Contracting Internal Controls and Risks

Contract Auditing v Contract Monitoring
We will cover the following:

• Overview of the internal audit function
• Importance of internal controls
• Stakeholders in the internal control environment
• Scenarios that render controls ineffective
• Impact of ineffective or no controls
Overview: What is Internal Audit?

- An independent, objective assurance and consulting activity that reports to the CEO and/or the Governing Board/Audit Committee.

- A collaborative partner in establishing the agency’s control environment.

- A provider of value-added, audit and non-audit services that help management improve agency operations.
Overview: What Internal Audit ‘isn’t’

- Does not accept risk on behalf of management
- Not a monitoring tool for the Executive Team
- Not an “enforcer” of policy
- Does not manage or perform duties related to functions reviewed and audited

THESE ARE MANAGEMENT’S DUTIES, NOT AUDIT FUNCTIONS
Overview: The Audit Process

- Annual Risk Assessment & Internal Audit Plan
- Notification and Pre-Audit Planning
- Entrance Conference
- Audit Field Work
- Communicating Results
- Exit Conference and Final Audit Reports
- Follow-Up Reviews
- Investigations as needed
Overview: The Contract Monitoring Process

- Notification
- Field Work
- Communicating Results
- Final Reports
- Follow-Up/Desk Reviews
Similarities: Auditing and Contract Monitoring

- **Auditing**
  - Establish relationships with management & staff
  - Evaluate agency compliance with laws, regulations, policies, and contractual agreements
  - Evaluate agency programs and operations in a short period of time
  - Issue audit reports and present results to entity management
  - Maintain audit documentation in support of reportable conditions

- **Monitoring**
  - Establish relationships with multiple contractors
  - Evaluate contractor compliance with laws, regulations, policies, and contractual agreements
  - Evaluate contractor programs and operations in a short period of time
  - Issue monitoring reports and present results to *contractor*
  - Maintain contract documentation in support of reportable conditions
**Similarities: Audit and Contract Management**

<table>
<thead>
<tr>
<th>Auditing</th>
<th>Contract Oversight</th>
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<tbody>
<tr>
<td>Establish relationships with</td>
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<tr>
<td>management &amp; staff</td>
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<td>Conduct audits to determine</td>
<td>Conduct quality reviews to</td>
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<td>whether agency performs</td>
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<td>Recommend risk mitigating</td>
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<td>processes to agency staff</td>
<td>processes to contract staff</td>
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<td>Review data, files, and other</td>
<td>Review data, files, and other</td>
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<td>compliance with criteria</td>
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<td>Recommend policy and</td>
<td>Recommend and implement contract</td>
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<td>procedure enhancements</td>
<td>policies and procedures</td>
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Establishing Inappropriate Relationships with Contractor

• Preferential referrals to one contractor over another

• Excessive Contract Amendments and Change Orders

• Training contract staff to “take over” as contractor management OR discussing future employment opportunities

• Holding financial interest in the contractor’s business

• Receiving kickbacks/bribes
Control Environment: Set the Tone

**Contractors**
- Establish sound business practices, comply with laws, policies, and contract agreements, and cooperate with contract monitoring protocols

**Clients**
- Request assistance when needed, provide accurate information to staff, and comply with program rules, terms, and conditions
Paying for False Claims

• Services are not provided at all or not in the quantity/quality promised
• Services are billed before they are provided
• Service is billed at the incorrect price
• Paying a duplicate invoice (“double dipping”)
• Signature or handwriting discrepancies

Paying for Services for which the client is not eligible

• Client falsifies information in order to receive services
• Person receiving the service is not the client approved to receive the service
Internal Controls: Contractor Risk

Irregular Account, Documentation, & Financial Activity

- No reconciliations to bank statements/accounting records
- Missing/skipped check #s, large number of voided checks
- Purchases without receipts or other documentation
- Payments sent to Post Office Boxes
- No approval or authorization signatures
- Payments in “round” dollar amounts
- Photocopies instead of originals
Internal Controls: Contractor Risk

Questionable Organizational Activities

- No segregation of duties in such departments as:
  - Payroll
  - Human Resources
  - Accounts Payable/Receivable
  - Inventory Management
  - Purchasing

- Supervisory and/or management overrides to existing purchasing and contracting policies and procedures

- High turnover amongst financial staff

- Uncooperative management and/or staff
<table>
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<tr>
<th>Contract Staff:</th>
<th>Supervisors/Managers:</th>
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<tr>
<td>- Maintain independence and be free from conflicts of interests with contractors</td>
<td>- Maintain independence; Communicate independence and conflict of interest policies</td>
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<td>- Attend training related to job duties; perform contractor training</td>
<td>- Ensure staff is adequately trained to perform job duties; Oversee contractor training</td>
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<td>- Review contracts and make renewal recommendations</td>
<td>- Review and approve contracts for implementation</td>
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<td>- Monitor contractors for compliance with laws, rules, and contract terms and issue reports</td>
<td>- Ensure contract monitoring is performed &amp; approve monitoring reports</td>
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<td>- Maintain support documentation of all contract related actions and decisions</td>
<td>- Ensure support documentation is maintained for all contract related actions and decisions</td>
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<td>- Be on the look out for Fraud, Waste, and Abuse and report it</td>
<td>- Communicate Fraud, Waste, and Abuse policies; Report occurrences</td>
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Case Study #1: Independence and Conflict of Interest

- Suzy has been a contract manager at Agency A for 4 years.
- Suzy has developed a good relationship with her Contractors, and has become friends with some of the contractors and their staffs.
- Managers think Suzy’s independence and objectivity might be compromised, but there are not enough resources to rotate staff on a period basis.
- Suzy is the only contract manager who is able to monitor these contractors and manage their contracts.
- Suzy likes it this way because she enjoys helping the contractors, and she understands their struggles if they are not meeting contract terms or other policies.
- Suzy does not think she should document deficiencies or write a corrective action plan when she knows the non-compliance is unintentional.
Case Study #1: Analysis and Results

1. Does Suzy have a valid reason for not documenting deficiencies or issuing a corrective action plan?

2. How can Suzy develop a rapport with the contractors, but ensure her judgment is not impaired?

3. What are the consequences of lacking independence?

4. What would be an “internal control” to mitigate the risk of issues arising from lack of independence or conflicts or interest?

5. Has anyone encountered a similar issue, and if so, how did you handle it?
Case Study #2: The Control Environment

• The legislature created the Contract and Procurement Agency, and it appointed Harry as the Executive Commissioner.

• Harry hired an Executive Management Team, some of whom were members of his college fraternity. Staff was hired from candidates that applied through the Human Resources website.

• Harry has friends who he believes would be excellent contractors to carry out state business. He directs the Executive Team to make sure his friends get approved for contracts.

• Staff, following policies and procedures, did not select these contractors, as they did not meet the conditions of the procurement. Harry used his position to override the decisions and create contracts with his friends.

• During a monitoring visit, staff noted myriad non-compliance issues. Although staff recommended non-renewal of the contracts, Harry overruled the recommendations.
Case Study #2: Analysis and Results

1. What sort of “tone” has Harry set for the agency?

2. What are the potential consequences from Harry’s actions?

3. What would be an “internal control” to mitigate the risk of issues arising from an insufficient ethical environment?

4. Has anyone encountered a similar issue, and if so, how did you handle it?
Ineffective or No Controls: What’s Wrong with This Picture

- Look for red flags and other clues that something is amiss ("professional skepticism").
Break Out Session: Fraud Identification

- How can you tell if a situation is fraud or just a mistake?

- Is the action intentional or negligent?

- How does management play a role in the problem identified?
Lessons Learned

- Beware of providers that “make up” documents and records for the monitoring visit.
- Responses on ICSQs may or may not be true in practice.
- Even if true, the controls stated on ICSQs may not be strong enough to protect against fraud!
- Wherever there is incentive, rationalization, and opportunity, there is always the potential for fraud.
- Prior to “jumping to conclusions” about fraud, discuss the facts of the situation with your supervisor.
- Contract monitoring tools and checklists can be useful, but they cannot replace your own judgment, intuition, and observations.
- Contract monitoring is a coordinated effort. Working with the Provider and Client, as well as Procurement, Program, and Contract Oversight will produce the highest results.
YOUR POLICY GOES HERE!
Wrapping It Up: What Can I Do?

• Actively participate in the contract risk assessment process
• Evaluate the ICSQ for red flags and verify contractor responses
• Watch for warning signs that a contractor may not be performing in accordance with the contract
• Perform regular billing reviews with an “eagle eye”
• Maintain the contract file with all support documentation
• Communicate with staff and managers
Wrapping It Up: Objectivity without the “Gotcha”

- You’ll learn more with objectivity than with a “gotcha” attitude
  - People are more willing to share information with someone that is approachable, friendly, professional, and credible

- Put the power of observation to good use
  - Be on the look out for the differences between what people say, what they do, and what the evidence reveals.
  - Just because it is not fraud today, does not mean it will not be fraud tomorrow
Wrapping It Up: Be an Actor, Not a Barrier

• **Barriers:**
  - What’s the point of filling out the survey when my opinion doesn’t matter?
  - I have too much work to do; I don’t have time to do more than what I’m already tasked to do; This isn’t my problem.
  - Why should I keep monitoring the same contractor or reviewing their bills over and over? They are perfect every time.
  - I am not familiar with certain job tasks and I can’t get the training I need.

• **Actions:**
  - Fill out surveys and feedback forms as accurately, honestly, and objectively as you can. Your opinion does matter.
  - Use your time wisely; You are the first line of defense in ensuring contractors are performing faithfully and honestly.
  - Nobody is perfect all of the time. Change up your practice and don’t settle into a predictable schedule or review routine.
  - Be honest and upfront about your needs and interests.
Questions, Comments, Feedback