

**AUDIT AGENCY HANDBOOK 65-109**

**1 DECEMBER 1997**

# **FRAUD AND WASTE INDICATORS**



**AIR FORCE AUDIT AGENCY**



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# AFAA HANDBOOK ON FRAUD AND WASTE INDICATORS

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## Chapter 1

### WHAT IS FRAUD?

Fraud is a generic term that embraces all the multifarious means which human ingenuity can devise, and which are resorted to by one individual to obtain advantage over another. These means include false suggestions, suppression of truth, surprise, trickery, cunning, dissembling, and any other unfair way by which another is cheated.



Simply stated, fraud (sometimes referred to as “white-collar crime”) is an illegal act where one obtains something of value through willful misrepresentation.

#### ELEMENTS

While not possible to list all variations of fraud, common elements exist.

1. **Intent** – willfully committing a wrongful act or achieving a purpose inconsistent with law or public policy. An honest mistake is not a crime. Intent is rarely self-evident but must be proven through a pattern of activity. Some of the more common ways to show intent include proof the offender:

- *had no legitimate motive for the activity.*
- *repeatedly engaged in the apparent wrongful activity.*
- *made conflicting statements.*
- *made admissions of guilt.*
- *acted to impede the investigation of the offense.*
- *made statements he or she clearly knew to be false.*

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2. **Disguise of purpose** – misrepresentations employed to accomplish the scheme. Misrepresentation occurs when (a) the representation was made and (b) the representation was false, by either omission or commission.

3. **Reliance** – the offender knowingly makes a misrepresentation, and the victim relies on and acts upon that misrepresentation.

4. **Voluntary** – the victim assists the offender. Proof that the victim (the Air Force) assisted the offender is usually not difficult to obtain. The investigator must ascertain the exact set of circumstances surrounding the fraud, determining what made the fraud possible. In the case of employee theft, for example, the victim entrusted the care of assets to the offender, thereby establishing a fiduciary capacity.

5. **Concealment** – hiding or preventing knowledge of the crime. Fraud schemes designed to conceal include:

- *Crimes too small for the victim to recognize.* In embezzlement cases, for example, the amount of money taken at one time is usually small compared to the total assets. By identifying a continuing pattern of theft, the investigator can show the concealment aspect.

- *Creating complex financial trails.* The more obscure the act, the more unlikely it will be detected. For example, fraudulent invoices and records are used in some frauds to conceal the crime. Proof of concealment in these cases can often be established because the entries had no business purpose other than to conceal.

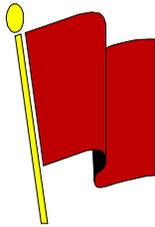
6. **Injury or damage** – the victim suffers loss of money or property from relying on and acting upon the misrepresentation.

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## **RECOGNIZING FRAUD**

The fraud environment can be summarized in two words: **opportunity** and **motive**. Both apply separately and jointly to individual Air Force employees, managers, and contractors. Most emphasis is given to individuals committing fraud for personal benefit, such as a financial gain. Auditors will also deal with organizational fraud—fraud committed for the direct benefit of the organization and the indirect benefit of individuals. Individuals who commit fraud for organizational benefit may be motivated differently than those who commit fraud for personal gain.

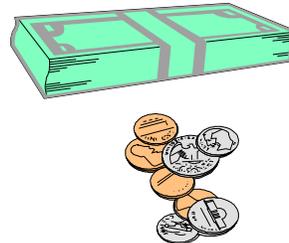


Regardless of the specific opportunity or motive, the key to preventing and detecting fraud and waste is recognizing fraud indicators or *red flags*. For auditors, these red flags, which can provide the initial warning and show the need for further review, often appear on the surface as administrative or managerial irregularities. As such, auditors must look below the surface.

However, auditors must remember that red flags are only indicators of possible fraud. Their existence is not proof a fraud occurred. Therefore, auditors must follow through on every red flag identified.

A red flag can be a specific condition directly attributable to dishonest or fraudulent activity. The condition may result from the fraud itself or from the attempt to conceal the fraud. Auditors reviewing operating controls need to know what red flags to look for in books, records, accounts, documents, reports, and reconciliations. Examples include the following:

- Missing/altered documentation
- Cash drawer shortages/overages
- Excessive voids or refunds
- Excessive late charges
- Inventory shortages/adjustments
- Duplicate payments
- Duplicate invoices



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Copies where originals are expected  
Support for payments is not canceled or marked paid  
A computer report total is incorrect

A red flag can also be an outside force that influences the decision to commit fraud, either for personal gain or for the benefit of the organization. These red flags can be categorized as *situational*, *opportunity*, and *personal characteristics*.

### 1. **Situational Red Flags**

For personal gain: High personal debt or losses  
Living beyond one's means  
Gambling or speculation  
Excessive use of alcohol or drugs  
Illicit sex  
Perceived inequities in the organization  
Resentment of superiors  
Inadequate income or greed  
Undue family/community expectations

For organizational benefit: Heavy expenditures  
Urgent need for favorable performance  
Temporary bad situation  
Revoked or imperiled mission status  
Excess production capacity  
Unfavorable economic conditions  
Insufficient working capital/equipment  
Obsolete inventories/production assets  
Significant decline in sales

The initial motivator for most who commit fraud is financial need. For example, sometimes an employee or contractor becomes engulfed by habits that require so much money that continuing the habit motivates fraud. In other instances, the financial need may be “one-time,” such as an outstanding debt. However, once the theft occurs and the financial need is met, the offender rarely ceases the dishonest activity.

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Fraud sometimes occurs when people become greedy and live beyond their means, which in turn creates additional financial problems. Living beyond one's means is a red flag that exhibits itself by expensive vacations; high social expenditures such as joining exclusive clubs, purchasing luxury recreational vehicles, and buying expensive personal items; and flaunting or bragging about one's money.



Some types of fraud require dynamic, ongoing, cover-up activity. Staying late, coming in early, and never taking vacations can be common red flags. Sometimes perpetrators will show a great deal of interest in the audit process, offering to help, providing explanations, and generally monitoring audit progress and directing the audit away from themselves. In addition, employee inquiries such as “Has anyone ever been caught stealing here?” or “I wonder what happens if an employee is caught taking inventory?” could alert a manager to fraud. Finally, employee excuses such as “I’m working on those records at home,” “We haven’t had time to make that deposit,” or “The bank lost that deposit” demand immediate follow-up action.

## 2. Opportunity Red Flags

For personal gain:

- Familiarity with operations and position of trust
- Close association with suppliers and key people
- Dominant top management
- Dishonest or unethical management
- Too much trust in key employees
- Rapid turnover of key employees
- Inadequate training programs
- Unrealistic productivity measurements
- Weak or dishonest personnel evaluations

Absence of a clearly defined code of conduct or an outside employment disclosure or policy statement is a red flag that should alert auditors. For example, if confusion exists among procurement personnel about

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what types of gifts are acceptable, personnel may accept increasingly larger gifts until these gifts turn into outright bribes or kickbacks.

Many factors, such as inequities in the work place, can lead to decreased employee loyalty. Even if circumstances do not justify an employee's feelings, employee perception that an injustice has occurred can be a red flag and should be sufficient to alert the auditor. Some of the most frequently identified reasons why employees used fraud to "correct" injustices follow:

- passed over for a raise or promotion
- assigned undesirable jobs
- subjected to disciplinary action
- feeling that pay is inadequate
- perceives favoritism to other employees
- resentment toward superiors
- frustration with job boredom



For organizational benefit: Related-party transactions  
Poor accounting records  
Poor internal controls  
Atypical or "hot" workload  
Inexperienced people in key positions  
Reluctance to give auditors needed data  
Continuous problems with inspectors  
Highly computerized organization  
Inadequate staffing in critical positions

Top management personalities commonly associated with fraud include wheeler-dealers or those who are feared, impulsive, too numbers-oriented, or insensitive to people. The opposites are managers who are friendly, calm, generous with their time, self-confident, and goal-oriented. An individual who is lax in enforcing internal controls is a common red flag. Just as a fire cannot occur without oxygen, a fraud cannot occur without opportunity. An excellent internal control system "on paper" does not ensure personnel follow the controls. Also, indifference to fraud by top managers can be a red flag. On the other

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hand, top management can prevent many internal frauds by setting an example and verbalizing intolerance for employee dishonesty.

### 3. Personal Characteristics Red Flags<sup>1</sup>



Low moral character  
Wheeler-dealer  
Rationalizes contradictory behavior  
Poor credit rating or financial status  
Lack of stability

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<sup>1</sup> Appendix IX, The Corruption Index, lists additional common personal characteristics of behavior that can be signs of fraudulent activity.



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## Chapter 2

### AUDITING FOR FRAUD

In recent years, white-collar crime has become one of the most significant problems in America. According to the Association of Certified Fraud Examiners, annual losses in the United States from white-collar crime are more than \$300 billion. Clearly, its effects have touched many elements of society, including law enforcement, justice, business, and government. Consequently, many fraud-related research projects and studies have been accomplished. One such study, funded by a large certified public accounting firm, identified the following reasons why auditors do not detect fraud.

- *unfamiliar with specific fraud exposures and symptoms*
- *audit work has form but no substance*
- *inadequate follow-through on fraud symptoms*
- *emphasis on time budgets drives out audit quality*
- *audit management “filters” the findings*
- *desire not to “rock the boat”*
- *belief management knows and condones fraud*
- *inappropriate sample sizes for the audit environment*
- *emphasis on control reviews*
- *not testing and developing findings*

The Air Force is committed to eliminating fraud and waste. During 1994 and 1995, major Air Force fraud investigations resulted in over 506 convictions and recovery of \$1.2 billion. Detection and prevention of these unwarranted activities are possible only through increased sensitivity of Air Force managers and the application of audit and investigative expertise. The fraud and waste scenarios presented in Appendixes I through VIII of this handbook<sup>2</sup> are from actual Air Force

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<sup>2</sup> Appendixes I through VIII contain fraud scenarios that occurred in Air Force operations and describe situations where auditors should make a fraud referral. Fraud indicators are arranged by functional categories but are applicable to a wide range of audits besides those identified within this handbook.

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audits and investigations. Auditors should familiarize themselves with the basic concepts surrounding each scenario and creatively use that knowledge to devise and apply audit steps when auditing areas susceptible to fraud.

### **GENERAL GUIDELINES**

1. Some fraud symptoms or red flags may always be present, even though fraud may not be. Therefore, do not overreact to them.
2. Do not “explain away” or allow managers to “explain away” red flags. Investigate them. In many instances, red flags that were previously “explained away” became self-evident after the fraud surfaced.
3. Pay attention to the world around you. Develop a profile of the area under review and the people in it. Be alert to the strange/odd/curious and get verifiable explanations.
4. Red flags are especially significant if they relate to a sudden change in lifestyle or behavior. For example, many people quickly spend money they “quickly” acquired. So, someone who is stealing may spend the proceeds, demonstrating a sudden and dramatic change in observable behavior.
5. When you identify spending-related red flags, do not try to investigate lifestyle. Instead, develop audit steps to obtain evidence of possible fraud. Leave the investigating to the investigators!

### **THE AUDITOR’S ROLE AND RESPONSIBILITIES**

To identify fraud and waste, auditors must understand the environment in which the related red flags occur. Activities vary significantly in their susceptibility to fraud. However, as a general rule, activities that manage personal-use items are the most susceptible. For example, cash operations require the most stringent internal controls while other operations vary according to demand and marketability of managed

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resources. Automobile gasoline operations are generally more susceptible to fraud than aviation fuel operations.



Additionally, auditors can no longer assume a passive role and simply be alert to the possibility that fraud or illegal acts could occur. On the other hand, auditors are not expected to have knowledge equivalent to that of a person whose primary responsibility is detecting and investigating fraud. However, auditors should:

1. Have sufficient knowledge of fraud to identify indicators that fraud may exist, to include fraud characteristics and the techniques used to commit fraud.

2. Be alert to opportunities, such as control weaknesses, for fraud to occur. If you detect significant control weaknesses, conduct additional tests to identify red flags. The presence of more than one red flag at any one time increases the probability that fraud may have occurred.

3. Evaluate fraud red flags and decide whether further action is necessary or an investigation is warranted. Notify appropriate Air Force authorities if the presence of red flags is sufficient to recommend an investigation. Remember, to prove fraud has or has not occurred is the trained investigator's responsibility, and the final determination of whether fraud exists is the court's responsibility.

Audit procedures alone, even when carried out with due professional care, do not guarantee fraud detection. Therefore, auditors should design audits to provide reasonable assurance of detecting irregularities or illegal acts.

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## **A FIVE-STEP APPROACH**

1. **KNOW THE EXPOSURES.** Know what can go wrong. Know who could do it. Know the opportunities for employees, managers, suppliers, agents, and contractors providing goods and services. For cooking the books for organizational benefit, know the pressure for favorable results. Understand the organization's systems and controls and what they are intended to prevent or detect.

2. **KNOW THE RED FLAGS.** For each exposure, know how it would be reflected in documents, reports, pay checks, reconciliations, accounts, complaint files, and adjusting or correcting entries.

3. **BE ALERT.** Auditors or managers detect many cases by following through on a red flag noted while actually looking for something else.

4. **BUILD AUDIT PROGRAMS TO LOOK FOR RED FLAGS.** Develop the audit program to include steps designed to look for red flags. Sampling plans should consider the fraud exposure and the reliability of internal controls. Building audit programs to look for red flags includes selecting large samples for limited fraud tests and using computer techniques to look for fraud occurrence. Stratification of the population, stratified sampling, directed sampling, and discovery sampling may prove helpful. (Note: No fraud is acceptable. However, auditors, in deciding sample sizes, actually determine the probability of detecting fraud. This probability is dependent upon the amount of fraud, the size of the population, and the sample selected.)

5. **FOLLOW THROUGH ON ALL SITUATIONS THAT APPEAR ODD, UNUSUAL, OR UNIQUE.** Operate with an attitude of healthy professional skepticism and resolve all discoveries that appear out of place. Beware of pressures to complete work on time. Be aware that the single event you are looking at may not be an isolated occurrence; it may be one of many. The auditor's overall fraud detection abilities center on the discovery of fraud red flags.

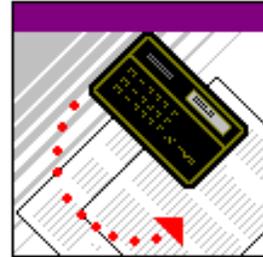
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In applying the five-step approach, auditors should consider the following:

- Fraud surfaces through:

Management reviews and controls  
Internal audit  
Public accountants  
Law enforcement  
Concerned employees  
Outside informants  
Unsolicited confessions



- Fraud opportunities increase when:

Segregation of duties breaks down  
Segregation of duties is not practical  
Supervisory reviews are absent or perfunctory  
Controls break down

- Fraud is more likely when transactions are:

Completed at remote locations or branches  
Under control of one person  
Processed outside of normal operating routines  
Initiated during vacation/illness/management change/leave of absence  
Processed by outside agents  
Provided special handling  
Related to unrecorded assets

## **FRAUD AND INTERNAL CONTROLS**

Over the years, the Air Force has adopted numerous procedures and controls designed to protect and safeguard resources. All Air Force organizations and contractors are responsible for establishing and maintaining an effective internal control system that safeguards government resources and assures the reliability of financial records. When properly followed and practiced, these procedures significantly reduce an activity's susceptibility to fraudulent and wasteful actions.

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Conversely, auditors and investigators have found that weaknesses, breakdowns, or circumventions of these controls create opportunities that may result in fraudulent practices. Two common reasons for circumventing controls follow: (a) people did not understand the reason for the controls or procedures and, consequently, did not understand why compliance was so important, or (b) they accepted the circumvention as the most effective and efficient method to get the job done.

As professional internal auditors, we play a significant role in the Air Force's internal and management control systems and, therefore, should have a thorough understanding of an organization's internal controls. Management aims these control systems, at least in part, at fraud. As such, Air Force management and the public expect auditors to evaluate internal controls for fraud. The following three-step procedure provides a systematic approach for evaluating internal controls.

1. Consider the types of errors that could occur. Considering the types of errors or frauds that could occur in processing transactions is a formidable task. To make the task more manageable, first flow chart the organization's transactions and then classify the transactions by function, operating unit, or cycle. Next, identify internal control objectives for each of those functions, units, or cycles. Finally, examine the controls that satisfy the control objectives. As an example, the following categories might be identified for an organization:

- sales and accounts receivable
- cash receipts
- purchases and accounts payable
- cash disbursements
- cash balances
- payroll
- inventories
- property, plant, and equipment acquisitions and deposits
- other assets and liabilities
- journal and general ledger entries

2. Determine control procedures that could prevent fraud. For each of these areas, determine whether sufficient controls are in place to

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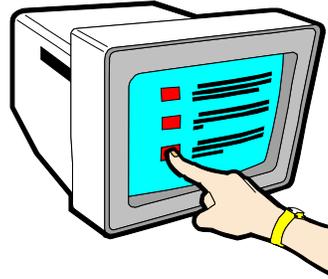
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provide reasonable assurance fraud would be difficult to accomplish. The key question is whether the essential control procedures would likely prevent or detect a significant error or fraud. This evaluation process may not only identify essential control procedures management needs to add, but it may also reveal management can delete some existing controls.

3. Determine if controls are in place and being followed. The next step is to determine whether the control procedures are functioning as intended. In many organizations, a significant difference exists between the control system as it is supposed to work (formal system) and the control system as it actually works (informal system). In fact, *a common contributing factor to fraud is not the lack of internal controls but the lack of compliance with existing internal controls.*

### **FRAUD, AUDITING, AND THE COMPUTER**

Fraud in the automated business environment may be more difficult to detect than in the manual environment, or it may be easier. Results of one study show that white-collar computer criminals are less likely to be caught, turned in, arrested, convicted, incarcerated, or serve long sentences. The results of this study were also used to develop the following profile of the “typical” computer criminal.



Ninety-eight percent of the time the offender is a company employee; someone who is a functional end-user (nontechnical), not sophisticated in computer use, and working in a non-supervisory position. The individual is bright, motivated, and works long hours with few or no vacations. The employee has no previous record and is the last person people would suspect of fraud.

Auditors interested in detecting fraud in a computer environment should apply the five-step approach discussed on page 12. In addition, specific

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knowledge of what can go wrong and the symptoms of computer-related fraud is essential. Some suggestions are:

- Determine specific computer-related fraud exposures for the audited area.
- Conduct research to identify those exposures that occur most frequently.
- Add the necessary audit steps to your program to provide reasonable assurance of identifying computer-related fraud symptoms.

If auditors know the specific fraud red flags that data files might show, the auditor can use computer audit retrieval techniques to search for these red flags in huge quantities of data. Once identified, auditors can research and resolve the red flags. Specific audit tests conducted when using computer retrieval techniques include:

**- Searching for:**

- duplicate payments
- inventory credit balances
- duplicate address files: payroll, vendor, pension, and health care
- high exposure transactions: large health claim payments/write-offs
- duplicate bank account numbers in direct deposit payroll systems
- repetitive accounts, names, or addresses in high-exposure transactions

**- Matching:**

- vendor address to employee address
- vendor address to former employee address
- inventory quantity and dollars to prior years
- inventory levels to tank capacity
- employee addresses to payment addresses
- current payment listing to vendor master list
- active payroll to disability, pension, worker's compensation claim files
- current table files used in financial programs to previous table files
- accounts payable to past due accounts receivable
- employee addresses to addresses of past due accounts
- date of computer password use to employee time off

**- Analyzing:**

- use of override transactions
- file maintenance on employee accounts

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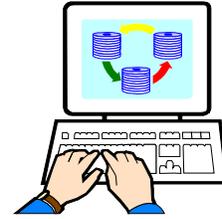
employee overtime  
sales returns after the end of an accounting period  
voids and refunds using employee passwords or ID numbers

**- Listing:**

large payments to individuals  
vehicles with high maintenance cost

**- Identifying:**

inventory scrapped, then reordered  
accounts with large dollar amounts  
post office boxes as shipping addresses



**- Footing:**

general ledger and files: receivables/deposits/bank accounts

## **REPORTING REQUIREMENTS**

The General Accounting Office Yellow Book standards require auditors to prepare a written report on tests of compliance with applicable laws and regulations. The report should contain positive assurance statements on those items the auditors tested for compliance and negative assurance on those items not tested. The report should also include all material instances of noncompliance and abuse and all instances or indications of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.



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## Chapter 3

### THE AUDIT/INVESTIGATION RELATIONSHIP

In 1989, AFAA signed the first memorandum of understanding with the Air Force Office of Special Investigations (AFOSI).<sup>3</sup> This memorandum facilitates the referral process (i.e., the process for auditors to refer potential fraud cases to the AFOSI for investigation, and the process for the AFOSI to request audit review and document potential fraud). Audit Agency Instruction 65-103, Chapter 6, contains specific referral procedures.



### THE AFAA/AFOSI TEAM CONCEPT

Timely exchange of information is essential to both the audit and investigative processes. The memorandum of understanding discusses the need for continuing coordination on all audits. As such, before starting an audit, the audit control point notifies the applicable AFOSI office of the scheduled audit and the audit scope. This serves two purposes:

1. The AFOSI can advise auditors of known or suspected problem areas within the planned audit scope or request an expanded scope to cover other suspected areas.
2. The AFOSI input will help eliminate duplicate coverage and ensure the audit will not interfere with any planned or ongoing investigation.

AFAA auditors should coordinate with the AFOSI on draft reports

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<sup>3</sup> As of November 1997, the AFAA and AFOSI were updating this memorandum of understanding.

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related to ongoing investigations to ensure the reports do not contain information that could jeopardize the investigation. The AFAA also sends the AFOSI a copy of each final audit report. Finally, with respect to audit support provided to AFOSI investigations, auditors may be required to testify during subsequent legal proceedings, and audit working papers and reports may be used as evidence during these proceedings.

## **UNDERSTANDING THE INVESTIGATIVE PROCESS**

AFAA auditors occasionally support AFOSI investigations. Therefore, all auditors should understand that an investigation is **not** an audit, and significant differences can exist between what auditors and investigators face on the job. As investigators, AFOSI agents can conduct extensive interviews, subpoena bank records, and perform other investigative tasks that are beyond audit responsibilities. Additionally, AFOSI investigations do not necessarily help Air Force managers do a better job. Instead, investigations are conducted to get the facts, find out what happened, and gather sufficient evidence to allow management to take corrective and/or legal action. As such, the investigator's role may be adversarial in nature. Finally, investigators sometimes face physical dangers, such as bodily harm. Therefore, secrecy can be essential to successful completion of some investigations.



Investigations involve more than determining whether something has gone wrong and finding out who did it. Specifically, investigator responsibilities include following through from discovery through court action and recovery, which can often require an investigator's case involvement over a period of years.

## **AUDIT'S ROLE**

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As mentioned earlier, auditors must take an active role in fraud detection. That role includes proper reporting of audit work and participating in informal discussions with AFOSI agents as indicators are identified. Specifically, when a fraud indicator is identified, the auditor should:

1. Immediately inform the audit supervisor. The supervisor is in the best position to determine what actions are required.
2. Formally notify local AFOSI officials.
3. Allow the AFOSI to run the investigation.
4. Identify all known factors in working papers. Professional working papers are critical to the success of a subsequent court case.

In addition, auditors must consider the total picture when deciding whether to refer a suspected irregularity. Some indicators, such as a phony document, may provide sufficient reason to initiate a request for an AFOSI review. In other cases, the auditor may need to recognize the interrelationship of several seemingly unrelated deficiencies or indicators which, when combined, warrant a referral. A good approach is to discuss the fraud indicators with local AFOSI agents when the indicators are first identified.



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## Appendix I

### ACQUISITION

#### OVERVIEW

Each year, the Air Force obligates and disburses well over 50 percent of its budget through contracts. For Fiscal Year 1996, nearly \$35 billion was obligated for several million new contractual actions. Both the large dollar value and volume of contractual actions emphasize the importance of continued internal audit activity in the procurement and contract administration operations.

#### FRAUD SCENARIOS

Individuals offering bribes, kickbacks, and payoffs do so in hopes of obtaining new or retaining old business, covering up short deliveries or inferior products and services, securing information to compete on bids, and obtaining approval and acceptance of completed work on Air Force contracts. Also, those seeking financial gain may solicit bribes, kickbacks, and payoffs at any time or at any level within the Air Force.

1. Wilford Hall Medical Center personnel had not established internal controls to promote maximum competition or to effectively monitor the purchases of heart pacemakers. During Fiscal Years 1992 and 1993, Center personnel purchased 290 pacemakers, valued at \$1.2 million, as a sole source action using a blanket purchase agreement. Contracting officials did not monitor the transaction or enforce separation of duties between the ordering and receiving functions. A hotline complaint led AFOSI agents to a military member accepting gratuities from two medical supply companies. Subpoenaed records disclosed the member and his wife accepted transportation and lodging on at least six occasions, as well as numerous lunches and dinners. Approximately 95 percent of the time, the member was in a position to decide which pacemaker to buy and from whom. [Report of Audit (ROA) 925-96-08, 2 Oct 95]

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2. Howard Air Force Base (AFB) contracting and transportation officials did not properly monitor or administer the Contractor Operated Parts Store contract. As a result, the contractor overcharged DoD users \$537,000 during a 2-year period. Langley auditors found parts were marked up as much as 113 percent because purchases were not approved by base officials or made through authorized manufacturers' distributors. For example, an Air Force customer purchased a part for \$110 and, 19 days later, paid \$217 (97 percent more) for the same part. Many parts were obtained from two companies that had the same address, phone number, or fax number as the store contractor. In addition, the contractor overcharged DoD users for freight expenses by as much as 630 percent. [ROA 512-95-04, 21 Oct 94]

3. Wright-Patterson auditors found inadequate administrative controls for the PW-229 engine warranty program. The program office tracking liquidated, Air Force-caused damages did not validate over \$1.6 million because the contractor did not identify all warranty actions that exceeded established repair or replacement times. In-depth reviews were needed to ensure the Air Force received all warranty benefits and remedies and that inaccurate warranty reporting did not cause loss of Air Force funds. The AFOSI was informed of the contractor's warranty reporting practices. [ROA 445-94-078, 13 Sep 94]

## **FRAUD INDICATORS**

### 1. Bids and Solicitations.

- presolicitation documents indicate purchases from a specific firm
- solicitation includes bid schedule items with low demand
- specification or statement of work requires a proprietary process
- complex procedures require middle man to do paperwork/mediate
- respected, well-qualified company refuses to do business/offer bid
- bids appear to drop when a new/infrequent bidder submits a bid
- some contractors bid frequently but never win
- certain companies come in high on some bids, low on others
- no logical cost variances to account for large bid differences
- same bids for shipping both short and long distances
- subcontractors pick up bid packages but do not submit bids

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## 2. Contract Awards.

- contracts awarded to select groups without seeking competition
- numerous emergency contracts awarded without competition
- low-bidding companies disqualified for unspecified reasons
- high-ranking officials interested in on-base businesses
- prior AF personnel work for firms doing government business
- multiple contracts awarded for concurrent work on project/item
- government estimates/contract award prices are consistently close

## 3. International Merchant Purchase Authorization Card (IMPAC).

- unauthorized purchases
- too many card holders within activity or unit
- purchases exceed demand and normal consumption rates
- card holders take cards home, on leave, or on temporary duty
- splitting requirements over 2 or more days
- purchases of items available through the supply system
- exceeding card dollar limit
- poor supervisory controls over card usage
- not accounting for purchases or to whom the cards were issued
- purchases returned for cash to stores that do not require receipts
- failure to turn in free products obtained with purchases

## 4. Contractor Operations.

- companies conducting business under several different names
- poor control over government property in contractor's possession
- irregular record entries for government-furnished stock
- use of government-furnished equipment on commercial work
- government-furnished materials not properly reimbursed
- unvarying patterns in small purchases abstracts
- new office machines malfunction
- extensive contract modifications
- low bidders repeatedly subcontracting work to higher bidders
- restricted parking allows access to valuable supplies/information
- supplies and services ordered by individuals with no legal authority
- improperly calibrated equipment used for acceptance testing
- contractors submit change proposals from Air Force personnel
- deficiencies in complex systems

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- contractors propose efforts requiring highly qualified personnel
  - one person authorized to both order and receive goods and services
  - contractor provides substitutes for contract-specified items
  - operating costs at different locations are markedly different

#### 5. Contract Administration.

- frequent complaints by users of supplies or services
- unqualified personnel assigned to monitor contractor performance
- inadequate documentation of contract violations
- slow enforcement of contract provisions
- contractor complaints of late Air Force payments
- progress payments greater than actual progress
- unreconciled inspection progress reports and invoices
- private business dealings/close social relationships with contractors
- payments made to other than official "remit to" address
- contractor overtime not verified
- contract not "downsized" after units required were reduced
- reimbursable materials not reviewed for fair and competitive prices
- Civil Engineer records not reviewed before approving payments
- payments authorized without receipt of services statement

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## **Appendix II**

### **LOGISTICS**

#### **SUPPLY RETAIL**

Base-level supply provides materiel to support Air Force worldwide wartime and peacetime readiness mission requirements. The Air Force determines needs and stocks sufficient supplies, equipment, fuel, and munitions.

#### **EQUIPMENT MAINTENANCE AND REPAIR**

This area encompasses all the organic (in-house) and contract maintenance, manufacture, assembly, repair, and modification operations. These functions cover all depot, base, and contract operations for aircraft, missiles, armament systems, vehicles, and support equipment. During Fiscal Year 1996, Air Force Materiel Command employed over 100,000 civilian and military personnel to accomplish depot maintenance operations while approximately 100,000 additional personnel accomplished base- and intermediate-level maintenance at organizations worldwide. These personnel supported an Air Force inventory of approximately 7,275 airframes, 57,270 jet and reciprocating power engines, 550 strategic ballistic missiles, exchangeable assets worth \$1.8 billion, and thousands of pieces of support equipment. The Air Force budget proposal for Fiscal Year 1997 contained about \$1.3 billion for in-service aircraft and missile modifications and an estimated \$4.1 billion for depot maintenance services.

#### **TRANSPORTATION**

The Air Force transportation function moves personnel, cargo, and deploying units worldwide through the use of organic and commercially

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contracted services. Lean logistics initiatives continue to dominate transportation planning and operations as managers seek ways to effectively use scarce resources to move mission-critical assets in peacetime and wartime. Similarly, managers are looking at innovative ways to use cheaper but effective commercial alternatives to perform transportation functions.

### **FRAUD SCENARIOS**

1. Langley auditors determined that retail sales personnel improperly processed supply transactions, resulting in a \$298,000 inventory loss. Internal controls did not ensure funds management integrity, accurate clothing issues records, notification of receipted equipment, and enforcement of tool issue center responsibilities. Unauthorized bulk issue reconciliation transactions were processed to reduce accountable inventory balances for tools, clothing, and individual equipment items such as small knives. Employees processed supply computer transactions, charging various base organizations for items which were neither ordered nor received. In addition, serviceable items were inappropriately transferred to the Defense Reutilization Marketing Office (DRMO) to reduce excess inventories and correct inflated demand levels caused by prior requisitions. [ROA 512-95-030, 24 May 95]

2. Charleston auditors assisted AFOSI officials in an investigation of DRMO property withdrawal procedures. Internal controls were not adequate to ensure Air Force members and contractors properly documented, obtained required authorization, and accounted for government property. The investigation disclosed that supply documents were generated to cover inventory loss or theft. Turn-in documents were found at DRMO attached to requests for the same item to be reissued back to the organization. Each document contained the statement "*DO NOT POST.*" DRMO employees related that none of the items, valued at \$176,000, were ever turned in. One contractor diverted a dump truck, bulldozer, front end loader, and two tractors, valued at over \$220,000, withdrawn from DRMO for use on non-Air Force property. [ROA 504-95-002, 5 Oct 94]

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3. AFOSI officials requested Ellsworth auditors evaluate inventory controls at a security police supply point. Auditors identified internal control weaknesses that allowed excess stock levels of \$185,000, inaccurate equipment records totaling \$276,000, and unauthorized credit card purchases of \$32,000. AFOSI agents recovered \$24,000 of stolen property. [ROA 218-95-007, 17 Feb 95]

## **FRAUD INDICATORS**

### 1. Document Control.

- destruction of computer input documents
- large quantity of record alterations
- transaction processed incorrectly to improve performance
- requisitioning nonstandard supply items
- excessive number of billed-not-received records
- charges for items not requested or received
- actual expenses approaching/exceeding budget faster than expected
- individual expenses are unusual/excessive/unexplainable
- excessive use of reject clear cards
- numerous reverse post transactions
- high number of post-post or wash-post transactions
- delinquent or lost documents
- identity changes for unit cost and warehouse locations

### 2. Storage and Distribution.

- failure to count palletized items
  - after-hours issues for non-mission essential items
  - warehouse refusals or serviceable balance with no location
  - downgrading serviceable property to scrap
  - false issue documents and walk-through issues
  - inadequate inspection of technical equipment
  - physical environment facilitates diversion of government property
  - receipt of items that cannot be traced to a valid requisition
  - unavailable/outdated list of authorized pick-up/delivery personnel
  - inaccurate/outdated authorized purchases list
  - significant losses of property sent via parcel post
  - diversion of property from authorized delivery destinations
- pilferable items not controlled

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- sudden increase in vehicle miles per gallon
  - many inventory adjustments under \$100 criterion for investigations
  - weapons not properly stored
  - inadequate small arms accountability and inventory records
  - small arms authorizations exceed allowances

### 3. Stock Control.

- frequent transfers to DRMO
- excess supply items/equipment not turned in to base supply/DRMO
- DRMO turn-ins with shelf life—computer automatically reorders
- forced transfer of new items to DRMO
- overcharges at the base service store
- abnormally high consumption of supply items
- personal clothing issued to civilian personnel
- sample inventory adjustments
- changes in security, pilferable, and controlled item codes
- specific/valid substitute items/quantities ordered but not received
- items/quantities ordered but not needed to perform the mission
- items not used for their intended purpose
- low-value supply items with unreasonably high prices
- expendability, recoverability, and repairability code changes
- numerous due-out cancellations from the same organization
- excessive item purchases exceeding normal stock levels
- new item purchases when existing items are useable
- purchases that exceed work requirements (gold plating)
- useable property turn-ins to generate new property requirements
- maintaining property that is not on accountable property records
- cannibalizing to generate credit for two or more items at turn-in
- short item broken in pieces and presented as two or more items
- war/field loss claims for property abandoned or destroyed
- deployments used to mask inventory shortages from loss/misuse
- losses covered by personnel signing for more items than received

### 4. Fuels.

- significant variations in consumption by registered vehicles
- lack of security at organization/unit tanks
- fuel loss from parked equipment
  
- no control over issues to small containers
- daily losses which roughly equal the maximum allowable loss

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- fuel temperature not considered when determining amount received
  - fuel truck loading seal numbers do not agree with invoice numbers
  - same individual consistently escorts delivery trucks
  - escorts remain in delivery vehicles
  - amount of fuel delivered is close to or exceeds tank capacity
  - issue tanks established without adequate justification
  - inadequate controls in the solid waste management program
  - lack of a reclaimed and recoverable fuel program
  - unit issues not consolidated monthly to compute gains and losses
  - issue tanks consistently show high water amounts during gauging
  - unmetred/unmeasured return of recovered fuel to unit tanks

#### 5. Household Goods Shipments.

- carrier complaints/rumors of unequal distribution of shipments
- overstated shipment weights (false tickets, switching trucks, etc.)
- do-it-yourself movers using larger vans than necessary
- most do-it-yourself rentals obtained from same contractor
- allowing space-available travel without proof of orders
- personal property carrier complaints about service quality
- billings for excessive waiting time during local moves
- unwarranted accessories service or packing material charges
- unusually large shipments of professional books/papers/equipment
- improperly classifying freight

#### 6. Cargo Operations.

- freight unevenly distributed among carriers
- freight loss/damage not on Government Bill of Lading at delivery
- freight services ordered and not rendered
- short-shipping freight
- use of military leave airfare for official travel
- overbuilding crates in packing and crating
- personal use of packing and crating material
- uncalibrated packing and crating scales
- dwindling supply of 463L air cargo pallets

#### 7. Munitions.

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- individuals removing ammunition from the range
  - unit signs for more ammunition than actually needed or received
  - no records of excess munitions being turned back
  - large amounts of expired munitions certified as being destroyed
  - spent ammunition brass not turned in to DRMO
  - munitions deliveries short of normal allocations

#### 8. Vehicle Maintenance.

- government funds used for replacement parts in new vehicles
- excessive parts replacement in vehicle maintenance
- high dollars for expendable, nonaccountable vehicle parts

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## **Appendix III**

### **CIVIL ENGINEERING**

#### **REAL AND INSTALLED PROPERTY**

Base civil engineers manage Air Force physical facilities valued at more than \$140 billion. Upkeep and preservation of this capital investment include maintenance of land, facilities, and installed property; family housing operations; utility and fire protection systems; and environmental programs.

#### **CONSTRUCTION**

Military construction projects add to the physical plant value. The Fiscal Year 1997 Air Force budget for military construction was over \$1.9 billion and provided limited funding for capital investment projects critical for readiness and retention.

#### **FRAUD SCENARIOS**

Base civil engineering operations have a high vulnerability to fraud and waste. While any aspect of the operations may be subject to irregular practices, past audits have disclosed higher risks in the areas of self-help, logistics management, production control, planning, work classification and funding, maintenance, and power production.

1. Auditors at Robins AFB identified internal control weaknesses and accountability problems with material use and disposition. From a review of 462 items valued at \$759,852, auditors could not account for 175 items (38 percent) valued at \$359,616. Civil engineering employees purchased materials against nonexistent projects or projects for which the materials were not valid requirements. Civil engineering personnel had neither established a system to maintain inventory balances nor adequately separated duties, and the small purchase process was not operating per established internal controls. All

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conditions provided the textbook opportunity for fraud. Investigators found employees using Air Force resources to build a barn at a personal residence and selling lawn sprinklers to hardware dealers. [ROA 425-91-46, 24 May 91]

2. Randolph civil engineers did not properly plan, manage, or control a contract to install siding, doors, and windows on 24 buildings. Auditors identified \$1.2 million in overpayments on 17 contract delivery orders. Additionally, siding requirements were not accurate; buildings were not measured exclusive of all openings (i.e., windows, doors, and louvers), and some building measurements were erroneously multiplied by a factor of two. Furthermore, the contractor was paid to paint both sides of the metal exterior doors, but was provided metal doors with factory-applied finish coating. Surveillance weaknesses resulted in engineers approving payments for replacing 21 doors on a building when the contractor only replaced 15 and for installing 114 windows in two buildings that only had a total of 69 windows. [ROA 925-95-66, 21 Jun 95]

3. Langley auditors found inadequate controls for the Lajes Field family housing program, which consisted of both military family housing units and privately owned cottages. Specifically, civil engineers improperly sold Air Force material (\$36,000) to private cottage owners for personal use and ultimate resale. Self-help store employees could only support deposits of \$24,000. In addition, the housing manager (a) misrepresented her job magnitude and accountability to obtain an upgrade to GS-12 (\$10,000 increase in pay and benefits), (b) authorized the conversion of two adjoining units into a five-bedroom unit for her family (complaints from others resulted in five additional conversions costing \$120,000), (c) changed cottage lease terms that reduced annual depreciation expense by 43 percent for two personally owned cottages, and (d) revised appraisal procedures to include repairs and improvements. The housing manager received a \$20,000 personal gain on the two cottages her family purchased, repaired, and sold based on her certified appraisals. [ROA 512-94-53, 20 Jul 94]

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4. Shaw AFB auditors supported an AFOSI investigation of a \$75,459 trash hauling, double-billing scheme. Using the contract specifications, truck hauling capacity, and tipping fees (fees paid to the landfill based on trash weight), auditors concluded the contractor collected refuse from multiple non-Air Force customers without disposal at landfills between pickups. The commingled refuse was then dumped, and the tipping fees were billed either totally to the Air Force or in some cases partially to another customer. During 3 of the 5 months reviewed, payments for tonnage exceeded the total amount of tonnage dumped. [OSI 94-24]

5. Auditors found inadequate controls over the administration of the Simplified Acquisition of Base Engineering Requirements (SABER) program at Maxwell AFB. Cost estimates were not adequate; price negotiations were not accurate; and SABER delivery orders were not authorized, approved, and controlled. As a result, civil engineering and contracting personnel issued 31 delivery orders (valued at \$1,392,371) outside the program scope, and the Air Force may not have received a fair and reasonable price on negotiated items. Government officials investigated these and other conditions associated with the SABER program. [ROA 516-95-32, 31 Aug 95]

### **FRAUD INDICATORS**

#### 1. Operations.

- large quantities or transfers of excess material
- high consumption of common-use items
- misplaced or misused government-furnished equipment
- no reported residual or excess materials
- reordering items that were recently written off as excess
- significant amounts of unscheduled overtime
- little or no separation of duties
- rework or repeated problems with the same repair or maintenance
- recurring personal use of government tools and equipment
- frequent changes to time cards
- unauthorized individuals obtaining supplies
- unsecured organizational fuel storage tanks
  
- open access to Air Force vehicles

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- indicators for self-help store (see supply operations-retail)
  - large blocks of time spent conducting relatively simple repairs
  - requests for new fixtures instead of repairing existing fixtures
  - property turn-ins unchecked by supervisors
  - turn-ins consistently claimed unusable/unserviceable
  - turn-ins that contain precious metals
  - high mileage on civil engineering vehicles
  - tools and equipment missing from the work site

## 2. Resources and Requirements.

- short-shipments and over-ordering
- specified use of brand name materials
- transfers from prior work orders to open or planned work orders
- transfers via any type of special holding or suspense accounts
- large inventory adjustments or write-offs
- seemingly high- or low-cost variances (labor or materials)
- significant extensions to the estimated completion date
- no coordination with or approval by state/federal inspectors
- inadequate justification for equipment rental agreements
- transfers between jobs and various funding appropriations
- cost estimates not based on total material or labor requirements
- high percentage of sole source materials/equipment
- inspector progress reports do not match contractor invoices
- SABER contracts used for single service projects (e.g., demolition)
- independent estimates not obtained for projects over \$200,000 limit
- excessive material consumption compared with work orders
- using personal vehicles when government vehicles are available
- using government vehicles to go to breakfast and lunch
- not responding to complex problems early in the day

## 3. Housing Management.

- customer complaints about services contracts
- installation property records not updated
- inflated, duplicate, or non-published price lists
- non-brand name materials sold as brand name items
- inadequate inspections by quality assurance evaluators
- extensive contract or job modifications
  
- abnormal orders of government-furnished materials
- unqualified or inexperienced personnel monitoring contracts

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- inadequate documentation of contract violations
  - contract options exercised despite poor performance
  - close government estimates and contractor bids
  - social or business dealings with contractors
  - substituted items or equipment
  - larger than usual progress payment
  - sales and volume discounts not identified, taken, or passed on
  - sweetheart companies or middlemen used to increase prices
  - late reimbursements for refuse and recycle programs
  - appliance replacements inconsistent with normal wear and tear



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## **Appendix IV**

### **ENVIRONMENT**

#### **OVERVIEW**

The Resource Conservation and Recovery Act and Federal Facilities Compliance Act require commanders to properly handle hazardous waste from generation to final disposal. Most environmental crimes revolve around contractors tasked with cleanup and removal of hazardous materials or occur in field environments where precautions are not taken to prevent fuel spills or oil contamination of the ground.

#### **FRAUD SCENARIOS**

1. The audit team determined Air Force environmental managers at the 11 bases reviewed did not adequately use existing disposal contracts or establish contractor oversight control procedures. These same managers did not properly plan, control, and bill for disposal services provided to customers. As a result, bases may not have obtained the best price for hazardous waste disposal, and the Air Force was vulnerable to violation notices and fines for improper disposal or environmentally unsafe contractor practices. [ROA 96052026, 29 Nov 96]

2. AFAA auditors found Air Force utility reimbursement management was not adequate at 7 of 18 bases reviewed. Civil engineers did not properly identify or bill all reimbursable customers for utility costs and did not correctly compute utility sales rates. These conditions occurred because engineers did not update memorandums of agreement with all reimbursable customers, annually recalculate utility sales rates, or require nonfederal activities to provide their own metering/regulating equipment. As a result, bases did not collect utility costs totaling approximately \$5 million annually during Fiscal Years 1994 and 1995. Over a 6-year period, the Air Force could collect an additional \$30 million. [ROA 95052012, 29 Aug 96]

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3. Auditors determined that F.E. Warren AFB did not effectively manage its Installation Restoration Program (IRP). For example, the base incurred at least \$3.58 million in expenses before the IRP manager obligated the funds. Further, the IRP manager authorized for payment at least \$86,000 of questionable and \$915,000 of unsupported expenditures. Also, because the IRP manager did not review billings for validity and accuracy, the Air Force could have overpaid as much as \$5.4 million in erroneous administrative and overhead charges. In addition, the IRP manager did not adequately define the scope of work on purchase requests and did not involve the contracting office in the purchase request process. As a result, the Air Force paid other contractors at least \$596,000 to accomplish tasks for which the IRP manager had already obtained funding. Finally, because the IRP manager was not familiar with acquisition requirements for government-furnished property, the Air Force did not retain custody of vehicles and equipment totaling \$655,000 which were needed to meet continuing IRP requirements. [ROA 26197032, 5 Jun 97]

### **FRAUD INDICATORS - HAZARDOUS MATERIALS**

- contractors do not have required permits/technical expertise
- improper disposal of clean-up wastes
- contractor using improperly trained personnel and inadequate equipment
- dumping contaminated waste material in isolated locations
- falsifying test results or not conducting required tests
- using test equipment not capable of identifying hazardous materials
- charging the Air Force for removing soil not contaminated or removed

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## Appendix V

### AUTOMATED SYSTEMS

#### INFORMATION TECHNOLOGY

The Air Force and DoD continue initiatives to identify and migrate standard automated information systems to support similar activities DoD-wide. These initiatives will eliminate redundant systems, thereby reducing the overall costs of operating and maintaining information systems. The Air Force is also continuing its software process improvement initiatives and acquiring computer-aided software engineering tools. These initiatives are expected to reduce the costs of developing and maintaining software through a more structured and reliable software development process. When implemented, these initiatives will facilitate the rapid transfer of large volumes of data and information throughout DoD. The Air Force annually budgets about \$2 billion for information technology activities.

#### FRAUD SCENARIOS

1. Auditors at Reese AFB identified \$96,938 in excess and unaccountable fiber optic assets that should have been redistributed because of base closure. This condition occurred because communications personnel did not accomplish adequate oversight and were not fully aware of base closure policy. In addition, base officials performed fiber optic work valued at \$33,779 after the base was recommended for closure. [ROA 207-96-019, 24 Jun 96]

2. Lakenheath auditors found equipment custodians could not locate or properly account for small computer hardware valued at \$178,000. This condition occurred because custodians did not conduct required inventories or maintain accountability when equipment was swapped out by computer maintenance personnel. [ROA 511-96-006, 3 Jan 96]

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## **FRAUD INDICATORS**

### 1. Program Deficiencies.

- unscheduled program runs during low computer-use hours
- excessive system crashes
- review and approval process not used for programming changes
- excessive edit overrides
- employee consistently refuses leave, promotion, or job change
- authorized personnel roster not in use
- no logical access procedures to prevent unauthorized access
- information disclosure to unauthorized individuals
- unattended on-line remote terminals

### 2. Documentation Deficiencies.

- hardware maintenance not documented
- files with little or no access history kept on-line
- lack of system documentation
- significant changes in reject rates
- automated records adjusted to agree with manual records
- no controls to ensure re-input of rejected transactions
- computer products printed that are not needed

### 3. Small Computer Vulnerabilities.

- equipment theft
  - illegal software duplication
  - purchase of unusable software
  - misuse of job control language
  - no hardware or software controls
  - inadequate system access controls
  - uncontrolled software development
  - unauthorized computer products in work areas
  - classified information on unauthorized computers
  - illegal or inappropriate internet use
  - personnel coming in early/leaving late to use computers
  - excessive computer time with few work products generated
  - files encrypted/password-protected for no obvious reason
- unaccountable/hidden/not readily accessible files on hard drive

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- lack of storage space (may indicate stolen hard drive or memory)
  - computers turned into DRMO that are lacking basic features
  - illegal or unregistered software on computers
  - employees taking home software packages
  - lax controls over access to various systems/networks
  - employee uses computer for personal business/games
  - unauthorized/illegal remote access to computers



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## **Appendix VI**

### **FINANCE AND ACCOUNTING**

#### **MILITARY PAY AND BENEFITS**

As a result of downsizing, the Air Force and DoD financial communities face major challenges in providing quality financial management support to all customers. The implementation of Air Force quality management is reducing regulations and empowering employees to make more decisions. These actions are reducing costs and improving efficiency; however, risk is increased. The Defense Finance and Accounting Service (DFAS) accomplishes the accounting function for the Air Force and is in the process of establishing customer financial services offices at each installation. Effective and complementary internal controls are critical to ensure DFAS operating locations and Air Force financial services offices continue efficient, economical, and legal practices.

#### **CIVILIAN PAY AND BENEFITS**

Personnel costs represent over 33 percent of the Air Force budget. Programmed personnel end-strengths for Fiscal Year 1997 were about 388,000 active duty military personnel, 180,000 civilian personnel, and 183,000 Reserve and Guard personnel. The high cost of personnel programs makes them likely sources for budget cuts. For example, by 1999 the Air Force plans to reduce to an estimated end-strength of 381,000 officers and enlisted personnel and 167,000 civilian personnel. Whenever possible, the reductions will come from middle management positions, in keeping with the overall philosophy articulated in the 1991 Air Force restructuring which reduced the number of major commands from 13 to 10 and eliminated 19 air divisions. Satisfying critical personnel needs in a time of budget reductions will be a major challenge to Air Force management for many years to come. This area covers Air Force compensation for civilian personnel, leave administration

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systems, time and attendance accounting, and controls over and authorization for overtime and incentive pay.

### **COMPTROLLER FUNCTIONS**

The Air Force and other DoD comptroller functions encompass travel, accounting systems, financial management/reporting, accounts receivable/payable, cash management, the industrial/stock funds, and the internal control review system.

### **COMMERCIAL ACTIVITIES**

The commercial activities program is directed by Office of Management and Budget Circular A-76, Performance of Commercial Activities. The program requires the government to perform commercial activities (e.g., refuse collection, grounds maintenance, and dining hall operations) by the most economical mode of operation (in-house or contract), as determined by comparing in-house costs with private sector costs. Since 1979, the Air Force has evaluated approximately 32,000 in-house operations under this program. The evaluations resulted in a 60 percent conversion to contract performance and a \$455 million reduction in the annual operating cost. Anticipated force structure reduction, reorganizations, base closures, and the general need to reduce operating and maintenance expenditures all point to the need for a stronger, more effective commercial activities program.

### **FRAUD SCENARIOS**

1. Auditors and AFOSI agents found inadequate internal controls within the civilian pay section at Maxwell AFB. Lack of supervision, duty separation, oversight, and documentation control resulted in over \$290,700 in fraudulent civilian pay disbursements. A civilian pay technician set up a “ghost” employee in the pay system and received nontaxable, direct deposit payments every 2 weeks for approximately 2 1/2 years. The fraudulent payments ended when a system change was implemented and the technician transferred to commercial services. The fraud was not detected because the technician

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was given complete control over the processes, documentation was either destroyed or corrupted, and required reconciliations were not done. [ROA 516-96-004, 18 Dec 95]

2. Auditors at Ramstein identified significant internal control weaknesses within the Paying and Collecting section at Aviano Air Base, Italy. The resulting audit report and AFOSI referral contained a possible \$262,500 loss of Air Force funds. In addition, errors understated accountability by \$4.1 million, and over 500 US Treasury and Limited Depositary Account (LDA) checks were destroyed without proper destruction/certification procedures. Cash transfers totaling \$12 million were not properly safeguarded, documented, or recorded in time to prevent kiting. Documentation did not support over \$80 million used to purchase cashiers checks and foreign currency. Officials attempted to erroneously write off \$1.3 million with offsetting debits and credits that could disguise serious problems with deposits in transit and replacement checks. The comptroller and other senior accounting officials did not establish a quality assurance program or enforce existing controls designed to protect public funds. Ramstein auditors assisted AFOSI agents in one of three investigations that disclosed a \$550,000 embezzlement. The former Chief of Paying and Collecting confessed to a number of currency scams stating, "If you know how to work the system, you can take it out, fix the paperwork, and no one would know that it happened." The circumstances surrounding the case were unique; however, the internal control weaknesses that allowed the loss could happen at other locations. Specifically, accountable officials did not perform required monthly bank reconciliations following the closure of the LDA. The accused used commercial cashiers checks and processed fictitious foreign currency gain/loss vouchers to conceal misappropriated, unrecorded funds (approximately \$246,000) that were set aside for outstanding LDA checks. Further, the Paying and Collecting Chief took three shipments of \$100 bills (\$279,700) intended for deposit with the Federal Reserve bank. The Chief had complete control over preparation, recording, and delivery to the post office for shipment. The theft went undetected because no effective procedures existed to follow up on deposit discrepancies. In this case, notices of

funds not received went to the person who stole the funds. Finally, the

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Paying and Collecting Chief made a duplicate separation bonus payment (\$21,257) to a friend. Again, no aggressive follow-up was ever accomplished. The Air Force sergeant was convicted of five larceny and five conspiracy offenses, court-martialed, sentenced to 8 years in prison, fined \$175,000, and given a dishonorable discharge. [OSI 94-15] [ROA 522-95-036, 14 Apr 95]

3. A locally initiated audit of the accounting and finance disbursing activity at Oslo, Norway generated an AFOSI referral and fraud investigation. Royal Air Force Lakenheath auditors found ineffective internal controls and procedures used to manage the purchase and reporting of Norwegian kroner. The former disbursing agent stole approximately \$29,000 by not reporting all kroner purchases on daily cash accountability records and by manipulating exchange rates. Almost daily, the agent used different exchange rates (i.e., State Department, local currency market, and variations of both) to value official foreign currency disbursements. The agent apparently speculated on the krone/dollar rate or used it to hide the amounts taken from krone purchases. AFOSI witnesses stated the agent bragged about making money for the government with exchange rates; maintained a “slush fund” to keep the Accounting and Finance Office cashier’s drawer balanced; and was a micromanager who would not allow coworkers to assist. The investigation also pursued whether the agent paid cash for a retirement home. [ROA 511-94-043, 9 Aug 94]

4. Royal Air Force Lakenheath auditors and AFOSI agents found that a commercial services technician defrauded Stavanger Air Base, Norway of \$690,114. The individual diverted checks to his Norwegian bank account, established under a false name using the same acronym as a large company doing official government business. This condition occurred because the technician was allowed to both process and mail government checks. The technician also had access to the control voucher log where he was able to hide the embezzlement by changing the payee’s information at will. Adequate separation of duties could have prevented this diversion. The commercial services technician also falsified payment documents to support a nonexistent household goods shipment. Inexperienced contracting personnel did not

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follow established laws and regulations that may have prevented the fraudulent \$11,337 payment. [ROAs 511-95-021, 4 Aug 95, and 511-95-022, 18 Aug 95]

5. AFOSI agents asked Maxwell auditors to help verify the impact/loss to the Air Force and to uncover other frauds that a commercial services accounting technician may have committed. The AFOSI investigation disclosed the technician used contract payment vouchers (Standard Forms 1034) to facilitate payment of government funds to his personal checking account on three separate occasions. The technician admitted that on each occasion \$39,500 was paid to the account by U.S. Treasury check prepared at the servicing DFAS office. Further investigation disclosed the technician processed vouchers with forged signatures, falsified invoices, erroneous contract numbers, and false vendor addresses. The fraud was not detected because supporting documents were destroyed and disbursements were distributed among several cost centers. [ROA 516-96-004, 18 Dec 95]

## **FRAUD INDICATORS**

### 1. Pay Operations.

- cashier fails to provide traveler a copy of paid travel voucher
- disbursements not timely processed into the accounting system
- accounts receivable not promptly collected
- failure to follow up on lost accountable forms
- insufficient restraints on access to controlled areas
- inadequate separation of duties
- ineligible member receives basic allowance for quarters
- single member receives "with dependent" rate for quarters
- poor unit annual leave records
- no surveillance of overseas military "rent plus" allowances
- falsely documenting flight time for credit towards flight pay
- overtime claimed but not performed
- after-the-fact overtime and compensatory time requests
- recruiters drawing special pay after leaving recruiting status

### 2. Travel.

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- excessive expense claims paid without supporting receipts
  - excessive temporary duty over weekend or holiday periods
  - traveler was also approving official on travel order
  - lengthy leave taken for short-term temporary duties
  - questionable or frivolous purpose for travel on orders
  - significant difference claimed by personnel who traveled together
  - travel was canceled but voucher paid for per diem
  - shared expenses (taxicab/private auto) claimed by each traveler
  - unreported trips home during long temporary duties
  - claims using a missing receipt statement instead of actual receipt
  - receipts for lodging/rental vehicles/etc. made on home computers
  - claiming maximum expenditures for items not requiring receipts
  - civilian claims compensatory time for nonduty weekends
  - travel during holiday periods to obtain holiday premium pay
  - frequent flyer points used for personal travel or free upgrades
  - maximum claims for meals on a permanent change of station move
  - claiming real estate closing costs when buyer/seller agreed to pay
  - claiming family moving costs when family remained behind
  - rent agreement where relative collects living/housing allowances
  - American Express card expenditures for non-travel items

### 3. Limited Depositary Accounts (LDAs).

- unreconciled LDAs and bank statements
- foreign currency control record (DD Form 2663) not maintained
- LDA funds not on accountable records
- LDA checks not returned to DFAS with monthly reconciliations
- LDA records poorly maintained
- foreign currency certificate improperly prepared/controlled
- unit self-inspections not documented
- not buying foreign currency from military bank/State Department
- confusing foreign currency revaluation policy
- foreign currency revaluation policy not followed
- incorrect exchange rates used to record transaction in US dollars
- minimum foreign currency balances not on hand

### 4. Operations.

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- Paying and Collecting operations not supervised
  - daily statement of accountability (DD Form 2657) not certified
  - mistakes on the DD Form 2657
  - no spoiled checks/control check record (DD Form 2661)
  - checks destroyed without proper certification
  - inadequate follow-up on DFAS non-receipt notices
  - little or no separation of duties
  - large write-offs or offsetting transactions
  - no controls over voucher log
  - missing documents or unsupported transactions
  - poor follow-up on Treasury Check Issue Discrepancy (TF 5206)
  - inadequate check control procedures
  - no security police escort for dollar shipments
  - funds in transit not supported by a detailed subsidiary ledger
  - inadequate quality assurance plan (no self-inspection/follow-up)
  - cash verification results not reviewed
  - using imprest funds instead of IMPAC card
  - imprest fund receipts but no purchased items
  - DFAS not meeting 30-day prompt payment requirement



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## Appendix VII

### QUALITY OF LIFE

#### SUPPORT SERVICES

Air Force services functions are supported with both appropriated and nonappropriated funds. Support services include lodging and laundry facilities, janitorial and audiovisual services, and food service and commissary operations. Approximately 6,000 military and civilian lodging employees manage and operate 3,000 temporary lodging units and 38,000 officer and airmen quarters. Annual income from lodging operations is approximately \$107 million. In addition, the Air Force spent about \$22.3 million in Fiscal Year 1995 on contract quarters for temporary duty travel. Further, approximately 2,753 military and civilian food service operations personnel serve over 48 million meals per year, with a food cost of \$80 million. Also, 67 food service contracts, valued at \$85 million, are in operation Air Force-wide.

#### NONAPPROPRIATED FUND (NAF) ACTIVITIES

Services activities are grouped into three categories (A, B, and C) which generally describe their entitlement to appropriated fund support. Category A activities (e.g., gyms and libraries) are supported almost completely with appropriated funds, the Air Force goal being 100 percent. Category B activities (e.g., skill development and community activities centers) receive substantial appropriated fund support. The Air Force goal is a minimum of 50 percent appropriated fund support for this category. Category C activities (e.g., revenue-generating enterprises such as membership clubs and bowling centers) receive no direct appropriated fund support except in remote and isolated areas. However, Category C activities are entitled to structural maintenance and repair and other indirect support. Approximately 1,500 Category C activities generate over \$605 million in revenues each year.

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## **FRAUD SCENARIOS**

1. Scott AFB auditors assisted AFOSI agents investigating allegations that commissary employees requested and received cash from local vendors. In turn, vendors were reimbursed through fictitious invoices or receipts for undelivered produce. Auditors found no assurance that internal controls were in place or functioning in the produce department to prevent or detect fraudulent activities. For example, commissary regulations only allowed 10 percent of produce purchases from local vendors. At Scott, over 50 percent was obtained locally. No procedures existed to determine whether items delivered agreed with what was ordered, and the same employees ordered and received produce. Commissary procedures allowed the produce manager to inflate selling prices by \$5,100 for 36 of 50 (72 percent) items reviewed and to discard produce without documenting spoilage losses. AFOSI agents estimate the amount of loss to be over \$250,000. [ROA 265-94-090, 12 Aug 94]

2. Auditors at Patrick identified a \$111,486 cash shortage at the base dining facility. During a 4-year period, contractor employees embezzled cash receipts that were not deposited with the Air Force commercial services section. This went undetected because the Air Force quality assurance evaluator did not reconcile the contractor's cash collection vouchers (AF Forms 1131) with the amount of funds recorded on the corresponding Air Force deposit vouchers or the supporting daily cash register tapes. The AFOSI investigation found that two employees were creating AF Forms 1131 and adding a commercial services control number on the vouchers as if the deposit were made. [ROA 520-95-002, 3 Oct 95]

3. March ARB auditors found weak internal controls allowed the billeting accounting manager to manipulate records and embezzle funds. AFOSI officials were informed that on one occasion the manager used the cashier's computer and took over \$500 from the register saying that finance had overpaid some accounts. When the cash report did not balance, the manager tried to replace the funds using an unauthorized method. With no separation of duties and several employees having

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access to accounting records, daily cash receipts, and cashier codes, individual culpability could not be determined. Additionally, control weaknesses existed with procedures used to manage accounts receivable (payments, write-offs, and check-in process). Finally, the services information management system night audit reports were not used to analyze or investigate discrepancies. [ROA 920-94-027, 24 Aug 94]

4. Maxwell auditors and AFOSI agents found NAF payroll check distribution procedures, personnel action notifications, and time and attendance (T&A) record review procedures were inadequate. NAF supervisors processed T&A data and directly received payroll checks for distributions to employees. This internal control breakdown allowed one supervisor to falsify time cards for a part-time employee. Subsequently, the supervisor received, forged, and cashed payroll checks valued at \$2,524. [ROA 516-95-026, 17 Jul 95]

5. Auditors at Seymour Johnson identified a \$7,600 “check lapping” fraud scheme at the officers’ club. The cashier was allowed to perform all facets of a single cash transaction. The employee received payments, mailed checks, wrote receipts, and deposited funds in the bank. Further, the employee did not record or deposit checks received for up to 38 days. The AFOSI investigation disclosed that the employee did not credit mail checks to accounts but logged in these checks as cash to replace stolen funds. The employee then used additional mail payments to credit the delinquent accounts. [OSI 93-17]

6. Offutt auditors found internal control weaknesses with the disposal of nonaccountable bowling equipment. The base bowling center manager sold NAF property (bowling balls, pins, and bumpers) to off-base organizations without the required approval of the base NAF custodian. In addition, the manager did not deposit proceeds from at least one sale for 41 days. The total number and value of such sales could not be determined. However, the AFOSI investigation resulted in the administrative removal of the bowling center manager. [ROA 260-95-011, 6 Mar 95]

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## **FRAUD INDICATORS**

### 1. Food Services.

- dining hall signature/cash records improperly used or controlled
- senior cook's requisition (AF Form 148) not verified and signed
- cash turn-ins and deposits not verified by Food Services Officer
- second helpings are rung up on register as a full meal
- unattended or unsecured subsistence items
- unlimited access to storage areas
- excessive contractor charges for dining hall equipment repairs
- excessive dining hall gains or losses
- excessive plate waste observed
- poor documentation for meals served away from dining halls
- food issued prior to preparation period
- unpaid meals by food service personnel
- poor documentation for leftovers disposition
- large amounts of unexplained food condemnations
- excessive costs for security guard beverages
- weak meal card control and issue procedures
- contractor paid on estimated rather than actual meals served
- inventory not traceable to recipe portions/serving schedules/sales
- large end-of-month inventory withdrawals/returns

### 2. Commissary.

- cash given for food stamp purchases
- food coupon irregularities
- expired coupons
- coupons for nonstocked items or goods not purchased
- refunding difference between coupon and price
- deducting coupons before adding surcharge
- large variances in department sales percentages
- abnormal gains or losses in meat or produce department
- meat not weighed upon receipt
- hamburger fat count higher than labeled
- processed item tests reflect excessive/no price for bones/fat/suet
- no shortage/overage on daily checker record (AF Form 2359)
- veterinarian fails to check meat or produce
- vendors provide employees snacks

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- vendors without store numbered/controlled name tags
  - in-checkers not identified in writing and periodically rotated
  - receiving documents not sent to control section daily
  - contracts do not permit credit/return of unsold products
  - vendors remove goods but fail to credit store
  - managers obtain sales figures before completing inventory
  - produce items sold by weight contain excess water
  - inadequate security for scanner operation
  - empty boxes among delivery items
  - vendors have access to final receiving documents
  - receiving documents signed before merchandise enters store
  - failure to document inferior food items
  - scales not available to weigh bulk items

### 3. Other Operations.

- unreconciled services night audit reports
- no contractor inspection plan and/or inadequate inspections
- inventory taken after contractor's month-end inventory
- improper inventory procedures
- no reconciliations among purchases, receipts, and billings
- inadequate equipment management
- incomplete guest check-in information
- unsupported write-offs
- purchase agreement orders not verified to invoice
- telephone calls/bills not verified
- inaccurate room charges

### 4. Club Operations.

- customer and employee complaints
  - time clocks and sign-in sheets in uncontrolled areas
  - recorded work hours different than tour of duty
  - complacency in slot machine operations
  - manipulating slot machines to pay off at a higher rate
  - neglecting the Prompt Payment Act
  - nonuse of the Air Force NAF Contracting Division
  - "short-pouring" by bartenders
  - bartenders selling from their own bottles and keeping the sales
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- improper use of Air Force funds to support NAF activities

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- improper NAF use for commander initiatives/contingency fund

#### 5. Management Controls.

- fund custodian exceeding monetary authority levels
- employee complaints about payroll irregularities
- increased accounts receivables on financial statements
- delays or crash projects in NAF-funded construction
- excessive package store item purchases
- bingo cards not date-stamped at time of purchase
- certain bingo players win most large-dollar games
- winners not signing for cash bingo or other game prizes
- bingo card sales not compared with sales receipts
- inadequate bingo procedures (cash/card control, duty separation)
- bingo verifier calling numbers on panel rather than on card
- fund-owned amusement machines emptied by only one person
- relationship between NAF employee/vending machine contractor
- vending machines fail to dispense product or return money
- wide variances in profit/income accounts (amusement machines)
- amusement machine keys not controlled
- vending machine readings not reconciled with cash collections
- poor inventory and sales records
- large inventory shortages offset by large overages
- activities that routinely misplace or lose documents
- invoices paid in excess of established prices
- weak procedures used to reconcile receipts from vendors
- check to terminated employee distributed to management
- expenses written off to promotions (e.g., free food)
- individual service contracts with relatives
- insufficient management emphasis on security controls
- no inventory duty separation (receiving/accounting/reconciling)
- no procedures for fund transfers
- food orders not reconciled with sales receipts

#### 6. Inventories.

- activities that seldom show inventory overages or shortages
- weaknesses in inventory handling procedures
- diversion of salvageable items to fraudulent or illegal sales
  
- high meat contamination rates
- vendor can access delivery records after in-checkers receive goods

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- empty boxes among delivered items
  - unattended or unsecured storage areas
  - receiving record signed/given to vendor before goods enter store
  - excess NAF equipment accumulated without proper controls
  - NAF equipment not distinctively marked
  - significant fluctuations in inventory results from resale activities
  - unexplained adjustments to inventory balances
  - merchandise overordering or overstocking
  - corrections or changes on inventory sheets not initialed
  - promotional material not stored separately from resale inventory
  - vendor samples not included in inventory
  - inadequate procedures for marking and counting stock

#### 7. Cash Controls.

- continual cash refunds
- collocated imprest or petty cash funds
- unexplained adjustments to accounts receivable
- stale items in bank reconciliations (old outstanding checks)
- second or unusual endorsements on checks
- unusual patterns in deposits in transit
- cash deposits not received by the bank
- no duty separation for receiving checks/posting them to accounts
- activities not providing receipts
- unusual fluctuations in cash from vending/amusement machines
- inadequate security for scanner operations
- cashiers untrained or without operating instructions
- missing sequentially numbered guest checks (sales slips)
- employee guest checks for free food and drinks
- scheduled fees not charged to favored customers or employees

#### 8. Cash Register Manipulations.

- sales not rung up
- working out of an open cash drawer
- cashier with cash register read, reset, or training mode keys
- patrons' view of register read window blocked
- failure to scan items sold
  
- pre-/post-dated checks, IOUs, etc. commingled with cash
- no advance approval for voided transactions/refunds/overrings
- consistent cash overages or shortages

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- checks from cashiers in the change fund
  - customers waiting in one line when other cashier lines are open
  - verifier of sales receipts has access to cashier functions/cash
  - words "*invalid receipt*" on customer's receipt tape
  - coupons rung up as cash
  - excessive use of "no sale" key
  - daily cumulative tape readings that do not agree

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## **Appendix VIII**

### **HEALTH CARE**

The Air Force Medical Service provides health care services through a worldwide system consisting of 89 medical treatment facilities. The mission is to maintain the health of Air Force active duty personnel and ensure maximum combat capability. Consequently, the highest priorities are medical readiness, operational support, quality of care, and improved patient access and satisfaction. The peacetime health care system, which includes aerospace medicine, preventative medicine, medical and dental care, and aeromedical evacuation, provides care to approximately 2,800,000 beneficiaries and employs approximately 50,300 active duty and civilian medical personnel. The Air Force health care cost for Fiscal Year 1996 was approximately \$4.7 billion, including \$2.0 billion for the salaries of military personnel and \$1.4 billion for the Civilian Health and Medical Program of the Uniformed Services. The Air Force is now converting to a system of managed care called TRICARE. The program will provide beneficiaries (retirees and dependents) a uniform benefits package and ensure their access to quality, low-cost health care.

### **FRAUD SCENARIOS**

1. McClellan auditors found internal control weaknesses that allowed a contractor to double-bill the government for health care provided to DoD personnel. AFOSI agents estimated the contractor was overpaid \$371,000 because Air Force medical treatment facility officials approved contractor invoices without review and provided little supervision to the quality assurance evaluator. In addition, contractor operating procedures did not ensure all patients treated were eligible for the medical care received. At last status report, the company offered to plea bargain. [ROA 415-94-011, 3 Dec 93]

2. Auditors at Randolph helped to confirm allegations that a military supply manager and others engaged in a conspiracy to steal and divert hospital-purchased equipment. The individuals set up several

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companies to illegally sell the equipment back to the Air Force at substantially higher prices and to facilitate money flow between the participants. Sales totaled over \$750,000, with mark-ups ranging from 7 to 63 percent. The military member was sentenced to 8 years in prison, reduced to lowest rank, and required to forfeit all pay and allowances, and will lose retirement benefits upon dishonorable discharge. Others await trial in federal court. [OSI 93-14]

## **FRAUD INDICATORS**

### 1. Contract Doctors.

- refer patients to their private practice or corporate partners
- charge for services not provided
- use own laboratories and represent them as outside laboratories
- bill for excessive patient loads (e.g., one patient every 3 minutes)
- charge inaccurate, high payment diagnostic codes
- patient record sent for each doctor to make entry/charge fees
- prescribe excessive medications

### 2. Operations and Claims.

- unauthorized use of military identification for medical benefits
  - pharmacy short-filling controlled substance prescriptions
  - loose controls on medical supplies maintained on wards
  - loose controls on drugs in flight surgeon bags/medic kits
  - claimant has history of leave abuse/leave balance was very low
  - temporary employee claims injury near end of employment
  - injury reported in the first pay period of employment
  - injured employee performs physically demanding outside activity
  - recovery time appears excessive based on nature of injury
  - employee claims disability for easily feigned injury
  - claimant changes physicians without apparent justification
  - injury claimed on Monday or immediately following a holiday
  - employee submits multiple claims/returns to work near 45th day
  - claimant received identical treatment prior to the claimed injury
  - claimant acts as a witness for another employee
  - injury not witnessed despite high probability it should have been
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- employees in same work area receive compensation at same time
  - numerous employees use same physician for job-related injury

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- insurance carrier encourages improper job-related injury claims
  - concealed employment while receiving compensation
  - evidence of falsified or altered claim forms
  - claim involves third party liability
  - supervisor recommends claim be denied
  - injury does not appear job-related
  - disability for non-job-related injury since first job-related injury
  - same individuals act as witnesses for numerous claimed injuries
  - claimant's only dependent is over 18 years of age



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## Appendix IX

### THE CORRUPTION INDEX

The Corruption Index lists the most common and recurring signs of fraud and corruption and the associated abnormal behavior which suggests hidden motives and interests. No single indicator is conclusive. Look for clusters and patterns of behavior, particularly conduct which appears contrary to normal practice.



1. The Corrupt Recipient or Embezzler. A person who is taking payoffs or embezzling funds often exhibits the following characteristics:

**The Big Spender.** Many corrupt recipients or embezzlers are caught because they spend ostentatiously or live beyond their means. Their new affluence is often explained by the claim that they spend every penny of their legitimate income or are heavily in debt. Others spend their money less conspicuously, often paying off debts or paying down mortgages, which requires closer study to detect.

**The Gift Taker.** An official who regularly accepts gifts, particularly those that seem questionable, is often susceptible to larger payments.

**The “Odd Couple.”** Corrupt payers and recipients often appear to have very friendly social relationships, which extend beyond normal business hours and contacts. Frequent lunches and dinners, joint business trips, and other after-hours contact, particularly between parties who do not appear to have much in common, may be signs of deeper and more troublesome ties between the parties.

**The Rule Breaker.** A person committing fraud will often bend, break, or ignore standard operating procedures or rules. Be particularly alert for someone who inserts himself or herself into areas in

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which he or she is not normally involved, or attempts to assert authority or make decisions that are normally made by others. The common signals include poor quality, late deliveries or high prices, and complaints from subordinates. Finally, look for higher prices, extra payments, or commissions approved by the suspect; these may be the source of kickback funds.

**The Unappreciated Workaholic.** Some hardworking and honest employees and public servants go bad because they become bitter about their lack of advancement, recognition, or material success. This leads them to rationalize the acceptance of illegal payments, particularly if they start as small gifts and favors from counterparts in the private sector or other companies who earn two or three times as much for doing essentially the same work.

The above condition may coincide with the “burn out” phenomenon, when the employee's enthusiasm and attention to work drastically deteriorate. Here the damage done by corruption is the most severe, as the recipient may sell out completely. This condition is often signaled by physical deterioration, poor work habits, negligence, shortened work hours, frequent absences, or alcohol or drug abuse.

An internal fraud or embezzlement may be indicated by the presence of an employee with access to company assets who refuses to take time off, declines promotions, and consistently works early and late. This may indicate he or she fears a replacement or co-worker will detect the wrongdoing. (It could also indicate a highly motivated, valued employee; remember, no single indicator is conclusive.) To be safe, however, many companies and agencies enforce a mandatory vacation policy and regular job changes in sensitive areas.

**The “Middle-Aged Crazy.”** Divorce and the financial pressures associated therewith, the “mid-life crisis,” and the corresponding need to boost self-esteem through a more lavish lifestyle, girl/boyfriends, etc. have led to irresistible temptations in numerous cases.

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**The Three “Bs.”** An old cliché—with just enough truth to survive—is that the cause for much corruption and embezzlement is the “three Bs:” booze, babes, and bets. Today one would also have to add drugs. Cocaine addiction by white-collar employees, and the fraudulent conduct it spawns, is an increasingly severe problem.

**Genuine Need.** Occasionally, legitimate financial pressures, such as illness of a family member, can induce participation in an illegal scheme. In such circumstances, the corrupt relationship often begins with “loans” or some other face-saving device.

2. The Corrupt Payer. Typical signs of a corrupt payer include:

**The Gift Bearer.** The businessman who routinely offers inappropriate gifts, provides lavish business entertainment, or otherwise tries to ingratiate himself with his counterpart is frequently the one who will offer still more valuable inducements under the table.

**The Sleaze Factor.** Unlike the typical corrupt recipient, who may be known as a diligent and honest employee, the payer is frequently a person with a generally poor reputation for integrity, both personally and in business. The payer may also be widely reputed within the industry to be involved in payoffs or other fraudulent activities or have a criminal record.

**The Too Successful Bidder.** A supplier who is consistently awarded work, without any apparent competitive advantage, may be providing under-the-table incentives.

**Poor Quality, Higher Prices.** Particularly after the corrupt relationship is sealed, the quality of product and service provided by the payer may deteriorate, and prices may increase. In certain highly competitive industries, however, payoffs may be used primarily as a means of getting a foot in the door, and subsequent service and quality may be adequate.

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**The One-Man Operation.** In certain industries, small, closely held companies, which do not have stringent internal audit reviews or the sales resources available to larger companies, are more prone to resort to payoffs than their larger corporate competitors. Also, be alert for the use of independent sales representatives, “consultants,” or other middle men; these are a favored way to funnel and conceal illegal payments.

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## Appendix X

### SUGGESTED READINGS

A personal reading program about fraud will enhance your understanding and complement this handbook. One of the best sources may be trade journals or publications devoted to government, DoD, or Air Force auditing. The *Internal Auditor* magazine regularly has articles addressing fraud. General business magazines such as *Fortune* include in-depth articles about dishonest and fraudulent activities. Also, the following references are provided:

Criminal Interrogation and Confessions, Fred E. Inbau, John E. Reid, and Joseph P. Buckley

Investigative Accounting, Kalman A. Barson

Fraud Auditing and Forensic Accounting - New Tools and Techniques, G. Jack Bologna and Robert J. Lindquist

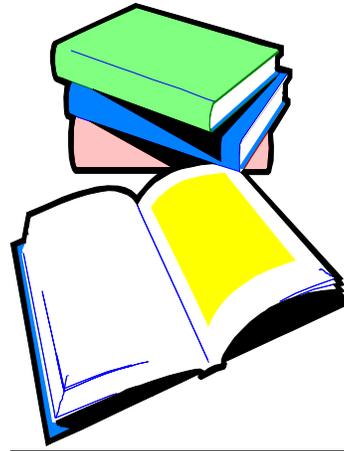
Report of the National Commission on Fraudulent Financial Reporting (October 1987)

Deterring Fraud: The Internal Auditor's Perspective, W. Steve Albrecht, Keith R. Howe, and Marshall B. Romney

How to Detect and Prevent Business Fraud, W. Steve Albrecht, et al

Report on the Study of EDP-Related Fraud in the Banking and Insurance Industries, The EDP Fraud Review Task Force of the American Institute of Certified Public Accountants

Ethical Theory and Business, Tom L. Beauchamp and Norman E. Bowie



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Indecent Exposure, David McClintick

(This book provides insight into the political interactions when a key executive is caught. A true story.)

Bankers, Builders, Knaves, and Thieves, Donald L. Maggin

Liars Poker, Michael Lewis

No Limit, Gary Ross

Computer Fraud & Countermeasures, Leonard L. Krauss and Aileen MacGahan

Computer Capers, Thomas Whiteside

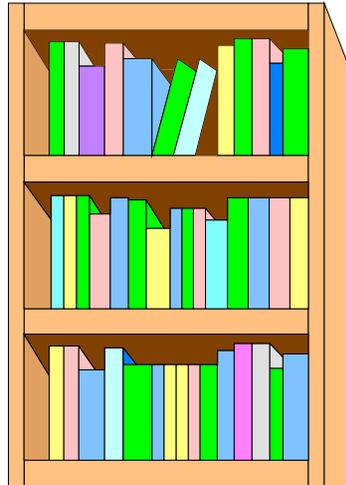
Criminal & Civil Investigation Handbook, edited by Joseph J. Grau

(This collection of articles relating to investigation is a valuable reference for auditors doing investigation.)

Protective Security Law, Fred Inbau, Manin Aspen, and James Spiotto

Standards for the Professional Practice of Internal Auditing, The Institute of Internal Auditors

Statements on Auditing Standards, American Institute of Certified Public Accountants



Computer Control & Audit, William C. Mair, Donald R. Wood, and Keagle W. Davis

Handbook on State Laws Regarding Secretly Recording Your Own Conversations [Available from the author: Barbara Ann Rowan (703) 823-2757]

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The Guide to Background Investigations [Sources of information on State, federal, and educational records: 1-800-247-8713 (In OK, (918) 491-9936)]

In addition, the following newsletters provide information relating to white-collar crime and fraud:

Forensic Accounting Review, published by Computer Protection Systems, Inc., (313) 459-8787

Computer Security Digest, published by Computer Protection Systems, Inc., (313) 459-8787

Bank Fraud - Bulletin of Fraud and Risk Management, published by Bank Administration Institute, (312) 228-6200

The Investigator, published by John Reid & Associates, (312) 876-1600