

## Spring 2021 - Internal Control News



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The purpose of this 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 employees, this newsletter seeks to raise awareness across state government on the importance of internal control. We hope that by providing you this array of information, we can keep you informed of internal control related activities, and help you implement and maintain effective controls in your areas of operations.

<https://finance.vermont.gov>

Volume 2 Issue 05

## Helpful Web Links - Internal Control Standards

*A Guide for Managers 2.0* is available with other important linked resources:

**IC Standards Guide:**

[https://finance.vermont.gov/sites/finance/files/documents/Pol\\_Proc/IC/FIN-Internal Control Standards Managers Guide Master.pdf](https://finance.vermont.gov/sites/finance/files/documents/Pol_Proc/IC/FIN-Internal%20Control%20Standards%20Managers%20Guide%20Master.pdf)

**IC Website Resources:**

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

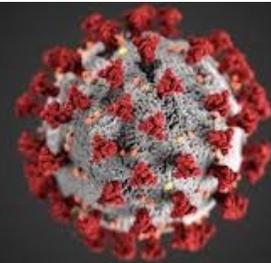
**IC Questions? Contact:**

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### COVID RELIEF FUNDING (CRF)

Be aware of *Waste, Fraud, and Abuse*  
of State & Federal Funds

REPORT  
COVID-19  
FRAUD



- **State of Arizona, A Resource to Combat Waste, Fraud, and Abuse**  
[A Resource to Combat Waste Fraud and Abuse.pdf \(az.gov\)](#) - September 2020.

**Below are some excerpts from the above PDF article published by the State of Arizona.**

## 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 point along that path.
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 be in compliance with 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/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 aforementioned fraudulent practices.



**I. Theft** - Theft occurs when a public official control, 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 in the course of 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 expenditures are based only on proper documentation. Proper documentation includes, but is not limited to, properly approved purchase 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 who notice 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, similar to 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 contract 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 similar to 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 dropping when a new bidder enters the competition or persistent high prices by all bidders.
- 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 actually 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 located 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 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 in order 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 in order 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.
- 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 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 reporting.
- 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.

## What to Do If You Suspect Fraud, Waste or Abuse?

If you have evidence of fraud, waste, or abuse activity, report such activity to management or an oversight agency.

A "Thank You" to the State of Arizona for publishing these important [Internal Control topics](#).

## DFM Staff Happenings....

### New Hire:

- **Ethan Latour, Deputy Commissioner of Finance and Management.** Commissioner Adam Greshin has appointed Ethan, to serve as Deputy Commissioner of the Vermont Department of Finance & Management. Ethan served as the Assistant Director of Policy and Communication in Governor Scott's Office for the past four years where his primary policy responsibilities were as liaison to Vermont's two largest agencies, the Agencies of Human Services and Education, working as a policy lead on healthcare payment reform, human services programs, education policy, spending and finances, as well as early care and learning, and higher education.



***"I am pleased to have Ethan join our Senior Management Team. Please welcome him to DFM as well as the State of Vermont."***

***Adam Grishin, Commissioner, Department of Finance & Management***

### Departure:

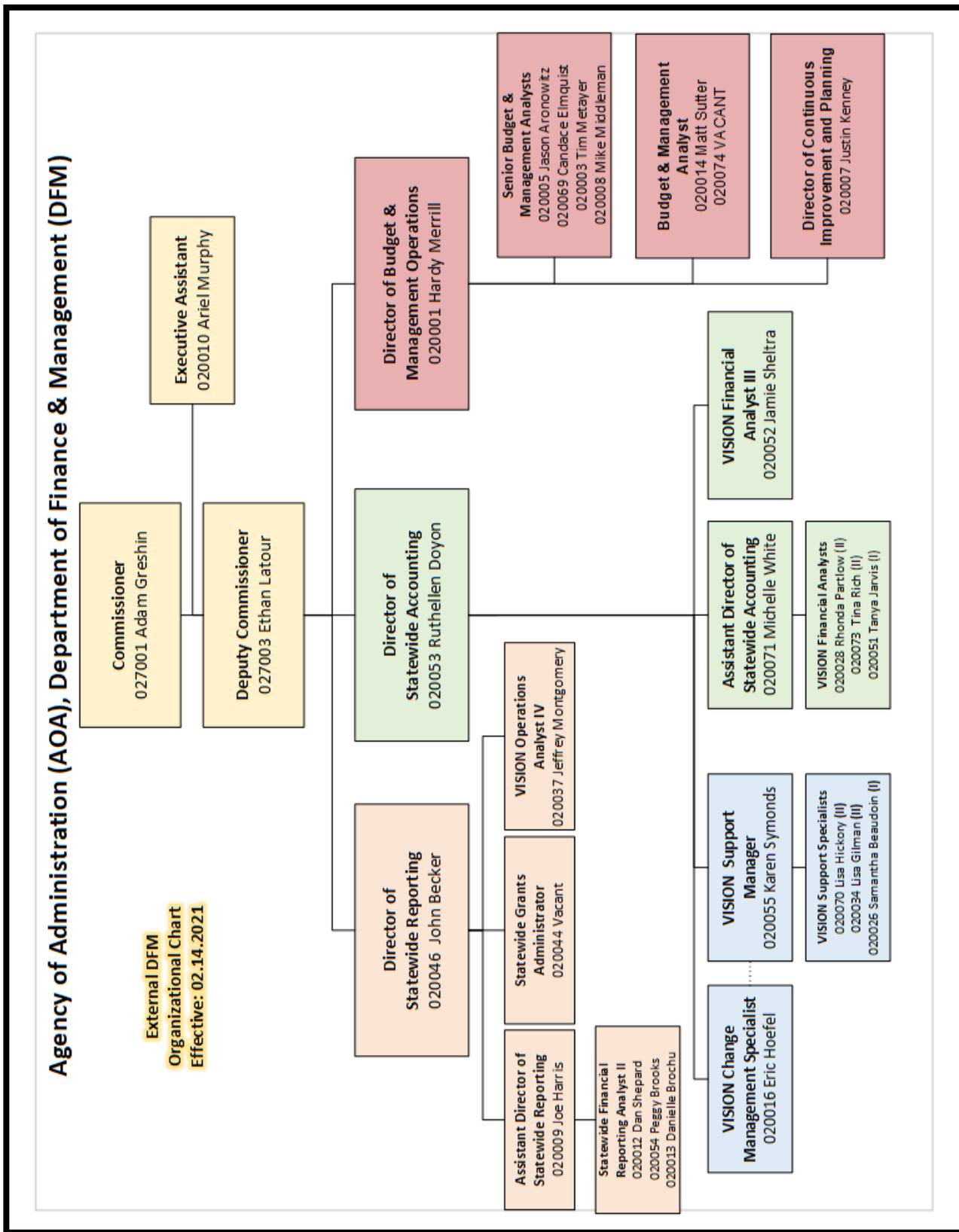
- **Cassandra Ryan, Statewide Grants Administrator.** Cassandra has taken a position at the Agency of Education (AOE) as Director of Regulatory Compliance and Risk Management.

***"We wish Cassandra the best of success in her new role."***

***John M. Becker, CPA, CGFM, Director of Statewide Reporting***

***Our Internal Control News*** is published quarterly in the ***Spring, Summer, Fall,***  
***and Winter*** by The Department of Finance and Management (DFM), Internal Control Unit.  
Please contact [jeffrey.montgomery@vermont.gov](mailto:jeffrey.montgomery@vermont.gov) with comments or future suggestions.

Our latest DFM – External Organizational Chart



<https://finance.vermont.gov/about-department>