

109112

The City of New York
Department of Investigation

Kenneth Conboy
Commissioner

NCJRS

FEB 11 1988

ACQUISITIONS

109112

EXECUTIVE SUMMARY

THE DETECTION AND PREVENTION OF FRAUD AND
ABUSE IN HUMAN SERVICES PROGRAMS CONTRACTED
FOR BY GOVERNMENT AGENCIES

August 1987

Project Director: Judith Frost
Project Associate: Ted Nelson
Consultant: Andrea G. Lange

This project was supported by the National Institute of Justice
(Award #84-IJ-CX-0079) and the New York City Department of Investigation

U.S. Department of Justice
National Institute of Justice

109112

This document has been reproduced exactly as received from the person or organization originating it. Points of view or opinions stated in this document are those of the authors and do not necessarily represent the official position or policies of the National Institute of Justice.

Permission to reproduce this copyrighted material has been granted by

NIJ/ U.S. Department of Justice
New York Department of Investigation

to the National Criminal Justice Reference Service (NCJRS).

Further reproduction outside of the NCJRS system requires permission of the copyright owner.

EXECUTIVE SUMMARY

Objectives

This project had several objectives which were refined as it moved along from the proposal to research design, to data collection, to analysis and presentation. In their final form these objectives, as stated in the main body of the report, were:

1. To determine the nature, extent and seriousness of reported fraud, corruption, and abuse in the three selected program areas in New York City and to identify their characteristic patterns;
2. To design a method for utilizing investigative case data for internal control review;
3. To evaluate internal controls in the three selected human service contract management systems to identify vulnerabilities to fraud and abuse;
4. To make recommendations for improving the City's methods of administering human service contract programs, leading to the development of a model system for fraud prevention and for improved management of New York City contract programs;
5. To adapt the model system for national use.

Objective #1 was fully realized during the first year of the project and is reported upon in Appendices B through F of the project report. A computerized version of the data used in its manual form to prepare these appendices was a product of the second year of the project. Chapter III: Results and Findings in the main body of the report is an analysis of the computerized data.

Objectives #2 and #3 were the focus of the project during its second year and are reported upon in Chapters IV and V of the main body of the report, entitled respectively, An Analytic Framework, and Analysis of Risk for Selected Administrative Functions.

Objectives #4 and #5 have been met explicitly or by implication within the main body and appendices of the report. Where the risk analysis pursued in Chapter V revealed vulnerabilities, recommendations were made to improve internal controls in the agencies and programs studied. These recommendations are applicable to many human service contract programs in New York City and are likely to be useful nationally as well.

This summary will indicate what a model system for fraud/abuse detection and prevention should consist of, particularly for New York City agencies. While we were unable to sample other jurisdictions to determine the relevance of our work for the management of their human service contract programs, we believe that the reader will be able to discern such connections where appropriate.

In December, 1986 after the writing of the main body of this report was completed, a report from the New York City Department of Investigation (DOI), to the Mayor, recommended restructuring of the City's Offices of Inspector General. The report, the text of which is included as Appendix G of this project report, has implications for "fraud prevention and improved management of New York City contract programs" (Objective #4). Whether the new system could be part of a "model system for national use" (Objective #5) is dependent to some extent on its success in detecting and preventing fraud and corruption in New York City. Adopting the New York City system in other jurisdictions is also dependent upon the judgment of such city, county or state officials as to its appropriateness and cost-effectiveness for their governmental entities.

Definitions

Fraud, corruption and abuse are not uniformly defined in the literature and are sometimes confused in casual communications. For the purpose of this project the three terms were defined as follows:

- Fraud: Intentional deception or illegal manipulation of government-funded programs, involving violation of civil or criminal statutes, for personal or other extraneous benefit.
- Corruption: A form of fraud, it involves officials or public employees receiving money or other goods in return for giving special treatment.
- Abuse: Involves improper use of program resources for personal or extraneous benefit, but without criminal intent to deceive.

While useful for differentiating allegations for analytical purposes, these terms are not wholly satisfactory. If they were not so firmly entrenched in the investigations field, a substitution of various forms of "feasance" would be appropriate and more descriptive of what was found in this study as well. Both corruption and fraud are malfeasance, with the former involving public officials and the latter anybody else. Malfeasance is intentional law-breaking, and the only additional distinction that needs to be made in specific instances is

whether it involves a public official or not. While corruption and fraud tend to be used interchangeably in popular discourse to describe illegal acts, abuse is insufficiently descriptive of the activities which occur under that rubric, only some of which are illegal. Substituting misfeasance for abuse when someone does something wrong or illegal without intending to deceive and non-feasance for abuse when someone fails to carry out his/her responsibilities are definitional improvements. Knowing that a contractor is either doing its job badly (mis-) or not at all (non-) can help a funding agency manager decide whether to provide technical assistance to the contractor in order to improve performance or to simply get rid of the contractor and attempt to recoup the funds already drawn down.

Sound contract management by funding agencies, effective supervision of the contract agency's Chief Executive Officer (CEO) by its board of directors in the exercise of their fiduciary responsibilities, and competent direction of staff by the CEO are the cures for mis- and nonfeasance. Assurance that these actions occur is the responsibility of government officials who manage human service contract programs, not investigative agencies, which, as argued in the Appendix G report, should be involved in anti-corruption (read, anti-malfeasance) activities instead. One-half of the allegations in cases researched for this study were abuse, primarily matters which took up the time of investigators that might better have been spent on malfeasance prevention and detection.

Scope of the Study

The choice of human service programs to be included in the study was based upon the fact that employment training, community services and housing assistance programs are federally-funded, currently through block grants, and implemented in New York City by means of contracts with private organizations. The unit of analysis essentially was the contract and the means by which it was "managed", that is, approved, monitored, evaluated and audited by the governmental funding agency and carried out by the contractor.

For this study funding agency contracting vulnerabilities were viewed from the perspective of Office of Inspector General (OIG) cases regarding private contractors. An OIG case consists of one or more complaints/allegations which have been made about the contractor in general, about one or more contractor staff or board members, or about one or more funding agency staff or other public officials vis-a-vis a particular contractor. Allegations which are coherent and attributable to a subject (a specific person or an organization) are opened as cases and investigated until they are able to be substantiated or unsubstantiated.

In the two and one-half year time period studied (July 1982 through December 1984), 28 percent of the community services

contractors in the NYC Community Development Agency (CDA) were investigated. Forty percent of the employment training contractors in the NYC Department of Employment had cases opened on them. In both agencies, one-fourth of all allegations investigated were substantiated as fraud, one-fourth as abuse.

Results

The extent of documentable loss established during the 2 1/2 years studied was small, about three percent of the total funds spent for employment training contracts and less than one percent for community services contracts. Loss determinations are not a normal course of events in New York City investigations, unless a case is referred to the Department of Investigation for possible criminal/civil prosecution or unless restitution is sought by the Office of the Inspector General responsible for the investigation. Generally, malfeasance of less than \$50,000 is not considered worth criminal prosecution and civil or administrative penalties are likely to be sought instead.

Check fraud was the most common single vehicle for malfeasance in this study. Other falsified fiscal documents cases were also common, such as inflated staff timesheets, and overbilling by vendors. Falsified documents can also be used to initiate check fraud. An example would be failing to complete termination forms for departed employees, thus generating checks which are forged and cashed.

Falsified client eligibility was a problem in the Summer Youth Employment Program (SYEP) during the time period for this study. This type of petty fraud, with a maximum "benefit" of less than \$700 to the youth and his/her family, has been more effectively controlled as a result of procedures installed with the assistance of the OIG/DOE.

Abuse, as noted above, can be misfeasance or nonfeasance--either acting wrongly or not acting when one should have--and has differing implications for contract management depending upon which it is. In this study, abuse sometimes also became a residual category when fraud could not be proved, as in one large case involving an organization's failure to pay employee withholding taxes, health insurance premiums and pension monies to the appropriate authorities--an example of nonfeasance.

Conflict of interest/nepotism is usually an abuse category which, if an intent to violate regulations for personal financial gain can be proved, would make it fraud. Most often in this study this common allegation was determined to have resulted from an ignorance of regulations or in no personal benefit (no kick-back) to the subject, other than possibly the satisfaction of helping a relative get a job or a contract.

Complaints about contractors and officials come to the OIGs

from a variety of sources, which in this study were classified as "inside", or "outside" depending upon whether the complainant was an employee of City government or not. Somewhat less than half of the complainants were insiders, usually funding agency staff who detected a problem with the contractor. The most frequent outside sources were staff or former staff of contractors, probably exercising moral/ethical concern about wrong-doing, or vindictiveness.

Contractor staff were also the most likely perpetrators of fraud/abuse in the study, with over four-fifths of the substantiated employment training program allegations and three-fourths of the substantiated community services program allegations lodged against them.

Sanctions against contractors and subjects for substantiated fraud/abuse principally included defunding of the contractor and/or restitution from the subject, with less than one-fourth of the substantiated fraud cases referred to the DOI or a District Attorney for possible prosecution.

An Analytic Framework

The method devised for using investigative case data to determine faults in internal controls (Objective #2) involved, first, the division of the generic system for contracting into an interconnected series of events, repeated at regular intervals, each leading to a particular objective or outcome. These "event cycles" as they pertain to human services program contracting are the revenue, expenditure and conversion/inventory cycles.

The revenue cycle for the funding agencies in this study essentially includes the receipt of and accounting for the block grant monies to be used for contracting and for supervision of their contractors. For contract agencies the revenue cycle includes various administrative functions ranging from applying for funds, through services provision and the reports related to it. For funding agencies, this is the expenditure cycle.

The expenditure cycle for contract agencies consists of all activities which involve payments to staff and vendors and for the facility in which the program is housed.

The conversion/inventory cycle includes the means by which the contract agency assures itself and the funding agency that its human and material resources are used for the purposes stated in the contract and not converted to illegitimate purposes. This cycle is not mutually exclusive of the revenue and expenditure cycles, since internal controls within those cycles can also assure the security of human/material resources. Such redundancies, however, are useful in directing funding agency attention to the need for on-site inspections and reviews, in addition to program and statistical reports and other "paper"

monitoring and auditing of contractor activities.

Within the cycles a number of administrative functions in both funding and contract agencies can be subjected to an analysis of risks. Internal control guidelines can be applied whenever a risk analysis specific to an administrative function is able to be completed. In fact the risk analysis itself usually indicates the controls which need to be in place in order to reduce potential vulnerabilities. The four accounting-related functions analyzed--internally generated checks, staff payments, purchasing, and participant payments--are highly vulnerable functions, as indicated by the number and nature of the OIG cases related to them.

In the contract agency revenue cycle the primary risks for the funding agency are in the administrative functions having to do with applications from contractors and their reports on service delivery. For those programs to which it is relevant, client eligibility is also a potential area of risk. Contract agency expenditure cycle risks revolve around the ways in which contract agencies handle their funds. Risks in the conversion/inventory cycle have to do with the fact that audits and follow-up procedures to secure inventory and funds when a contract is closed-out sometimes tend to be instituted too late or are non-existent.

In this study the majority of allegations were in the contract agency expenditure cycle. Substantiated fraud allegations were, not unexpectedly, likely to also be in this expenditure cycle, while substantiated abuse allegations were more likely to occur in the revenue cycle for employment training programs and in the expenditure cycle for community services programs, many of which in the CDA do not manage their own finances.

The distribution of allegations among administrative functions within the cycles was different for employment training and community services programs. The major kinds of allegations in employment training programs had to do with contractor payments to participants and staff, while for community services programs the most prevalent allegations were for vendor and staff payments and with regard to the citizen participation activities in reviewing and recommending community-based organizations for funding. These were followed closely by conflict of interest/nepotism and inappropriate staff behavior allegations.

Indications that more or less effective controls were in place was determined by the proportion of allegations which resulted from "insider" complaints. Overall about one-third of all complaints came from people in the public sector. But among the prevalent allegations, about half of the participant payment allegations in employment training programs, and in vendor payments and abuse of citizen participation activities allegations in the community services programs, were from insiders. A relatively high proportion of inside complaints

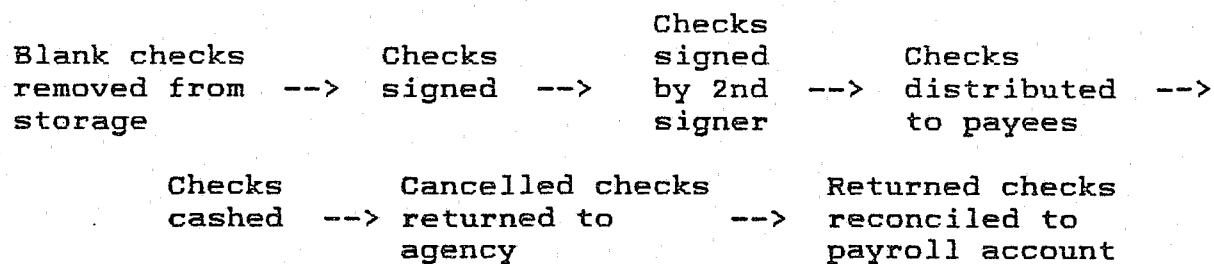
indicates that detective controls may be more effective in those functions to which such allegations relate. However, if there are also a large number of allegations, then there may not yet be effective preventive controls in place.

Although points of vulnerability and the risk analysis related to each point can be determined independently of investigative case data, such cases make it easier to focus upon the most vulnerable points--those for which effective controls may be lacking. A risk-analysis has a logical structure which must be exhaustively delineated if an effective control system is to be designed. For the four accounting-related functions analyzed in this project, controls which are instituted must also be thoroughly and constantly monitored. Complaints/allegations which occur after such controls are installed indicate either poor monitoring or an incomplete risk analysis/internal control procedure.

The following sets of outlines of vulnerable points and potential patterns of fraud and abuse involving internally-generated checks, staff payment procedures, purchasing functions and participant payments are reproduced in their entirety from the main body of the report. These are models for any jurisdiction wishing to reduce its risks in dealing with such contractor - related matters.

The first three of the outlines are not necessarily restricted in their application to human service contract programs but can apply to any kind of contract and/or to direct-service programs operated by the public agency itself. The fourth one, participant payments, is relevant to any training or educational program in which participants are paid salaries or stipends for attending the program.

The following is a diagram of the potential vulnerability points involved in check-writing transactions:



Potential vulnerabilities at each point are as follows.

Potential Patterns of Fraud and Abuse Involving Internally-Generated Checks:

1. Removal and signing:

- o Blank checks removed from storage by someone other than authorized personnel, forged, and negotiated.
- o Authorized person removes checks from storage, makes them out to self or accomplice, forges one or both signatures.
- o Authorized person makes check out to legitimate person or business, forges endorsement to self or agency account.
- o Authorized person makes check out to fictitious person or business, forges endorsement to self or different agency account.
- o Authorized person makes check out to self (no attempt to conceal fraudulent transaction, possibly because no controls are operating in the situation).

2. Processing of cancelled checks by agency:

- o Reconciliation is performed by the same people who write checks.
- o Reconciliation is performed by an unqualified person.
- o Checks are reconciled to bank statement but not to accounts payable records.
- o No reconciliation is performed.

3. Check distribution:

- o Check distribution is performed by the same person who is authorized to write checks.
- o Check distribution is performed by the same unauthorized person who forged the check.
- o Filled out checks are stolen during distribution process, forged, and cashed.

4. Check cashing:

- o Bank personnel unknowingly accept forged checks endorsed with false payee name. Account number is one set up by the thief--bank credits only account number, not title of account.

5. Covering theft in accounting records:

- o Person writes and cashes check to self or accomplice with or without forgery, enters legitimate expense and payee in accounts payable. Books balance. The returned check is reconciled against bank statements but

not against accounts payable ledger.

- o Same as above, except person also writes a check to the legitimate payee, which is then kept in storage. This similar device may be used when funding agencies require copies of checks with fiscal reports.
- o Checks are written back and forth among accounts in a series of inter-connected "loans" that creates a sufficiently confusing accounting trail to cover the misappropriation of funds from one of the accounts.

Vulnerable Points in Staff Payment Procedures:

Employee hired/ terminated; --> documents prepared	(Documents submitted to --> funding agency)	New employee placed on pay- --> roll/terminated removed
--> Weekly timesheets --> prepared	Amounts of wages, fringe, etc. calculated	(Payroll sent to automated --> payroll system)
	!	
	! Checks written	
	!--> for withholding ----!	
	tax, pension, !	
	etc. !	
	!	
--> Staff checks --> written	Staff checks --> distributed	Checks cashed --> Cancelled checks reconciled to account

-(Procedures in parentheses are not performed by all contractors).

Potential Patterns of Fraud and Abuse Involving Staff Payment:

1. Adding new employees; deleting those terminated:

- o When an employee is terminated, he/she is retained on payroll without his/her knowledge. Termination forms required by the funding agency are not sent, time sheets are forged, and the resulting paycheck is forged and cashed.
- o A terminated employee continues to submit timesheets or consents to have them submitted for him.
- o An employee is placed on payroll before he begins work; timesheets and check endorsements are forged.
- o An employee is placed on the payroll more than once, using different names and social security numbers.

2. Filling out and approving timesheets:

- o Entire timesheet is forged by person other than the one named on the timesheet.
- o Timesheet is filled out by staff member it belongs to, but for inflated hours.
- o Supervisor knowingly or unknowingly approves falsified timesheet.
- o Supervisor's approval is forged.

3. Distribution:

- o The person in charge of approving timesheets is in charge of distributing checks.
- o The person in charge of preparing payroll is in charge of distributing checks.
- o The person who falsified timesheets has unauthorized access to checks before or during distribution.
- o Check cashing:
 - Bank or check cashing personnel unknowingly accept forged checks.
 - Bank or check cashing personnel knowingly accept forged checks, with or without kickbacks.
- o Payment of withholding taxes and pension funds:
 - Payment entered in accounts payable, check written, but never sent.

Vulnerable Points in Purchasing Functions:

Contractor Writes	(Bids/Purchase		
Purchase Order/	--> Order Approved By	--> Vendor	<-----
Solicits Bids	Funding Agency)	!	!
!		!	!
Contractor		Vendor	!
Receives	<-----	Sends	!
Goods		Goods	!
!		!	!
Contractor		Vendor	!
Accounts Payable	<-----	Invoice	!
Receives Invoice			!
!			!
Contractor Writes			!
Vendor Payment	-----		!
Check			

Potential Patterns of Fraud and Abuse Involving Vendors:

1. Purchase orders; bid solicitation:

- o Through prior arrangement with vendor, purchase order is written for inflated price.
- o Dates or other information on purchase order are altered to conform to funding agency regulations.
- o There is no written purchase order.
- o Bid solicitation is fixed; kickback is paid.
- o Bids or written estimates are forged by contractor in order to force selection of pre-determined bidder.

2. Delivery of goods:

- o Vendor delivers less than the quality/quantity/condition of supplies/equipment, bills full amount, kickback paid.
- o Packing slip is never compared to purchase order.
- o Physical goods never compared to packing slip.
- o Goods received by same person who ordered them.
- o Goods never delivered.

3. Vendor invoice:

- o Invoice for more than price of goods.
- o Invoice from fictitious or "dummy" vendor firm.
- o Invoice altered, submitted more than once.
- o Invoice copied, submitted to more than one funding source.
- o Whole invoice forged.

4. Vendor check written:

- o Vendor check written for inflated price, undelivered goods, etc.
- o Checks unknowingly or knowingly signed by authorized signatures.
- o Checks forged or falsified by unauthorized person(s).

5. Accounting and reconciliation:

- o Accounts payable entered, though check never written or never sent to vendor.
- o Accounts payable entered with authorized vendor name, though check made out to unauthorized person.
- o Vendor checks reconciled by same person who wrote checks.

Potentially Vulnerable Points and Patterns of Fraud and Abuse in Participant Payments:

In spite of the different systems involved, it is possible to identify certain areas of vulnerability that they have in common, though the fraud patterns resulting from each vulnerability point may vary from program to program, as a result of different procedures:

1. Application/Eligibility Determination:

- o Eligible applicant applies and is accepted, but does not participate. Unauthorized person obtains his ID card and assumes his identity in program. Resulting checks are forged and cashed by the impostor.

2. Deleting Terminated Participants From Payroll:

- o When the participant drops out, he is retained on payroll without his knowledge. Contractor staff fail to turn in required termination forms; timecards are forged, and the resulting paycheck is forged and cashed.
- o OJT subcontractor continues to bill the prime contractor for terminated participant(s) (with or without collusion from prime contractor staff).

3. Filling Out and Approving Timecards:

- o Participant inflates hours on timecards with or without supervisor's collusion.
- o Staff member forges participant timecards for expediency; no fraud intended.
- o OJT subcontractor forges no-show participant's time records to substantiate falsified inducement claim.

4. Check Distribution:

- o The same staff member is authorized to approve time-sheets, post time to the payroll, and pick up participant checks.
- o The staff member who falsifies participant timesheets has unauthorized access to participant checks before or during distribution.
- o Participant uses false ID to secure another participant's checks.
- o Participant falsely claims his check was lost or stolen in order to receive an additional check.
- o Participant receives wrong check because DOE or contractor staff failed to check his ID.
- o Funding agency staff steal checks before distribution to contractors.

5. Check Cashing:

- o Participants or staff use false ID to cash stolen checks.
- o Bank or check cashing personnel unknowingly accept forged check.
- o Bank or check cashing personnel knowingly accept forged check, with or without kickback.

As an addendum to the risk analysis for check-writing transactions, a number of recommendations were made for improving New York City controls over the use of funds for human service contract programs. These are reproduced below for their possible relevance to other jurisdictions.

Recommendations (for New York City):

1. An inventory of bank accounts held by City government or agents for various purposes connected with human service contract programs should be performed on an annual basis by a central City authority. Internal controls protecting access to these accounts should then be reviewed annually by the same authority, in addition to routine audits.
2. Auditors and/or contract managers should review the physical security of blank checks at contract agencies and should make recommendations for increasing security when necessary.
3. The City should adopt a general policy regarding the signatures required on checks written on contractor accounts funded by the City. Two signatures, including one board officer

and one staff executive should always be required.

4. Contractor board members should receive training in the rudiments of internal control required in contract agencies, with emphasis on protection of assets in checking accounts and the need for separation of responsibilities.

5. Contractor boards should be urged to adhere to the following procedures and safeguards in approving expenditures and signing checks.

- o Board members must never pre-sign checks.
- o The board member signing the check should receive a complete package including back up documents (purchase orders, etc.), indicating executive approvals, before signing the check.

6. The board treasurer should take responsibility for assuring that contractor staff responsibilities for fiscal affairs are properly organized with appropriate oversight and division of responsibilities.

7. All programs should have a fiscal officer or comptroller who has responsibility for organization of fiscal operations in the contractor agency. (Even a part-time bookkeeper of a small agency could assume this responsibility.) The treasurer of the board should make sure that this position is properly covered in the event of illness or absence of the fiscal officer. The fiscal officer should report regularly, in person, to the board of directors.

8. The City should develop an internal control questionnaire to be completed jointly by the contract agency's fiscal officer and board treasurer, providing assurance that proper authorization procedures and separation of duties are in place.

The risk analysis/internal control guideline approach becomes rather academic when applied to non-accounting-related functions, such as was done for "setting overall program objectives" and "program application" in the project report. Program objectives are determined, usually in general terms, by legislation authorizing funding for the program. Later these are made more specific by the federal and state agencies which distribute the funds to local government units, which in turn administer (and may contract for) the mandated service delivery programs. The risks involved are those associated with any legislative/administrative process, namely that decisions about objective may be manipulated to favor one group of clients and/or providers of services over another.

Specificity of objectives, full disclosure of and

accountability for decisions made about client target groups and services provision, and prevention of conflicts of interest/nepotism, among the funding agency, contractors, vendors and clients are the "control guidelines" for reducing risks in "objective setting". In fact they are simply sound management principles, sometimes subverted by favoritism and greed.

Program application, by prospective contractors to funding agency, is subject to a number of risks, almost all of which are present if vague, poorly written and/or badly administered policies and procedures exist.

The Control Guideline Chart for Program Application developed in this study is reproduced below. Proper management of the program application process by funding agencies will avoid most charges of mis-and non-feasance against them. Good management can also prevent mal-and mis-feasance by contractors seeking funding. OIG cases related to the program application function were not common in this study and those that did occur can be attributed to gaps in funding agency procedures and practices. When detected they can easily be remedied before the next applications process begins.

Unlike the accounting-related functions reviewed above which require constant monitoring of controls, program application risks/control guidelines need only be looked at whenever a new application process is about to be scheduled. Currently new applications are accepted once every two years in the agencies studied in this project. A review of the previous process in light of the investigative cases and managerial problems which resulted is likely to provide the information needed to improve procedures and practices.

Control Guideline Chart 2

Program Application

<u>Activity</u>	<u>Risk of Abuse of Fraud</u>	<u>Control Guideline</u>
Eligibility for proposers determined; RFP written	Eligibility rules or RFP can be designed to favor specific groups	RFP and eligibility rules should be reviewed by City-wide oversight body
Availability of RFP is published	RFP not advertised widely enough to give all potential applications an opportunity to learn about it	Timing and placement of advertisements must be governed by City-wide regulations
RFP and other essential information made available	Information made available selectively or given to some ahead of time	Records must be kept of information shared with contractors after the RFP is published; information given to one applicant must be given to all
Contract agency writes proposal	Contract agency receives help from inside the funding agency	Conflict of interest regulations must be made known to contractors and funding agency staff, and emphasized through training
Proposals received by the agency	Proposals accepted after the deadline	Written procedures for receiving applications must be available; applications must be date-stamped, signed for and logged in as received
Funding agency evaluates proposals; makes funding decisions	Individuals evaluating proposals have conflict of interest or other source of bias relating to specific applicants	Applications should be evaluated by at least two evaluators who do not know the identity of the applicant

Application forms should be written in such a way that identifying data is separated from the other content, in order to make "blind" rating possible

Contract managers and others previously associated with the applicant may write evaluations of past work, but should not participate in evaluation of current proposals, or in funding decisions

Evaluation criteria not clearly defined.

Evaluation criteria should be written in such a way as to provide a clear basis for decision-making by evaluators, and should be derived directly from program objectives and requirements

Criteria related to population needs not related to empirical data base

Criteria related to population needs should be related to a standard database such as the US Census, Bureau of Labor Statistics, etc.

Evaluation instruments with clear instructions for applying criteria should be used; they will then form a permanent record of contract funding decisions

Measures of past performance inadequate or unavailable, especially for work with other City agencies

Evaluations of applicants performance on previous contracts with funding should be prepared in standardized format and

Funding agency
evaluation

should be incorporated into evaluation of current applications

A City-wide database should be available to provide information on applicants past performance with all other City agencies

OIG

Information on past
OIG investigations
not available or
not used

Procedures and forms
for obtaining OIG
evaluations must be
established

Adequate time must
be allowed for OIG
background check

A City-wide database
must be made available
for contractor
background checks

Contract Management

While the risk analysis/internal control guideline approach is of limited value in delineating vulnerabilities in such generic administrative functions as setting overall program objectives and program application, it is of even less value when the administrative function has no common definition. For the funding agencies in this study contract management is that kind of function.

Contract management can include almost everything a funding agency does vis-a-vis its contractors. However, it usually includes much less than that when operationalized in terms of the titles and job description of staff assigned to "oversee" contractors. Only for the employment training programs in this study are the staff even called "contract managers". None of these are highly paid positions and are subject to high turnover. It may well be, also, that there simply is no one "best way" to manage contracts.

Most of the following discussion is drawn from Appendices C, D, E and F in the project report, with regard to the contract management structure and functions in the Community Development Agency (CDA), the Department of Employment (DOE), including the separately administered Summer Youth Employment Program (SYEP),

and the Department of Housing Preservation and Development (HPD).

The Community Development Agency has the most sophisticated contract management system of the three agencies in this study. It is a complex "checks-and-balances" system, with the persons who have "hands-on" responsibility for a contractor having almost no routine duties other than visiting, reporting and providing technical assistance to the up-to-45 contractors assigned to them. These Contract Officers are expected to spend an average of about one week per year (more or less according to the size of the contract) on their field visits, which serve to verify the "paperwork" that has been submitted by the agency on its programs. They also offer technical assistance to the contractors when needed, or arrange for it from a special unit in the CDA if a problem is more than they can handle in their brief visits.

The entire CDA system essentially involves various means of monitoring contract Workscopes, which contain specific Levels of Service (LOS) for the activities each contractor has agreed to provide. The Workscope is drawn up from the agency's program application for, and legalized through, its CDA contract. Monitoring includes:

- 1) reviews of agency board of directors minutes, provided by the contractor to determine if the agency is engaged in the programs it contracted for and if the board is properly overseeing the way the money is being spent;
- 2) analyses of "deliverables", which are samples of program records submitted by contractors at specific times, as required by their contracts;
- 3) reviews of CDA Management Information System (MIS) forms, which contain program statistics and are submitted monthly by the contractor;
- 4) field visit reports from the contract officers.

Should the monitoring reveal a failure, or the anticipated probability of failure of the agency to meet its contracted-for LOS in one or more activities, the agency may be placed under a Special Condition, unless the failure is severe as discussed below. Special Conditions are restated LOS for what a contract agency can realistically be expected to produce given its present difficulties, and agreed to by the CDA. The CDA's agreement is based upon the revised LOS falling within an acceptable range of cost-of-service, for which the CDA maintains statistics on an activity-by-activity basis.

Special Conditions are subject to Compliance Reviews which if failed can bring about an Administrative Hearing. Contractors which are found not to be meeting a "minimal acceptable standard" for their LOS (subjectively defined as meeting only half or less

of the contracted-for service units in one or more activities) can be scheduled for an Administrative Hearing at any time after the first few months of the contract, whether or not they are under Special Conditions and/or have had a Compliance Review. Such Hearings offer the contractor a chance to explain in person, to CDA top management and senior supervisory staff, why the contract is not being fulfilled. Hearings can result in defunding, additional Special Conditions and Compliance Reviews or continued funding with a revised LOS and no Special Conditions. Any mal- or mis-feasance which is revealed at any time in the monitoring process is referred to the OIG (See Appendix C for a complete discussion of the CDA).

In addition to contract compliance monitoring and field visits, DOE Contract Managers have responsibility for negotiating contracts and, in particular, the contractor's Project Operating Plan (POP), and for approving disbursements of funds (neither of which is true for CDA staff responsible for various aspects of Contract Compliance). DOE contracts are usually set up for an eighteen to thirty month period, but government funding reductions within a contract's time frame can cause it to have to be renegotiated. This results in a revised Project Operating Plan which in its initial or revised form specifies how many people are to be trained in which type(s) of program(s) at what cost. Contract negotiations and reopenings, and the various fiscal materials and performance reports submitted by contractors to obtain monthly (now less often) payments generate substantial paperwork for DOE Contract Managers, sometimes preventing them from spending the expected two to three days a week in the field (as occurred during the time period for this study).

Participant time cards (measuring program attendance) and participant placement reports (measuring ultimate contractor performance in terms of jobs in which participants were placed) justify contractor payments and are the major potential sources of fraud and abuse in the DOE. Verification of the accuracy of these time cards is not necessarily the responsibility of DOE Contract Managers, but their field visits can serve a preventive function and possibly assist other units of the DOE when suspicions are aroused about a contractor's paperwork.

The current set of contractors in the DOE is a stable group, honed down over the years by a combination of cost-effectiveness evaluations, self-elimination and substantiated fraud/abuse allegations. However, there has been a great deal of turnover among DOE Contract Managers, who are not highly paid and subject to several levels of supervision. In addition, a 1984-1985 reorganization combined DOE Adult and Youth Programs and made a number of staff redundant, in light of the consolidation.

Contract Managers are required to formally monitor (in addition to regular field visits) their three or four contractors once during each training cycle (which is usually four to six months in length), by using a complex set of forms covering the

administrative, fiscal and program aspects of the contractor's work. The formal monitoring requires a collaborative relationship with appropriate contractor staff if the forms are to be completed adequately. Problems which are found may be able to be dealt with on the spot, or a Corrective Action Plan may need to be instituted. Such a Plan can indicate management deficiencies which need to be addressed, areas of regulatory non-compliance and program inadequacies. Failure to meet performance goals as specified in the Project Operating Plan can also result in a Corrective Action Plan. Contract Managers are expected to work with their contractors, with the assistance of other units of the DOE, to improve matters and/or renegotiate the contract if necessary. (See Appendix D for a full discussion of the DOE.)

In HPD some of the Community Consultant Contract (CCC) Project Managers work out of HPD field offices near the communities in which the CCCs have targeted their services. Some work in the "borough offices", all of which are located in HPD's downtown Manhattan headquarters. In this study it was determined that Project Managers located in the field offices were more likely to do on-site monitoring than those in the borough offices.

While field visits are the only way to verify that the information provided by the contractor in its reports to HPD is accurate, there must be compatibility between what can be seen by monitoring a contractor, and the information provided in a report submitted by the contractor. HPD's Scope of Services, negotiated when the contract is being developed, and the quarterly reports which the CCCs are required to submit to HPD are well-coordinated with each other in both format and content. Neither is well-tailored to on-site monitoring, particularly for those CCCs managed out of the field offices.

In this study some Project Managers and their field office supervisors were found to have developed their own monitoring forms for keeping track of what was going on in individual buildings in their area. Essentially their monitoring had become independent of the paper reports, as in the CDA, but only for some Project Managers and informally rather than by design, unlike the CDA.

The Scope of Services is not necessarily suited to what some CCCs are doing on a day-to-day basis and therefore difficult to monitor through field visits. Project Managers should not have to establish their own means of determining whether a CCC is providing contracted-for services; the Scope of Services needs to be made more relevant to the work being done by the CCCs.

As with the DOE contractors, most of HPD's less productive CCCs have been weeded out over time, and the ones that remain are well-known to the funding agency. Similarly with the DOE, HPD Project Managers are intimately involved in the application and contracting process.

However, none of the "checks-and-balances" present in CDA's monitoring of contractor performance exist for HPD's CCCs. A probable reason for this difference is that none of HPD's human service programs have attracted OIG attention for malfeasance, unlike those in the CDA. And, as noted, the HPD contract management "system" is not attuned to exposing misfeasance, since the contract Scope of Services and the "matching" quarterly reports submitted by the CCCs are not readily able to be verified in terms of on-site performance monitoring. It may be that the programs are too small to be worth stealing from; and, they are also highly visible in the communities served. (See Appendix F for a complete discussion of HPD's human service contract program management.)

The common elements for reducing risks in a human service program contract management system, as revealed by the analyses of the three funding agencies in this study, are:

- o A well articulated services contract which specifies who is to be served; how many of those eligible for service are to receive it; the nature of the services to be provided; the time frame for the services; the place(s) where the services are to be provided; the program materials and staff (number and quality) needed for services provision; the measurable outcome of the services, etc.
- o Program and fiscal reports which the contractor is required to submit at regular intervals and which are coordinated with the specification in the services contract and verifiable both by sampling the contractor's own records and by on-site monitoring by funding agency staff.
- o Contract management staff who are trained to review program and financial materials in order to spot discrepancies within them and with the contract provisions. Such staff must also be sufficiently free from paperwork to perform on-site monitoring of their contractors, again with a focus upon potential violations of contract provisions and discrepancies with program/fiscal reports submitted by the contractor.
- o A management system for dealing with contractors who are out of compliance with their contracts. Special Conditions/Compliance Reviews and Administrative Hearings, as in the CDA, are a formal means of doing so, as are the more recently instituted Corrective Action Plans in the DOE. The intervention must be timely and specific, not when a "cycle" is nearly finished or only vaguely related to the contract provisions.

Investigation of Complaints/Allegations

In order to do an overall analysis of a funding agency's vulnerability to contractor fraud/abuse, one can approach the task deductively or inductively. The former approach involves reviewing the funding agency's policies, procedures and practices vis-a-vis its contractors and the contractors' actions in response to them. Investigative cases are used in this context to illustrate potentials for fraud and abuse within a particular administrative function. Properly applied by funding agencies and within contractors, risk analyses can reduce the opportunities for fraud and abuse.

The inductive approach utilizes a chronology of investigative cases to establish vulnerabilities to fraud and abuse within a funding agency's system of managing its contractors, as was done in Appendices C through F. Cases which detect a potential for fraud and/or abuse must be proactively responded to by the funding agency if further fraud and/or abuse of a similar nature is to be prevented.

Investigative cases, however, must be handled properly if the fraud/abuse is to be substantiated and the necessary administrative actions taken to prevent its re-occurrence. It was judged that a number of cases were not investigated in a timely fashion or thoroughly and vigorously enough.

In December 1986 a report in which the City's Inspector General System was assessed by the City Department of Investigation offered the following conclusions about investigative case handling in eight sampled OIGs (none of which were the CDA, DOE or HPD).

"The survey indicated the overall inadequacy of the criminal investigative effort. Among the causes are ambivalence about the degree to which criminal investigations should take priority over service-oriented functions helpful to agency management; the lack of sufficient staff dedicated to criminal investigation; and the lack of technical, supervisory, and managerial competence. It is likely that all three are major contributors, in varying degrees, to poor performance. There are significant examples of excellent IG investigative performance, just as there were outstanding investigative efforts identified in the case sample. However, without clear allocation of responsibility for the City's investigative effort to the Department, it will be impossible to establish a fully reliable assessment of the competence of the Inspector General program and, to the extent that the assessment is unsatisfactory, to set the program right." (p.20)

The major recommendation in the report for correcting the "overall inadequacy of the (City's) criminal investigative effort" is to clearly allocate "responsibility for the City's investigative effort to the Department of Investigation". The basis for this recommendation was that

"serious institutional flaws exist in the Inspector General system. Principally, decisive control of the individual offices remain, in practical effect, in the hands of the agency heads. Because resources, promotions, salary enhancements, and ultimately, therefore, priorities are subject to an agency head's control, the Commissioner of Investigation cannot carry out the duty imposed upon him implicitly by the City Charter and explicitly by Mayoral Executive Order. This has led to the absence of uniformly high standards of practice and procedure across the Inspector General system. This has led to inflexibility in the ad hoc application of Inspector General investigative resources across agency lines. This has led to divided loyalties, confusion on the question of accountability, and an insularity of outlook which has injured the overall quality and deterrent capacity of the field anti-corruption effort. This has led, in some instances, to dereliction of duty, passivity, and a reluctance to aggressively investigate in some cases." (p. 31)

Care, however, was taken to preserve a collaborative relationship between the OIGs and the agencies they are responsible for investigating, although the central control of the OIGs is to be with the DOI. As stated in the report:

"The Commissioner of Investigation shall be responsible for developing policy and strategy for the Inspector General system, for the preparation and allocation of a system-wide budget, and for the assignment, direction, and evaluation of all Inspector General personnel in the various agencies and departments. This responsibility shall be carried out, however, in a strict, regular, ongoing, and comprehensive collaboration with each agency head.

Agency heads will remain principally responsible for the maintenance of corruption-free agencies through this formal collaborative arrangement, by developing procedures and systems to protect against corrupt activity unique or common in each agency, by hiring employees of integrity, by careful managerial oversight and high-quality supervision of subordinates and staffs, and by adequate review and monitoring of fiscal commitments and processes. The Commissioner of Investigation and agency heads shall, on a mutual and joint basis, employ the Inspector General system as an instrument to facilitate the development and implementation of a jointly devised anti-corruption policy and program in each agency." (pp.25-26)

Also recommended in the report is a reallocation of functions related to disciplinary and "non-anti-corruption" managerial matters (essentially mis- and non-feasance, or program abuse as defined in this study) now performed by the OIGs:

"Inspectors General shall be responsible for the identification and investigation of corrupt or criminal activity and conflicts of interest within their respective agencies.

Inspectors General shall also assist agency heads in the identification and elimination of corruption hazards. Disciplinary and non-anti-corruption managerial functions and associated investigative tasks shall be reassigned to units within each agency and shall no longer be performed by Inspectors General. Contract background review tasks shall be limited to issues directly indicative of past or current criminal activity. The Vendex system, however, will maintain a central, automated, and fully accessible data repository, containing both performance and background data to inform and support agency contract decisions." (p.28)

Unified Oversight of Contracts

The reference in the above citation to the (proposed) "Vendex system", which would be a major part of the City's centralized contract controls points up the fact that the City currently does not have unified oversight of its 3000 human service program contracts on any level, from proposal approvals through post-contract audits.

The lack of a unified system for overseeing contracts extends from the inability to secure accurate information on a particular contractor's past and present contractual relationship with City agencies (other than what the contractor chooses to himself disclose in his application for funding) to the fact that there are no unified audit and audit follow-up procedures and practices with regard to all of the contracts a contractor may have with the City in a given fiscal year. In the project report it is recommended that not only should all human services contracts over a minimum amount be audited, but also that all such audits should be monitored by the City in order to determine whether the deficiencies identified in the audits have been systematically remedied.

The lack of priority given to coordinated management of human services contracts is sometimes assumed to be based upon the fact that Federal monies are the primary source of funds for these contracts and, therefore, the Federal, and the State "pass-through" agencies should carry responsibility for them. However the City had \$400 million of its own tax-levy money in human services contracts (in FY 1984) and thus shares responsibility with other governmental entities for assuring the cost-effectiveness of human services provision.

A unified system is likely to contribute to the prevention of fraud and abuse by the setting of common standards for monitoring and auditing contracts. It is also likely to expose macro-level double billing (one contractor contracting with different funding agencies for the same program to serve the same clients or charging more than 100% of a staff person's time to various contracts), which occasionally has been found by an investigative accountant in cases opened for another reason.

These particular New York City-based recommendations may be less relevant to other jurisdictions which simply are unlikely to have the complex and frequently overlapping administrative structure which the City has for managing its human services programs. In the review of programs and contractors done in this study it was found that both the DOE and CDA fund employment training programs (one of the three Illustrative Case Studies in the report exemplifies this vulnerability), and that the CDA and HPD both fund housing assistance programs, these in a few instances with the same contract agencies (but supposedly for different target populations geographically). Whenever a contractor was found to have contracts with more than one funding agency, separate accounts were maintained, but there is no easy way to guarantee program and staff separation and to avoid the risk of double billing.

Summary of a Model System

In summary, a model system for preventing and detecting mal-, mis- and non-feasance in public agency contracting for private providers to deliver human services programs includes:

- 1) A risk analysis of those accounting-related functions for which it is particularly appropriate and the subsequent development of internal control guidelines for contractors to follow, and for funding agency staff to frequently monitor, in order to reduce the identified risks. (Investigative cases and documented management problems will reveal control and/or monitoring failures once the guidelines are promulgated.)
- 2) A contract management system composed of: a well-articulated services contract; regularly-submitted program and fiscal reports, coordinated with the specifications in the contract; funding agency staff who conduct frequent field visits to contractors and who have been trained to spot discrepancies within the reports and between the reports and their field monitoring; and, a timely and organized procedure for dealing with contractors who are out-of-compliance with their contracts.
- 3) An investigative organization whose responsibility it is to detect malfeasance in contracted-for programs and in funding agency management of them, and to reduce the potential for such corruption and fraud by recommending and following-up on preventive measures to be instituted by the funding agency and by its contractors.
- 4) A unified system of contractor oversight within a given jurisdiction so that a governmental entity (city, county, state) can determine the kinds of programs/services it is purchasing from which sources,

for what clients, thereby reducing the potential for double-billing and the waste caused by overlap.