



Fraud Hotline Activity OLA Results from Pursuing Allegations

Presentation to
Maryland General Assembly
Joint Audit Committee

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Department of Legislative Services Office of Legislative Audits

Hotline History

- August 2002 – JAC instructed OLA to implement a hotline and web referral process for the reporting of allegations of fraud, waste, and abuse in State government operations.
- February 2003 – OLA's hotline and web referral process were launched with an expected call volume of 200 calls per year.



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Hotline Marketing

OLA's hotline and web referral process are marketed to State employees through a variety of methods including:

- Fraud Posters in State Offices
- Biennial message on State employee payroll notices
- Annual email reminders to State employees

**REPORT FRAUD OR ABUSE
IN STATE GOVERNMENT**

Available 24 Hours a Day, 7 Days a Week.
Information Received is Considered Confidential.
You Can Remain Anonymous.



Call Toll Free
1-877-FRAUD-11
(1-877-372-8311)
or report fraud at our website
www.ola.state.md.us
(Click on Stop Fraud)

What kinds of issues should be reported?
Fraud • Misuse or Abuse of State Resources
Theft • Potential Conflicts of Interest • Corruption
Significant Violations of Laws and Regulations • Vendor Kickbacks



Maryland General Assembly
Department of Legislative Services • Office of Legislative Audits
301 West Preston Street • Room 1202 • Baltimore, Maryland 21201

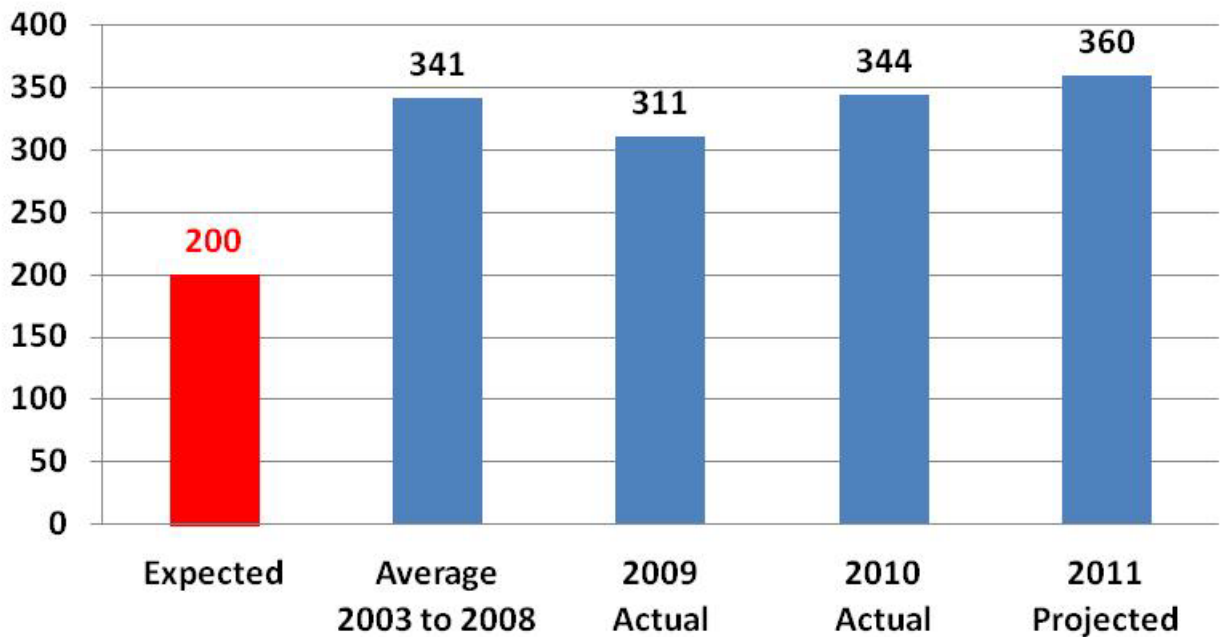




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Hotline Activity

Call Volume (Calendar Year Basis)



Volume has consistently exceeded expectations



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Hotline Operations

- Allegations are received by phone, web referral, mail, and from OLA staff auditors in the field.
 - Callers are assured that the information provided is considered confidential and are provided with information about the State's "whistleblower" laws, if reassurance is needed.
 - Audit professionals (certified fraud examiners) handle calls during business hours in accordance with established procedures.
 - All allegations are assessed for credibility and due diligence is performed before field investigations are initiated.
 - Allegations are either investigated by OLA, referred to the applicable State agencies, or not pursued.
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Hotline Allegation Disposition

Hotline Allegation Disposition (February 2003 through September 2011)	
Investigations in Process or Completed by OLA	22%
Referred to Future OLA Audit or Investigation	2%
Referred to State Agencies	42%
Not Pursued	34%



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Allegation Findings

OLA will highlight the following report findings related to fraud, waste and abuse allegations:

- **State Highway Administration – Special Review** (Report Dated June 24, 2011) - *Possible conflict of interest and questionable procurement practices*
- **State Highway Administration – Special Review** (Report Dated November 21, 2011) – *Improper use of contract funds*
- **Department of Natural Resources** (Report dated April 1, 2011) – *Questionable corporate purchasing card activity*
- **Department of Environment** (Report Dated November 21, 2011) – *Questionable procurement activity*



Department of Legislative Services Office of Legislative Audits

State Highway Administration (June 24, 2011)

Original Hotline Allegation:

Possible conflict of interest between SHA management employees and architectural and engineering firms.

Key Findings:

- A senior SHA management employee in SHA's Office of Construction (OOC) appeared to have solicited funds from firms doing, or seeking to do, business with SHA potentially violating State Ethics Laws, a Governor's Executive Order, and SHA policies. The employee's business interest was not always disclosed on the annual Financial Disclosure Statements filed with the State Ethics Commission. **(Finding 1)**
 - A former senior SHA management employee started working for a firm doing construction management and inspection services for SHA within 12 days of retiring from SHA in December 2008. The employee was directly involved in SHA's procurement of the firm's contract and subsequently was directly involved in this contract as an executive of the firm. **(Finding 2)**
 - SHA employees were routinely hired by firms doing business with SHA but no attempts were made to identify these employees and/or to ensure that their employment was not violating State Ethics Laws and SHA policies. **(Finding 3)**
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State Highway Administration (June 24, 2011)

Key Findings: (continued)

- Our review of the procurement and related payments for two \$16 million contracts involving the aforementioned employees and firms disclosed several deficiencies including:
 - The failure to perform a complete rating of the technical proposals and adequately document certain key components of the rating process (**Finding 4**)
 - Independent contract approval process was compromised (**Finding 4**)
 - SHA, in conjunction with the firms, redirected contract funds from the two aforementioned contracts for unrelated projects, and/or to conceal overspending on other contracts, thereby circumventing Board of Public Works oversight and approval. (**Finding 5**)

Disposition:

- OLA referred this case to the Office of Attorney General's Criminal Division and to the State Ethics Commission
 - Expanded review performed of construction inspection services contracts (Special Review dated November 21, 2011)
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State Highway Administration (November 21, 2011)

Background:

We performed an expanded review of construction inspection services contracts processed by the Office of Construction due to concerns identified in our June 2011 Special Report. We reviewed invoices totaling \$70 million from 16 contracts involving 12 firms for the period from 1/1/08 to 4/4/11.

Key Findings:

- SHA and 10 architectural and engineering firms arranged to use unexpended balances of contracts, totaling \$11.3 million, to pay for work that was outside the scope of those contracts without obtaining required Board of Public Works (BPW) approval. These arrangements are indicative of a less than arm's-length relationship that, in turn, could raise questions regarding the integrity of the procurement and payment process for subsequent contracts involving these firms. **(Finding 1)**
 - SHA did not issue written task orders to formally assign work and to manage construction inspection services contracts awarded to the firms. As a result, SHA could not effectively monitor services provided by firms, as well as the related charges billed by the firms. **(Finding 2)**
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State Highway Administration (November 21, 2011)

Key Findings: (continued)

- During the period from September 2008 through August 2009, SHA improperly extended the contract expiration dates for all nine construction inspection services contracts reviewed that had expired, allowing SHA to retain approximately \$26 million in unspent contract funds. SHA extended the related contract periods for certain of these contracts a total of 19 times—resulting in extensions of each for two or more additional years—without BPW approval. **(Finding 3)**

- Our test of four contract awards totaling \$34 million and approved by the BPW, disclosed that SHA could not adequately support the amount of funds that had been requested. Furthermore, our review of supporting documents disclosed no consistent, discernible basis for estimating construction inspection contract values. The percentage of construction inspection contract values to related construction costs ranged from 3 to 27 percent based on original estimates and ranged from 5 to 11 percent based on subsequent support. **(Finding 4)**



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State Highway Administration (November 21, 2011)

Key Findings: (continued)

- SHA procured new construction inspection contracts even though unspent funds remained on existing contracts. For example, in November 2009 SHA requested and received BPW approval for a \$10 million contract when there was \$36.5 million in contract funds remaining in other contracts in this district (See table below). Furthermore, as previously noted in Finding 3, during this same period, SHA was entering into agreements with firms to extend the contract terms to retain unspent funds. (Finding 5)

Construction Inspection Contracts for One District					
Contract	BPW Approval	Contract Amount	Remaining Balance of Earlier Contracts as of		
			10/15/08	12/17/08	11/18/09
1	06/21/06	\$ 8,000,000	\$ 4,440,276	\$ 4,067,744	\$ 1,734,312
2	07/26/06	\$ 8,000,000	\$ 5,185,068	\$ 4,515,665	\$ 2,665,936
3	10/18/06	\$ 8,000,000	\$ 5,810,564	\$ 5,464,158	\$ 3,362,342
4	10/15/08	\$ 16,000,000	-	\$ 16,000,000	\$ 12,957,848
5	12/17/08	\$ 16,000,000	-	-	\$ 15,741,364
6	11/18/09	\$ 10,000,000	-	-	-
Total		\$ 66,000,000	\$15,435,908	\$ 30,047,567	\$ 36,461,802



Department of Legislative Services Office of Legislative Audits

Department of Natural Resources (April 1, 2011)

Corporate Purchasing Card Activity (Finding 2 – Exhibit 1)

- Purchases made by one employee using both the corporate purchasing card and invoice payment transmittal process were not always thoroughly reviewed by supervisory personnel, resulting in potential fraudulent transactions by this employee.
 - In January 2010 the Comptroller of Maryland questioned a CPC purchase by this employee. DNR initiated an investigation and identified other questionable purchases by this employee and referred the matter to OLA and the OAG.
 - With the concurrence of the OAG we expanded the investigation and found a pattern of questionable purchases made by this employee via both the CPC and transmittal process.
 - We identified over \$71,000 in questionable purchases, many of which were delivered to the employee's home address.
 - According to the OAG website, the employee has been indicted on one count of Felony Theft Scheme by a Grand Jury.
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Department of Legislative Services Office of Legislative Audits

Department of the Environment (November 21, 2011)

Bay Restoration - Septic System Upgrades (Finding 6– Exhibit 2)

- The pattern of bidding between two contractors involved in 57 septic system projects totaling \$1.1 million was questionable, with the average grant award for these projects being \$7,000 higher than the statewide average.
 - For 50 of the projects, these two contractors were the only bidders and there appeared to be a pattern of alternating low bids between the contractors.
 - A review of the bid documentation for 19 projects disclosed a consistency between the winning bid costs regardless of the contractor performing the work. The average costs when each contractor was the lowest bidder was \$20,800 and \$20,200, respectively.
 - Two of these projects (totaling \$38,800) were for each contractor's residence, with the homeowner winning the bid.
 - For 23 projects totaling \$452,600, the bid documentation submitted was not always complete or proper. For example, bids were not always appear unique to the specific project or was missing critical information (such as, bid date, property address, name of applicant).
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Conclusion

Efforts Devoted to OLA's Hotline Have Been Worthwhile

- Significant efforts have been made to build awareness of the hotline.
- Hotline activity has continued to exceed initial expectations.
- OLA continues to identify and report on significant findings, in both fiscal compliance audit reports and reports of special reviews based on hotline allegations.

Exhibit 1

Fraud Hotline Activity – December 13, 2011

Excerpts from the Department of Natural Resources Report Dated April 1, 2011

Office of Legislative Audits Finding

Questionable Purchases

Finding 2

Purchases made by one employee through the use of corporate purchasing cards and the invoice payment transmittal process were not always thoroughly reviewed by supervisory personnel, resulting in potential fraudulent transactions by this employee.

Analysis

Purchases made by one employee through the use of corporate purchasing cards (CPC) and the invoice payment transmittal process were not always thoroughly reviewed by supervisory personnel. The supervisory review of CPC purchases made by this employee was deficient and not conducted in accordance with the Comptroller of Maryland's *Corporate Purchasing Card Program Policy and Procedures Manual*. Even though a supervisor approved the related activity, the monthly cardholder activity logs did not include all of the purchases listed on the related bank statement and purchases were not always supported by vendor invoices.

Furthermore, in some instances, the aforementioned cardholder making the purchases also signed the log as one of the approvers. The lack of a thorough supervisory review and the lack of supporting documentation allowed significant potentially fraudulent transactions by this employee without detection by DNR. In addition, this employee also initiated and approved the payment request forms for purchases made through the invoice payment transmittal process, resulting in other questionable transactions.

In January 2010, the Comptroller of Maryland – General Accounting Division, based on its own monitoring of CPC activity, contacted DNR regarding a questionable corporate purchasing card purchase totaling \$720 made in December 2009. DNR initiated an investigation of this CPC transaction and expanded it to other selected questionable purchases made with the same card and other purchases made by the cardholder through the invoice payment transmittal process. As a result of this investigation, DNR identified a number of questionable purchases made by the employee and referred the matter to the Office of the Attorney General – Criminal Division for further investigation.

During the course of our audit, we expanded on the previous DNR investigation, with the concurrence of the Criminal Division, and found a pattern of questionable purchases made by this cardholder via both the CPC and transmittal process. We identified over \$71,000 in questionable purchases, many of which were delivered to the employee's home address. In many instances, the cardholder made purchases on-line and then prepared an invoice to serve as documentation of the purchase, often using a common product description that misrepresented what was actually purchased. For example, although the invoices may have indicated the purchase of certain office supplies, the actual items purchased included computer games and equipment, clothing, and numerous gift cards. In addition, due to the volume of activity in some months exceeding the employee's card limit, the employee used the CPC assigned to another DNR employee (with that employee's consent) to make additional questionable purchases. DNR terminated this individual's employment in March 2010.

The Comptroller of Maryland's *Corporate Purchasing Card Program Policy and Procedures Manual* requires each cardholder's immediate manager to approve monthly charges, including determining whether the transactions were appropriate. According to the bank's records, as of December 3, 2010, DNR had 912 active CPCs and the related expenditures totaled approximately \$9 million during fiscal year 2010.

Recommendation 2

We recommend that DNR

- a. reiterate to all employees that all CPC activity is required to be thoroughly reviewed by a supervisor, who must ensure that the monthly cardholder activity logs include all of the purchases listed on the related bank statement, and ensure that all purchases are supported by vendor invoices and approved;**
- b. ensure that all purchases made through the invoice payment transmittal process are reviewed and approved by supervisory personnel; and**
- c. continue to work in conjunction with the Office of the Attorney General to investigate and resolve the aforementioned alleged fraudulent activity.**

Response from the Department of Natural Resources

Questionable Purchases

Finding 2

Purchases made by one employee through the use of corporate purchasing cards and the invoice payment transmittal process were not always thoroughly reviewed by supervisory personnel, resulting in potential fraudulent transactions by this employee.

Recommendation 2

We recommend that DNR

- a) reiterate to all employees that all CPC activity is required to be thoroughly reviewed by a supervisor, who must ensure that the monthly cardholder activity logs include all of the purchases listed on the related bank statement, and ensure that all purchases are supported by vendor invoices and approved;
- b) ensure that all purchases made through the invoice payment transmittal process are reviewed and approved by supervisory personnel; and
- c) continue to work in conjunction with the Office of the Attorney General to investigate and resolve the aforementioned alleged fraudulent activity.

Department Response:

The Department agrees with the finding and related recommendations. The current DNR protocol and Comptroller guidelines require supervisory review of all CPC purchases; appropriate documentation and reconciliation of all purchases, and additional review by a unit administrator and an administrative staff person in FAS. The alleged fraud occurred due to employees not following established procedures; the procedures and protocols were in place.

After immediately alerting the Office of the Attorney General (OAG) and the Office of Legislative Audits of the alleged fraud, the Department: 1) convened its Leadership Team (unit and program directors) to alert them of the potential fraud and to emphasize the importance of following existing procedures for approval of credit card usage; 2) met with unit fiscal officers to review credit card policies and procedures; 3) conducted a study and evaluation of its system of internal controls for credit card purchasing; and 4) analyzed Department-wide credit card usage and reduced the number of cards issued. Going forward, the Department will develop an on line training seminar to share information obtained from DBM's Fraud Committee, including the University of Maryland's Fraud Analysis presentation made in January 2011 and the Risk and Materiality Assessment presented in June 2010.

Purchases paid through the invoice payment transmittal process require a single signature from an approved unit fiscal contact. In cases where the unit fiscal contact is the individual making the purchase, the potential exists that no "supervisory" review will be made. The Department will change its current invoice processing procedures to require an independent level of review and approval from the person submitting the invoice. The Department will continue to assist the OAG as requested in its investigation of the alleged fraudulent activity.

Exhibit 2

Fraud Hotline Activity – December 13, 2011

Excerpts from the Department of the Environment Report Dated November 21, 2011

Office of Legislative Audits Finding

Bay Restoration Fund

Background

The Bay Restoration Fund (BRF) enabling legislation, which became effective July 1, 2004, established the Wastewater Treatment Program (WWTP), and the Septic System Program to further Maryland's efforts to reduce nitrogen and phosphorus loading in the Chesapeake Bay. The Septic System Program is funded by imposing a \$30 annual fee on each property served by an onsite well and septic system. Funds collected are to be used to upgrade or replace existing septic systems or to install new septic systems with the best available technology (BAT) for nitrogen removal, which reduces the septic system's nitrogen load in half. According to State law, funding priorities for septic upgrades are first given to failing septic systems in the Chesapeake and Atlantic Coastal Bay Critical Area² and then to failing septic systems that MDE determines are a threat to public health or water quality. WWTP is a separate program targeted at upgrading 67 major wastewater treatment plants with enhanced nutrient removal technologies, which is funded by a \$2.50 monthly fee on each household served by a wastewater treatment plant.

In addition, Chapter 280, Laws of Maryland, 2009, effective October 1, 2009, requires all new and replacement septic systems serving property in the Critical Area to include the BAT for removing nitrogen, and these systems are also eligible for funding through the BRF, whether or not they replace an existing failing system. Funding for septic systems (including new and replacement systems) is provided to property owners, on a reimbursable basis, who obtain certain approvals and inspections. Prior to July 1, 2010, septic grants were awarded either directly through MDE or by designated local jurisdictions allowed to process septic grant applications. Effective July 1, 2010, although MDE still funds the projects through the BRF, the awards for these septic projects are the responsibility of the local county health departments or other related local organizations, in accordance with MDE revised policies and procedures. MDE subsequently makes payments to the locals to reimburse eligible property owners.

² The Chesapeake and Atlantic Coastal Bay Critical Area includes all land within 1,000 feet of Maryland's tidal waters and tidal wetlands. It also includes the waters of the Chesapeake Bay, the Atlantic Coastal Bays, their tidal tributaries, and the lands underneath these tidal areas.

According to MDE's records, there are approximately 420,000 septic systems in Maryland, of which approximately 52,000 are located within the Critical Area. As of September 30, 2010, MDE has awarded funding to upgrade 2,417 septic systems, of which 1,251 systems were located within the Critical Area. According to the January 2011 BRF Annual Status Report, as of September 30, 2010, approximately \$36.9 million in grants have been awarded since the program was established, of which \$17.7 million was awarded directly to property owners by MDE, and \$19.2 million was provided to local jurisdictions to fund septic grant awards to property owners. Additionally, as of September 30, 2010, MDE has awarded approximately \$322.2 million in grants to upgrade wastewater treatment plants. As of June 30, 2010, according to the State's records, the balance in the BRF approximated \$86 million, of which approximately \$5.2 million was for the Septic System Program, and the balance was for the WWTP.

Finding 6

MDE's process for reviewing applications and awarding grants prior to July 1, 2010 for the Septic System Program lacked adequate oversight and our review disclosed a number of questionable awards.

Analysis

MDE's process for reviewing applications and awarding grants prior to July 1, 2010 for the Septic System Program lacked adequate oversight. As a result, there was a lack of assurance that septic system bids submitted were independent and fair and that the number of grants awarded was maximized. Prior to July 1, 2010, during the application process, property owners were required to submit a minimum of three bids for the installation of the septic systems; the bids were required to include at least three separate manufacturers of the best available technology (BAT) septic system units and at least two different installers.³ However, MDE allowed installation contractors to act as agents for property owners which allowed the contractors to solicit and collect the required bids for the project, including their own bids. Consequently, the contractors had access to the other bids and could adjust their own bids. We also noted that, when making the awards, MDE generally did not sufficiently review bid documentation for completeness, comparability, and legitimacy.

Based on our analysis of MDE's grant award records related to applications processed directly by MDE, we identified higher than average grant awards on 57 projects awarded during the period from May 1, 2008 to March 2, 2009, which involved two installation contractors serving the same geographic area of the State. Specifically, the average grant award for these 57 projects was \$19,860; whereas, the average grant award for the other 1,596 projects located throughout the remainder of the State was \$12,600—a difference of approximately \$7,260. We reviewed

³ One installation contractor could provide two bids, each with a different BAT septic system, resulting in the submission of three bids from two different installers.

these 57 projects, with awards totaling approximately \$1.1 million, and noted the following questionable practices:

- Based on our detailed review of 51 projects totaling approximately \$1 million, the pattern of bidding between the aforementioned two installation contractors was questionable. Specifically, for 50 projects, these two contractors were the only bidders, with one of the contractors submitting two bids, each with a different BAT system, to account for the required three bids. For the remaining project, all three bids were submitted by the same contractor. Additionally, 2 of these 51 projects, which totaled approximately \$38,800, were for each contractor's home residence in which the other contractor was the losing bidder. For 49 projects, the winning bids, which had been submitted by both contractors, included the installation of the same manufacturer's BAT unit. Furthermore, one of the two contractors was the only authorized supplier of this unit in Maryland.

Our review of the bid documentation for 19 of these 51 projects, which were approved during the period from January 5, 2009 to March 2, 2009, disclosed a consistency between the winning bid costs regardless of the contractor performing the work. Specifically, one contractor was the low bidder on 11 projects (with an average cost of \$20,769) and the other contractor was the low bidder on 8 projects, (with an average cost of \$20,185), with the same BAT systems installed in each case.

- For 23 projects, the bid documentation submitted by these two contractors was not always complete or proper. Specifically, bids for BAT units did not always identify the specific property or project information and did not always include the dates that the estimates were provided. We identified 11 projects, totaling approximately \$210,000, in which the losing high bids did not appear to have been specifically prepared for the project under consideration; rather, the bids appeared to be copies of previously submitted bids used for other projects. Additionally, for 12 other projects totaling approximately \$242,600, either certain critical information (such as bid date, property address, name of applicant) in the losing bid documentation was missing or this critical information was hand-written onto a generic form bid; these characteristics were unlike bids for other projects submitted by the same contractor.

We believe that the aforementioned questionable practices and conditions could be contributing factors in the average grant award for these projects being approximately \$7,260 higher than other projects throughout the State. When we brought the aforementioned conditions to its attention, MDE could not provide an explanation. The cumulative average cost differential for these 57 projects is in excess of \$400,000. Based on the aforementioned conditions, we referred this matter to the Criminal Division of the Office of the Attorney General. A referral to the Criminal Division does not mean that a criminal act has actually occurred or that criminal charges will be filed.

As previously noted, while there are no established regulations governing this program (see Finding 5 in this report), effective July 1, 2010, MDE revised its procedures for determining and

awarding septic system upgrade grants. These revised procedures establish maximum grant award amounts and provide for MDE to pre-approve BAT units eligible for installation, eliminating the need for applicants to obtain competitive bids. If a homeowner decides to install a BAT unit that is not pre-approved, the grant award is now limited to the established maximum grant award and the homeowner is responsible for the cost difference. These revisions should help reduce the potential for future questionable awards similar to the aforementioned awards we identified. As of June 8, 2011, the specific BAT unit used routinely by the two contractors had not been pre-approved by MDE. Additionally, MDE's current maximum grant award is \$12,307 for the region of the State where the aforementioned 57 projects were located, which is approximately \$7,550 less than the average award for the 57 projects.

Recommendation 6

We recommend that MDE work in conjunction with the Office of the Attorney General to investigate and resolve the aforementioned questionable activity. We also recommend that, for all septic grants processed by local jurisdictions after July 1, 2010, MDE ensure the local jurisdictions are administering the Septic System Program in accordance with established requirements.

Response from the Department of the Environment

Finding 6

MDE's process for reviewing applications and awarding grants prior to July 1, 2010 for the Septic System Program lacked adequate oversight and our review disclosed a number of questionable awards.

Recommendation 6

We recommend that MDE work in conjunction with the Office of the Attorney General to investigate and resolve the aforementioned questionable activity. We also recommend that, for all septic grants processed by local jurisdictions after July 1, 2010, MDE ensure the local jurisdictions are administering the Septic System Program in accordance with established requirements.

MDE Response

MDE partially concurs with the finding, but will fully implement the recommendation.

The Department will work with the Office of the Attorney General related to the issues included in the finding and take appropriate action based on the results of the investigation. Also, MDE has already taken steps to ensure that all septic grants processed by local jurisdictions after July 1, 2010, are administered in accordance with established requirements.

As expressively acknowledged by the auditors, MDE had proactively revised its procedures and by doing so had already addressed the concerns raised by the audit finding. Moreover, in the Department's view, there are other possible explanations for the cost differential based on differences in technology. MDE is conducting additional investigation into the circumstances surrounding the cost differential and will provide the results of the investigation to the Office of the Attorney General.