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Alabama Association of  
School Business Officials

# Navigating the Risks Associated with Procurement Fraud

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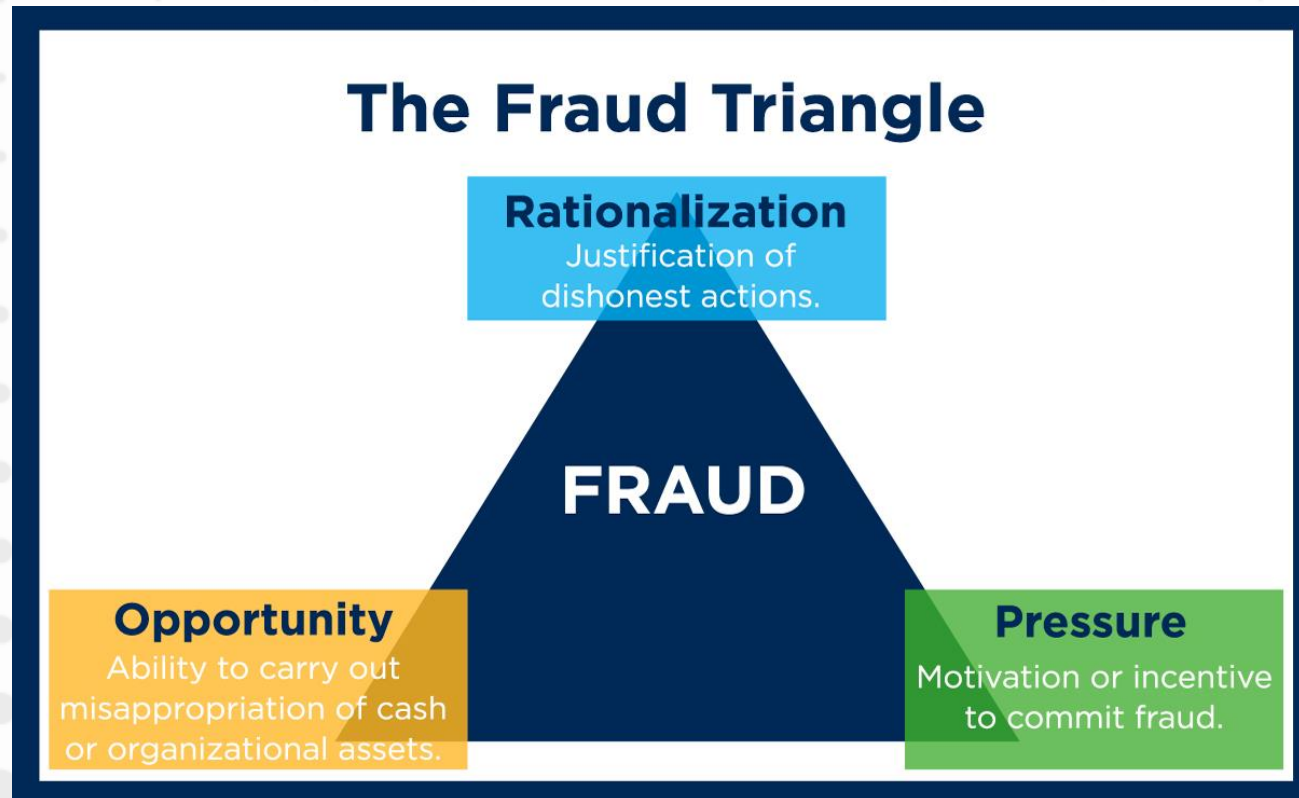


# Training Objectives

- ▶ Review the elements of fraud and fraud statistics
- ▶ Identify the common fraud schemes utilized in purchasing
- ▶ Discuss common detriments faced by governments when trying to implement effective controls
- ▶ Review case studies of procurement and purchasing fraud
- ▶ Review fraud prevention methods and internal controls to mitigate risks associated with procurement fraud
- ▶ Discuss the effects that fraud can have on an organization

# Fraud Basics

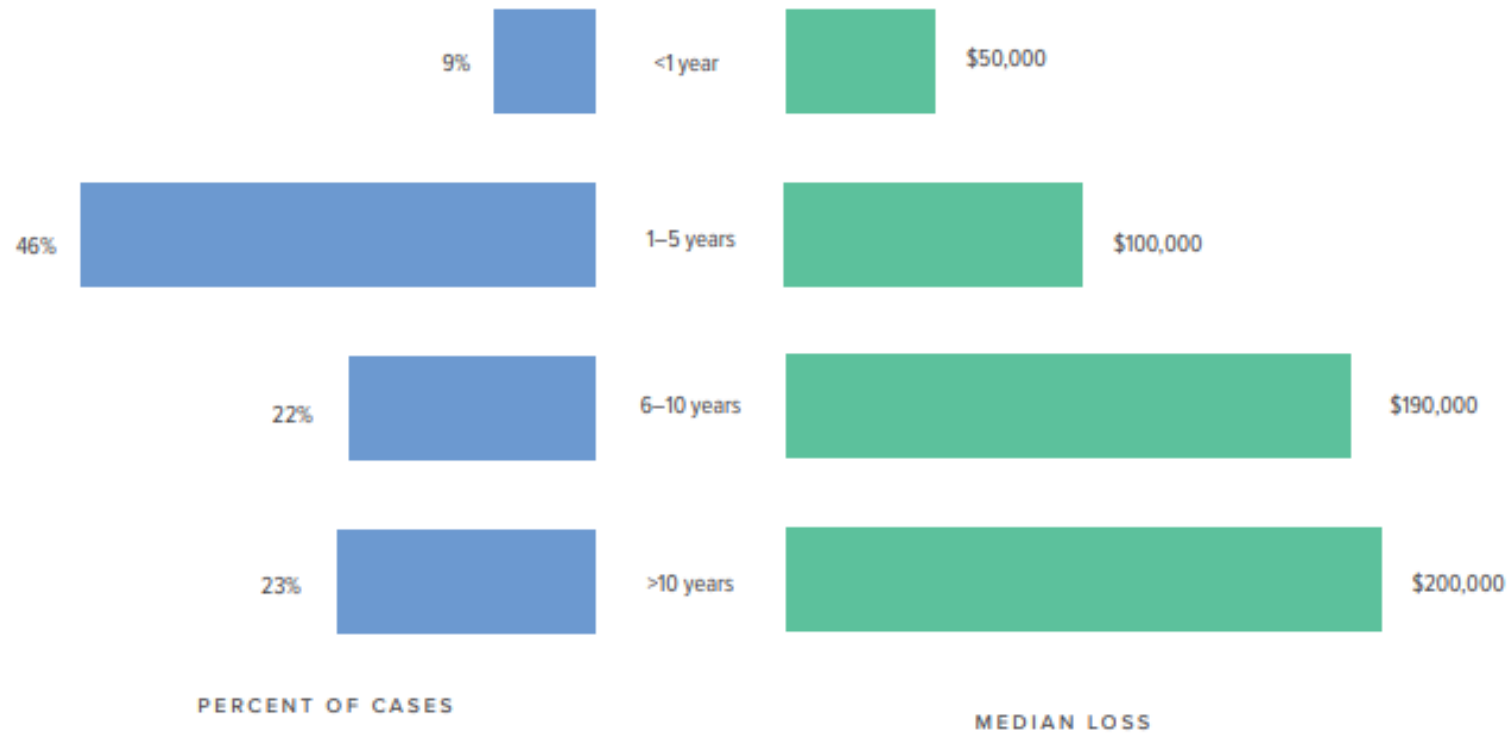
- ▶ Fraud Triangle – A model for explaining the factors that cause someone to commit occupational fraud.



# Overview of Fraud

Source – ACFE 2020 Report to the Nations

FIG. 29 How does the perpetrator's tenure relate to occupational fraud?



# What Are The Control Weaknesses That Contribution To Occupational Fraud?

## From the 2020 ACFE Report to the Nations:

- Lack of Internal Controls – 32%
- Override of Existing Internal Controls – 18%
- Lack of Management Review – 18%
- Poor Tone at the Top – 10%
- Lack of Competent Personnel in Oversight Roles – 6%
- Other – 6%

# Common Behavioral Red Flags

## From the 2020 ACFE Report to the Nations:

- Living beyond their means - 42%
- Financial difficulties – 26%
- Unusually close association with vendor/customer – 19%
- No behavioral red flags – 15%
- Control issues/unwillingness to share duties – 15%
- “Wheeler-dealer” attitude – 13%
- Divorce/family problems – 12%
- Addiction problems – 9%
- Complaining about inadequate pay – 8%
- Refusal to take leave – 7%
- Excessive pressure from within the organization 7%

# Procurement Fraud Schemes

## Bid Rigging

- 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.

## Conflict of Interest

- A person with fiduciary responsibility to the institution exploits their position for personal gain.
- An example would be a project manager for a new school who fails to disclose their partial ownership in the selected firm completing a portion of the work.



# Procurement Fraud Schemes

## Phantom Vendors

- Fictitious vendors are established as reputable firms.
- Payments are made to these vendors with no work having been performed or goods received.

## 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 is over the bid threshold.

## Substitution of Goods

- 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.

# Procurement Fraud Schemes

## False Claims

- Costs invoiced do not match contract terms or rates.
- Vendor has included costs for other clients, or reimbursable costs that are not supportable.

## P-Card Misuse

- Employees use their p-card to purchase personal items.
- Employees purchase restricted items, e.g. alcohol.
- Use of p-card to circumvent other established purchasing procedures, e.g. purchase orders.

# Public Entity Risks/Detriments

- ▶ Decentralized procurement function
- ▶ Lack of segregation of duties
- ▶ Purchases made prior to formal approval process
- ▶ Lack of three-way match of documentation
- ▶ Improper training of staff
- ▶ Ineffective communication of purchasing and procurement policies

# Case #1 – Change orders – Port of Seattle

## Performance Audit Report

### Port of Seattle Construction Management

Report No. 100008



December 20, 2007

# Case #1 – Port of Seattle Construction Management

- ▶ The Port circumvented competition by awarding contracts at “less competition required” levels and then amended the contracts to higher levels, splitting purchases, and awarded sequential no-competition agreements (page 53)
- ▶ A consulting agreement awarded in 1993 grew without competition from \$950,000 to more than \$30 million (page 69)
- ▶ A consulting agreement awarded in 1998 grew without competition from \$10 million to more than \$120 million (page 76)
- ▶ The port altered contractor invoices in order to pay a contractor for an amount that exceeded the maximum contract amount

# Case #1 – Port of Seattle Construction Management

- ▶ A 3rd Runway project procurement violated applicable procurement laws, and POS concealed details of this unusual procurement from the Board.
- ▶ Port management did not provide reports on contract administration/bid irregularities and information related to professional consulting services to the Board, as required by Board's delegation of authority.
- ▶ Managers approved an agreement and amendments in amounts that exceeded their authority.
- ▶ A former employee of one contractor managed the contractor's construction project. The consultant served on a selection committee that awarded a \$5.8 million contract to one of their company's subcontractors.

# Case #1 – Port of Seattle Construction Management

## Possible fraud at Port focus of criminal probe

By Jim Brunner and Bob Young  
*Seattle Times staff reporters*

The U.S. Justice Department has launched a criminal investigation of the Port of Seattle, following a recent state audit that accused the Port of wasting public money and raised the specter of possible fraud in construction contracts.

State Auditor Brian Sonntag disclosed the investigation Monday, releasing a letter his office had received Friday from U.S. Attorney Jeff Sullivan.



MIKE SIEGEL / THE SEATTLE TIMES

# Case #2 – Purchasing Cards – Amazon Sally



Office of the Washington State Auditor  
Pat McCarthy

Fraud Investigation Report

**Lake Quinault School District No. 97**

Grays Harbor County

For the Investigation Period August 1, 2008 through  
January 31, 2015



# Case #2 – Purchasing Cards – Amazon Sally

- ▶ The District's former Accounts Payable Secretary was responsible for completing and monitoring district purchase orders, processing accounts payable payments, and management of district purchasing cards.
- ▶ The secretary falsified a request to issue a card in her name using a signature stamp of the District's superintendent.
- ▶ The secretary also had access to use store credit accounts at a home improvement and office supply stores, as well as an additional credit card issued under the District's name.
- ▶ The secretary charged items such as vacations, a refrigerator, pet supplies, clothing, shoes and perfume to the District's credit accounts.

# Case #2 – Purchasing Cards – Amazon Sally

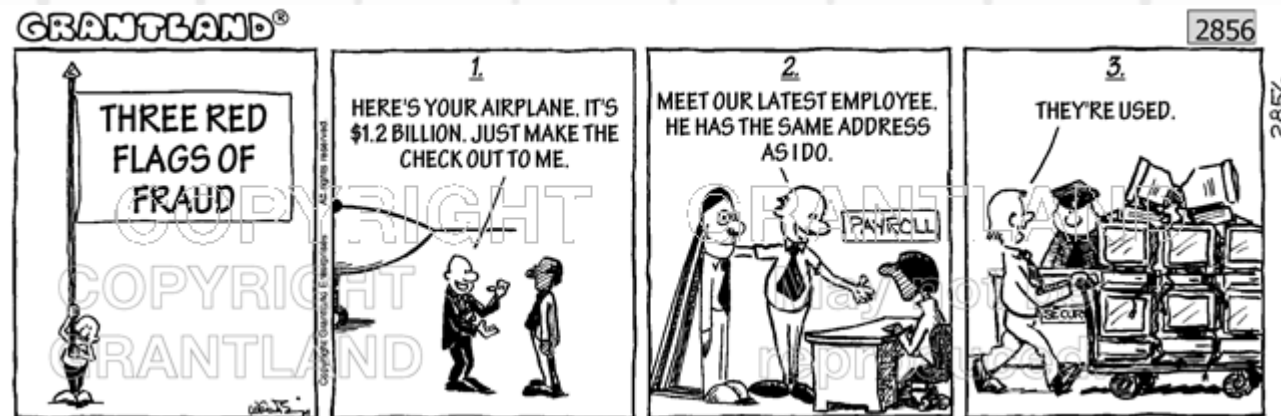
- ▶ A subsequent search performed by the Sheriff's office found some of the items purchased in the home of the former secretary.
- ▶ The results of the investigation identified a misappropriation of \$118,871, and additional questionable expenses of \$142,797.
- ▶ The loss occurred over the period of August 2008 through January 2015.



# Case #2 – Purchasing Cards – Amazon Sally

Control weaknesses noted included:

- ▶ Lack of independent review of credit card statements
- ▶ Ineffective review of supporting receipts, lack of supporting documentation
- ▶ Incompatible duties (purchasing, payment, monitoring)
- ▶ Generic purchase card
- ▶ Signature stamp



# Case #3 – Dear John

- ▶ A maintenance department supervisor was responsible for procuring shop parts and supplies for a public transit authority.
- ▶ The supervisor had developed a close relationship with one of the parts suppliers, and the agency almost exclusively purchased small shop supplies from this vendor.
- ▶ The public agency discovered that the vendor was providing the employee with various gifts and gratuities as a thank-you for continuing their business relationship.
- ▶ This was discovered when the employee mistakenly emailed his boss (John) thanking him for the Blazer tickets, instead of the vendor.

# Case #4 – The 36 hour day

- ▶ An insurance pool contracted with a private law firm to handle litigation on a claim involving black mold for a public housing project.
- ▶ The pool had a retainer agreement which specified the approved hourly rates for the firm's counsel, and specific reimbursable costs for travel and materials related to the active litigation of the case.
- ▶ The pool has several levels of review of claims expenses which included the claims adjuster, Pool Director, Pool Board and Audit Committee, and an independent claims auditing firm.

# Case #4 – The 36-hour day

▶ In reviewing detailed invoices from this firm, the following concerns were noted:

- Billing rates were in excess of the rates approved in the retainer agreement
- The billing statement contained numerous errors, including one entry for a day where 36 hours was billed from one individual.
- Billed charges included time of the significant other
- Invoices included entertainment expenses of the attorney and his significant other



# Case #5 – Franklin County

- ▶ The County Auditor's office sent W-9 forms to all vendors requesting updated information.
- ▶ One form came back return to sender, additional requests were sent, all of which were undeliverable.
- ▶ The County Auditor's staff called the telephone number on a recent invoice which belonged to a trucking equipment company that had purchased the vendor's assets in December 2001. Although the vendor was no longer in business, the County continued to make payments to the vendor.

# Case #5 – Franklin County

- ▶ The former Public Works Accounting Director pleaded guilty to stealing funds and was sentenced to 16 years in prison.
- ▶ In total, there was approximately \$2.8 million in questionable and identifiable costs that were misappropriated.
- ▶ The Director had a prior federal conviction for stealing \$142,000 in 1986 while he was a financial officer with the Federal Bureau of Reclamation in Montana.



# Internal Control Considerations

- ▶ Rotation of staff responsible for procurement across different vendor relationships
- ▶ Require all employees with direct purchasing responsibilities to review entity policies and procedures on a periodic basis (including ethics, conflict of interest and purchasing policies)
- ▶ Routine review of vendors to ensure that pricing is in accordance with agreements and other contractual terms are being met
- ▶ Development of an independent review process of bids and quotes independent of those requesting goods or services to determine if pricing is at market rates
- ▶ Review transactions to ensure district procurement thresholds are being followed
- ▶ Independent process to screen and review all new vendors, including possible associations with existing vendors or employees of the district

# Internal Control Considerations

- ▶ Establish policies and procedures and ensure they are enforced
- ▶ Regular audits of accounts payable to look for duplicate disbursements and validity of charges
- ▶ Ensure payments made outside the normal process are approved, supported, and comply with district policies
- ▶ Only pay off original invoices
- ▶ Review vendor lists for unusual vendors or excessive payments (consider performing confirmations or requesting new W-9's)
- ▶ Review transactions that are out of the ordinary
- ▶ Require vendors submit supporting documentation for any reimbursable expenses

# Internal Control Considerations

- ▶ Require employees receiving a p-card to sign an agreement which includes district policy requirements, restrictions on use, etc.
- ▶ Implement daily and monthly spending limits on p-cards
- ▶ Review merchant/transaction types and consider blocking types that do not align with district policy (casinos, cash advances, international merchants, etc.)
- ▶ Employee background checks
- ▶ Segregation of duties (purchasing, receiving, payment)

# Recovering From Fraud or Loss

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It is important to note that fraud can have lasting effects on an organization that extend beyond the financial loss itself:

- Public perception – Ridgefield School District example

**Report: Ridgefield schools a fraud victim**  
Auditor says former employee overpaid herself \$806K

By [Marissa Harshman](#), Columbian Health Reporter  
Published: March 16, 2010, 12:00 AM



**Former Ridgefield School District  
employee charged with fraud**

By Marissa Harshman / The Columbian Apr 21, 2010 0

# Recovering From Fraud or Loss

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- Public perception –
  - Impacts the District's ability to pass levies and bonds
  - Can affect the ability of a student organization to fundraise or receive donations
- Work place morale
- Increased audit & borrowing costs

Questions?