

Contract Fraud and Abuse Risk Examination

Consists of five major steps to ensure your organization has safeguards in place against contract fraud and abuse which are sufficient to prevent, detect, enhance prompt reporting, and have the capability to respond to such threats—and—that management and the workforce understand their responsibilities in providing a culture of procurement integrity.

BY SHERYL STECKLER and TOM CAULFIELD

Regardless if it is a public or a private entity, the organization will typically have a strategic objective of ensuring all phases of obtaining necessary goods and services are performed legally, with fairness, honesty and impartially, and is supported by a valid requirement within the organization. In sum, they work hard to ensure that all of their contracting is done with the highest degree of *procurement integrity* and free from fraud and abuse. Anything less places the organization at significant risk to contract termination, default, litigation and for a private entity - suspension and/or debarment.

In pursuit of their strategic objective, undeniably, the most significant threats to achieving or maintaining procurement integrity comes from the abundant fraud and abuse schemes targeting today's contracts and the myriad of ways each of those schemes can be performed. Contract fraud and abuse are, by its very nature, a product of human behavior and performed with willful intent. Each fraudster and/or abuser is motivated differently, thus each one creating a different risk and therefore requiring a different strategy for preventing and detecting their actions.

To protect against the traditional schemes of contract fraud and abuse, along with the people that deliberately deploy those schemes, the organization must develop and operate a sound and effective contract fraud and abuse risk mitigation strategy. Some organizations have an entity-wide fraud risk mitigation program that includes the threats posed by contract fraud and abuse. Others may develop a tailored procurement fraud prevention and detection program specifically focused to protect their contracting.

Regardless if the risk mitigation strategy is an entity-wide approach or one exclusively designed for contract fraud and abuse schemes, to ensure the value of the risk mitigation strategy, the organization must periodically evaluate its effectiveness. The periodic evaluation should:

- Ensure their unique degree of contract fraud and abuse risks is accurate;
- Test the effectiveness of their procurement integrity controls¹; and
- Confirm there is a valid commitment to procurement integrity throughout the organization.

This is all done with an organizational-specific “*Contract Fraud and Abuse Risk Examination.*”

¹ Procurement Integrity Controls are the people, processes, procedures, and/or management systems that are designed to provide reasonable assurance regarding the prevention, detection, prompt reporting, and ability to respond to procurement fraud, procurement abuse, or non-compliance within the ~~entity's~~ organization's procurement processes, policies, or instructions.

Risk Assessment vs. Risk Examination:

Many times people will mistakenly confuse the difference between a risk assessment and a risk examination. A “risk assessment” is designed toward the risk of financial statement fraud, asset misappropriation, and/or corruption. The purpose is to identify, measure, prioritize, and evaluate risks so that a risk management program/strategy can be later designed.

Once the risk management program/strategy is designed and operating for a period of time, periodically the effectiveness of the program/strategy needs to be evaluated and that is done with a “risk examination”. In others words, risk examinations are evaluating the risk mitigation program/strategy’s effectiveness in protecting against identified risks. When looking at an organization’s contracting, a “*contract fraud and abuse risk examination*” is designed specifically to evaluate the effectiveness of the organization’s policies, procedures, and operations to protect against the risk of contract fraud and/or abuse.

There are five major steps to a contract fraud and abuse risk examination.ⁱ

1. ***Documentation Analysis***
2. ***Risk Theory Development***
3. ***Structured Interviews***
4. ***Vulnerabilities Testing***
5. ***Report the Findings***

Documentation Analysis

Using existing organizational documents:

- Identify, review, and perform an estimate of the existing procurement integrity controls’ effectiveness against the traditional contract fraud and abuse schemes; and
- Pinpoint any of the procurement integrity controls that are not found within the current documentation.

Along with analyzing documents you should:

- Assess the complexity of the procurement processes' - the more complex a process, the greater the chance that fraud will slip through the cracks;
- Examine the average number of transactions - the more transactions, the easier it is to hide misconduct;
- Determine if a procurement process is manual or automated. Manual processes may allow for employees' manipulation. Automated systems have "touch points" in which employees can enter, alter, and/or extract data; and
- Compare procedures and policies to maintaining and promoting a culture of procurement integrity with those of industry standards (i.e. ethics policy, anti-fraud policy, whistleblower policy, training requirements related to ethics, etc.).

Risk Theory Development

Utilizing the results of the documentation analysis, a “*Risk Theory*” is developed – theorize your best guess as to how a fraud scheme could corrupt your procurement processes and by who. As part of your theory development, you should establish as many “risk theories” as possible on how

a particular portion of the documented procurement processes could be compromised focusing on the following elements;

- The specific scheme(s) that could compromise the process;
- At which decision point (occupation/person) would the specific scheme(s) occur; and
- The steps required for the scheme(s) to transpire.

Keep in mind, the ability to identify specific contract fraud and abuse schemes depends on the assessors' knowledge of this area. Because much of this portion of the examination is anticipating the behavior of a potential perpetrator(s), the assessors should have a background in the detection and prevention of contract fraud and abuse, procurements, assessing procurement integrity controls, risk mitigation strategies, fraud risk theory development, and organizational culture.

Structured Interviews

The next steps of an examination would be performing both management and workforce interviews. With Executive Management interviews you would want to identify the following:

- Management's perception of areas within procurement and operations that are vulnerable to certain fraud and abuse schemes;
- The potential financial, operational, and reputational impacts of a successful fraud or abuse scheme;
- The degree of potential noncompliance with internal procurement policies, procedures, and/or processes designed to prevent and detect fraud and abuse (i.e., procurement integrity controls); and
- Management's contract fraud and abuse risk response and tolerance thresholds.

With workforce/employee interviews you would want to identify the following:

- Workforce's perception of vulnerability of the traditional procurement fraud and abuse schemes;
- Obtain their understanding on the effectiveness of the procurement integrity controls;
- Gauge their belief of likelihood of occurrence of the "contract fraud and abuse risk theories;" and
- Determine any differences between management and the workforce in perceptions of vulnerabilities, risk tolerance, risk response, and commitment to procurement integrity.

It is important, early in the interviews, to reinforce the purpose of the interview is to obtain the employees' perceptions on vulnerabilities to their organization's processes and not to identify misconduct by co-workers. Prior to the interviews, a management decision must be made regarding the degree of confidentiality that will be allowed during the interviews.

Vulnerability Testing

The testing of procurement fraud and abuse risk theories has the potential of developing actual fraudulent events and therefore protocols need to be established prior to initiating this step when/if fraud indicators are identified. With each of the more likely procurement fraud and abuse schemes identified:

- Interview the employees directly linked to that particular procurement process and obtain the interviewees' perceptions on the probability of occurrence and compromise; and
- Identify with the employee any possible causal factors and potential mitigation solutions.

Report the Findings

The *Contract Fraud and Abuse Risk Examination* report should answer the question of how effective the organization's contract fraud and abuse risk mitigation program/strategy is working. The report should also contain recommendations for the creation and/or enhancements to procurement integrity controls, along with a prioritization of those recommendations based on their degree of risks and/or implementations duration. The report should not only identify what improvements need to be consider, but why and who within the organization should assume responsibility for its implementation and management. The final report should become a critical document for refining the organization's fraud mitigation strategy/plan.

Closing

An organization that wishes to ensure procurement integrity must have an effective fraud and abuse mitigation strategy. The strategy must:

- Have a demonstrated commitment to procurement integrity within an ethical culture;
- Be built with sound protections into organizational/company policies, procedures, processes, and instructions that are designed to the organization/company's unique procurement risk; and
- Have a robust examinations that identifies all internal and external deficiencies.

Now, picture the organization you work for. Imagine if management and the workforce were asked the following three questions:

1. What are the four most likely fraud and abuse threats to your organization's procurements?
2. What are four prevention and detection mitigation controls that are currently in place to protect your organization's procurements?
3. What is expected of you to ensure procurement integrity?

Could they answer? Could you? It's your duty to ensure that your organization is best protected with sound procurement fraud and abuse prevention and detection mitigation controls.

About the Authors

The authors Sheryl Steckler and Tom Caulfield, President and Chief Operating Officer of Procurement Integrity Consulting Services, LLC, www.procurement-integrity.net; a woman owned small business company specializing in developing, assessing, and structuring strategies to assure contracting integrity. The company also assists clients in identifying and mitigating their inherent risk to procurement fraud and abuse. Sheryl and Tom also train domestically and internationally on the most prevalent procurement schemes of fraud and abuse in today's contracting along with the most successful proactive and reactive protections against those same threats.

ⁱ Please note that it is beyond the scope of this article to describe in detail each step of a Procurement Fraud and Abuse Risk Examination. Therefore, overarching descriptions of the five major steps have been provided.