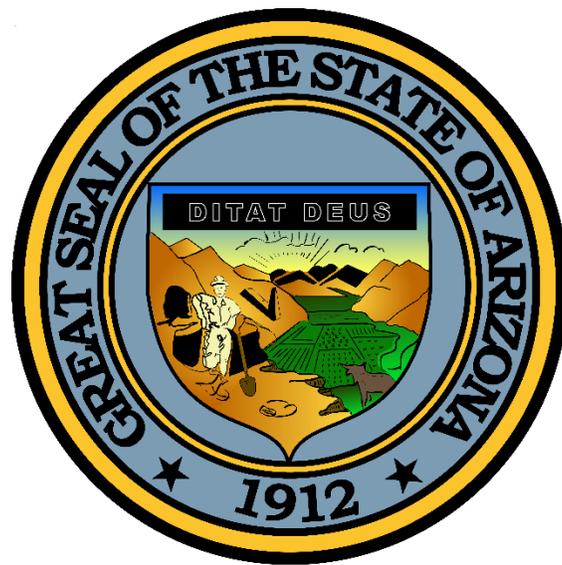


State of Arizona

A Resource to Combat Waste, Fraud, and Abuse



September 2020



Douglas A. Ducey
Governor

**Governor's Office of
Strategic Planning and Budgeting**
1700 West Washington, Suite 600, Phoenix, Arizona 85007
(602) 542-5381 • FAX: (602) 542-0868

Matt Gress
Director

State of Arizona Employees:

The Governor's office is committed to ensuring the fiscally responsible and transparent management of monies provided to Arizona by the multiple COVID-19 Federal funding resources.

I have directed the Economic Recovery Management Team (ERMT), within the Governor's Office of Strategic Planning and Budgeting, to coordinate and assist agencies in compiling adequate policies and procedures to prevent waste, fraud, and abuse from occurring within the programs and projects funded by these resources. ERMT has developed this guide with assistance and resources from the Arizona Department of Administration's General Accounting Office and the Office of the Auditor General in identifying areas with potential for waste, fraud, and abuse and provide tools for enhancing systems of internal control in compliance with federal requirements.

Employees at all levels of state service should be aware of agency programs designed to prevent and detect occurrences of waste, fraud, and abuse and take an active role in helping enforce them. Together, risks associated with these activities may be avoided or discovered, and resolved at every level of the organization.

We're in this together and we will return stronger. Thank you for your service to Arizona and your continued support to accomplish these goals.

Sincerely,

A handwritten signature in blue ink that reads "Matt Gress".

Matt Gress, Director
Office of Strategic Planning and Budget



Governor's Office of

Strategic Planning and Budgeting

1700 West Washington, Suite 600, Phoenix, Arizona 85007
(602) 542-5381 • FAX: (602) 542-0868

Douglas A. Ducey
Governor

Matt Gress
Director

Dear Colleagues:

The Office of Strategic Planning and Budgeting is providing fraud detection and prevention resources and tools for state agencies, local governments, nonprofit organizations and others to ensure that they have the proper mechanisms in place to prevent and detect waste, fraud, and abuse of taxpayer dollars. This guide has been created with that goal in mind. The information contained in this guide is the result of collaboration between the Office of the Governor, the Office of the Auditor General, the Arizona Department of Administration's General Accounting Office, and oversight agencies that will be investigating allegations of waste, fraud, and abuse. While it is impossible to prevent all fraud, being proactive in our approach to prevention can help decrease the chances of problems in the future and help detect, investigate and correct occurrences.

The COVID-19 pandemic has brought unexpected and unprecedented challenges to our Arizona families, businesses, schools, and institutions. The Federal response resulted in multiple funding streams into Arizona to address and support the medical and financial issues experienced during this time, including the \$2 trillion dollar Coronavirus Aid, Relief, and Economic Security (CARES) Act. These needed relief funds come with the expectation that costs incurred are necessary and reasonable for proper and efficient performance and administration of the funding.

One type of Federal assistance established by the CARES Act was the Coronavirus Relief Fund (CRF). The CARES Act included \$150 billion in CRF monies for the U.S. Department of the Treasury to directly distribute to eligible state, local, and Tribal governments. In Arizona, five qualifying municipalities and counties received funding, along with the State government. In an effort to support the remaining Arizona cities, towns and counties that did not receive direct funding, the Office of the Governor established the AZCares Fund to provide immediate relief for COVID-19 response and recovery efforts to those locals.

The State of Arizona, through its many agencies, departments, boards and commissions providing critical services and managing CARES Act and other recovery funding, is responsible for establishing and maintaining effective internal controls. In addition, the State must ensure compliance with the requirements of laws, regulations, contracts, and grants applicable to the appropriate funding. Prevention and detection of fraud, waste, and abuse are part of these responsibilities.

Going forward, one thing is certain – all eyes will remain focused on how CARES Act and other COVID-19 recovery dollars are spent. By being proactive and vigilant, we can help to mitigate the potential for problems in the future. While this task may seem daunting, it is important to recognize that there are a number of tools available to agencies. The State of Arizona's General

Accounting Office, Office of the Auditor General, and the Office of the Governor are committed to helping agencies work to prevent and detect waste, fraud, and abuse of government funds throughout Arizona

Sincerely,

A handwritten signature in blue ink that reads "Matt Hanson". The signature is written in a cursive, flowing style.

Matt Hanson, Assistant Director
Office of Strategic Planning and Budget
Economic Recovery Management Team (ERMT)



LINDSEY A. PERRY
AUDITOR GENERAL

ARIZONA
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

State of Arizona colleagues:

The Auditor General's Office is committed to working with the Arizona Governor's Office and General Accounting Office to help Arizona government prevent and detect waste, fraud, and abuse. The Coronavirus Aid, Relief, and Economic Security (CARES) Act and other COVID-19 recovery monies require an unprecedented level of accountability to ensure that public monies are properly spent on programs to help our Arizona families, schools, colleges and universities, healthcare facilities, and other businesses in need. Federal regulations over the use of these monies require prudence and transparency. A strong internal control system is the cornerstone of accountability and helps ensure that monies are spent for allowable purposes and helps prevent fraud, waste, and abuse.

The Auditor General's Office is here to help you establish and maintain a strong internal control system over CARES Act and other COVID-19 monies, as well as all public monies. It is also critical that your employees at all levels be aware of fraud risk factors and take an active role in helping enforce established controls. Employees specifically responsible for administering CARES Act and other COVID-19 monies should have a thorough understanding of any federal compliance requirements over these monies and document the federal guidance that they used in their decision making. Creating a control-conscious environment is one of the best ways to prevent fraud, waste, and abuse.

Because we are responsible for auditing the State of Arizona's federal programs, including CARES Act and other COVID-19 programs, we appreciate this partnership with the Governor's Office and General Accounting Office to help you be fiscally responsible and demonstrate the accountability and transparency these critical times call for.

Sincerely,

Lindsey Perry, CPA, CFE
Auditor General

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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; and
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**
- II. **Bribery**
- III. **Conflicts of Interest**
- IV. **Kickbacks or unlawful “pay to play”**
- V. **Collusive Bidding**
- VI. **Overcharging or substitution of materials, equipment, or supplies**
- VII. **Fraudulent claims and misrepresentation of eligibility**

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 Arizona Revised Statutes ([A.R.S.](#)) § [13-1802](#), 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.

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. If an employee accepts a bribe, the employee could be in violation of [A.R.S. §13-2602](#), and could be subject to a felony conviction.

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.

Internal Controls

- ✓ Segregate employee responsibilities so that one person does not have the independent ability to process, review, and approve contracts and other binding agreements.
- ✓ 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 periodically. Employees who have disclosed a conflict with a vendor or applicant should be excluded from participating in the contracting or granting process.

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. If an employee intentionally or knowingly violates [A.R.S. § 38-501 through 38-511](#) (conflict of interest), the employee could be subject to a felony conviction.

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 form.

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. If an employee accepts a kickback, the employee could be in violation of [A.R.S. §13-2602](#), and could be subject to a felony conviction.

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 particular 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.

Internal Controls

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. A separate file should be maintained for public inspection of all known conflicts of interest and monitored by the Agency periodically. Employees who have disclosed a conflict with a vendor should be excluded from participating in the contracting process.

V. Collusive Bidding: Bid Rigging and Price Fixing

Collusive bidding occurs when there is either bid rigging or price fixing of awarded contracts. If an employee participates in collusive bidding, the employee could be in violation of the Arizona Procurement Code and [A.R.S. § 41-2616](#). The employee could be subject to a felony conviction and liable for the recovery of all public monies paid plus 20% of such amount.

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.

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.

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

a. 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:

- Mismarking 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.

b. 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.

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. Initiate efforts to address and establish maintenance of effort requirements and develop policies and procedures to help ensure that salaries and wages charged reflect actual time spent working on the project. Specific to COVID-19, click [here](#) for the State of Arizona General Accounting Office (GAO) Time and Effort Guidance.

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 State of Arizona General Accounting Office (GAO) Publications [here](#), News and Updates [here](#), COVID-19 Time and Effort Guidance [here](#)
- ❖ The State of Arizona Office of the Auditor General [here](#)
- ❖ The White House, Office of Management and Budget (OMB) Uniform Guidance [here](#)
- ❖ U.S. Department of Treasury [here](#)
- ❖ Pandemic Response Accountability Committee (PRAC) [here](#)
- ❖ United States Government Accountability Office (U.S. GAO), Standards for Internal Controls [here](#), A Framework for Managing Fraud Risks in Federal Programs [here](#)
- ❖ United States Department of Justice Fraud Section (FRD) [here](#), Grant Fraud Handout [here](#)
- ❖ The Association of Certified Fraud Examiners (ACFE) [here](#)
- ❖ The Institute of Internal Auditors (IIA) [here](#)
- ❖ The Association of Government Accountants [here](#)

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.

OR

Blow the Whistle:

If you have a complaint involving public funds, the following contacts are available:

Contact Information

For CARES Act

Office of Strategic Planning and Budgeting

Phone: (602) 542-5381

Website for submittal: <https://grants.az.gov/report-fraud>

For CARES Act or Other Fraud

Arizona General Accounting Office (GAO)

Phone: (602) 542-5405

E-mail: reportfraud@azdoa.gov

Office of the Arizona Auditor General

Phone: (602) 553-0333

The State of Arizona Attorney General

Phone: (602) 542-5025

Whistleblower Protections

Employment Protection Act

Arizona Statutes A.R.S. 38-531 through A.R.S. 38-534 protect public employee whistleblowers from personnel reprisals. The statutes identify who is protected and what kinds of reprisals they are protected from in statute. For more information please visit the links below.

- [38-531. Definitions](#)
- [38-532. Prohibited personnel practice; violation; reinstatement; exceptions; civil penalty](#)
- [38-533. Exemptions](#)
- [38-534. Appropriate independent personnel boards](#)

Who is protected?

Employees of the State and its agencies or political subdivisions, including, but not limited to, cities, towns, counties and regional school districts, or any authority, commission, board or instrumentality thereof.

What are whistleblowers protected from?

Covered individuals are protected from being discharged, suspended, or demoted, or from any other adverse employment action being taken as a reprisal for making a protected disclosure.

What kinds of disclosures are protected?

Any disclosure made by an employee to any public body* of an activity or practice that the employee believes is in violation of a law, rule or regulation, or which the employee believes poses a risk to public health, safety or the environment.

*A public body can be:

- U.S. Congress or state legislature;
- Popularly elected local government body;
- Federal, state or local judiciary;
- Federal, state or local regulatory, administrative or public agency or authority, or instrumentality thereof;
- Federal, state or local law enforcement agency, prosecutor's office or police/peace officer; and/or
- Any division, board, committee or commission of any of the above.