

The Anatomy of Procurement Fraud



It's Wednesday afternoon and you (the contracting officer) receive a phone call from a program manager who shares the following:

I have been working in the research division for just over a year. Upon arriving, I was assigned a vendor to monitor. During that time, I have been reviewing and approving work assignments by the vendor with no significant problems. About a month ago, I received an e-mail from the vendor asking me to approve a work assignment for a deliverable that I did not believe was in accordance with the terms and conditions of the contract. I met with the vendor without notifying our procurement section (you) and told the vendor that the request was clearly inappropriate and not an allowable expense under the contract and I could not support payment. The vendor disagreed with my decision so I followed up the meeting with a notification to my boss, Mr.

Dale. Mr. Dale had been responsible for the oversight of this same vendor for several years prior to my arrival. Mr. Dale told me to not worry and that he would take care of it by talking to the vendor so I did not need to notify you at our procurement section. I don't know if anything is wrong, and I don't want to get anyone into trouble; however, I just learned that Mr. Dale had approved the work completion request that I had disapproved. Mr. Dale did not tell me about his decision. I overheard it from a person in our payment section. I started asking around as to why he would approve what I had disapproved without telling me. I learned that Mr. Dale's daughter works for this vendor and has been for the last two years. Since learning of all this, I have not talked to him as I am worried about how it could affect my job.

This type of notification is not uncommon for those working in the procurement, audit, or fraud examiner¹ fields. This type of allegation can suggest a range of potential fraud schemes² that, if true, could indicate possible violations of company/organizational policies related to impartiality or conflict of interest, or it can point toward more serious violations like receipt of bribes, gratuities, or kickbacks. Welcome to the world of procurement fraud.

Procurement fraud, or contract fraud, as it is sometimes called, is believed by many professionals to be one of the most common and costly of all white-collar crimes. It has become increasingly elaborate—many times being technology driven—and it saddles the public and private sectors with costs to reputations and balance sheets. Most distressingly, it undermines confidence in the organizational structure and its management. The U.S. federal government alone issues over \$500 billion per year in federal contracts, grants, and loans—\$500 billion of our tax dollars.

At its most basic level, *fraud* is defined as “an intentional perversion of truth for the purpose of inducing another, in reliance upon it, to part with some valuable thing or to surrender legal right.”³ Simply stated, fraud is a false representation of the truth, involving trickery and deception in order to illegally enrich the fraudster. With procurement fraud, the misrepresentation of the truth, in most cases, occurs somewhere in the acquisition process.⁴ What many professionals fail to accept is that the misrepresentation is fashioned by a fraudster, or fraudsters, who has a deep operational knowledge of your procurement process and is therefore connected to the contract.

Depending on the fraud scheme being employed, the consequences of procurement fraud will always involve some type of loss, which is usually a financial loss. However, some fraud schemes can also jeopardize personal safety, like in schemes involving defective products, counterfeit parts, and product substitution. Unlike financial statement and accounting fraud, procurement fraud is slightly less likely to be driven by senior management; it is more likely to be found in organizations with weaker controls, culture, and/or morale. I have also found procurement fraud more often in

companies that are more geographically remote, where divisions, operations, and processes are not central to a company's main business, and in places where the "tone at the top" is not effectively communicated. Procurement fraud prevention is a significant challenge for multinational companies since they often operate in regions and industries around the world where the local business environment and culture are permissive or where fraudulent behavior may be encouraged or even required.

The search for procurement fraud can be difficult at times, as on the surface, it generally only leaves faint clues or indicators⁵ to be discovered, normally by untrained observers. On any given day, valid fraud indicators are being dismissed as administrative oversights when found in documentation, or assumed as false indicators when either observed or overheard. Many program managers and division-level management view any hint of fraud in their programs as either negatively impacting their careers or the future funding for their section. These program managers therefore continuously minimize any suggestion that fraud might exist. I am not suggesting these managers are deliberately covering up fraud; they are simply rationalizing away what they are observing. "The only thing necessary for the triumph of evil is for good men to do nothing."⁶ Or, in our case, "The only thing necessary for the triumph of procurement fraud is for good people to report nothing."

Adding to procurement fraud's elusiveness in a significant way is the "veil of trust" the fraudster will carry with some employees of the organization being victimized. Remember, the fraudster is usually connected to the acquisition process in some way; therefore, the fraudster is currently, or has in the past, interacted at some level with the employees of the victimized organization. The degree of interaction between the fraudster and the employee reinforces this veil of trust, and therefore the fraudster is often considered to be a "trusted agent" by the same people whose trust has been violated. This "trusted agent" status highlights the peculiar dichotomy of procurement fraud: These crimes cannot succeed without trust, but neither can business.

Unlike crimes against persons and property, where the crime committed is apparent (e.g., assault, murder, vandalism, etc.), procurement fraud schemes are much more subtle. Further, during most crimes against a person or property, the criminal act is clearly understood from the beginning and the major investigative question is to identify the person who committed the crime. However, in procurement fraud, many times the person/subject is in fact known to the investigator, and the investigative question is whether the actions are a violation. Also, in procurement fraud investigations, the fraud indicators that caused the initiation of the investigation in reality are simply a lead to a totally different fraud scheme. For example, an observation of split purchases could be an indicator of a program manager circumventing higher-level review within the procurement process in order to expedite a contract action. However, in reality, the split purchase was an attempt to mask a decision to not compete a contract award after acceptance of a bribe. Many organizations have a requirement to have full and open competition for all contracts over a certain dollar value, and by splitting the order, a fraudster can stay below that threshold.

When I first started working procurement fraud investigations for the U.S. federal government, I rarely had a case involving a fraudulent cost accounting scheme. This was most likely because, as investigators, we did not understand the impact those types of schemes had on general and administrative costs to government contracts. Today, fraudulent cost accounting schemes are a normal case initiation as frequent as a bribery or kickback case.

There is no greater tool in the detection of procurement fraud than knowledgeable employees (procurement officials, auditors, inspectors, investigators, and fraud examiners) looking for, developing, and reporting potential procurement fraud indicators. Most contracts are not tainted by fraud, and most fraud indicators do not denote fraud. However, by exposing fraud indicators in the most efficient way, and properly assessing them, we, as professionals, are taking the appropriate steps to uncovering fraudulent acts, identifying the fraudster(s), protecting our organizational resources, and fulfilling our professional requirements.

In closing, remember that the only difference between a mistake and a fraud is the intent.

Endnotes

¹ Fraud examiners are those persons responsible for exposing and resolving fraudulent acts within their organization from inception to disposition. More specifically, fraud examination involves obtaining evidence and taking statements, writing reports, testifying to findings, and assisting in the detection and prevention of fraud.

² A “fraud scheme” is the specific methodology used to commit, conceal, and benefit from the fraudulent act.

³ Henry Campbell Black, *Black’s Law Dictionary*, sixth ed. (West Publishing Co., 1979).

⁴ The acquisition process is all-inclusive, from identification of the requirements to requesting bids to receipt of services/material to making final payment for the contracted item.

⁵ A “fraud indicator” is a set of circumstances that are unusual in nature or vary from the normal procurement process.

⁶ Edmund Burke, British political writer and statesman in the late 1700s.