

First Friday Fraud Facts

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The Idaho State Controller's Office distributes this newsletter as a cost-effective method of increasing awareness about ways to detect and prevent fraud, waste, and abuse in government.



QUESTIONS OR COMMENTS:

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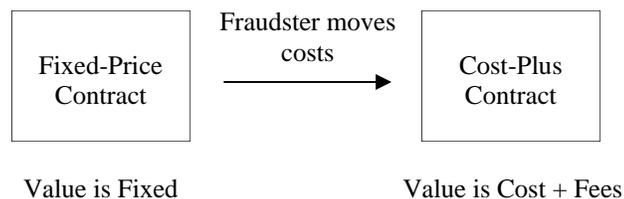
Welcome to First Friday Fraud Facts (F⁴). This edition will cover a common type of procurement fraud referred to as cross charging and the three-way match principle.

CROSS CHARGING

Cross Charging is a common type of procurement fraud and occurs when a contractor improperly shifts costs and expenses from one contract to another in order to illegally increase the contractor's profits. Assume, for example, that a contractor has two contracts in place with a government. One contract is a fixed-price contract—one for which the contractor will receive an agreed upon amount upon completion of work. The other contract is a cost-plus contract—one for which the contractor is paid on the basis of his or her costs plus an agreed upon fee or profit percentage.

To boost profits, the contractor moves costs relating to the fixed-price contract to the cost-plus contract. The contractor receives full payment on the fixed-price contract. The contractor is paid for these costs again when they are included on the cost-plus contract.

Cross-Charging Diagram:



Considering the size of certain government contracts, cross charging can prove quite lucrative to the fraudster.

Cross charging is similar to improper cost allocation; the former involves two types of government contracts, while the latter involves charging the costs of a private sector contract to a public contract.



Without considerable oversight and an understanding of the costs likely to be incurred under a cost-plus contract, cross charging and improper cost allocation schemes may be difficult to identify and deter.

RED FLAGS

- Frequent errors/corrections of errors on invoices and other documents
- Billing for time - one contract contains names of persons assigned to another contract
- Contractor costs on the fixed-price contract are unusually low
- No requests for contract changes on fixed-price contract
- Costs on the cost-plus contract are considerably higher than those expected or budgeted

BEST PRACTICES

- Procedures should be in place to look for high rates of errors or corrections related to billings
- Procedures should be in place to see whether contract personnel are billed to more than one contract for the same periods of time
- Require contractor statements for fixed-price contracts
- Evaluate the number of contract change requests on fixed contracts
- Evaluate the costs in comparison to budgeted costs and the costs experienced for similar types of projects

FISCAL FOCUS—THE THREE-WAY MATCH

Three-way match refers to an integrated process that matches the invoice presented for payment to the purchasing and receiving records. Performing a three-way match can help you avoid improper payments, resolve receiving questions, and provide valuable documentation to resolve billing disputes.

A simple, effective system starts with a numbered purchasing record that provides the requester, order date, quantities, price, payment terms, specific description of the item(s) ordered, and other specific details. The receiving department uses the purchasing record to verify what was ordered matches what was received. The payables department uses both

the purchasing and receiving records to efficiently make proper payments or quickly initiate a billing dispute.

The three-way match can benefit you in other ways:

- Identify discounts for which you might qualify
- Avoid penalties for nonpayment when goods have been received, but an invoice is missing
- Identify problem vendors
- Identify payables to include on the GAAP Accounts and Other Payables Closing Package

Information about Internal Controls related to the purchasing, receiving, and paying processes, can be found on the Office of the State Controller's website (www.sco.idaho.gov, under Internal Controls) or on the NASACT website (<http://nasact.org>, under NASC, Committees, Information Sharing Groups, and Internal Controls).

Purchasing rules, newsletters, and other helpful information are available on the Idaho Division of Purchasing Website (<http://purchasing.idaho.gov/publications.html>)

ANNOUNCEMENTS:

1) Mark your calendars to attend one of the following Idaho SCO's Annual Internal Control Training sessions:

a) Tuesday, April 3, 2012, from 8:15 a.m. – 10:15 a.m.

OR

b) Thursday, April 5, 2012, from 8:15 a.m. – 10:15 a.m.

2) The 2011 Comprehensive Annual Financial Report (CAFR), Citizen-Centric Report, and the Legal Basis Financial Report are now available on the SCO's website at www.sco.idaho.gov. Under "What's New" click on "2011 Comprehensive Annual Financial Reports are Now Available" to access all three reports online.

