After several incidents that resulted in fines for Chloe Churchill, including allegedly harassing a local resident, the counselor found herself facing a total loss of 315 days of pay, and so was stuck in quite the financial bind. Churchill sought to hire her spouse as an assistant in order to earn more money for the household, but was told that this was not allowed under the city's hiring of relatives policy. Churchill confided in a close acquaintance and campaign volunteer, Sofia Gonzalez, about the situation she found herself in. Wanting to help her

out, Gonzalez would've proposed the idea of working as her assistant and splitting the pay with Churchill's husband, sharing the workload with him.

### Jazz Clemente

I have no idea how that conversation went, but it sounds like she was looking for someone with political ambitions to help her get what she wants, a campaign volunteer of all people.

### Frédéric LeBlond

Definitely possible. Churchill agreed to the arrangement. Gonzalez worked 20 hours per week for about 11 months and sent a portion of her bi-weekly pay to Churchill's husband. She would've transferred a total of \$21,000 out of \$37,000 received to the spouse. The spouse, Albert Churchill, also said he worked about 20 to 30 hours per week and handled several responsibilities, including advising the counselor on member motions and communications, scheduling and executing community and charity initiatives. At some point in early 2020, Gonzalez raised concerns about a high tax bill she received due to the paychecks from the city. Remember, from the city's perspective, the only individual being paid is Gonzalez, and as such, the tax burden was solely on her, despite Churchill's husband receiving part of her salary.

### Jazz Clemente

I can't believe she didn't think of this when she suggested the arrangement.

### Frédéric LeBlond

Agreed. But the relationship between them eventually became difficult and Churchill terminated Gonzalez in June 2020.

### Jazz Clemente

Wow. After Churchill and her husband benefited from Gonzalez, they got rid of her just like that?

## Frédéric LeBlond

Yep. It's really weird. I wonder why they never thought of these potential issues. Well actually, the issue with the tax bill wasn't the first time Gonzalez felt uncomfortable with the situation she found herself in. Long before her termination, Gonzalez raised concerns about the situation to the regional counselor and the complaint was escalated to the Integrity Commissioner and eventually to the police. Although she may have suggested the arrangement, perhaps she realized she bit off more than she could chew.

Churchill was originally charged for fraud over \$5,000 and breach of trust by a public officer. These charges were withdrawn in favor of fraud under \$5,000. She served a three-month conditional sentence that required her to remain in her residence between 1000 PM and 600 AM. Interestingly, she was permitted to retain her seat and even won her reelection in October 2022.

Jazz, what do you think about this story?

## Jazz Clemente

It's interesting to see how she was able to find a workaround and have her husband paid by the city. However, what is more interesting is how the original charges were withdrawn and she remains in power to this day.

## Frédéric LeBlond

I guess it's really true what they say, better the devil you know than the one you don't.

The next story is a shorter one and showcases some common employee frauds and the importance of whistleblower hotlines. Three City of Caribou employees were fired due to reports made through the city's fraud and waste hotline in 2020. One employee took 32 annual leave days over several years without recording it in the system. A manager had been verbally approving the vacation and counted on the employee to report it. That said, the manager was part of a different office and was unaware the employee had taken leave without claiming it. This is time theft and although the employee received verbal approval, they were bypassing system controls related to time off and vacation.

One other employee did work for their private business on city time during their probation period. This is moonlighting and time theft. Keep in mind, the city is paying this employee a salary in exchange for time worked towards his interest and has restrictions on what additional employment staff can obtain to ward off potential issues with conflicts of interest.

There was also another employee who was handing in medical notes and claiming sick leave while working for another organization. More moonlighting and time theft. And honestly, I don't think those were real medical notes, so some forgery as well.

## Jazz Clemente

Time theft has gotten more common in the recent years. Because of COVID, a lot of employees are working from home. Productivity has increased for a lot of companies. However, there are definitely cases where employees saw this as an opportunity to steal time from their company. This could be done by taking extra days off like in this story or for others, working two jobs at the same time. I see this as a recurring story online and I hope the people involved in these crimes get caught.

## Frédéric LeBlond

The next story I'd like to present is a case of very creative tax fraud, specifically relating to GST/HST refunds and how a group of housewives got rich off of them. Meryl York, Samantha O'Reilly, Kinsley Strauss and Kylie Strauss ran several companies which supposedly engaged in the sale of cookbooks, salad dressings, wigs, children's fur coats, frozen food, as well as catering. The organization claims to have done \$56 million in sales out of several locations, including a home in Eastern Canada. These sales included 54,000 cookbooks in six months, hundreds of children's coats priced at \$1,000 and half a million dollar orders for frozen dinners. They did not have employees and in many cases did not have bank accounts. While they claimed high sales figures, they collected very little sales tax and were seeking large GST/HST refunds. They were paid \$276,000, but were ultimately denied more than three million after CRA became suspicious.

Jazz, could you explain to us how this happened?

## Jazz Clemente

Sure. I've done a good amount of HST reasonability analysis while working in assurance. The only way businesses can get an HST refund would be when the amount of HST they collected from their customers is less than the amount of HST they paid to their suppliers. So, follow me here. In Ontario, for example, our HST rate is 13%. If company A sold \$100,000 worth of goods, they would have to pay back \$13,000. However, if in the same timeframe, company A had one million dollars worth of expenses, be it in cost of good sold, administrative supplies or repairs and maintenance,

then CRA would have to pay them back \$130,000. The net amount of \$117,000 would then be the HST refund. In the case of these four ladies, the question is, why were they making significantly more expenses than their sales and how were they even able to afford, if it was real?

### **Frédéric LeBlond**

That's true. Being denied over three million dollars in HST refunds shows that there is a significant difference in their sales and expenses. That huge discrepancy is probably what prompted CRA to investigate in the first place, I'm guessing.

### **Jazz Clemente**

Right. The only way this would be reasonable is if the products they were selling were zero-rated. Frozen food could be zero-rated, but in Ontario, books are taxed at 5% and clothes are taxed at 13%.

### **Frédéric LeBlond**

Thanks, Jazz. This is super interesting. So here's how the CRA found out for sure. While investigating the case, a CRA investigator came across a handwritten expense report claiming the business had done over \$115,000 in business with a company that had a name very similar to that of a fake company devised by a character in the popular sitcom, Seinfeld.

### **Jazz Clemente**

Sounds like someone really got inspired by George Costanza at that moment.

### **Frédéric LeBlond**

So expenses, sales reports and invoices were submitted to support their claims. However, CRA was unable to find any trace of the stores or enterprises the companies did business with, and even the addresses didn't appear to exist. Adding to the complexity of the fraud scheme, even when CRA began to review and audit the credit returns, the ladies in their companies supplied fake invoices and amended claims to hide their fraud. The individuals and their companies were found guilty of 20 charges including half for fraud. They were found to have significantly inflated sales and operating expenses in an attempt to get higher GST/HST refunds. CRA even believes that the majority of their transactions are fictitious. The individuals were given prison terms between two to four years and fines between \$335,000 and \$2 million.

The last case I'd like to discuss is that of a company whose broken promises misled investors and caused much pain in the stock market. Note that the following is a subject of a class action lawsuit and has yet to be tested in court. As such, our discussion is made under the assumption that the misconduct did in fact occur. Though Kryptonite presented itself as a pharmaceutical company using very advanced tools to create tailored immunotherapy products, they had no products out at the time, but they did have applications to begin human trials for new drug candidates pending approval from the FDA. They had stated in previous public filings that Kryptonite could commence trials within 30 days of those applications unless the FDA imposes a clinical hold. Based on this positive information, Kryptonite prepared to go public through an initial public offering, or IPO for short.

Prior to this offering, Kryptonite learned that their products received some bad news as the FDA had indeed decided to impose a clinical hold, meaning that their plans to begin human trials would not occur in the timeline they had promised and may never even occur at all. This was not reflected in the IPO documents, which continued to state that clinical testing was expected to proceed as normal later that year, which never happened. Kryptonite later made a vague remark in passing that they had received comments from the FDA regarding some clinical hold issues. It was eventually revealed that they had learned about said issues prior to the IPO, as explained earlier. These misrepresentations resulted in significant losses for investors as the news resulted in a severe decrease in share price. As expected, the company couldn't be valued as highly if they did not have the ability to continue with their research. Given the fact that this piece of information would've greatly influenced investors, it is a material piece of fact that should have been disclosed, which is the basis of this class action lawsuit.

### **Jazz Clemente**

You know how they say investing in the stock market is like informed gambling? In this case, vital information was withheld and decisions were made without knowing the real risks involved. It is unfortunate that so many people were, in a sense, defrauded by Kryptonite that the class action lawsuit was filed.

### **Frédéric LeBlond**

I'm really curious to see how this lawsuit will turn out. Organizations like Kryptonite should understand that there's a price to dishonesty. People chose to invest in this

company on the basis that they would eventually be able to perform their human trials. So of course, they'd be on the lookout if those trials didn't occur when promised, they were bound to find out. Is it really worth making millions on an IPO if you have to pay double in fines? I really don't think so.

We do have a special guest here with us today. I'd like to introduce our very own Kas Rehman. Kas is a partner at KPMG Canada and leads our Eastern Ontario and Atlantic Forensic practice and has over 30 years of experience helping clients manage fraud risks. Kas, our stories this week focused on conflicts of interest and unethical conduct. What should we do to avoid finding ourselves in these types of situations and what can organizations do to mitigate the damage these can cause?

### **Kas Rehman**

Thanks, Fred. Those are great questions and those are questions I get all the time. And the stories you've told all relate to some form of unethical behavior, including conflicts of interest. Sometimes there's very little you can do to avoid a conflict of interest, but what's important is how do you handle those situations? So I think importantly, we should look at what does a conflict of interest mean. I think we should start with a definition, and I've written a definition down here and let's try this one. It's, a conflict of interest as a circumstance or situation that has or may be perceived by a fully informed reasonable observer to have an impact on the organization or its employee in their ability to perform objectively or otherwise act without bias. Now, that's a mouthful for sure, but let me unpack that a little bit and give you a few ways to describe what a conflict of interest really is.

So one way to describe it is, a financial, commercial or business employment or other interest or activity outside of an organization where such an interest might be prejudicial or detrimental to the discharge of an employee's official duties and responsibilities. And another way to look at it is, activities in an employee's personal affairs could impair or call into question their ability, perform their duties and responsibilities in an objective manner. So it's really anytime you're in a situation as an employee or what you're involved with outside of work potentially and possibly within work, could create a situation where you're not acting in the best interest of your organization, which is your responsibility as an employee. So sort of some definitions and ways of looking at and describing what conflicts of interest are.

Knowing this, what can we do? And given the stories you've

shared with us, what can you do to mitigate the risks associated to conflicts of interest? And there's lots you can do. So first of all, organizations should have a conflict of interest policy where the concept of conflicts of interest are clearly defined. Because as you can tell, it's not always clear what constitutes a conflict of interest, and folks have some difficulty sometimes in knowing where the line is and whether they're about to cross it or not. So having some very clearly defined examples in your conflict of interest policy goes a long way to helping provide clarity for your employees. But not just having a policy that's not going to help entirely because if the policy is just sitting on a shelf somewhere or on some website or on some portal, your employees are never going to look at it or may not look at it. So it's really important to think about providing conflict of interest awareness training for your employees.

So having regular training, whether it's once a year, a couple times a year, but this will allow your employees to better recognize a conflict of interest situation and how to handle those conflicts of interest situations when they occur. This training should be really clear about giving guidance on scenarios, much like the stories you've presented to us, Fred, and could result in that you know, want to be able to describe scenarios where there is actual conflicts of interest or even perceived conflicts of interest. So that training goes a long way to helping provide clarity to employees.

The other thing you want to do for your organization is to provide your employees with an ethical decision making framework, which really helps guide your employees on how to look at a situation and determine the best course of action. I've seen some organizations having a very clearly written out framework that says, here is what you're looking at. Here's what you should be thinking about in terms of this particular situation, and here's what you need to do to make a decision as to what the best course of action is, which could be do nothing or could be raise your hand and say, "I think I have a conflict of interest." Or maybe seek more guidance from other individuals within the organization. So having that ethical decision making framework as part of your training and also as a standalone document goes a long way in terms of clarifying what an employee should do if they're faced with an ethical dilemma or a conflict of interest dilemma.

Another key one is, in terms of steps you can take, is having mandatory disclosures so that your organization is aware of potential conflicts of interest. So as an employee, if I'm an employee of an organization, I should have to declare at

least every year whether I think I'm in a conflict of interest situation in any particular business dealings that I have. So a really good example is if I'm in a situation where I procure for my organization, so I'm in the procurement department and I know that we're about to hire a company that belongs to one of my friends. If I'm involved in the decision making, that's clearly a conflict of interest and I need to make sure I'm declaring that. So not only declaring it at the time of that conflict when it occurs, but to think about it on an annual basis to say, are there any other situations where I may be in conflict, where my employer should be aware?

So those are some tips that you should keep in mind from an organizational perspective to help generate more awareness and provide some frameworks for your employees. Probably the most important thing an organization can do is to have a strong reporting mechanism for your employees. So if they see unethical behavior, they know that they can report it in some way. So we often refer to these reporting mechanisms as whistleblower lines, but it's not just whistleblower lines. For me, it's an incident reporting mechanism. So you want to make sure that your employees know that if they see someone else in a situation that might be in a conflict, that they have a mechanism and an ability to report that situation. And it may be that if there's nothing to it or it may be that it's something that really needs to be looked into.

So for a reporting mechanism to be really effective, it needs to be first of all, accessible and understood. So as an employee, I need to know how I can access this mechanism. Is it an email? Is it a phone call? Is it just a brown envelope under a door somewhere? What is the mechanism? And it could be all three of those or it could be more so, but it's got to be accessible to me and I need to know exactly what to do. I always think of the culture in our airports where we talk about see something, say something. It's really to protect everyone. And when I'm a traveler, I see those posters everywhere and I know exactly what to do if I see something unusual. There's phone numbers, there's websites, there's email addresses, all kinds of ways of reporting unethical behavior in the airport.

So that's the kind of culture you want to have within your organization to protect everyone. I mentioned a few different mechanisms and ways of reporting. You want to make sure that all those mechanisms are all consolidated in some way so that whoever's looking at all these reports, the emails, the ones that come through a website, the ones that come through a phone line, that's really important that they're consolidated and that you have some kind of triaging

mechanism on the other end. You want to make sure that there's an ability for your complaints or for that whistleblower line or the incident reporting mechanism to have anonymity. So if I want to be anonymous, I can be, when I report something. You might get more reports of situations if people can feel comfortable that they're not going to be aimed or involved, that they're reporting something that they see as untoward.

You want to make sure that the process is confidential if they're reporting something and you want to especially make sure that there's independence from management. So your incident reporting mechanism has to be separate from management. It has to be a way that, if management is involved in some kind of conflict of interest situation or other wrongdoing, that the process bypasses management, it goes right to the board or the audit committee. And it has to be clear that this process is non-retaliatory and that the employees are protected so that if they make a report, regardless of what the outcome might be, there's no repercussion to the employee for making a report.

And then lastly, I think it's important to say you've got to have a compliance committee put together and have it ready in advance so that when all these reports come in, they're appropriately triaged and investigated and reported back to the board or the audit committee. So those are some things that you can do from a conflict of interest perspective. To sum up, I would say make sure there's a ton of awareness within your organization. Make sure people know that they can report wrongdoing or other conflicts of interest through some kind of incident reporting mechanism and make sure as an organization you follow through all the reports that come in.

### **Frédéric LeBlond**

Thanks so much for joining us today, Kas.

### **Jazz Clemente**

Each episode, we'd like to leave you with a little something to help increase fraud awareness. Here's Fred with our fraud scheme of the week, collusion among contractors, part of procurement fraud.

### **Frédéric LeBlond**

Do you feel like your organization always cycles through the same contractors? It might not be a simple coincidence. These contractors may be colluding together to guarantee that they get your lucrative contracts and leave both you and their competition in the dark. There are several ways they

can do this, including complimentary bidding, bid rotation, and bid suppression. Complimentary bidding happens when competitors submit token bids. In other words, bids that are not serious attempts at winning the contract. This is done in order to influence the contract price and who ultimately gets awarded the contract. Token bids could be priced too high, could fail to meet certain requirements, or could contain unacceptable special terms. These token bids can make the real bid appear like the best option even when it would otherwise be mediocre on its own.

As for bid rotation, this happens when two or more contractors conspire to rotate contracts among themselves. They exchange information with each other in order to ensure they all win a similar share of the purchasing organization's business. This essentially involves two or more businesses acting as one team and splitting the work among themselves. And for bid suppression, this happens when a contractor gets their competitors to refrain from bidding or to withdraw a previously submitted bid. The competitor may agree to do so in exchange for a subcontract or a payoff or may face extortion if they refuse to cooperate. This is different from bid rotation in that they're not acting as a team and there is no promise to yield in a future bidding opportunity.

### **Jazz Clemente**

So how do you manage this?

### **Frédéric LeBlond**

You need to make sure you are looking for certain red flags when potentially dealing with collusion among contractors. These include the following.

The same contractors keep reappearing on each project. There are fewer competitors than usual. The bidders appear to be close with each other. There's evidence of collusions, such as using the same typeface, or having the same mathematical errors on several bids. The qualified contractors you are expecting to bid aren't submitting bids. Work is being subcontracted to losing bidders. Some bids aren't conforming to specifications. Prices fall when a new contractor enters the competition. The winning bid and all bids in general seem to be too high and the winning bid is the last party to have entered. Catching these red flags early will help secure your organization against procurement fraud.

KPMG Forensic professionals transform how clients identify, mitigate, and respond to risk, saving time and money. We

help individuals and organizations stay on top of fraud, and we would love to help you too. On behalf of the whole KPMG in Canada's Forensic team, thank you very much for tuning into this episode of the KPMG Fraudcast.

### **Jazz Clemente**

And we hope you join us again next time.