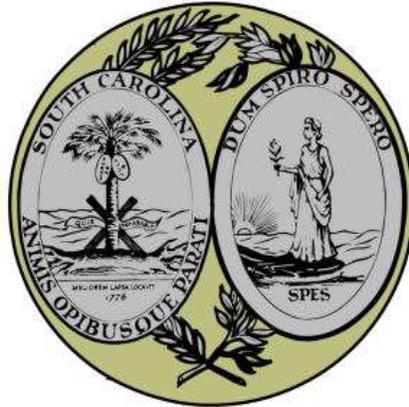


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## Fraud Risk Assessment of South Carolina's Statewide Procurement System

## I. Executive Summary

South Carolina's Statewide Procurement System (SPS) has a low risk for fraud. This is important because a significant portion of the State's \$24 billion budget is executed through the SPS annually. This review provides the public an understanding and an appropriate level of assurance of the fraud risk when the State spends taxpayer funds. Additionally, this review provides a firm foundation for the Budget and Control Board (BCB) and agencies oversight when deploying finite audit resources in providing assurance testing of the SPS.

A procurement fraud risk assessment is designed to collect multiple data sets from as many optics as practical to understand the risk of fraud in a complex procurement system. This review's sources included procurement officer interviews; continuous audit results of the SPS by the Procurement Services Division (PSD), BCB; review of vendor protests and appeals to the PSD and the Procurement Review Panel (PRP); actual cases of procurement fraud in State government; confidential surveys to procurement officers, internal auditors, and vendors; and a high level comparison of the SPS to best practices.

The quantitative data, also known as the hard numbers, developed in this review are supportive of a low risk fraud environment. Actual procurement frauds in State government were extremely low—fiscal year (FY) 2013-2014 had four incidents for a total loss of \$425,700, of which one incident amounted to \$415,000. Review of procurement protest and appeals to the PSD and PRP demonstrated near zero were based on integrity or fairness issues. The survey results of the procurement officers and internal auditors showed the number of fraud incidents observed, as opposed to suspected, over the past three years were 3% and 12%, respectively. The internal auditor's 12% observed fraud was concerning; further analysis of their narrative comments revealed single events, often involving the use of low dollar purchase card (P-card) transactions. With 1000 surveys submitted to vendors, only five requested interviews, and those described only *suspected* individual frauds and not *observed* or systemic frauds.

The qualitative data from both procurement officer interviews and confidential surveys paint a picture of a high integrity SPS environment. The SIG's interviews of 17 procurement officers demonstrated a highly professional, committed group with a keen understanding of maintaining SPS integrity. Most telling was their ethical standards typically resembling a "no cup of coffee" rule and managing relationships to avoid even appearances of impropriety, which were much more restrictive than State ethics laws demand. The internal auditor's survey results were positive in most areas, but certainly audit skepticism was healthy and present in their responses which should be heeded. Just because the incidents of fraud were low does not mean the risk and unreported incidents couldn't be higher.

Throughout all the interviews and surveys, no one raised an issue of a pattern or systemic fraud scheme. Fraud will occur in \$5 billion of annual SPS transactions, but the fraud data was so disproportionately low that it was indicative of a low risk of fraud in the SPS. The issue closest to an unhealthy pattern involved the use of sole source (FY12-13: \$127,612,720) and emergency (FY12-13: \$32,356,612) procurement methods. Virtually every data source flagged these two procurement methods as high risk and the BCB continuous audits confirms a pattern of non-compliance. Non-compliance with established internal controls does not necessarily equate to fraud, but it is certainly the breeding ground for fraud and waste. This pattern needs to be reversed.

Realizing with over 100 agencies in the Executive Branch operating the SPS, there will be a bell curve of risk for fraud in each agency. But overall, the data is clear—the State’s SPS has a low risk of fraud.

The SIG lays much of the credit with the State’s foresight in developing a robust procurement system modeled with best practices, as well as the PSD’s “personal touch” providing leadership, guidance, and direction to the over 100 Executive Branch agencies. PSD has successfully created a statewide procurement system with esprit de corps despite operating in a highly decentralized agency environment.

Regardless of the SPS’s low risk of fraud, there are opportunities to consider for improvement. A wise person once said, “If you are not going forward, you are going backwards.” Areas to consider incremental improvement include:

- Develop mitigation controls for the top tier identified fraud risks: sole source; emergency procurement; information technology; and indefinite delivery contracts.
- Place the SIG’s confidential hotline number on key standard procurement documents to facilitate SPS participants in reporting fraud, which likely will provide a more significant impact of deterring fraud based on the existence of an easy, confidential reporting mechanism.
- Adding additional capacity in the PSD, particularly in training and standardization of a statewide procurement manual, would leverage the capabilities of procurement officers in agencies, which would improve effectiveness and lower fraud risk.
- Agencies could modify their respective codes of conduct for all employees to incorporate the current informal higher standards used by procurement officers, such as no gifts and avoiding even the appearance of impropriety or conflict of interest standards.
- Conduct periodic fraud risk assessment surveys.
- Periodically provide fraud awareness training.

It is rare to conduct a review where the data so heavily leans in one direction leading to a convincing and positive conclusion—the State’s SPS has a low risk for fraud.

# Table of Contents

	<u>Page</u>
I. Executive Summary.....	1
II. Background.....	4
A. Objectives.....	4
B. Overview of the Statewide Procurement System.....	4
C. Overview of Fiscal Year 2012-2013 Procurements.....	7
III. Record Review.....	7
A. State Procurement Services Division Audits of Agencies.....	7
B. Analysis of State Procurement Protest Processes.....	8
1. Protests to the Chief Procurement Officer.....	8
2. Appeals to the Procurement Review Panel.....	8
C. Procurement Frauds Conducted in Fiscal Year 2013-2014.....	8
IV. Procurement Officers’ Interviews.....	9
V. Surveys of Statewide Procurement Process Participants.....	10
A. Procurement Officers.....	11
B. Internal Auditors.....	13
C. Vendors.....	16
VI. Conclusion.....	17
VII. Findings and Recommendations.....	18

Appendices: [Link to Appendices](#)

- A. Procurement Officers’ Survey Results
- B. Internal Auditors' Survey Results
- C. Vendors’ Survey Results
- D. Structured Interview Questions for Procurement Officers

## **II. Background**

### **A. Objectives**

This review was self-initiated by the State Inspector General (SIG) based on several factors. The SPS is the single function of state government woven into all agencies with the design to ensure effective use of taxpayer funds, to include preventing waste and fraud. This review provides the public an understanding and the appropriate level of assurance of the fraud risk in the SPS. Additionally, this review provides a firm foundation for the BCB and agencies oversight when deploying finite audit resources in providing assurance testing in the SPS.

This review's objectives were:

- Interview a cross section of procurement officers and the PSD to obtain their subject matter expertise and experience on fraud in the SPS;
- Survey SPS participants, primarily procurement officers, agency internal auditors, and vendors, on fraud risk in the SPS, while also providing confidentiality;
- Review records to discern indicators of fraud, to include PSD audits of agencies' procurement operations, participant protests of solicitations or awards, and actual frauds conducted in the SPS during the recent fiscal year;
- Map the SPS processes to analytically identify areas of risk for fraud; and
- Most importantly, improve the procurement processes by identifying and mitigating fraud risks to deter and prevent fraud in a function of government that annually spends billions of taxpayer dollars.

### **B. Overview of the Statewide Procurement System**

The PSD provides the State's central procurement operation for all State agencies covered by the South Carolina Consolidated Procurement Code (Procurement Code). The PSD has three primary functions: serves as a procurement subject matter expert providing guidance, advice, and training to facilitate state agencies procurement operations; delegates authority to individual agencies to make direct purchases below a certain dollar threshold based on capabilities; and assumes responsibility for agency purchases above each respective agency's delegated dollar limit threshold authority.

The purposes of the Procurement Code are: (a) to provide increased economy in state procurement activities and to maximize purchasing dollars while ensuring that procurements are the most advantageous to the State and in compliance with the provisions of the Ethics laws (b) to foster broad-based competition for public procurement within the free enterprise system; (c) to develop procurement capability responsive to user needs; (d) to consolidate, clarify, and modernize the law governing procurements in this State and permit the continued development of explicit and thoroughly considered procurement policies and practices; (e) to require the adoption of competitive procurement laws and practices by units of state and local governments; (f) to ensure the fair and equitable treatment of all persons who deal with the procurement system which will promote increased public confidence in the procedures followed in public procurement; (g) to provide safeguards for the

persons engaged in the public procurement process; and (h) to develop an efficient and effective means of delegating roles and responsibilities to the various government procurement officers.

Normally, each agency has a procurement officer who manages procurement functions and ensures that the Procurement Code regulations are followed. Contracts can be initiated by the agency or PSD on behalf of the agency.

Generally, the SPS process takes the following steps:

- An agency *need* is identified;
- A *solicitation* is written and published in the South Carolina Business Opportunities (SCBO) newsletter with the exception of small purchases less than \$2,500 (\$10,000 for higher education institutions);
- A *competition* is held (vendor responses judged responsive, vendors judged responsible, and bids or proposals are evaluated);
- A *vendor* is awarded the procurement; and
- A *contract* is negotiated and executed.

The State implemented an enterprise-wide software to manage its business operations, the South Carolina Enterprise Information System (SCEIS). Except for the State's colleges and universities, all State agencies utilize SCEIS for their business operations.

Procurements are conducted utilizing 17 different methods, which, to simplify understanding, can be categorized into the following framework:

#### Primary Types of Procurements

Small Purchases: Procedures on procurements up to \$50,000:

1. Purchases not in excess of \$2,500: non-competitive process; purchaser attests purchase price is “fair and reasonable;”
2. Greater than \$2,500 to \$10,000: solicitation of written quotes from a minimum of three vendors with the award made to the lowest responsive and responsible source;
3. Greater than \$10,000 to \$50,000: written solicitation that must be publically advertised requesting written quotes, bids or proposals, with the award made to the lowest responsive and responsible source;

Greater than \$50,000: a publically advertised, competitive process is required that may be accomplished by using one of five different methods depending on the commodity solicited and the method most advantageous to the State:

4. Competitive fixed priced: a process resulting in awards to multiple vendors who agree to the state’s maximum contract price;
5. Competitive on-line bidding (reverse auction): award to low bidder using e-procurement system with deadline for real-time bidding;
6. Competitive sealed bid: award to low bidder meeting the published specifications and contractual terms and conditions;

7. Competitive best value bidding: a method to allow other factors besides price to be considered in an award where price may be weighted no less than 60%;
8. Request for Proposals (RFP): a method used where other factors are considered more important to the State than price, which may not be a factor – offers are scored on the stated criteria and an award is made to the highest scoring offeror following negotiations;

### Specialized Types of Procurements

9. Sole source procurements: award to one vendor determined to be the only source;
10. Emergency procurements: an award made under conditions of a threat to public health, welfare, efficiency or safety where normal procurement procedures cannot be followed;
11. Information technology (IT): awards made for IT needs required to be procured by the Information Technology Management Office;
12. Construction Services: Unique procedures applicable to the complexities of construction, such as design-build and bid-build contracts;
13. Indefinite delivery contracts (IDC): competitive award establishing vendor contract to provide construction or design services to be used for a limited period of time and a limited total expenditure;
14. Statewide term contracts: award to bidders who meet requirements to maximize the buying power of all agencies on routine products and services;
15. Qualification based selection: non-competitive process; award based on qualifications for professional design services with fees less than \$25,000;
16. Auction or bankruptcy sale: unique procedures applicable when the state disposes of bankruptcy property; and
17. Exempt services & commodities: General Assembly statutory exemptions of procurements "exempted" from the Procurement Code.

The SPS also provides an avenue to protest if a solicitation is restrictive or the process is unfair, which is a quality control to reinforce the SPS's commitment to fair and equitable treatment and promote public confidence. The initial protests are in writing directed to the appropriate Chief Procurement Officer (CPO) responsible for construction, information technology, or supplies & services. Participants then have a right to appeal a CPO's decision to the PRP, which is a separate state agency composed of a panel of non-state employees with subject matter expertise selected by the Governor.

This framework of the SPS provides only an overview. The thrust of the State's SPS follows the fundamentals of public procurement: promotes openness, fairness, and transparency for public scrutiny, all to prevent fraud, collusion, or unjust favoritism; insure equal opportunity to compete; secure the public benefits of full and open competition; provide flexibility to accommodate complex purchases; and provide for efficiency and economy in the expenditure of public funds. Ideally, the SPS's processes strive to operate by balancing the need for fiscal accountability with the needs of agencies and vendors for user friendly processes to improve timeliness and save costs from missed opportunities or administrative overhead. The temptation to trigger all possible safeguards must be tempered to find that balance point of the appropriate level of safeguards while maintaining an efficient and effective SPS to meet its procurement mission.

### **C. Overview of Fiscal Year 2012-2013 Procurements**

The State's most recent complete FY budget, 2013-2014, was approximately \$24 billion. Tallying up the exact expenditures conducted by the SPS is somewhat complicated because not all agencies use SCEIS and a few other idiosyncratic factors, such as, the Department of Transportation uses the federal procurement standards. However, in a conservative estimate, the SPS handles at least \$5 billion annually. In FY 2012-2013, the State executed in excess of \$19 billion in SPS contracts (the life of the contracts vary from one to five years).

### **III. Record Review**

#### **A. State Procurement Services Division Audits of Agencies**

PSD's Audit and Certification Office (ACO) continuously audits state agencies' procurement transactions, averaging eight audits annually, designed to evaluate the system of internal controls over procurement. The objective is to provide management with reasonable, but not absolute, assurance of the integrity of the procurement processes.

During FY 2012-2013, ACO audited eight agencies' procurements that included review of \$153,628,541 of reported sole source procurements; \$7,374,301 of reported emergency procurements; 24,367 procurement card transactions; transactions involving 82 construction contracts; and transactions associated with 34 IDCs. ACO's testing methodology includes, but is not limited to, testing selected transactions from the general ledger accounts maintained on SCEIS to the agencies' supporting justification maintained for validity and appropriateness in compliance with the Procurement Code; quarterly reporting of emergency, sole source and unauthorized procurements to the BCB; ratifications of applicable transactions; accurate reporting of procurement transactions; circumvention of the Procurement Code/splitting of orders; favoritism of vendors; proper approvals obtained; IT purchases are in compliance with the agency IT Plan; IDC and construction contract payments for compliance with the State Engineer's Office procedures and the Procurement Code; properly reporting surplus property; and review of questionable procurements.

During the most recent fiscal year, ACO had 237 findings. Of these 237 findings, 142 were technical non-compliance issues such as no Drug-Free Workplace certifications (115); inappropriate use of exemptions (2); no written certification for grant exemptions (4); and no single transaction limit established for P-card transactions (2).

The residual 95 findings were considered more significant substantive non-compliance to include inappropriate sole source procurements (50); inappropriate emergency procurements or insufficient documentation to support emergency determinations (29); no proof of competition (14); and unauthorized procurements (2). The SPS's processes were designed to protect both the vendors and the state, but in these instances, non-compliance creates the potential for fraud, waste, and abuse. Of particular note are the sole source and emergency procurement method findings because both appear to be a recurring pattern. Given this pattern and the large amount of dollars in FY 2012-2013 sole source (\$127,612,720) and emergency procurements (\$32,356,612), this pattern of non-compliance is an unhealthy sign and is inconsistent with the SPS to promote competition to lower costs and mitigate fraud or even the appearance of impropriety. Although these substantive non-compliance findings did not detect integrity or fraud issues, it does not mean there was none and certainly the

risk of fraud, waste, and abuse is heightened when these types of procurement methods are, intentionally or unintentionally, circumvented.

The most telling fact impacting the fraud risk assessment is that ACO did not detect even one instance of fraud during its review of agency procurements over the past five years. This continuous audit model serves as a deterrent, and its results are indicative of a low fraud risk environment and provides confidence that the procurement processes are being properly maintained by the agencies in compliance with the Procurement Code.

## **B. Analysis of State Procurement Protest Processes**

The SPS includes provisions for participants, primarily vendors, to protest procurement process actions or decisions. A mechanism for protests adds a quality control to reinforce the SPS's commitment to fair and equitable treatment and promote public confidence. The initial protests are directed to the appropriate CPO responsible either for construction, information technology, or supplies & services. Participants then have a right to appeal a CPO's decision to the PRP.

### **1. Protests to the Chief Procurement Officer**

The SIG reviewed 48 recent protests to the CPO. Forty seven protests (98%) did not raise any fairness or integrity issues. These generally pertained to technical issues with bids or the appropriate application of procurement code processes. However, one protest raised a fairness issue, which, based on file documentation, warranted further review by the SIG. SIG field interviews and further record reviews determined the initial concerns of unfairness did not have merit.

### **2. Appeals to the Procurement Review Panel**

Protests denied by a CPO can be appealed to the PRP. The SIG reviewed the 19 protests appealed to the PRP during FY 2011-2012 and FY 2012-2013. Eighteen protests (95%) did not raise any fairness or integrity issues; these generally pertained to technical issues with bids or the appropriate application of procurement code processes. However, one protest raised a fairness issue that was effectively addressed by the CPO in a judgment to re-solicit the bid, and upheld by the PRP.

## **C. Procurement Frauds Conducted in Fiscal Year 2013-2014**

The SIG produces an annual report on fraud conducted by Executive Branch employees. The most recent FY 2013-2014 reporting identified four procurement frauds totaling \$425,700. All four involved the misuse of P-cards, which allowed the P-card holder to make non-competitive purchases under a \$2,500 threshold. Two frauds were nominal in nature averaging several hundred dollars, but the remaining two were significant with losses of \$10,000 and \$415,000. Both of these frauds were conducted by front-line employees converting P-card purchases to personal use. In both cases, adequate SPS internal controls were in place, to include the requirement of supervisory review and approval of monthly P-card statements. The problem was lack of appropriate supervisory oversight in executing the established internal controls.

The most illustrative “lessons learned” were gleaned from examining the \$415,000 fraud. This scheme occurred over a period of six years with the front-line employee exploiting two significant gaps in the agency’s financial control environment. First, the supervisor was insufficiently engaged in the work of a subordinate to understand the basis for the fraudulent purchases or just not paying attention when approving the subject’s monthly P-card bills. Second, the best practice of separating the end user, the subject, from the actual purchaser was not followed. The subject was issued a P-card for convenience rather than need. Assigning a P-card to an end user who is operating independently in a remote location or making frequent low dollar amount purchases in the field is reasonable; but in this case, the subject was buying expensive computer components while stationed at the agency’s headquarters. Failure of both of these basic financial controls provided the subject the opportunity to develop multiple fraud schemes, to include submitting fraudulent invoices for fictitious companies; over-purchasing items and selling the excess inventory; and the theft and resale of existing inventory.

#### **IV. Procurement Officers’ Interviews**

Seventeen procurement officers from 12 agencies and PSD staff were interviewed with structured interview questions (see Appendix D). The interviewees demonstrated a highly professional, committed group with a keen understanding of maintaining SPS integrity. Most telling was their ethical standards typically resembling “no cup of coffee” rules and managing relationships to avoid even appearances of impropriety, which were much more restrictive than State ethics laws demand.

Universally, the procurement officers attested to the high integrity environment within the SPS. Almost as universal was their respect and appreciation for the PSD’s leadership, guidance, and direction to agencies. Despite well developed, standardized procurement processes, procurement officers still make many judgments on a case by case basis requiring these agencies to seek input from the deep experienced pool of procurement officers at the PSD. Access and the responsiveness of these PSD subject matter experts seems to be key to making the entire SPS operate effectively.

Individual issues with sufficient frequency impacting fraud risk were identified and presented below:

- The highest risk issue noted by the large majority of the procurement officers was the need to maintain a properly staffed and experienced central procurement office. The agencies were very positive concerning the assistance and guidance provided to them by the PSD, but were concerned with the turnover/attrition within the office and the loss of such institutional knowledge. While this is not necessarily a fraud issue, the procurement officers rely so heavily on PSD that any erosion to its capabilities impacts field agencies. Additionally, if overall SPS capabilities erode due to lack of central expertise and training, it could certainly increase the fraud risk.
- Thirteen (76%) of the 17 procurement officers indicated the need for fraud awareness training. Only one agency indicated they have instituted fraud training internally and developed a fraud policy.
- Three (18%) of the 17 procurement officers indicated that justification for panel evaluator’s scores were not always maintained with the file, which, for a RFP contract award determination, is expressly required.

- Three (18%) of the 17 procurement officers indicated concerns that the risk of sole source determinations in many cases did not meet the criteria of a true sole sourced vendor, and competition was not solicited, which subsequently increased the cost to the state. As stated in the Procurement Code, “in cases of reasonable doubt, competition should be solicited.”
- Three (18%) of the 17 procurement officers indicated concern for risk of abuse of inappropriate purchases or fraud relative to P-card transactions, and noted instances of occurrences in the past. However, the issue is not more controls, but actually adherence to current controls, such as supervisory oversight, would limit the opportunity for fraudulent activity.
- One (6%) agency indicated that Statewide term contracts were being used to circumvent the procurement bidding process. This has potential for abuse, hiring specific vendors based on personal relationships, rather than competitively bidding the job for the most qualified vendor. Another interviewee described a new pattern where agencies use the Statewide IT contract for projects that should require a competitive bid process. This seems to be occurring because agencies may not have the skill set to establish an IT scope of work in a competitive bid process. An IT competitively bid contract can protect an agency from non-performance, while the use of the statewide contract inhibits establishing firm deliverables, thus exposing an agency to little recourse for underperformance.
- The Procurement Code and the ensuing State regulations stipulate that all governmental bodies will develop an internal Procurement Procedures Manual. Agencies interviewed reported that each one developed their own internal procurement manual. The procurement manuals for these 12 agencies ranged from 3 pages to 219 pages. These manuals and procedures are used to provide guidelines for agency personnel involved in the procurement processes and to facilitate the agency's certification. PSD does not have a model procedures manual for agencies, which may be a cost/effective opportunity to support both operational effectiveness and training, particularly in smaller agencies.
- Seven (41%) of the 17 procurement officers indicated there is a significant need for enhanced training to ensure the people that work in procurement have the proper training, and that training should be routinely provided without cost. Procurement officers indicated that many of the classes were cancelled by PSD and not rescheduled. Training is imperative to those that are assigned as the agencies' procurement officers, to ensure they have the knowledge and skills to adequately conduct the procurement processes of the agency.

## V. Surveys of Statewide Procurement Process Participants

After gaining a full understanding of the SPS from record reviews and procurement officer interviews, the SIG developed a confidential survey instrument for all procurement officers and internal auditors in agencies, as well as a sample from the vendor community. Survey response data from each population is as follows:

- procurement officers: 71 of 100 surveyed responded; 71% response rate;
- internal auditors: 50 of 160 surveyed responded; 31 % response rate; and
- vendors: 43 of 1000 surveyed responded; 4% response rate.

The survey and corresponding results for the procurement officers, internal auditors, and vendors are contained in Appendices A, B, and C, respectively. This section of the report will summarize and analyze the survey results. The analysis will be grouped into the following categories: integrity; management’s response to fraud; fraud observations & risk by procurement method (the 17 procurement methods in the background section, page 5); fraud observations & risk by type of fraud; procurement processes; agency audit capabilities to deter fraud; and improvement opportunities to mitigate fraud.

To simplify the summary, the majority of survey questions are known as “agree/disagree” questions where a statement is made with five possible responses: strongly agree; agree; disagree; strongly disagree; and uncertain.

### **A. Procurement Officers**

#### **Integrity**

The survey included the following four “agree/disagree” questions pertaining to employee and SPS’s process integrity:

- The State’s procurement processes are designed to prevent fraud, collusion, or unjust favoritism in the award of public contracts.
- My agency operates within the State procurement guidelines with fairness.
- The employees charged with the responsibility to conduct the procurement processes operate with integrity.
- My agency has adequate controls in place that would reasonably prevent the occurrence of fraud.

The aggregate results were 99.5% agreed/strongly agreed; 0% disagreed/strongly disagreed; and less than 1% were uncertain.

#### **Management’s Response to Fraud**

A key control to lower fraud risk is the “tone” management sets. The survey had two “agree/disagree” questions pertaining to management’s response to fraud:

- Suspected fraud or corruption is appropriately addressed by agency management.
- Suspected fraud or corruption is appropriately referred to law enforcement by agency management.

The aggregate results were 89% agreed/strongly agreed; 1% disagreed/strongly disagreed; and 10% were uncertain.

### **Fraud Observations & Risk by Procurement Method**

Respondents were asked to individually review each of the 17 types of SPS procurement methods (described on page 5), and then indicate whether the respondent had *observed* or *suspected* fraud in the method in the past three years. The possible responses were: *never observed or suspected* fraud; *suspected* only fraud; *observed* only fraud; *observed and suspected* fraud; or never used the method.

For each of the 17 procurement methods, 33%, on average, of the respondents had never used a particular procurement method. Respondents with experience in a procurement method were asked to select the best response among four options: *never observed or suspected* fraud (96.5%); *suspected* only fraud (2.7%); *observed* only fraud (0.7%); or *observed and suspected* fraud (0.1%). The survey made the distinction between suspected and observed fraud where observed fraud carries much more risk. Combining the two “observed” response options, only 0.8% of responses had observations of fraud during the past three years, which were only in five SPS procurement methods: small purchases with P-cards (1); \$2,500-\$10,000 three bids (2); emergency procurement (1); information technology (3); and statewide term contracts (1). Of these eight incidents, three categories were lower dollar procurements, while information technology had the highest frequency and likely higher dollar procurements.

Respondents were asked to rate the fraud risk (likelihood & impact) in each procurement method. Eleven (65%) of the 17 procurement methods were considered low risk by 90% or greater of those with experience with the method. Those with less than a 90% low risk rating are contained in the below table:

<b>Procurement Method</b>	<b>Low</b>	<b>Moderate</b>	<b>High</b>
Small Purchases (\$2,500 - \$10,000 category)	<b>81</b>	16	3
Request for Proposals	<b>78</b>	17	5
Small Purchases with P-cards (< \$2,500)	<b>72</b>	26	2
Indefinite Delivery Contracts	<b>70</b>	26	4
Emergency	<b>68</b>	28	4
Sole Source	<b>59</b>	33	8

### **Fraud Observations & Risk by Type of Fraud**

The survey presented five types of fraud: collusion among vendors; collusion of vendor with employee; relationship corruption (help/hurt procurement officer); employee only; and vendor only. Respondents were asked to individually review each of the five types of frauds, and then indicate whether the respondent had *observed* or *suspected* fraud in this type of fraud in the past three years. The possible responses (results) were: *never observed or suspected* fraud (90.0%); *suspected* only fraud (7.0%); *observed* only fraud (1.7%); or *observed and suspected* fraud (1.3%).

The survey made the distinction between *suspected* and *observed* fraud where observed fraud carries much more risk. Combining the two “observed” response options, only 3.0% of responses had observations of fraud over the past three years, which were only in two types of fraud: employee only (6) and vendor only (4). The actual observed fraud was in the category of lower risk fraud by individuals, where collusion frauds have a greater loss risk.

Respondents were asked to rate the fraud risk (likelihood & impact) of each type of fraud, which were:

<b>Fraud Types</b>	<b>Low</b>	<b>Moderate</b>	<b>High</b>	<b>Uncertain</b>
Employee only	<b>75</b>	15	4	6
Relation corruption	<b>62</b>	23	7	8
Collusion among vendor	<b>56</b>	23	7	14
Collusion between vendor/employee	<b>61</b>	27	4	8
Vendor only	<b>55</b>	27	6	12

### **Procurement Processes**

The survey included the following two “agree/disagree” questions regarding the understanding of the procurement processes:

- Question: The State’s procurement processes are easily understood.  
(72% agreed/strongly agreed; 18% disagreed/strongly disagreed; and 10% were uncertain)
- Question: Adequate training has been provided to employees involved in the procurement processes.  
(88% agreed/strongly agreed; 6% disagreed/strongly disagreed; and 6% were uncertain)

### **Improvement Opportunities to Mitigate Fraud in the SPS**

Ideas were developed primarily from interviews and data collection on possible improvement opportunities to mitigate fraud in the SPS. The table below sets forth seven proposed ideas ranked by the survey respondents:

<b>Proposed Improvement Opportunity Ideas</b>	<b>Low</b>	<b>Moderate</b>	<b>High</b>	<b>Uncertain</b>
Formalize statewide procurement procedures manual	14	30	<b>48</b>	8
Provide fraud awareness training	14	34	<b>46</b>	6
Clarify & heighten ethics standards	21	30	<b>41</b>	8
Enhance internal controls of procurement processes	27	38	<b>28</b>	7
Clarify & elevate SCEIS’ audit capabilities	24	15	<b>27</b>	34
Establish procurement fraud hotline	23	35	<b>27</b>	15
Conduct an annual fraud risk assessment survey	31	37	<b>21</b>	11

### **B. Internal Auditors**

#### **Integrity**

The survey included the following four “agree/disagree” questions pertaining to employee & SPS process integrity:

- The State’s procurement processes are designed to prevent fraud, collusion, or unjust favoritism in the award of public contracts.
- My agency operates within the State procurement guidelines with fairness.

- The employees charged with the responsibility to conduct the procurement processes operate with integrity.
- My agency has adequate controls in place that would reasonably prevent the occurrence of fraud.

The aggregate results were 71% agreed/strongly agreed; 7% disagreed/strongly disagreed; and 22% were uncertain.

### **Management’s Response to Fraud**

A key control to lower fraud risk is the “tone” management sets. The survey had two “agree/disagree” questions pertaining to management’s response to fraud:

- Suspected fraud or corruption is appropriately addressed by agency management.
- Suspected fraud or corruption is appropriately referred to law enforcement by agency management.

The aggregate results were 53% agreed/strongly agreed; 11% disagreed/strongly disagreed; and 36% were uncertain.

### **Fraud Observations & Risk by Procurement Method**

Respondents were asked to rate the fraud risk (likelihood & impact) in each of the 17 procurement methods. In all 17 procurement methods presented below, the internal auditors rated fraud risks much higher than the procurement officers:

<b>Procurement Method</b>	<b>Low</b>	<b>Moderate</b>	<b>High</b>
Emergency	30	30	<b>40</b>
Sole Source	28	35	<b>37</b>
Indefinite delivery contracts	16	53	<b>31</b>
Small Purchases with P-card (< \$2,500)	48	25	<b>27</b>
Construction based	42	35	<b>23</b>
Exempt services & commodities	32	45	<b>23</b>
Information technology	42	42	<b>16</b>
Bid \$2,500 - \$10,000	50	40	<b>10</b>
Auction/bankruptcy sale	57	33	<b>10</b>
Small architect, engineer & land surveying	48	45	<b>7</b>
Fixed price bidding	57	37	<b>6</b>
Competitive Sealed bidding	63	34	<b>3</b>
Best value bidding	51	46	<b>3</b>
Statewide term contracts	67	31	<b>2</b>
Bid \$10,000 - \$50,000 via advertisement	63	35	<b>2</b>
On-line bidding	67	33	<b>0</b>
Request for Proposals	68	32	<b>0</b>

Note: The “Uncertain” responses were eliminated and the ratings recomputed in this analysis.

### **Fraud Observations & Risk by Type of Fraud**

The survey presented five types of fraud: collusion among vendors; collusion of vendor with employee; relationship corruption (help/hurt procurement officer); employee only; and vendor only. Respondents were asked to individually review each of the five types of fraud, and then indicate whether the respondent had *observed* or *suspected* fraud in the type in the past three years. The possible responses (results) were: never *observed or suspected* fraud (70.0%); *suspected only* fraud (18.0%); *observed only* fraud (5%); or *observed and suspected* fraud (7%).

The survey made the distinction between *suspected* and *observed* fraud where observed fraud carries much more risk. Combining the two “observed” response options, 12% of responses had observations of fraud over the past three years, which were in all five types of fraud. The internal auditor’s 12% observations was concerning, and further analysis of their narrative comments revealed single events, often involving the use of low dollar P-card transactions.

Respondents were asked to rate the risk (likelihood & impact) of each type of fraud, which were:

<b>Fraud Types</b>	Low	<b>Moderate</b>	High	Uncertain
Vendor only	22	<b>56</b>	8	14
Collusion between vendor/employee	20	<b>44</b>	24	12
Employee only	26	<b>44</b>	18	12
Relation corruption	22	<b>40</b>	20	18
Collusion among vendor	40	<b>36</b>	4	20

### **Agency Audit Capabilities to Deter Fraud**

The following three questions addressed this issue, along with the corresponding results:

- My agency adequately audits its procurement processes to provide reasonable assurance of detecting fraud. (8% strongly agreed; 32% agreed; 18% disagreed; 12% strongly disagreed; and 30% were uncertain)
- My agency conducts formal risk assessments to identify and mitigate procurement fraud risk. (10% strongly agreed; 24% agreed; 32% disagreed; 12% strongly disagree; and 22% were uncertain)

Data collection throughout the review has been overwhelmingly favorable. However, this internal audit response had the highest level of disagreement of all survey responses. This concern is somewhat mitigated by the fact the PSD continuously audits agencies’ procurement processes on a rotating schedule without substantial substantive findings.

## **Procurement Processes**

The survey included the following two “agree/disagree” questions regarding the understanding of the procurement processes:

- Question: The State’s procurement processes are easily understood.  
(48% agreed/strongly agreed; 28% disagreed/strongly disagreed; and 24% were uncertain)
- Question: Adequate training has been provided to employees involved in the procurement processes.  
(52% agreed/strongly agreed; 14% disagreed/strongly disagreed; and 34% were uncertain)

## **Improvement Opportunities to Mitigate Fraud in SPS**

Ideas were developed primarily from interviews and data collection on possible improvement opportunities to mitigate fraud in the SPS. The table below sets forth seven proposed ideas ranked by the survey respondents:

<b>Proposed Improvement Opportunity Ideas</b>	<b>Low</b>	<b>Moderate</b>	<b>High</b>	<b>Uncertain</b>
Enhance internal controls of procurement processes	6	28	<b>62</b>	4
Conduct an annual fraud risk assessment survey	18	24	<b>52</b>	6
Clarify & heighten ethics standards	12	38	<b>44</b>	6
Clarify & elevate SCEIS’ audit capabilities	12	30	<b>44</b>	14
Provide fraud awareness training	6	42	<b>42</b>	10
Establish procurement fraud hotline	18	40	<b>38</b>	4
Formalize statewide procurement procedures manual	20	42	<b>32</b>	6

### **C. Vendors**

The SIG judgmentally selected a sample of 1000 vendors from the SCEIS database from the 19 vendor industry categories. In addition, the SIG published a notification in the SCBO newsletter for seven weeks, notifying the vendors that the SIG is conducting a fraud risk assessment of State government’s procurement processes, and as key stakeholders in the procurement process the SIG is seeking their valuable input and observations.

Unfortunately, the SIG only obtained 43 vendor survey responses, which was a 4.3% response rate. This small sample undermines the reliability of the survey data. This prevents a full presentation of the survey results in the body of this report, but the raw data of the vendor survey results is contained in Appendix C.

The SIG does feel comfortable with a high level analysis of the vendor survey data that may be useful:

- In the 11 agree/disagree questions analyzing the integrity of the procurement processes and the procurement offices, the aggregate results were: 53% agreed/strongly agreed; 11% disagreed/strongly disagreed; and 36% were uncertain. The 36% uncertain seemed surprisingly high. The 11% disagree rating equates with a general dissatisfaction level, which, from a high level view, seems positive towards the SPS.

- In the five types of fraud (vendor collusion; employee/vendor collusion; relationship corruption; employee fraud; and vendor fraud), the aggregate results when asked to rate the risk (likelihood & impact) of each type of fraud were: 37% low; 16% moderate; 10% high; and 37% uncertain. Again, uncertain seems high.
- Two vendor questions showed the actual number of “observed” fraud; one was 9% and the other was 5%. This was less than internal auditors (12%) and greater than procurement officers (3%). The SIG interviewed all vendors requesting an interview—five. All five described past State procurements where each suspected some level of fraud. What was interesting, all five described a particular transaction of *suspected* fraud and not an *observed* fraud or systemic fraud within the SPS.

Throughout the review, the SIG recognized the management adage of “process protects,” which equates to clear rules, standardization, and monitoring promotes confidence and assurance in achieving appropriate, or fair, outcomes. But even within this rigorous SPS process, procurement officers have built in flexibility to exercise judgment in making determinations at various stages of the process. It is these areas that seem to draw interviewee or survey respondents’ suspicions which does not infer there is anything improper, just an event that is driven by judgment rather than a rote process.

## **VI. Conclusion**

The measurement of any process, results in quantitative data and qualitative data, which then must be synthesized into judgments and conclusions, and then hopefully into recommendations to improve in a pragmatic matter. The SIG presents its data in a robust manner to allow readers to filter the data through their own experiences leading to their own judgments, conclusions, and recommendations. Still, it is incumbent upon the SIG to provide its analysis to this voluminous data.

The SIG’s analysis starts with looking from a high level on all its data sources, which hopefully measured the SPS from multiple optics for a fair analysis. The sources included procurement officer interviews; PSD’s continuous audit results of the SPS; review of vendor protests to PSD and appeals to the PRP; actual reported procurement fraud in state government; surveys to procurement officers, internal auditors, and vendors; and a high level comparison of the SPS to best practices.

The SIG’s analytical foundation begins with assessing quantitative data composed of “hard numbers,” and then brings qualitative data to bear. In this case, the review of actual procurement frauds in State government was extremely low given the billions of dollars executed by the SPS—FY 2013-2014 included four events for a total loss of \$425,700, with one incident at \$415,000. Review of PSD and PRP activity demonstrated near zero appeals based on integrity or fairness issues. The survey results of the procurement officers and internal auditors showed the number of fraud incidents observed, as opposed to suspected, over the past three years were 3% and 12%, respectively. The internal auditor’s 12% observed fraud was concerning, but further analysis of their narrative comments revealed only single events, often involving the use of low dollar P-card transactions. With 1000 surveys sent to vendors, only five requested interviews, and they described *suspected* individual fraud incidents, but not any systemic or *observed* fraud. The quantitative results are consistent with a low risk of fraud.

The qualitative data from both procurement officer interviews and confidential surveys paints a picture of a high integrity SPS environment. The SIG's personal interviews with 17 procurement officers demonstrated a highly professional, committed group with high integrity. The internal auditors' survey results were positive in most areas, but certainly audit skepticism was healthy and present in their responses which should be heeded. Just because the incidents of fraud are low does not mean the risk and unreported incidents couldn't be higher.

Throughout all the interviews and surveys, no one raised an issue of a pattern or systemic fraud scheme. Fraud will occur in \$5 billion of annual SPS transactions, but the fraud data was so disproportionately low that it was indicative of a low risk of fraud in the SPS. The issue closest to an unhealthy pattern involved the use of sole source (FY12-13: \$127,612,720) and emergency (FY12-13: \$32,356,612) procurement methods. Virtually every data source flagged these two procurement methods as high risk and the BCB continuous audits confirms a pattern of non-compliance. Non-compliance with established internal controls does not necessarily equate to fraud, but it is certainly the breeding ground for fraud and waste. This pattern needs to be reversed.

Realizing with over 100 agencies in the Executive Branch operating the SPS, there will be a bell curve of risk for fraud in each agency. But overall, the data is clear—the State's SPS has a low risk of fraud.

Regardless of the SPS's low risk of fraud, there are opportunities for improvement. A wise person once said, "If you are not going forward, you are going backwards." The SIG has set forth recommendations below to be considered by both individual agencies and PSD as ideas for incremental improvement.

## **VII. Findings & Recommendations**

**Finding #1:** Based on data collected, the SPS has a low risk for fraud.

**Finding #2:** The PSD is highly effective in its mission and sustaining an SPS with a low risk for fraud.

**Recommendation #2:** Even in a tight resource environment, resource enhancements to the PSD have a significant leveraging impact to facilitate the 100 Executive Branch agencies to improve their production and capabilities, particularly resources for training and possibly standardization of a statewide procurement manual baseline.

**Finding #3:** The wide variety of data sources clearly rated the following procurement methods as the top tier fraud risks: sole source; emergency procurement; information technology; and indefinite delivery contracts.

**Recommendation #3a:** The PSD should consider additional cost/effective controls to mitigate the perceived higher risks in these procurement methods.

**Recommendation #3b:** Individual agencies should consider examining these higher risk procurement methods unique to their agency, and consider cost/effective mitigation strategies.

**Finding #4:** Establish a procurement fraud hotline is a cost/effective mechanism to deter and identify fraud.

**Recommendation #4:** The PSD should consider placing the SIG's confidential hotline number on key standard procurement documents to encourage SPS participants to report fraud, which likely will provide a more significant impact of deterring fraud based on an easy, confidential reporting mechanism.

**Finding #5:** A cost effective fraud mitigation tool would be for agencies to modify their respective codes of conduct for all employees to incorporate the current higher informal standards used by procurement officers, such as no gifts and avoiding even the appearance of impropriety or conflict of interest standards.

**Recommendation #5:** Agencies should consider modifying the respective codes of conduct.

**Finding #6:** A cost effective fraud mitigation tool for the statewide SPS would be to conduct periodic fraud risk assessment surveys.

**Recommendation #6:** The SIG will collaborate with PSD on an appropriate frequency for a fraud risk assessment survey and execute this task.

**Finding #7:** A cost effective fraud mitigation tool would be providing fraud awareness training.

**Recommendation #7:** The SIG will collaborate with PSD on developing a fraud awareness program.