



Spring 2024 - Internal Control News

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The purpose of this **DFM Internal Control Quarterly Newsletter** is to provide agencies and departments with articles on good business practices, fraud prevention, and internal control responsibilities. Through articles intended to promote educational and professional development opportunities for state employees, this newsletter seeks to raise awareness across state government on the importance of internal control. We hope that by providing you with this array of information, we can keep you informed of internal control related activities, and help your staff and division implement and maintain effective internal controls. <https://finance.vermont.gov> Volume 6, Issue 16

DFM Standard Internal Control - Helpful Web Hyperlinks:

Website Resources: <https://finance.vermont.gov/policies-and-procedures/internal-controls>

Standard Internal Control Manager's Guide: [Purpose of Guide \(vermont.gov\)](#)

Quick Hyperlink Reference Guide: [Finance/files/documents/Pol_Proc/IC/Guidelines.pdf](#)

State Auditor's Fraud, Waste, and Abuse Hotline: 1-877-290-1400 or [Reporting Fraud, Waste or Abuse](#)

DFM, IC Questions? Contact: fin.internalcontrol@vermont.gov

■ Bulletin 3.5 Update - Effective Immediately

On behalf of the Agency of Administration, Deputy Secretary Sarah Clark, please be advised that several minor administrative corrections have been made to Agency of Administration Bulletin 3.5, Procurement and Contracting Procedures, and Form AA-14 - Contract Summary and Certification.



A memo from Deputy Secretary Clark and updated forms, may be found on our website at <https://aoa.vermont.gov/bulletins/3point5>. Should you have any questions, please reach out to the Office of Purchasing and Contracting at SOV.OPC@vermont.gov.

■ Important SAIC Reminders - Per the 2024 Instructions:

- **Appointing Authorities:** There are only 3 weeks remaining to submit your 2024 Certified SAIC Report. Please submit your questionnaire **On-Time**. The project completion date runs through **close of business Monday April 8th, 2024**. This is a **hard close date** and impacts the State's overall **Participant's On-Time Submission Rate**. If you are unable to meet this deadline, please contact jeffrey.montgomery@vermont.gov as soon as possible so that **your Agency can request an official "Late Waiver Approval from DFM"**. This "Official Late Waiver" avoids any late point penalty reductions that ultimately impact the State of Vermont's overall performance scoring.
- The **Verification Box** ☒ must be checked off by the **Primary Contact** person completing the questionnaire, indicating the questionnaire was **discussed and approved** with the area's "Key Personnel and / or Subject Matter Experts." Please plan your time & meetings accordingly.
- The **Certification Box** ☒ must be checked off by the **Highest Appointing Authority** (i.e., Secretary, Commissioner, etc.) and cannot be delegated to Deputies or other subordinate positions. It must also be **e-mailed from** the Appointing Authority's State of Vermont's e-mail account.



For those Agencies that have already submitted your 2024 Certification – We Thank You!

■ Battling Waste, Fraud, and Abuse

A refresher article on Waste, Fraud, and Abuse in State Government

Introduction: Addressing the potential for waste, fraud, and abuse can be simplified into three steps. Agencies should:



1. Map out the path of the funds they are handling.
2. Identify the potential for waste, fraud, and abuse at each path point.
3. Determine how to mitigate the potential for waste, fraud, and abuse.

The first part of this guide helps in this process by identifying "red flags" that agencies can look for in various areas and provides examples of best practices to avoid or detect occurrences. The second part of this guide provides a set of useful tools that can be used to update internal control policies to better address waste, fraud, and abuse prevention. Regarding internal controls, The White House's Office of Management and Budget (OMB) Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance), §200.303 Internal Controls, states that is a standard to integrate internal controls into your agency's policies and processes. The guidance explicitly states: The Non-Federal entity must: (a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the federal award in compliance with federal

statutes, regulations, and the terms and conditions of the Federal award. These internal controls should follow guidance in “Standards for Internal Control in the Federal Government” issued by the Comptroller General of the United States or the “Internal Control Integrated Framework”, issued by



the Committee of Sponsoring Organizations of the Treadway Commission (COSO). b) Comply with Federal statutes, regulations, and the terms and conditions of the Federal awards. (c) Evaluate and monitor the non-Federal entity's compliance with statutes, regulations and the terms and conditions of Federal awards. (d) Take prompt

action when instances of noncompliance are identified including noncompliance identified in audit findings. (e) Take reasonable measures to safeguard protected personally identifiable information and other information the Federal awarding agency or pass-through entity designates as sensitive or the non-Federal entity considers sensitive consistent with applicable Federal, state, local, and tribal laws regarding privacy and obligations of confidentiality. All Waste, Fraud, and Abuse has the same pattern.

- Pressure and Motivation - There is a will to commit waste, fraud, and abuse.
- Opportunity - There is minimal oversight or lack of controls within the organization.
- Rationalization - Individuals who commit waste, fraud, and abuse view it as an accepted practice or part of their rights as a contractor or employee.

What is Fraud? Fraud is a deliberate deception to secure an unfair gain. This could be a monetary, contractual, or other type of advantage that is unlawful. The best strategies to mitigate fraud risks are to increase awareness of the common types of fraud and incorporate appropriate risk management controls to prevent fraud or detect it as early as possible. Employees should be aware of the internal control process and be able to identify red flags that indicate there is the potential that fraud, waste, or abuse may occur and which steps to take to prevent or detect the occurrence. Red flags are clues or hints that something out of the ordinary may occur or has occurred and that a closer look at an area or activity is required.

Common Types of Fraud

There are seven common types of fraud in government. Subsequent pages outline how to identify the type of fraudulent practices and examples of internal controls that entities can put into place to mitigate the fraud.

I. Theft - Theft occurs when a public official controls, takes, or converts property or services of the public without permission or consent for his or her own benefit or the benefit of another. If an employee participates in theft, the employee could be in violation of Statute and could be subject to a felony conviction. Indicators include, but are not limited to:

- Incomplete accounting records and expenditures lacking supporting documentation, including purchase orders, receipts, shipping invoices, etc. Unsupported petty cash or purchase card transactions. Unsupported or unreasonable travel reimbursements.
- Checks made payable to cash or checks issued in large, even amounts or to employees. Expenditures made to vendors not normally used during government business.
- Lack of or untimely reconciliations of expenditures to the budget, grant award, etc.
- Unexplained or unreasonable sales or cost trends (e.g., indirect grant costs).

- Abnormal employee behavior, such as an employee living beyond his/her means, gambling addictions, working overtime, or never taking vacation. Unlabeled or unlogged equipment, unauthorized use of equipment purchased with restricted funds.

For Internal Controls, establish compliance processes for the applicable requirements of laws, regulations, contracts, and funding along with national best practices.

For example: Agencies should segregate employee responsibilities so that one person does not have the ability to independently process, review/reconcile, and approve expenditure transactions. Ensure the processing of expenditure is based only on proper documentation. Proper documentation includes, but is not limited to, properly approved purchases, requisitions, purchase orders, receiving reports, and vendor invoices. This includes all purchase card transactions and travel reimbursements.



II. Bribery

Bribery occurs when a vendor offers a monetary or non-monetary benefit to a public official with the intent to influence that public official's vote, opinion, judgment, exercise of discretion or other action in his/her official capacity as a public official. Indicators include, but are not limited to:

- A public official or employee who has a lifestyle that dramatically exceeds his or her salary.
- Oversight officials socialize with or have private business relationships with contractors, vendors, applicants, or their families.
- A contracting employee who declines a promotion to a non-procurement position.
- A contracting employee who insists or shows a keen interest in contractors using a certain subcontractor or broker.
- A significant contract change order which lacks sufficient justification.
- Other inspectors at the job site noticed a pattern of preferential contractor treatment.

III. Conflicts of Interest

In fraud involving conflict of interest, a public official misrepresents that he or she is impartial in business decisions when he or she has an undisclosed financial interest in a contractor, vendor applicant, or consultant. Indicators include, but are not limited to:

- Unexplained or unusual favoritism shown to a particular contractor or applicant. A public official disclosing confidential bid or application information to a contractor or applicant, and/or assisting one of them in preparing the bid or application. A public official having discussions about employment with a current or prospective contractor or applicant. A close socialization with and acceptance of inappropriate gifts, travel, or entertainment from a contractor or applicant including the ability to purchase such items at below fair market value.
- A public official who does not normally participate in the purchasing or granting process and inserts himself/herself by issuing/directing a payment, awarding a contract or grant, or purchasing a good or service. A public official who directs staff to contract with or award a relative. Contractor names obtained from accounts payable documents match names listed in conflict-of-interest disclosure.

For Internal Controls, agencies and other organizations should segregate employee responsibilities so that one person does not have the ability to independently process, review, and approve contracts. Require all employees to file an annual conflict of interest statement. A separate file should be maintained for public inspection of all known conflicts of interest and monitored by the agency or organization periodically. Employees who have disclosed a conflict with a contractor, vendor, or applicant should be excluded from participating in the contracting or awarding process. Following State law, agencies and other organizations should communicate and implement policy to address the acceptance of nominal gifts and meals.



IV. Kickbacks or Unlawful “Pay to Play.”

In kickback schemes, a contractor or applicant secretly pays a fee to the government employee for being awarded the contract, like bribery and conflict of interest. Indicators include, but are not limited to:

- Unexplained or unreasonable limitations on the number of potential subrecipients or subcontractors contacted for award, bid, or offer.
- Continuing awards to subcontractors or subrecipients with poor performance records.
- “No-value-added” technical specifications that dictate contracts or grant awards to organizations.
- Non-qualified and/or unlicensed subcontractors working on prime contracts.
- Poor or nonexistent contractor or applicant procedures for awarding of subcontracts or grants through competition.
- Purchasing employees maintaining a standard of living exceeding their income.

For Internal Controls, related to kickbacks or unlawful “pay to play” type of fraud, are like those implemented to mitigate conflicts of interest fraud. Segregate employee responsibilities so that one person does not have the ability to independently process, review, and approve contracts. Require all employees to file an annual conflict of interest statement.

V. Collusive Bidding: Bid Rigging and Price Fixing

Collusive bidding occurs when there is either bid rigging or price fixing of awarded contracts. Bid



rigging is an illegal agreement between two or more competitors. It is a form of collusion, which is illegal in the United States. It is also a form of price fixing and market allocation and involves an agreement in which one party of a group of bidders will be designated to win the bid. It is often practiced where contracts are determined by bid, for example, with government construction contracts. Price fixing is an agreement among competitors to raise, fix, or otherwise maintain the price at which their goods or services are sold. Indicators include, but are not limited to:

- Bid prices drop when a new bidder enters the competition or persistent high prices by all bidders or unusual bid patterns: too close, too high, round numbers, or identical winning margins or percentages. Rotation of winning bidders by job, type of work, or geographical area.
- Losing bidders hired as subcontractors. Apparent connections between bidders; common addresses, personnel, or telephone numbers. Similar prices on non-standard items and making identical errors in contract bids.

- Losing bids that do not comply with bid specifications or where only one bid is complete and other bids are poorly prepared.

For Internal Controls, document all contractors and their subcontractors currently under contract performing similar work to determine reasonableness of pricing. Evaluate bidding criteria to determine if collusive bidding appears to have occurred during the selection process. Review contractors' prior proposals and pricing to determine if there is a fluctuation in bid amounts or trend in which the contractor is awarded. Include these reviews on your evaluation checklist.

VI. Overcharging or Substitution of Materials, Equipment, or Supplies

Under this fraud scheme, a contractor misrepresents how much construction and non-construction materials, commodities, equipment and/or supplies were used on the job to increase profit. Indicators include, but are not limited to:

- Discrepancies are present between contractor-provided quantity documentation and observed data compared to amounts requisitioned or required.
- A refusal or inability to provide supporting documentation. Copies of documentation are submitted when originals are expected. The contractor resists inspection during the job or delivery process. Packing lists, bills of lading, or other shipping and receipt records have altered or missing information. Irregularities in standard stationery or other contractor documents that are used to calculate payments.
- An unusually high volume of purchases from one source. Invoiced goods cannot be in inventory or accounted for not taking advantage of contracted discounts or volume purchasing. The acquisition price is not easily discernible.

For Internal Controls, process expenditures are based only on proper documentation. That documentation includes, but is not limited to, properly approved purchase requisitions, purchase orders, receiving reports, and contractor invoices. All documentation should be the original contractor invoices, certification reports (time and accounting records), status reports on construction projects (e.g., punch list), etc. Ensure that all expenditures processed are reviewed and approved by another employee.

VII. Fraudulent claims and misrepresentation of eligibility

Product Substitution - In a fraud scheme involving product substitution, a contractor misrepresents the product used to reduce costs for materials. These indicators include, but are not limited to:

- Mismatching or mislabeling of products and materials, A contractor who restricts or avoids inspection of goods upon delivery, A contractor refuses to provide supporting documentation regarding production or manufacturing.
- Photocopies of necessary certification, delivery, and production records exist where originals are expected, Irregularities in signatures, dates, or quantities on delivery documents.
- A high rate of rejections, returns, or failures, Certifications required in the contract are not signed.
- A contractor offers to select samples for testing programs, Failure to supply warranty information, Failure to apply manufacturers' rebates/discounts toward final costs.

Time Overcharging - In a time overcharging scheme, a contractor or subrecipient misrepresents the distribution of employee labor to charge



for more work hours, or a higher overhead rate to increase profit or mislead on maintenance of effort reporting. Indicators include, but are not limited to:

- Unauthorized alterations to timecards and other source records.
- Hours and dollars consistently at or near budgeted amounts.
- Timecards are filled out by supervisors, not by employees.
- Photocopies of timecards submitted where originals are expected.
- Inconsistencies between contractors' labor records and their employees' timecards.
- Frequent payroll adjustment entries with descriptions such as "charged wrong accounts" included on a following request for payment or labor charges with contracts are inconsistent with contract progress.
- Lack of a clear audit trail to verify propriety of labor charges.
- Job misclassification – apprentice workers billed out at higher rates.

Waste, Fraud, and Abuse Indicators by Organizational

Responsibility - waste, fraud, and abuse can occur in other areas of business that may not be as evident as the "Red flags" discussed above. These areas of business may have the following indicators, but are not limited to:

Management

- Lack of or little oversight.
- Lack of or little training for employees.
- Lack of a fraud hotline or failure to support whistleblower programs.
- Failure to investigate and respond to identified issues.
- Lack of or little management understanding or support for systems, processes, and controls.
- Minimal or no checks and balances, Minimal or no segregation of duties.
- Improper use of funds, Supervision assuming work of subordinates, High personnel turnover.

Accounting / Fiscal Services

- Lack of or failure to follow internal controls.
- Lack of or failure to follow compliance with controls over management override.
- Unauthorized transactions, Excessive transactions with "round" numbers.
- Unexplained or unsupported entries in records, unusual bank transactions.
- Failure to reconcile inventories and financial records.
- Current spending is inconsistent with authorized budget levels.
- Altered records, Large or frequent cash payments, sequentially numbered purchase orders, checks, invoices, receipts, etc., for the same purpose.
- Insufficient or no supporting documentation Audit, Little or no audit trail.
- No prior audit or excessive time since prior audit, repeat audit findings going unresolved.
- Difficulty in providing information or documentation for audit purposes.
- Inability to support questioned costs.



Where Can You Find Additional Information?

- The White House, Office of Management and Budget (OMB) Uniform Guidance.
- U.S. Department of Treasury.

- Pandemic Response Accountability Committee (PRAC).
- United States Government Accountability Office (U.S. GAO), Standards for Internal Controls.
- United States Department of Justice Fraud Section.
- The Association of Certified Fraud Examiners (ACFE).
- The Institute of Internal Auditors (IIA).
- The Association of Government Accountants.

If you have evidence of fraud, waste, or abuse activity, report such activity to management or an oversight agency. The *State Auditor's Fraud, Waste, and Abuse Hotline* is: 1-877-290-1400 or e-mail [Reporting Fraud, Waste or Abuse](#). A special "Thank You" to the **State of Arizona** for previously publishing these important **Internal Control - Fraud Tips and Preventions**.

▪ DFM Staff Happenings - No Staffing News to Report

[DFM Org Chart](#)

