



Protecting an Agency from Procurement and Vendor Fraud

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Agenda

- Public Policy – Competition
- General concepts of Procurement rules and regulations
 - Statutory bidding requirements
 - Exceptions (non-biddable items)
 - Administrative procurement rules
- Auditor's Role and Responsibilities
- Fraud Risks
 - Criminal conduct
 - M/WBE fraud
 - Vendor schemes
- Fraud prevention and effective controls

Public Policy

“It is the purpose of this Code and is declared to be the policy of the State that the principles of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts by or for any State agency.”

Illinois Procurement Code, 30 ILCS 500/1-5

Goals of Procurement Rules

- Transparency
- Encourage competition
- Best value
- Purchase from responsive and responsible vendors
- Establish a system of effective vendor management
- Reduce risk of vendor and employee fraud
- Effective use of public funds

Statutory Bidding Requirements

- Generally, purchases with a value of more than \$25,000 must be subjected to sealed, competitive bid process.
 - IL Procurement Code, 30 ILCS 500/1-1 et seq
 - IL School Code, 105 ILCS 5/10-20.21
 - IL Public Community College Act, 110 ILCS 805/3-27.1

Exceptions

- IL Procurement Code
 - Contracts between the State and its political subdivisions
 - Employment contracts
 - Purchase of real estate
 - Contracts to prepare for litigation
 - Electric power procurement
 - others

Exceptions

➤ School Code / Community Colleges

- Individuals possessing a high degree of professional skill
- Printing of finance committee reports
- Printing or engraving of bonds
- Change orders less than 10% of the original contract
- Service contracts - parts and equipment
- Data processing equipment and telecommunication equipment, software or services
- Duplicating machines and supplies
- Natural gas (when less than offered by public utility)
- Previously owned equipment
- Sole source
- Emergency

Administrative Rules

- Can be more restrictive than statutory rules and detail policies, procedures and rules for other types of procurement
 - RFP
 - \$ thresholds requiring various levels of approval
 - Criteria to be reviewed
 - Review process
 - Selection
 - Responsibility

Selection

- Competitive, Sealed Bids
 - Timely received
 - Public Bid opening
 - Lowest responsive and responsible bidder
 - Product or Service Acceptability
 - Public Award

Auditor's Role

“Auditors should design the engagement to detect instances of fraud and noncompliance with provisions of laws, regulations, contracts and grant agreements that may have a material effect on the subject matter or the assertion thereon of the examination engagement. Auditors should assess the risk and possible effects of fraud and noncompliance with provisions of laws, regulations, contracts and grant agreements that could have a material effect on the subject matter or an assertion about the subject matter of the examination engagement. When risk factors are identified, auditors should document the risk factors identified, the auditor's response to those risk factors individually or in combination, and the auditors' conclusions.”

Government Auditing Standards (Yellow Book)

Auditor's Role

Role

- Design audits to identify fraud indicators
- Recognize fraud indicators
- Document and report

Goal

- Promote economy, efficiency and effectiveness
- Protect public interest
- Bring about positive change in performance
- Increase accountability and integrity
- Ensure taxpayer money is spent in the public's best interest

Fraud

➤ Includes

- Knowing or reckless misrepresentation of the truth
- Concealment of a material fact to induce another to act to his detriment
- Unconscionable dealing

➤ Common Law Fraud elements

- False representation or a concealment of a material fact
- Knowledge or reckless disregard of a statement's falsity
- Intent to deceive
- Reliance by the deceived party
- Damage to the deceived party

Assessing Risk – Materiality

➤ Material

- Having influence or effect
- Yellow Book - Includes quantitative and qualitative measures in relation to the subject matter of the audit
- AICPA - the auditor's consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of users
- In Government sector threshold of materiality may be lower

Procurement Fraud Risk

- Organizational Fraud – fraud committed for the benefit of the organization and as a result, the indirect benefit of the individual
 - Get the job done
 - Bonuses, recognition, promotions, job retention
 - Don't know the rules
 - Pressure

Risk of Waste / Fraud – Bid Specs

- Purchaser has to know the specs
- Can't create sole source
- Should not be written by a bidder
- Clearly specify products to be purchased
- Understandable to bidders
- Identify Code or Certification requirements that must be met
- Can products be checked against specifications
- All products included in tabulation
- Compatible products
- Do you really need...?

Risk – Bids

- Misrepresentations
 - Responsive – ability to perform
 - Responsible – good company
- Bid Rigging
- Bid Rotating
- Disclosure of bidding information

Bid Rigging Schemes

- Bid Suppression
 - Competitors agree not to bid
 - Usually payoff to non-bidding competitor
- Complimentary Bidding
 - Bidders submit intentionally high bids or non-compliant bids
 - Gives appearance of competition
- Bid Rotation
 - Competitors take turns submitting the lowest bid on a series of contracts
- Customer or Market Division
 - Competitors divide customers or geographic locations
 - No bids or complimentary bids in other areas

Bid Rigging- Indicators

- Companies submit bids with identical individual line items or lump sums
- Bids exceed agency's estimate of contract value
- Bids exceed companies bids to other agencies
- Winning bidder awards subcontracts to losing bidder
- Large gap between winning and losing bid
- Same spelling or math errors, same handwriting, address or fax

Criminal Conduct

- Interference with contract submission and award
 - Disclose specifications (outside public disclosure process)
 - Force to hire sub-contractor or individual to receive award
- False Statements on Vendor Applications
- False entries
- Unlawful participation – employee directly or indirectly benefitting from public contract

Criminal Conduct

➤ Stringing

- With intent to evade bidding requirements – “strings” contracts or job orders
- How many transactions?
- Planning
- Complicity (Organizational Fraud)

Risk of Fraud – Sole Source

➤ Sole Source Procurement

- “Contracts may be awarded without the use of a specified method of source selection when there is only one economically feasible source for the item.”
IL Procurement Code 30 ILCS 500/20-25
- Unique qualifications of contractor to perform
- Others unable to perform to perform

➤ Fraud Risk

- Did specifications create sole source?
- Favored bidder
- Truly sole source
- Sufficient procedures – notice, evaluation, disclosure
- Avoid competition

Emergency

- Emergency - A purchasing agency may make emergency procurements without competitive sealed bidding
 - When there exists a threat to public health or public safety
 - To protect against further loss of or damage to State property
 - Minimize serious disruption in critical State services that effect health, safety or the collection of substantial State revenues
 - Insure integrity of State records
- Term of the purchase limited to the time reasonably required for competitive procurement
- Subsequent justification and notice

IL Procurement Code 30 ILCS 500/20-30

Risk of Waste/Fraud - Emergency

- Truly an emergency?
- Poor planning can't create an emergency
- Rushed timelines
- Lack of vendor oversight
- Excessive billing
- Substandard work
- Favored vendor
- Inappropriate relationship with decision-makers

Change Orders

- Change Order – “...change in a contract term, other than as specifically provided for in contract, which authorizes or necessitates an increase or decrease in the cost of the contract...”
- No bidding if less than 10% of the original contract
- Germane to original contract
- Not foreseeable
- Subsequent justification and notice

Change Orders - Risk of Fraud

➤ Fraud Risk

- Foreseeable?
- Bad specifications can't create "unforeseeable"
- Excessive billing
- Avoid competition
- Fair price on original scope?

M/WBE Fraud

- M/WBE Program - Aspirational goals for M/WBE participation in goods and services contracts to ameliorate the effects of historic racial and gender discrimination
- Fraud
 - Certification
 - Ownership
 - Pass through
 - Commercially useful function
 - Misrepresent \$\$ received
- Crimes
 - Misrepresentation in obtaining certification (See 720 ILCS 17-10.2, 17-10.3)
 - 720 ILCS 17-10.3(d) – fraudulently obtaining moneys reserved for DBEs
 - Federal – mail and wire fraud

Bribes and Kickbacks

- Bribery (720 ILCS 5/33-1)
 - With the intent to influence a public act
 - Promises or tenders property or a personal advantage
 - Briber / “Bribee”
 - Failure to report
- Kickbacks (720 ILCS 5/33E-7)
 - Money, fee, commission, credit, gift, gratuity, thing of value to any prime, sub, or employee
 - Direct or indirect
 - For favorable treatment

Improper Inducements

- “Wining and Dining”
- Gifts
- Improper hospitality
- Risk
 - Fosters collusion, lack of vendor oversight and management.
 - Looks like bribery
 - Avoid the appearance of impropriety

More Vendor Fraud

- Overbilling
- Mischarging – charge unallowable costs(Explain)
- Product substitution
- False/Fraudulent Insurance/Bonding documents
- Ghost Vendors
 - Anomalous payments just under spending threshold - \$24,999
 - Round dollar amounts
 - Payments to other address
 - Duplicate invoices

Fixed Price and Time and Materials

- Fixed Price
 - Encourages contractor to be efficient
- Time and Materials
 - Does not encourage contractor efficiency
 - Reimbursed for costs related to performing

Effective Controls

- Due Diligence
- Ethics Policies / Codes of Conduct
- Gift Ban
- Debarment Policy
- Segregation of Duties
- Vendor Management
- Duty to Cooperate / Right to Audit
- Fraud Hotline / Whistleblower System
- Independent Monitor
- Proactive - Audit / Review / Data Mining

Prevention and Effective Controls

- Due Diligence
 - Who are we contracting with?
 - References
 - Excluded Parties List System – debarred?
 - Know the marketplace – prevent over-pricing
- Ethics Policies / Codes of Conduct
 - Applicable to vendors and employees
 - Defines Business Relationship
 - Defines Direct and Indirect economic interest
 - Defines “Relative”
 - Conflicts of Interest
 - Contract Management Authority
 - Post employment restrictions

Gifts

State Officials and Employees Ethics Act – Gift Ban (5 ILCS 430/10-10)

- Employee shall not solicit or accept any gift from any prohibited source
- Includes spouse and immediate family
- Exceptions
 - Pay market value
 - Political fundraiser
 - Travel expense to discuss State business
 - Personal friendship
 - Food or refreshments not exceeding \$75 per person on a single calendar day
 - Food, refreshments, lodging, transportation related to outside business
 - Any item from one prohibited source, during one calendar year less than \$100

Debarment Policies

- Identify acts or omissions that constitute grounds for debarment
 - Fraud or criminal offense
 - Failure to perform
 - History of unsatisfactory performance
 - History of failure to meet M/WBE goals
 - Ethical misconduct
 - False statements
 - False claims
 - Refusal to cooperate
 - Debarred by another entity
 - Violating voluntary exclusion agreement

Debarment Policies

- Describe procedures
- Voluntary exclusion, interim constraints and debarment – ineligible to enter into contracts with entity
 - General or subcontractor
- Debarment Lists
- Prohibition effects
 - Controlling persons
 - Owners, officers, directors
 - Employees
 - Affiliates

Internal Controls

- Segregation of duties
 - Order / Authorize services
 - Receive
 - Receipt
 - Review invoice
 - Request payment
 - Approve payment
 - Ledger entries
 - Evaluate vendor performance
 - Method of Payment
 - Employees pick up check?

Internal Controls

- Vendors managing vendors
- Mandatory record retention
 - Emails
 - Billing records
 - Detailed / Itemized expense records
 - Records of payments to subcontractors
- Right to Audit
- Duty to cooperate
- Positive pay

Other Controls

- Independent monitor
 - Defined scope based on presumed or identified areas with a high risk of fraud
 - Fee paid by vendor
- Fraud Hotline
- Whistleblower system
- Data mining
 - Employee / vendor data match
 - Phone #'s
 - Bank accounts
 - Addresses
 - PO Box

Prevention Plans

- Communicate policies
- Training – rules, regulations and policies
- Cross-train staff
- Regularly Audit
- Whistleblower system
- Who will investigate
 - Law enforcement not always the answer
 - Evidentiary issues
 - Preserve evidence
- Communicate with media
 - Get out in front of the story
 - Systems in place to detect, deter and punish vendor fraud

Questions?

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