

Schemes of the Fraudster



A review of several common types of fraud and/or abuse schemes that “fraudsters” may use to compromise a fair procurement. Become familiar with these schemes, and you can beat the fraudsters at their own game.

Most people in the private and public sectors want to be treated fairly and in good faith, be part of honest and open competition, and obtain or provide goods and services at a reasonable cost. Unfortunately, there are also those who may take the pathway of dishonesty and target the vulnerabilities in the procurement process for their own personal gain. These unscrupulous individuals—“fraudsters”—will use any one of 44 traditionally known fraud and/or abuse schemes to compromise a fair procurement.

Procurement fraud and abuse schemes are no accidents; they are actions performed with willful intent and are the byproduct of deceptive human behavior. It is important to recognize that each of these schemes can be conducted over a hundred different ways and at various decision points in the procurement process—only being left to the perpetrator’s imagination and motivation, his or her access point into the procurement process, the type of procurement method being used, and the effectiveness of your organization’s PICS Procurement Integrity Control System¹®.

Even though there are 44 schemes, each one is intended to manipulate one or more of three procurement actions: either the selection of the contractor, the cost of what the buyer will pay, and/or the quality of the material or services being provided. Over half of the schemes are targeting the selection of the contractor, which, if successful, will enable the fraudster to deploy additional schemes against the cost or quality of the materials or services. For example, if several corrupt contractors agree to perform a bid-rotation or bid-rigging scheme to manipulate the selection of a contractor to their preferred choice, in nearly all cases, they would also devise a mischarging scheme corrupting the cost being paid by the buyer.

With 44 schemes, it is not possible to describe each one; therefore, this article will focus on the schemes observed most frequently and the ones targeting the selection of the contractor. Bribery, extortion, and gratuity schemes are without question the most damaging to an honest procurement. With bribery, a common example involves a contractor compensating an insider to receive a contract. Extortion takes place when an insider demands payment from a potential contractor in return for influencing a contract action. Gratuity is a payment made by a contractor to an insider as an appreciation for a favorable procurement decision. The contractor’s belief is that by paying the gratuity, the same decision-maker will lean in the favor of that contractor in future procurements. A gratuity payment is not expected by the insider, which makes it different from a bribery payment.

If bribery schemes were not bad enough, in most cases they will also include some type of secondary scheme related to mischarging. These mischarging schemes are referred to as “kickbacks” and are the *quid pro quo* portion of a conspiracy between the corrupt contractor paying the bribe and the corrupt insider accepting it. Contractors who have inappropriately corrupted the

selection of the award of the contract become confident that they are able to corrupt the post-award payments for the goods or services. As both schemes require a conspiracy between the insider and the contractor, they both derive additional financial benefit by mischarging.

To give an illustration of financial damages involving bribes with kickback, based on a forensic examiner's calculation during an actual fraud investigation led to concluding roughly \$400,000 in bribes was paid to seven insiders at a particular organization, who then permitted approximately \$3.8 million in mischarging. Experience indicates this is not an uncommon occurrence.

The Procurement Process

The procurement process begins with identifying a need or requirement for goods or services, which should be supported by a written justification. The description of the requirement and the justification is crucial, so review them anytime you have a concern of a fraud or abuse scheme. Missing or weak justifications are one of the best fraud indicators of an insider colluding with a contractor. If there is such collusion, the insider may attempt to draft unduly narrow requirements or specifications, thereby only allowing his preferred contractor to qualify. Likewise, an insider might draft unduly broad requirements or specifications to qualify an otherwise unqualified bidder. This narrowing or broadening of requirements and specifications is traditionally referred to as the "rigged requirements/specifications scheme."

The rigged requirements/specifications scheme is just one of several used to corrupt the selection of the best contractor. Another scheme, and the one that seems to be used most often during the selection phase of procurement, is the "unjustified sole source scheme." This scheme is when an insider deliberately writes an unwarranted sole-source justification to avoid a competitive bid process, meaning that a contract is entered into with only one source. This scheme is intended to avoid a higher-level review by management, thereby decreasing the possibility of exposing the inappropriate action. Another scheme used to elude a higher-level review is the "split purchase scheme." In this scheme, a valid single purchase is separated into two or more purchases by the fraudster, each below upper management level review or competitive bidding thresholds.

One cautionary note: Sometimes the unjustified sole-source and split-purchasing schemes are done by well-intentioned employees to expedite the procurement processes by eliminating any extra reviews. This conduct is not related to any fraudulent activity, but to the employee's desire to speed up the procurement process. Although not procedurally right, it is not a fraudulent act.

Once a valid requirement is generated and justified, the procurement process is designed to solicit and select the best contractor. This is when the buyer relies on written specifications and the statement of work detailing the types and amounts of goods and services to be provided. These documents are intended to provide both the potential bidders and the selecting official with a concrete basis for making the final selection. Sometimes, in preparing these documents, collusion occurs between an insider and the contractor in where the corrupt contractor will submit a low bid knowing there is no profit. The corrupt insider accepts the low bid knowing that following the award of the contract, there will be several changes to the contract so that the corrupt contractor can submit excessive costs without being challenged.

This fraud scheme is referred to as the "change order abuse scheme"—an insider knowingly accepts a bid without any margin of profit because of an agreement to post-award change orders.

This is sometimes also referred to as “buying into the contract” or “low-balling.” It is important to note that it is legal for a contractor to submit a no-profit bid. Despite this, procuring officials need to focus particular attention to bids inordinately outside the range of the other bidders and ensure the difference has a logical explanation. Procurement officials also need to question any change orders occurring shortly after the award of the contract.

There are several additional techniques to corrupt the selection portion of the procurement process, especially with some type of bid manipulation scheme. Examples include an insider accepting late bids, changing bids, or re-bidding work unnecessarily. Others would be schemes to unduly limit the number of potential competitors learning of the procurement opportunity. This can occur by using obscure publications for the advertisement, publishing the advertisement during holiday seasons, or providing a vague or inadequate synopsis of the advertisement. These are all referred to as “advertisement schemes.”

Yet another scheme is the “leaking of acquisition data.” This scheme is when a corrupt insider discloses sensitive procurement information to a single contractor—e.g., other bidders’ proposals, future requirements, or the funding ranges.

Conspiracy between Contractors

Up to this point, many of the schemes discussed require a conspiracy between a corrupt insider and one or more contractors. There are also schemes that can occur without the knowledge or help of an insider, but which require a conspiracy between contractors. These schemes are referred to as “collusive bidding, price fixing, bid rotation, or bid rigging schemes” and describe various forms of illegal anticompetitive activity. The common thread throughout all of the anticompetitive schemes is that they involve contractors agreeing to limit competition, particularly with respect to pricing. “Anticompetitive schemes” will always result in increased costs, as the losing bidder or bidders are monetarily compensated for being part of the conspiracy. There is no trust between fraudsters, so the promise from one fraudster to another that the next contract award will be rotated is not enough of a guarantee.

The last fraud scheme we would like to highlight is a “bid suppression scheme.” This scheme is when one contractor is paying off competitors to not bid or using forceful means to discourage participation by other contractors.

Summary

In closing, procurement fraud and abuse schemes vary in scope and methods, become more complex the longer they occur, generally involve a conspiracy, and often require the perpetrator or perpetrators to have significant operational knowledge of the procurement systems they are corrupting. Additionally, and not surprising, organizations with ineffective or nonexistent procurement integrity controls face more significant risk to financial losses and long-term damage to their reputation.

You must accept that there is material risk of fraud and abuse within your procurement processes. Failing to recognize these risks exposes you to the full range and deceptive actions of the fraudster and, therefore, the consequences of potential debarment, contract termination, financial losses, public mistrust, criminal penalties, and civil sanctions. Understanding the schemes and knowing

your degree of vulnerability will enable you to develop effective procurement integrity controls to shield your procurements and ensure they are free of fraud and abuse.

Endnotes

¹ A PICS® is how the entity ensures procurement integrity, protects their interest, and best achieves its objective of fair and honest procurement practices.