Contract and Procurement Fraud

Performance Schemes
Invoicing Schemes

- Vendor submits fraudulent invoices to generate false payments
  - False invoices
  - Inflated invoices
  - Duplicate invoices
Preventing Invoicing Schemes

- Segregate ordering duties and payment of invoices duties.
- Separate certification and authorization duties.
- Conduct periodic checks for duplicate invoices.
- Check order invoices for evidence that the orders are both genuine and authorized.
Red Flags of Invoicing Schemes

- Supporting documents that are inadequate, copied, altered, or forged
- Invoices in even amounts (round numbers)
- Invoice details that do not match contract items, purchase order, receiving records, inventory, or usage records
- Unusually high volume of activity for a specific vendor
Red Flags of Invoicing Schemes

- Multiple invoices at or just below threshold levels
- Unapproved invoices from vendors
- Invoices without a valid purchase order
- Invoices lacking detail
- Vendor who does not produce documents or responds to inquiries in a timely manner
Red Flags of False Invoicing Schemes

- Invoiced goods or services cannot be located in inventory or accounted for.
- No acknowledgment of receipt was offered for invoiced goods or services.
- A questionable or no purchase order exists for invoiced goods or services.
- The contractor’s records do not reflect that the work was done or that necessary costs were incurred.
Red Flags of Inflated Invoicing Schemes

- Invoices and supporting documentation contain abnormal fluctuations in costs, prices, inventories, and other discrepancies.
- Supporting documentation is not adequate or appears copied, altered, or forged.
Red Flags of Duplicate Invoicing Schemes

- Multiple payments:
  - On the same invoice number
  - To the same vendor on the same date
- Multiple invoices:
  - With the same item description
  - For the same amount on the same date
Red Flags of Duplicate Invoicing Schemes

- Vendors with the same invoice numbers
- Invoices that exceed approved purchase order amounts
- Current supplier costs that exceed historical costs of items purchased
Detecting Invoicing Schemes

- Compare physical inventory with purchases.
- Determine reasonableness of quantities purchased by office or user.
- Check reasonableness of purchase prices to identify inflated invoices.
- Identify payments where vendor number, invoice number, and amount are the same.
- Check receiving documents to verify receipt of items.
Detecting Invoicing Schemes

- Identify and review alterations, missing documentation, and photocopied documents.
- Use Benford’s law to detect falsified data.
- Determine whether the invoices support the quantities shown in the inventory records.
- Identify multiple payments with:
  - The same invoice number
  - The same vendor or amount on the same date
  - The same item description
Detecting Invoicing Schemes

- Find invoice payments issued on non-business days.
- Identify multiple invoices at or just below threshold levels.
- Identify invoices:
  - From unapproved vendors
  - Without a valid purchase order
  - That exceed the approved purchase order amounts
Detecting Invoicing Schemes

- Determine reasonableness of the number of units purchased and the cost per unit on invoices.
- Review voided checks.
- Compare employee and vendor addresses.
Non-Conforming Goods or Services

- Delivering inferior/substandard items
- Substituting items
- Delivering or using lower quality items
- Delivering or using counterfeit, defective, reworked, or used items
- Delivering items that have not been tested
- Falsifying test results
- Making false certifications
Preventing Non-Conforming Goods or Services

- Comprehensive inspection program:
  - Inspect work being performed and materials being used at various intervals.
  - Periodically review inspections to ensure procedures are being followed.
  - Perform after-the-fact testing.
Red Flags of Non-Conforming Goods or Services

- Red flags in compliance certificates
- Red flags in materials testing and test documentation
- Red flags in inspection records
- Red flags in appearance of materials used
- Red flags in materials returns
Detecting Non-Conforming Goods or Services

- Request assistance from outside technical personnel to conduct after-the-fact tests.
- Examine product packaging, appearance, and description.
- Segregate and identify the source of any suspect product.
Detecting Non-Conforming Goods or Services

- Review the contractor’s books, payroll, and expense records to see if they incurred necessary costs to comply with contract specifications.
- Review the inspection and testing reports.
- Exercise audit rights to examine the contractor’s records.
Change Order Abuse

- After the procuring entity awards the contract, the corrupt contractor submits fraudulent change orders.
  - To increase its price
  - To improperly extend or expand contracts
  - To avoid re-bidding
Preventing Change Order Abuse

- Educate procurement employees
  - About change order abuse and its red flags
  - To be cautious of contracts where numerous or high-dollar value change orders are requested
- Determine the reasonableness of excessively low bids.
- Review all proposed change orders involving price increases to ensure that the additional costs are necessary to the work scope of the contract.
Red Flags of Change Order Abuse

- Numerous change orders are justified on a variety of grounds
- Employee approves numerous unexplained or unjustified change orders for the same contractor
- Repeated pattern of change orders that increases the price, scope, or period of an agreement, issued after procuring entity awards the contract
Red Flags of Change Order Abuse

- Questionable, undocumented, or frequent change orders awarded to a particular contractor
- After contract is awarded, bid specifications that lack detail are clarified by issuing a change order
- Poorly drafted requests for change orders
Red Flags of Change Order Abuse

- Pattern of change orders just below threshold limit
- Employee of procuring entity that is directly involved in both determining requirements and procuring the item
- Period of an agreement is extended by change orders instead of re-bidding
Detecting Change Order Abuse

- Examine contract change orders that:
  - Add new items
  - Increase the scope, quantity, or price of the existing contract
  - Extend the contract
  - Fall just under review limits
  - Are poorly drafted, questionable, undocumented, or overly frequent
Cost Mischarging

- Contractor charges the procuring entity for costs that are not allowable, not reasonable, or that cannot be allocated to the contract directly or indirectly

- Two primary methods:
  - Material cost mischarging
  - Labor cost mischarging
Material Cost Mischarging

- Typically involves raw material or interchangeable parts

- Methods:
  - Charging material costs incurred on a fixed-price contract to a cost-type contract
  - Applying inappropriate rates
  - Making inappropriate transfers of materials
  - Purchasing excessive materials or materials from an affiliated party
Red Flags of Material Cost Mischarging

- Previously delivered items transferred from ongoing jobs to open work orders
- Items scheduled for future delivery transferred from ongoing jobs to open work orders
- Items transferred at costs that are substantially different from actual costs
- Mass transfers of items from one job order to various other job orders
Red Flags of Material Cost Mischarging

- Materials used in production are different than those used in the proposal or contract
- The contractor includes unnecessary or obsolete items in proposals
- The contractor charges costs to the original job order when there is no physical inventory left on the job site
- Increase in transfers of items to inventory write-off or a scrap account
Red Flags of Material Cost Mischarging

- The contractor makes transfers to any type of holding account
- The contractor does not properly account for the materials
- Initial billings for actual material costs are in excess of negotiated costs
- Later billings show a downward adjustment in material costs as labor/overhead costs increase
Red Flags of Material Cost Mischarging

- Improper billing costs become apparent
- Vague terms used to bid materials based solely on management’s judgment or estimates
- The contractor fails to report excess or residual inventory
- The contractor gives poor explanations for a high percentage of non-competitive subcontract awards
- There is a lack of a clear audit trail to verify propriety of material charges
Detection of Material Cost Mischarging

- Examine material cost transfers:
  - From government contracts to commercial
  - Through any type of suspense or holding account
  - From ongoing jobs to jobs not scheduled for delivery until a much later date
  - From prior lot work orders to current or future work orders
  - To inventory write-off accounts
  - To scrap accounts
Detection of Material Cost Mischarging

- Determine if contract costs have exceeded or are expected to exceed the contract value.
- Determine if materials are properly charged to the job.
- Examine materials ordered and charged in excess of contract requirements.
- Examine seemingly unrelated materials charged on routing slips.
Detection of Material Cost Mischarging

- Identify any unusual changes in materials costs over time.
- Compare the standard and actual costs of materials.
- Perform the contractor to determine ownership and search for any signs of corruption.
- Scan the general ledger, accounts receivable subsidiary ledger, and sales journal for unusual adjusting entries.
Labor Cost Mischarging

- Contractor charges the procuring entity for work that was not actually performed

- Methods:
  - Transferring labor costs
  - Falsifying the labor distribution
  - Billing for the type of service performed
  - Billing for employees’ expenses that were not incurred
  - Fictitious time cards
  - Altering time cards
Preventing Labor Cost Mischarging

- Conduct vendor due diligence.
- Compare wage rates with external sources.
- Clearly define sensitive technical labor classifications.
- Review time-charging practices.
- Use a budget.
- Conduct site visits.
Red Flags of Labor Cost Mischarging

- Billings not in line with estimates
- Excessive or unusual labor charges
- Sudden, significant shifts in labor charge levels
- Labor charges inconsistent with contract progress
- Vague or minimal education, credential, and experience qualification requirements for labor positions
Red Flags of Labor Cost Mischarging

- Contractor has high employee turnover rate among procurement personnel
- Contractor must hire large numbers of personnel quickly
- Significant increases in charges to overhead accounts
- Increased labor hours with no corresponding increases in material used or units shipped
Red Flags of Labor Cost Mischarging

- Actual hours and dollars consistently at or near budgeted amounts
- Labor standards not updated after contractor improves its manufacturing technology
- Unavailable supporting documentation
- Lost personnel files
- No audit trail to verify propriety of labor charges
Detecting Labor Cost Mischarging

- Examine labor cost records.
- Conduct site visits.
- Compare time cards and total hours billed.
- Compare labor costs over time.
- Compare standard and actual labor rates.
- Calculate the percentage of total direct labor charged to each contract.
Detecting Labor Cost Mischarging

- Compare labor distribution summaries with payroll records.
- Compare labor account totals from prior year to current year.
- Look for terminated employees who are charged to contracts.
- Compare employee personnel records to contract position qualification requirements.
Co-mingling of Contracts

- Contractor bills for the same personnel, fees, or expenses under one or multiple contracts
- Often involves duplicate contract payments
Preventing Co-mingling of Contracts

- Review contracts prior to their award to ensure that statements of work to be performed are not duplicated in other contracts.
- Identify contractors holding more than one contract that have similar work statements.
  - Closely monitor billings for duplicate payments.
Red Flags of Co-mingling of Contracts

- Contractor with more than one contract that has similar work statements
- Invoices for similar expenses for work under different contracts
- Invoices for more than one job during the same period
- Multiple contract awards for similar work given to same contractor
- Same employee billed to more than one job for the same period
Detecting Co-mingling of Contracts

- Identify contracts awarded to the same company to determine whether they run concurrently and if each provides for the same efforts.
- Examine payment records to determine if the contractor billed for the same expenses under more than one contract.
- When reviewing contractors’ records, check for multi-contract awards.