Preventing procurement fraud in the public sector
Objectives

> Illustrate the risks associated with the contracting process
> Define the parameters of fraud versus human error and mistakes
> Highlight examples of best practices in contract administration
> Identify strategies and internal controls to reduce procurement risk
Overview: Why fraud occurs
Types of procurement fraud
How public agencies can fall short
Detecting procurement fraud
Fraud investigation considerations
Strategies for preventing procurement fraud
Overview:
Why fraud occurs
Fraud /frôd/

Wrongful or criminal deception intended to result in financial or personal gain. A person or thing intended to deceive others, typically by unjustifiably claiming or being credited with accomplishments or qualities.

Synonyms
- Swindle, Trickery, Deception, Scam, Cheat
Why people commit fraud

Pressure

- Political pressure.
- They were asked to perform a small “favor” this one-time.
- Financial stress (e.g., high medical bills, gambling addiction).
- Desire to advance in their career.

Opportunity

- Individuals think no one is watching.
- They got away with it once, so why not do it again.
- Perceived understanding of how to “beat” the system.
- Weaknesses in internal controls.

Rationalization

- Individuals believe they are justified in their actions and can repay the money before anyone notices.
- Belief they are underpaid and the action is justified.
- Family obligations.

Source: Fraud Triangle, Donald R. Cressey
Types of procurement fraud adapted from the Uniform Occupational Fraud Classification System

- Corruption
  - Bid Rigging
  - Bribery
  - Conflicts of Interest
  - P-Card Misuse
  - Phantom Vendors
  - Splitting
  - Substitution of Items

- Asset Misappropriation

- Fraudulent Statements
  - Fictitious Revenues
  - Improper Disclosures
  - Overstated Credentials

Source: Association of Certified Fraud Examiners
Types of procurement fraud:

**Corruption**
- The agreement of multiple bidders to manipulate the procurement process.
- Bidders agree to rotate bidding, bid high prices, or participate in anticompetitive practices.

**Bribery**
- Vendors provide kickbacks to purchasers and authority makers in exchange for contracts.
- The bribe can be monetary, tickets to sporting events or work on personal property.

**Conflicts of Interest**
- A person with a fiduciary responsibility to the institution exploits their position for personal benefit.
- An example is a Project Manager for the installation of a new soccer field who fails to disclose that he has partial ownership in the selected firm completing the work.

**P-Card Misuse**
- Employees use their P-Card to purchase personal items.
- Employees purchase restricted items e.g. alcohol.
Types of procurement fraud: Corruption continued

**Phantom Vendors**
- Fictitious vendors are established as reputable firms.
- Payments are made to these vendors even though work was never performed.

**Splitting**
- In order to avoid the threshold for competitively procuring goods and services, the request is split into small purchases.
- The cumulative amount of the purchase order is well over the bid threshold.

**Substitution of Items**
- Suppliers submit substitute items without prior approval of the requestor.
- The substitute items are inferior to the specifications and can either be of lesser cost or lesser quality. However, the institution is billed at the higher price.
Types of procurement fraud: Asset misappropriation

- Suppliers intentionally ship an incomplete order, but the receiving slip states that a full order was delivered.
- Employees steal inventory.
- Good inventory is marked as scrap so that it can be discarded and then resold.
Types of procurement fraud: Fraudulent statements

- **Fictitious Revenues**
  - Firms overstate their financial revenues to appear more financially solvent than they really are.
  - Institutions believe that the firm is in good financial health, but the firm may be on the brink of bankruptcy or not in a position to complete the work.

- **Improper Disclosures**
  - Firms fail to disclose their full ownership structure, which may lead to doing business with debarred or decertified firms.
  - Firms fail to state any current or legal issues that may impact the award of their contract.

- **Overstated Credentials**
  - Firms provided inflated qualifications of their company and staff performing the work.
  - They may overstate their success rate with past projects or experience performing comparable projects.
How public agencies can fall short
Weaknesses in the procurement process

- Decentralized procurement function
- Lack of segregation of duties
- Maverick or after-the-fact purchases
- Lack of a three-way match process
- Failure to have a formal procurement policy
- Lack of cross-training for staff
- Lack of an internal audit function
Detecting fraud
What to look for

Internal signs
>
> Purchase orders created after hours (e.g., weekends, evenings, holidays)
> An initial low bid is awarded, followed by multiple change orders
> Minimal documentation for procurement requests submitted
> A losing bidder is hired by the winning bidder, which may suggest that the winning bidder did not have the qualifications to perform the work
> Close social relationships between suppliers and college and university personnel (e.g., gifts, trips, tickets)

External signs
>
> The ownership structure is the same for multiple firms
> Companies who share offices with other suppliers that do business with your institution
Fraud investigation considerations
Establish a fraud incident plan to outline how the investigation will be conducted and the necessary resources.

**Approach**
- Create an investigation plan
- Maintain communication with the investigation team
- Take corrective action as soon as possible
- Have a debriefing meeting after the investigation
- Develop a public relations strategy

**Considerations**
- Internal and external resources
- Applicable state statues and laws
- Investigation budget
- Timeline for completion
- Reporting requirements
### Steps in a typical investigation

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<tr>
<th>Step</th>
<th>Action</th>
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| **1. Notify the right people** | • Notify HR for personnel matters  
• Legal department for advice and representation  
• Department and institutional leadership  
• Do not include anyone what may have a conflict of interest with the investigation |
| **2. Designate a lead investigator** | • Head of Internal Audit  
• Outside investigator |
| **3. Suspend service** | • Determine if services may continue during the investigation |
| **4. Collect the evidence** | • Secure any evidence relating to the vendor, including contracts, invoices, formal correspondence and goods provided  
• Collect any emails and voice mails  
• Preserve and log legal documentation and establish chain of custody |
| **5. Perform interviews** | • Develop an interview plan  
• Interview appropriate parties as soon as possible  
• Determine if interviews should be recorded |
Questions to ask

- Were the actions deliberate and intentional?
- Was the offense committed by one or more individuals?
- At what stage in the procurement process did the fraud occur?
- Was fictitious paperwork created?
- Was the contract established to facilitate fraud?
- Are there protocols in place that should have caught the fraud?
Once the investigation is complete, report the results as quickly as possible. Potential considerations include:

> Issuing a final report that details the findings and results.
> Updating/implementing all applicable policies and procedures to address weakness in internal controls.
> Sharing any key take-aways to prevent future fraud through staff development and training.
> Determining if any disciplinary action should be taken or if the case should be referred to law enforcement as a criminal matter.
Strategies for preventing procurement fraud
## Competencies for contract managers

<table>
<thead>
<tr>
<th>Technical competencies</th>
<th>Aligned skills</th>
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<tbody>
<tr>
<td>Perform requirements planning</td>
<td>• Determine appropriate procurement method</td>
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<td>• Write detailed requirements/scope of work</td>
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<td>• Create an appropriate cost structure</td>
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<td>Effectively communicate with bidders</td>
<td>• Lead pre-bid/pre-proposal conferences</td>
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<td>• Respond to bidder inquiries via a formal addendum</td>
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<td>Perform technical analysis of proposals</td>
<td>• Evaluate bidder responsiveness to the requirements and non-price factors</td>
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<td>• Evaluate pricing proposals</td>
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<td>• Perform bidder due diligence e.g., background checks and site visits</td>
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<td>Perform negotiations</td>
<td>• Lead negotiations</td>
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<td></td>
<td>• Conduct discussions with bidders to determine their capacity and qualifications</td>
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<tr>
<td>Manage vendor performance</td>
<td>• Inspection and acceptance of goods and services</td>
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<td></td>
<td>• Contract monitoring to ensure work performed is in compliance with contract terms</td>
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<td></td>
<td>• Hold regular meetings to review vendor performance</td>
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Contract management strategies

Develop detailed specifications and/or scope of services
> Clearly state the “Who, What, When, Why, Where and How” the services are to be provided.
> Include deliverable due dates, special qualifications/licenses needed, and how the final product will be provided to the institution.

Conduct research and background checks on bidders before they are awarded a contract
> Use web-based searches and disclosure statements to research vendors (e.g., Google, LexisNexis, and Secretary of State business search)
> Conduct searches on current and past directorship and consider extending the searches two levels down to look for common links.

Perform announced and unannounced site visits
> Determine if the vendor has appropriate inventory and supplies for the business they are in.
> Interview the owner to understand how involved they are in the daily operations of the business.
Include pertinent clauses in contractual documents

> Stipulate language that details minimum performance standards, dispute resolution steps, and penalties for failure to meet performance expectations.

> Sample clauses include right to audit, substitutions, compliance with all laws and termination for cause/convenience.

Include performance indicators in contracts and evaluate vendors on them

> Establish the frequency for evaluating performance indicators within the contract.

> Make the indicators specific and measurable.

Maintain segregation of duties and internal controls

> The person who approves the purchase should not be the person who makes the purchase request.

> Automate the procurement process so that there is an audit trail.
Procurement systems can provide reports that can be used to monitor purchases for fraud and abuse.

**P-Cards**
- Split transactions
- Over limit transactions
- Even dollar amounts
- Purchases made during non-office hours
- Multiple purchases to one vendor
- Account credits and declines

**POs and Contracts**
- Unauthorized approvals
- Payments made within a week
- Similar invoices
- Purchase orders made during non-office hours
- Multiple purchase orders to the same vendor
- Even dollar amounts
Ethical behaviors

Conflicts of interest

- Avoid the appearance of impropriety.
- Avoid professional or personal activity that would create a conflict of interest.
- Shelter the procurement process from political influence.

Conduct with suppliers

- Refrain from showing favoritism to suppliers.
- Refrain from asking suppliers to provide donations or sponsorships.
- Treat all suppliers the same.

Best practices

- Maintain a Corporate Responsibility Policy
- Promote a fair and transparent policy (e.g., require competition and post awards online)
- Limit or prohibit gifts and meals with suppliers
Characteristics of a strong procurement function

Support from institutional leadership
- Establish clear policies and procedures.
- Communicate that fraud will not be tolerated.

Whistleblower program
- Anonymous hotline
- No retaliation

Constant monitoring
- Be diligent – frequent and by surprise
- Cross-train employees
- Trending analysis
Association of Certified Fraud Examiners, Fraud Tree: 
https://acfe.com/fraud-tree.aspx/

National Association of Educational Procurement website:  
http://www.naepnet.org

National Institute for Governmental Procurement website:  
http://www.nigp.org

The Institute for Internal Auditors website: 
https://na.theiia.org/
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