Auditing Purchase Cards

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Outline of Presentation

- Background
- GAO Audit Approach
- Case Study Examples
- Concluding Remarks
GAO is an independent, nonpartisan research and investigative arm of the U.S. Congress.

GAO’s mission is to help improve the performance and the accountability of the federal government.
What We Do

Systematically tests the design and effectiveness of federal systems, processes, or controls

Uses innovative and proactive methodologies

Develops practical solutions (recommendations or matters for consideration by Congress) for problems that we identify; and

As appropriate, refers criminal matters or other cases identified to the Department of Justice, federal agency Inspectors General, or other relevant officials (e.g., state governments)
What We Use

Government data
  Tax records, Social Security data, grants and disbursement data

Law enforcement tools
  National Criminal Information Center, Financial Crimes Enforcement Network, Lexis-Nexis law enforcement

FraudNet
  Government hotline to report fraud, waste, and abuse
  www.gao.gov/fraudnet/fraudnet.htm
  fraudnet@gao.gov
  1-800-424-5454
What We Use

Source: GAO.
What We Use

The Fraud Risk Management Framework

- Confront: combating fraud by enforcing an active, robust, and comprehensive crime detection and reporting program

- Assess: regular fraud risk assessments and an annual review of fraud risk management

- Commit: a culture and commitment to fraud risk management

- Monitor and adapt: monitor the environment and report outcomes

Design and implement a strategy for fraud response and control solutions to mitigate assessed fraud risk

Source: GAO, GAO-15-992SP
The Federal Purchase card program
– Grew from less than $1 billion in 1994 to about $19 billion in 2017.
– Initial focus was on getting programs up and running.
– Audits identified control weaknesses and vulnerabilities to fraud.
GAO’s Approach to Auditing Purchase Card Programs

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Understanding the Purchase Card Program

Evaluating the adequacy of internal control designed to mitigate the risk of fraudulent, improper, and abusive transactions, requires the auditor to gain an in-depth understanding of:

– The risk of fraud
– The relevant laws and regulations and
– The specific organization’s mission activity operations and its purchase card program operations (from purchase request to payment).
Definition of Fraudulent, Improper, and Abusive Activity

**Fraudulent purchases**

- Use of the government purchase card to acquire goods or services that are unauthorized and intended for personal use or gain constitute a fraud against the government.

- Examples include a cardholders’ unauthorized purchase of power tools for his home, a vendor’s intentional charges for services not provided, and the unauthorized use by a third party of a cardholder’s compromised or stolen account for personal gain.

- Generally referred to as “potentially fraudulent” unless there has already been a fraud conviction in a court of law.
Definition of Fraudulent, Improper, and Abusive Activity

*Improper purchases*

- Government purchase card transactions that are intended for government use but are not permitted by law, regulation, or organization policy.

- Examples include certain types of purchases of meals or refreshments for government employees within their normal duty stations, purchases split to circumvent micropurchase or other single purchase limits, and purchases from other than statutorily designated sources.
Abusive purchases

- Purchases of authorized goods or services at terms (e.g., price, quantity) that are excessive, are for a questionable government need, or both are considered abusive.

- Examples include purchases of items such as $300 day planners, $350 bedside radios, and allowable refreshments at excessive cost; purchases of designer leather goods, and year-end and other bulk purchases of computer and electronic equipment for a questionable government need.
Indications and Categories of Fraud

Signs, signals, and patterns indicating the potential for fraud
- Weak management
- Failure to follow legal or technical advice
- Unethical leadership
- Weak internal controls
- Promise of gain with little likelihood of being caught
- Missing or altered documents
- History of impropriety
- Unexplained decisions, transactions, or both
Indications and Categories of Fraud

*Theft* involves property, facilities, and services. An authorized or unauthorized cardholder purchase of goods or services intended for personal use or gain.
Indications and Categories of Fraud

_Fictitious transactions_ can involve a single party (e.g., a cardholder supports the acquisition of goods or services for personal use with false documentation, or a vendor bills the government for goods or services never delivered). Fictitious transactions can include collusion (e.g., a cardholder knowingly approves documentation supporting a vendor’s invoice for goods or services never provided).
**Kickbacks** may be offered by a vendor or solicited by a contractor or government buyer. Kickbacks in a government purchase card program can include collusion between a cardholder and a vendor. The cardholder makes authorized purchases from the vendor, who charges the government an excessive price and “kicks back” a percentage of the amounts received to the cardholder.
Indications and Categories of Fraud

Conflict of Interest is present when a government official participates in approving or deciding a matter in which the official or a relative has a financial interest. The potential for a conflict of interest in a purchase card transaction exists whenever a cardholder or a relative has a significant financial interest in a vendor or contractor.
Understanding the Purchase Card Program
Laws and Regulations

Establishment and Operations of the Purchase Card Program
– Federal organization purchase card programs must comply with the terms of the GSA SmartPay® Master Contract and the task order under which the organization placed its order for purchase card services.
– Organization purchase card programs must also comply with the Department of Treasury Financial Manual.
– Individual organizations may be subject to specific statutory criteria for the management of purchase cards.
Procurement Methods and Standards

- Purchases made with the purchase card should be made in accordance with generally applicable procurement laws, regulations, and organization procurement policies and procedures.
- FAR provides governmentwide policies and procedures for acquisition by all executive agencies.
- Agencies frequently issue supplemental acquisition regulations as well.
Understanding the Purchase Card Program
Operations and Programs

Need to understand organization operations:
– The nature and size of overall operations
– What the individual activities involved in the purchase card program do and how they do it;
– The general job descriptions, level of education, and number of personnel in those activities; and
– The volume and appropriate type(s) of purchase activity to expect.
Understanding the Purchase Card Program Operations and Programs

Need to understand the organization’s purchase card programs:

– Review existing documents such as purchase card program descriptions, policies and procedures, operational manuals or instructions
– Conduct interviews with program personnel
– Conducting walk-throughs of selected purchase card transactions is a key process.
– Coordinate the audit effort with the bank service provider.
Put simply, internal control is a process used by management to help an entity achieve its objectives.
# Introduction to Internal Control Components and Principles

## Components

- **Control Environment**
- **Risk Assessment**
- **Control Activities**
- **Information & Communication**
- **Monitoring**

## Principles

1. Demonstrate Commitment to Integrity and Ethical Values
2. Exercise Oversight Responsibility
3. Establish Structure, Responsibility, and Authority
4. Demonstrate Commitment to Competence
5. Enforce Accountability
6. Define Objectives and Risk Tolerances
7. Identify, Analyze, and Respond to Risk
8. Assess Fraud Risk
9. Analyze and Respond to Change
10. Design Control Activities
11. Design Activities for the Information System
12. Implement Control Activities
13. Use Quality Information
14. Communicate Internally
15. Communicate Externally
16. Perform Monitoring Activities
17. Remediate Deficiencies

Source: SASO
Recent GAO purchase card audit reports have identified the following six elements as significantly affecting the control environment surrounding a purchase card program:

- Management’s philosophy (tone at the top)
- Span of control
- Financial exposure
- Training
- Discipline
- Purchasing and reviewing authorities
Assessing the Adequacy of the Design of Control Activities

Our audits of purchase card programs have the following six areas as key transaction-level control activities in mitigating the risk of fraudulent, improper and abusive purchases:

– The determination of a legitimate government need
– Screening for required sources of supply
– Independent receipt and acceptance
– Establishing accountability over certain property
– Cardholder reconciliation and
– AO review
Testing the Effectiveness of Key Control Activities

In our audits of purchase card programs, we used two basic types of control testing to evaluate the effectiveness of internal control activities:

– Statistical sampling

– Nonrepresentative selections
Pursuing Fraudulent, Improper, and Abusive Purchases

GAO’s purchase card methodology includes procedures designed specifically to identify potentially fraudulent, improper, and abusive purchase card transactions and it entails:

– Data mining

– Conducting follow-up procedures using forensic auditing techniques on selected transactions and on cases of potentially fraudulent purchases detected during the audit process.
Summary of Audit Approach

• Obtain a detailed understanding of the process
• Identify key controls and obvious vulnerabilities
• Sample transactions to test the effectiveness of key controls
• Obtain data file of all transactions
Summary of Audit Approach

- Use data mining and file comparisons to identify unusual transactions
- Analyze supporting documentation
- Consult with investigators and legal counsel to identify improper payments
- Verify that real property was actually recorded in the agency’s property records
GOVERNMENTWIDE PURCHASE CARDS

Actions Needed to Strengthen Internal Controls to Reduce Fraudulent, Improper, and Abusive Purchases
GOVERNMENT PURCHASE CARDS

Little Evidence of Potential Fraud Found in Small Purchases, but Documentation Issues Exist
Concluding Remarks

- Purchase card abuse has received high-level attention through audits, congressional oversight, and legislative mandates.

- Federal agencies have taken action to improve purchase card program controls and strengthen oversight and monitoring.

- Continuing efforts on data mining, investigations of fraud and abuse, and disciplinary actions are key to an effective purchase card program.
Questions

• Your turn:
  – Questions
  – Comments
  – Experiences
GAO on the Web

Web site: http://www.gao.gov/

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