A Resource to Combat Fraud, Waste and Abuse

State of Arizona

April 2010

Governor's Office of Economic Recovery

State of Arizona

Janice K. Brewer
Governor

Office of the Governor
1700 West Washington Street, Phoenix, AZ 85007

Main Phone: 602-542-4331
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April 1, 2010

State of Arizona Employees:

My administration is committed to ensuring the fiscally responsible and transparent management of monies provided to Arizona by the American Recovery and Reinvestment Act (ARRA) of 2009.

I have directed my Office of Economic Recovery (OER) to coordinate all ARRA activities statewide and assist agencies in compiling adequate policies and procedures to prevent fraud, waste and abuse from occurring within the programs and projects funded with ARRA resources. OER has worked with the General Accounting Office and the Office of the Auditor General to develop this guide to assist state agencies in identifying areas with potential for fraud, waste and abuse and provide tools for enhancing systems of internal control in compliance with ARRA requirements.

Employees at all levels of state service should be aware of agency programs designed to prevent and detect occurrences of fraud, waste and abuse and take an active role in helping enforce them. In that manner, risks associated with these activities may be discovered and resolved at every level of the organization.

Thank you for your service to Arizona and your continued support to accomplish these goals.

Janice K. Brewer
Governor

Janice K. Brewer
Governor

Arizona Office of Economic Recovery

James J. Apperson
Director

April 1, 2010

Dear Colleagues:

Governor Brewer is committed to ensuring the prudent fiscal and programmatic management of funds provided through the American Recovery and Reinvestment Act (ARRA) of 2009 that have been entrusted to our state. The Governor strongly encourages all agencies to implement suitable fraud, waste and abuse prevention and detection programs to ensure that these funds are invested properly.

Arizona has been ahead of the curve in getting the appropriate systems and processes in place to implement ARRA effectively. Further, Governor Brewer has directed our office to work with you to ensure that the state is in a leadership position in several critical oversight areas, as well. To that end, we have been proactive in taking a number of steps to minimize fraud, waste and abuse of ARRA funds.

Our office has already identified the state agencies and programs through which ARRA funds flow. Governor Brewer, through our office, is now directing those agencies to review their existing internal control plans and update and/or amend the plans, if necessary, to satisfy ARRA's compliance and oversight requirements. The plans will be further reviewed by this office and the General Accounting Office as well as the oversight agencies that will be investigating allegations of fraud, waste and abuse. The purpose of that review is to identify any perceived vulnerabilities or concerns, either based upon the substance of the plans or on the results of past audits or investigations involving particular agencies, and to assist agencies in implementing suitable solutions.

We also engaged outside experts to help our office conduct an ARRA readiness assessment. The focus of this effort was to assess existing internal control systems, beef up any areas that require additional attention, and ensure sufficiently robust centralized oversight to resolve any issues at the earliest possible moment. We believe that this guide, made possible through cooperation with the Arizona Office of the Auditor General and the General Accounting Office, will assist you in addressing these critical issues.

It is our responsibility to the people of Arizona to ensure that all of the ARRA funds are spent in a fiscally responsible and transparent manner. Governor Brewer invites you to join us in making sure that we continue to lead the nation in this critical area.

Sincerely,

James J. Apperson, Director
Governor Brewer's Office of Economic Recovery

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

February 18, 2010

State of Arizona employees:

The American Recovery and Reinvestment Act (ARRA) of 2009 requires an unprecedented level of accountability to ensure that taxpayer monies are properly spent on programs that make a difference to communities across the country that have been impacted by the downturn in the economy. In addition to this high level of accountability, ARRA also requires an extraordinary level of transparency that will result in a great deal of scrutiny over the way monies are used. A strong system of internal control is the cornerstone of any system of accountability and helps ensure that monies are spent for allowable program purposes and helps prevent fraud, waste, and abuse.

With that in mind, we strongly encourage you to establish and maintain a strong system of internal controls over ARRA monies, as well as ***all*** public monies, and with respect to ARRA, have a thorough understanding of the new federal compliance requirements. Employees at all levels of your organization should be aware of fraud risk factors and take an active role in helping enforce established controls. Creating a control-conscious environment is one of the best ways to prevent fraud, waste, and abuse from occurring.

As always, the Office of the Auditor General is committed to helping governments in Arizona establish and maintain strong systems of internal control. Our Office is responsible for auditing the State of Arizona's federal programs, including programs funded with ARRA monies. These audits will include the evaluation of the internal controls your organization has established to ensure compliance with federal laws and regulations. We have investigated and helped prosecute individuals who were ultimately determined guilty of the types of frauds covered in this Guide, and we will continue to do so.

We hope this Guide will provide you with useful information as your organization strives to demonstrate the accountability and transparency these critical times call for.

Debbie Davenport
Auditor General

Introduction

Never before has so much effort been focused on the oversight of government funds. With the passage of the American Recovery and Reinvestment Act (ARRA) of 2009 came unprecedented levels of transparency and scrutiny. Now, more than ever, it is critical for agencies to ensure that they have the proper mechanisms in place to prevent and detect fraud, waste and abuse of taxpayer dollars. This guide has been created with that goal in mind.

The information contained in this guide is the result of collaboration between the Office of the Governor, the Office of the Auditor General, the General Accounting Office, the Governor's Office of Economic Recovery, the Governor's Accounting Office and oversight agencies that will be investigating allegations of fraud, waste and abuse. While it is impossible to prevent all fraud, being proactive in our approach to prevention can help decrease the chances of problems in the future and help detect, investigate and correct occurrences.

Addressing the potential for fraud, waste and abuse can be simplified into a three step process. First, an agency should map out the path of the funds they are handling. Next, the agency should identify the potential for fraud, waste and abuse at each point along that path. Finally, agencies need to determine how to mitigate the potential for fraud, waste and abuse. The first part of this guide helps in this process by identifying "red flags" that agencies can look for in various areas and provides examples of best practices to avoid or detect occurrences. The second part of this guide provides a set of useful tools that can be used to update internal control polices to better address fraud, waste and abuse prevention.

Going forward, one thing is for certain – all eyes will remain focused on how ARRA dollars are spent. By being proactive and vigilant, we can help to mitigate the potential for problems in the future. While this task may seem daunting, it is important to recognize that there are a number of tools available to agencies. The General Accounting Office and the Governor's Office of Economic Recovery are committed to helping agencies work to prevent and detect fraud, waste and abuse of government funds throughout Arizona.

For assistance, please contact:

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All Fraud, Waste and Abuse
Has the Same Pattern

Pressure/Motivation
There is a will to commit fraud, waste and abuse

Opportunity
There is minimal oversight or lack of controls within the organization

Rationalization
Individuals who commit fraud, waste and abuse view it as an accepted practice or part of their rights as a contractor or employee

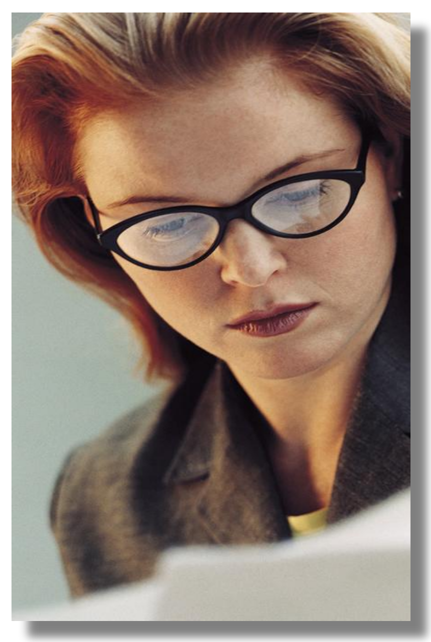
What is Fraud?

There are a number of different definitions, but fraud is largely a deliberate deception to secure an unfair gain. This could be a monetary, contractual or other type of advantage that is unlawful. Proper internal controls and awareness of fraud risk factors help prevent fraud from occurring.

Employees should be aware of the internal control process and be able to identify red flags that indicate there is the potential that fraud, waste or abuse may occur and which steps to take to prevent or detect the occurrence. Red flags are clues or hints that something out of the ordinary may occur or has occurred and that a closer look at an area or activity is required.

What are some of the common types of fraud that governments may experience?

- Theft
- Bribery
- Conflicts of Interest
- Kickbacks or Unlawful “pay to play”
- Collusive Bidding: Bid Rigging and Price Fixing
- Minority Business Enterprise, Disadvantaged Business Enterprise or Women-Owned Business Enterprise Fraud
- Materials, Equipment and Supplies Overcharging
- Product Substitution
- Time Overcharging



Theft

Theft occurs when a public official controls, takes, or converts property or services of the public without permission or consent for his or her own benefit or the benefit of another. If an employee participates in theft, the employee could be in violation of Arizona Revised Statutes (A.R.S.) § 13-1802, and could be subject to a felony conviction.

Indicators include, but are not limited to:

- Incomplete accounting records and expenditures lacking supporting documentation including purchase orders, receipts, shipping invoices, etc.
- Unsupported petty cash or purchase card transactions
- Unsupported or unreasonable travel reimbursements
- Checks made payable to cash or checks issued in large, even amounts or to employees
- Expenditures made to vendors not normally used in the course of government business
- Lack of or untimely reconciliations of expenditures to the budget, grant award, etc.
- Unexplained or unreasonable sales or cost trends (e.g. indirect grant costs)
- Abnormal employee behavior, such as an employee living beyond his/her means, gambling addictions, working overtime, or never taking vacation

Internal Controls

- Segregate employee responsibilities so that one person does not have the ability to process, review/reconcile, and approve expenditure transactions.
- Process expenditures based only on proper documentation. That documentation includes, but is not limited to, properly approved purchase requisitions, purchase orders, receiving reports, and vendor invoices. This includes all purchase card transactions and travel reimbursements.

Bribery

Bribery occurs when a vendor offers a monetary or non-monetary benefit to a public official with the intent to influence that public official's vote, opinion, judgment, exercise of discretion or other action in his/her official capacity as a public official. If an employee accepts a bribe, the employee could be in violation of A.R.S. §13-2602, and could be subject to a felony conviction.

Indicators include, but are not limited to:

- A public official or employee who has a lifestyle that dramatically exceeds his or her salary
- Oversight officials socialize with or have private business relationships with contractors or their families
- A contracting employee who declines a promotion to a non-procurement position
- A contracting employee who insists or shows a keen interest in contractors using a certain subcontractor or broker
- A significant contract change order which lacks sufficient justification
- Other inspectors at the job site who notice a pattern of preferential contractor treatment

Internal Controls

- Segregate employee responsibilities so that one person does not have the ability to process, review, and approve contracts.
- Require all employees to file an annual conflict of interest statement. A separate file should be maintained for public inspection of all known conflicts of interest and monitored by the Agency periodically. Employees who have disclosed a conflict with a vendor should be excluded from participating in the contracting process.

Conflicts of Interest

In fraud involving conflict of interest, a public official misrepresents that he or she is impartial in business decisions when he or she has an undisclosed financial interest in a contractor or consultant. If an employee intentionally or knowingly violates A.R.S. §§ 38-501 through 38-511 (conflict of interest), the employee could be subject to a felony conviction.

Indicators include, but are not limited to:

- Unexplained or unusual favoritism shown to a particular contractor or consultant
- A public official disclosing confidential bid information to a contractor, assisting the contractor in preparing the bid
- A public official having discussions about employment with a current or prospective contractor or consultant
- A close socialization with and acceptance of inappropriate gifts, travel, or entertainment from a contractor or the ability to purchase such items at below fair market value
- A public official who does not normally participate in the purchasing process and inserts himself/herself by issuing/directing a payment, awarding a contract, or purchasing a good or service
- A public official who directs staff to contract with a relative
- Vendor names obtained from accounts payable documents match names listed in conflict of interest disclosure forms

Internal Controls

- Segregate employee responsibilities so that one person does not have the ability to process, review, and approve contracts.
- Require all employees to file an annual conflict of interest statement. A separate file should be maintained for public inspection of all known conflicts of interest and monitored by the Agency periodically. Employees who have disclosed a conflict with a vendor should be excluded from participating in the contracting process.
- Following State law, institute and communicate a policy to address the acceptance of nominal gifts and meals.

Kickbacks or Unlawful "pay to play"

In kickback schemes, a contractor or subcontractor secretly pays a fee to the government employee for being awarded the contract, similar to bribery and conflict of interest. If an employee accepts a kickback, the employee could be in violation of A.R.S. §13-2602, and could be subject to a felony conviction.

Indicators include, but are not limited to:

- Unexplained or unreasonable limitations on the number of potential sub-contractors contacted for bid or offer
- Continuing awards to subcontractors with poor performance records
- "No-value-added" technical specifications that dictate contract awards to particular companies
- Non-qualified and/or unlicensed subcontractors working on prime contracts
- Poor or nonexistent contractor procedures for awarding of subcontracts through competition
- Purchasing employees maintaining a standard of living exceeding their income

Internal Controls

- Segregate employee responsibilities so that one person does not have the ability to process, review, and approve contracts.
- Require all employees to file an annual conflict of interest statement. A separate file should be maintained for public inspection of all known conflicts of interest and monitored by the Agency periodically. Employees who have disclosed a conflict with a vendor should be excluded from participating in the contracting process.
- Institute a policy to address the acceptance of nominal gifts and meals in accordance with State law.

Collusive Bidding: Bid Rigging and Price Fixing

Collusive bidding occurs when there is either **bid rigging** or **price fixing** of contracts awarded to vendors. If an employee participates in collusive bidding, the employee could be in violation of the Arizona Procurement Code and A.R.S. § 41-2616. The employee could be subject to a felony conviction and liable for the recovery of all public monies paid plus 20% of such amount.

Bid rigging is an illegal agreement between two or more competitors. It is a form of collusion, which is illegal in the United States. It is also a form of price fixing and market allocation, and involves an agreement in which one party of a group of bidders will be designated to win the bid. It is often practiced where contracts are determined by bid; for example, with government construction contracts.

Price fixing is an agreement among competitors to raise, fix, or otherwise maintain the price at which their goods or services are sold.

Indicators include, but are not limited to:

- Bid prices dropping when a new bidder enters the competition or persistent high prices by all bidders
- Unusual bid patterns: too close, too high, round numbers, or identical winning margins or percentages
- Rotation of winning bidders by job, type of work, or geographical area
- Losing bidders hired as subcontractors
- Apparent connections between bidders; common addresses, personnel, or telephone numbers. Similar prices on non-standard items and making identical errors in contract bids
- Losing bids that do not comply with bid specifications or where only one bid is complete and other bids are poorly prepared

Internal Controls

- Document all vendors and their subcontractors currently under contract performing similar work to determine reasonableness of pricing.
- Evaluate bidding criteria to determine if collusive bidding appears to have occurred during the selection process. Review vendors' prior proposals and pricing to determine if there is a fluctuation in bid amounts or trend in which the vendor is awarded the contract. Include these reviews on your evaluation checklist.

Minority Business Enterprise (MBE), Disadvantaged Business Enterprise (DBE), or Women-Owned Business Enterprise (WBE) Fraud

Under this scheme, a contractor misrepresents who performed the contract work in order to increase job profit while appearing to be in compliance with contract goals for involvement of minority, disadvantaged or women-owned businesses.

Indicators include, but are not limited to:

- A situation where employees are shuttling back and forth between prime contractor and a MBE/DBE/WBE business' payrolls
- Orders and payment for necessary supplies made by individuals who are not employed by a MBE/DBE/WBE owned business
- A prime contractor facilitated purchase of MBE/DBE/WBE business
- A MBE/DBE/WBE business owner is never present at the job site
- A prime contractor always uses the same MBE/DBE/WBE
- Financial ownership agreements between prime and MBE/DBE/WBE contractors exist beyond the contractual relationship
- Joint bank accounts exist between prime contractor and MBE/DBE/WBE subcontractors
- A business owner lacking background, expertise, or equipment to perform subcontract work
- An absence of written contracts between prime and subcontractors

Internal Controls

- Evaluate payroll certification reports to determine the reasonableness of employees listed.
- Determine the validity of the MBE/DBE/WBE status of contractor and subcontractors.

Materials, Equipment and Supplies Overcharging

Under this fraud scheme, a contractor misrepresents how much construction and non-construction materials, commodities, equipment and/or supplies were actually used on the job to increase profit.

Indicators include, but are not limited to:

- Discrepancies are present between contractor-provided quantity documentation and observed data compared to amounts requisitioned or required
- A refusal or inability to provide supporting documentation
- Photocopies of documentation are submitted when originals are expected
- The contractor resists inspection during the job or delivery process
- Packing lists, bills of lading, or other shipping and receipt records have altered or missing information
- Irregularities in standard stationery or other contractor documents that are used to calculate payments
- An unusually high volume of purchases from one vendor
- Invoiced goods cannot be located in inventory or accounted for
- Not taking advantage of contracted discounts or volume purchasing
- The acquisition price is not easily discernible

Internal Controls

- Process expenditures based only on proper documentation. That documentation includes, but is not limited to, properly approved purchase requisitions, purchase orders, receiving reports, and vendor invoices. All documentation should be the original vendor invoices, certification reports (time and accounting records), status reports on construction projects (e.g., punch list), etc.
- Ensure that all expenditures processed are reviewed and approved by another employee.

Product Substitution

In a fraud scheme involving product substitution, a contractor misrepresents the product used in order to reduce costs for materials. These indicators include, but are not limited to:

- Mismarking or mislabeling of products and materials
- A contractor who restricts or avoids inspection of goods upon delivery
- A contractor refuses to provide supporting documentation regarding production or manufacturing
- Photocopies of necessary certification, delivery, and production records exist where originals are expected
- Irregularities in signatures, dates, or quantities on delivery documents
- A high rate of rejections, returns, or failures
- Certifications required in the contract are not signed
- A contractor offers to select samples for testing programs
- Vendor fails to supply warranty information
- Vendor fails to apply manufacturers' rebates/discounts toward final costs

Internal Controls

- Process expenditures based only on proper documentation. That documentation includes, but is not limited to, properly approved purchase requisitions, purchase orders, receiving reports, and vendor invoices. All documentation should be the original vendor invoices, certification reports (time and accounting records), status reports on construction projects (e.g., punch list), etc.
- Ensure that all expenditures processed are reviewed and approved by another employee.

Time Overcharging

In a time overcharging scheme, a consultant or contractor misrepresents the distribution of employee labor on jobs in order to charge for more work hours, or a higher overhead rate to increase profit.

Indicators include, but are not limited to:

- Unauthorized alterations to timecards and other source records
- Hours and dollars consistently at or near budgeted amounts
- Timecards are filled out by supervisors, not by employees
- Photocopies of timecards submitted where originals are expected
- Inconsistencies between consultants' labor records and their employees' timecards
- Frequent payroll adjustment entries with descriptions such as "charged wrong accounts" etc. included on a following request for payment
- Labor charges with contracts are inconsistent with contract progress
- Lack of a clear audit trail to verify propriety of labor charges
- Job misclassification – apprentice workers billed out at higher rates

Internal Controls

- Process expenditures based only on proper documentation. That documentation includes, but is not limited to, proper time and accounting records, original timesheets, and proper classification of employees' positions and rates.
- Ensure that all expenditures processed are reviewed and approved by another employee.

Fraud, Waste and Abuse
Indicators by Organizational Responsibility

Fraud, waste and abuse can occur in other areas of business that may not be as evident as the "red flags" discussed above. These areas of business may have the following indicators, but are not limited to:

Management

- Lack of or little oversight
- Lack of or little training for employees
- Lack of a fraud hotline or failure to support whistleblower programs
- Failure to investigate and respond to identified issues
- Lack of or little management understanding or support for systems, processes and controls
- Minimal or no checks and balances
- Minimal or no segregation of duties
- Improper use of funds
- Supervision assuming work of subordinates
- High personnel turnover

Accounting / Fiscal Services

- Lack of or failure to follow internal controls
- Lack of or failure to follow compliance with controls over management override
- Unauthorized transactions
- Excessive transactions with "round" numbers
- Unexplained or unsupported entries in records
- Unusual bank transactions
- Failure to reconcile inventories and financial records
- Current spending inconsistent with authorized budget levels
- Altered records
- Large or frequent cash payments

- Sequentially numbered purchase orders, checks, invoices, receipts, etc., for the same purpose
- Insufficient or no supporting documentation

Audit

- Little or no audit trail reporting
- No prior audit or excessive time since prior audit
- Repeat audit findings going unresolved
- Difficulty in providing information or documentation for audit purposes
- Inability to support questioned costs

Where Can You Find Additional Information?

The Arizona General Accounting Office (GAO)
https://gao.az.gov/publications

The Institute of Internal Auditors (IIA)
https://na.theiia.org/Pages/IIAHome.aspx

The Association of Certified Fraud Examiners (ACFE)
http://www.acfe.com/fraud-resources.aspx

United States Government Accountability Office (U.S. GAO)
Standards for Internal Controls (GAO/AIMD-00-21.3.1)
https://www.gao.gov/assets/670/665712.pdf

The White House, Office of Management and Budget (OMB)
Management's Responsibility for Internal Controls (Circular A-123)
https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/memoranda/2016/m-16-17.pdf

What to Do If You Suspect Fraud, Waste or Abuse

If you have evidence of fraud, waste or abuse activity, report such activity to management or an oversight agency.

OR

Blow the Whistle:

If you have a complaint involving public funds, the following contacts are available:

Contact Information

For ARRA

Arizona Office of Grants & Federal Resources Fraud Hotline (602) 542-7567
e-mail or mail correspondence to the following sources:

Matthew D. Hanson, GPC
matthew.hanson@azdoa.gov
ADOA – Office of Grants & Federal Resources
100 North 15th Ave., Suite 305
Phoenix, AZ 85007

For ARRA or Other Fraud

Arizona General Accounting Office (GAO) (602) 542-5601
Or e-mail: reportfraud@azdoa.gov

Office of the Arizona Auditor General
Special Investigations Unit (SIU) (602) 553-0333

Office of the Arizona Attorney General (602) 542-4853

Employment Protection Act
(Whistleblower Protections)

Section 1553 of the American Recovery and Reinvestment Act (ARRA) of 2009 provides guidelines regarding protections for public employees and contractors who wish to make disclosures to expose violations of law or risk to public health, safety or environment in a "whistleblower" mode. Additionally, A.R.S. § 23-1501.3 and Arizona whistleblower statutes (A.R.S. § 38-531 through A.R.S. § 38-534) provide guidelines for the protection of "whistleblowers" in government service.

Who is protected?

Employees of the State and its agencies or political subdivisions, including, but not limited to, cities, towns, counties and regional school districts, or any authority, commission, board or instrumentality thereof.

What are whistleblowers protected from?

Covered individuals are protected from being discharged, suspended, or demoted, or from any other adverse employment action being taken as a reprisal for making a protected disclosure.

What kinds of disclosures are protected?

Any disclosure made by an employee to any public body* of an activity or practice that the employee believes is in violation of a law, rule or regulation, or which the employee believes poses a risk to public health, safety or the environment.

*A public body can be:

- U.S. Congress or state legislature
- Popularly elected local government body
- Federal, state or local judiciary
- Federal, state or local regulatory, administrative or public agency or authority, or instrumentality thereof
- Federal, state or local law enforcement agency, prosecutor's office or police/peace officer
- Any division, board, committee or commission of any of the above