INTEGRITY MONITORS:

A strategy for preventing, detecting, and remediating fraud, waste, and abuse in infrastructure programs

CohnReznick

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INTEGRITY MONITORS: AN INTRODUCTION

Large infrastructure programs, such as IIJA and ARPA, also come with large opportunities for fraud, waste, and abuse. An effective strategy for preventing, detecting, and remediating, fraud, waste, and abuse is to use integrity monitors.

An integrity monitor is an independent third party retained by a company or organization to minimize opportunities for fraud, waste, and abuse, and to help assure compliance with legal and regulatory requirements. The role of an integrity monitor has evolved to include not only fraud prevention, but also the protection of public funds and private investments from loss, theft, or mismanagement in various programs and industries.

By employing the skills of multiple disciplines such as auditing, legal, investigative, engineering, project management, and loss prevention, an integrity monitor works to create a culture of legal and regulatory compliance and accountability. This is accomplished through training, monitoring of controls and activities, and performing compliance audits. The benefits of an integrity monitoring program include many things, most notably the protection of an agency or organization's assets, business reputation, and operations.

With the integrity monitoring strategies outlined in this whitepaper, agencies can begin to formulate a plan for using integrity monitors to potentially save millions of dollars lost to fraud, maintain taxpayer confidence, and help ensure on-time, on-budget missions.

INSPECTOR GENERAL ACT OF 1978 PROVIDES THE FRAMEWORK FOR INTEGRITY MONITORING

The *Inspector General Act of 1978* centralized audit and investigative activities in a single independent office within each of the major federal agencies. The purpose of the Act is to:

- Conduct and supervise audits and investigations relating to programs and operations of agencies

- Provide leadership and coordination, and recommend policies for activities designed to promote economy, efficiency, and effectiveness in the administration of, and to prevent and detect fraud and abuse in, such programs and operations

- Provide a means for keeping the head of the establishment and the Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and operations and the need for corrective action

The Act serves as the framework for creating an integrity monitoring program. With the passage of the *Inspector General Reform Act of 2008*, the independence of the Inspectors General has been enhanced and the Council of the Inspectors General on Integrity and Efficiency (CIGIE) was formed.

VULNERABILITY OF THE INFRASTRUCTURE INDUSTRY

While few industries are impervious to fraud, the unique nature of the infrastructure industry makes it particularly vulnerable. A typical infrastructure project brings together many stakeholders and large sums of money for a relatively short span of time. With so many parties coming on and off the project at various stages and innumerable financial transactions being made, a typical infrastructure project creates an environment conducive to fraud and corruption. No one is immune: contractors, developers, government agencies, workers and, of course, taxpayers have all been victimized.

Why is there so much corruption? There are two primary reasons: a high degree of susceptibility and numerous incentives.

Susceptibility

The infrastructure industry is susceptible to corruption and racketeering for a variety of reasons that include:

- **Multiple parties:** Typically, there are multiple parties (e.g., owners, representatives, construction managers, general contractors, subcontractors, consultants, suppliers) moving on and off of a project, and aggregating thousands of workers.

- **Multiple critical components:** These components are subject to control by corrupt actors, such as union officials who can control labor, material costs, and schedule.

- **High government regulation:** Many public projects are highly regulated at each layer of the project, which makes them susceptible to corrupt public officials.

- **Time is money:** Since disruptions to a construction schedule equate to increases in project costs and delays in the project owner's return on investment. Time delays and anything or anyone (e.g., contractors, suppliers, union officials, and inspectors) that can interrupt the sequencing or timing of construction makes a construction project more susceptible to corruption.

- **Low bid contracts:** Government agencies are often required to award contracts to the lowest bidder. Low bid contracts entice unscrupulous contractors to "recover" their profits in some manner. Many times they will employ a fraud scheme such as billing for work not performed or materials not used.

- **Illegal payments:** Crooked contractors will include bribes in the cost of doing business as they may help in obtaining favorable labor contracts with corrupt unions. Bribes can be included in the cost of doing business by crooked contractors. This is usually done to help obtain favorable labor contracts with corrupt unions.
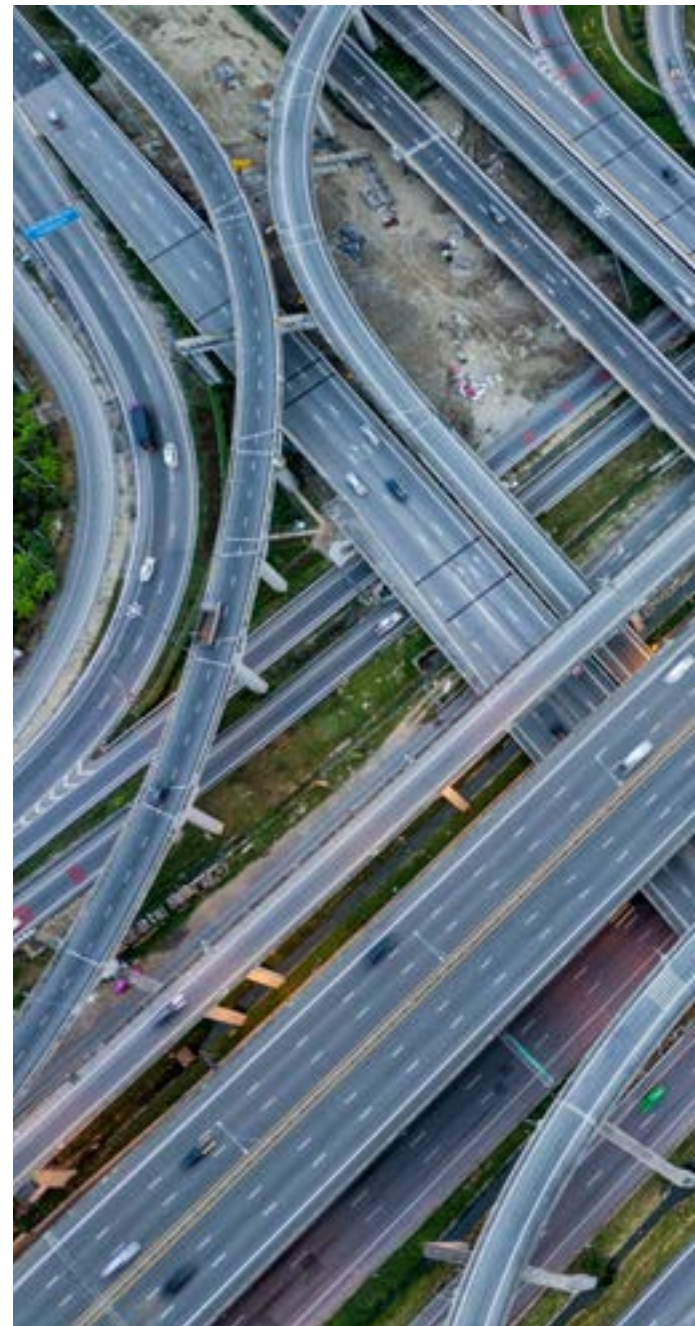
Incentives

There are numerous incentives that make infrastructure projects susceptible to corruption. Some of these include:

- **Infrastructure projects involve enormous sums of money:** Huge dollar value contracts make even a small skim very profitable. For example, One World Trade Center is a $4 billion construction project. A skim of 1% equates to $40 million.

- **Costs of illegal payments can be easily acquired and disguised:** Because of the large number of contractors usually working on a construction project, it can be very difficult to prevent illegal payoffs during the construction process and is just as difficult to discover them after the project is completed.

- **Ancillary incentives:** The market for illicit goods and services – such as gambling, drugs, and loan sharking – can attach themselves to a construction site. In some instances, the funds generated from such activities are laundered through the construction company. In addition, the sale of ancillary services – such as food vendors, trash removal, and security – can also find their way onto a construction site.

- **Valuable nonmonetary rewards exist:** It's possible for labor racketeers to obtain political power through their control of political action committees and their ability to deliver votes.

Types of Crime

Examples of integrity issues as well as the related corruption and racketeering that have plagued the industry over the years include the following:

- **Extortion and bribery:** Payments squeezed from contractors by union or public officials to avoid direct or implied threats are generally characterized as extortion. Extortion is usually the result of union officials demanding payments from contractors by threatening to cause labor problems through a disruption of schedule, sabotage to the project, or physical harm to the contractor's employees. When payments are made to gain an unfair advantage in winning contract awards, these payments are considered bribes. Bribes given to or solicited by the government are usually paid in exchange for contracts and building permits.

  In addition, public officials have accepted bribes from contractors who commit legal and regulatory violations and want officials to "look the other way." With respect to union officials, bribes come in many forms such as favorable union labor contracts or the lack of enforcement of collective bargaining provisions.

- **Theft:** Construction equipment and material theft and vandalism account for $1 billion a year in losses and other costs to contractors, a number that has risen 10% since 1996 and is expected to continue to increase, according to a For Construction Pros article. The impact of construction job site theft also includes the costs contractors incur to replace or rent equipment to finish the job, the costs of downtime, and the costs of project overruns resulting from project delays.

- **Fraud:** Construction fraud occurs in a variety of ways, but one of the most prevalent schemes involves submitting invoices for work not performed and materials not used.

- **Intimidation and violence:** Threats by organized crime elements or corrupt union officials have often been used to attempt to exact payments from contractors to avoid problems on their projects.

- **Sabotage:** Contractors and developers are subject to the "purposeful destruction of materials, fixtures, or structures" by corrupt union workers, or so-called "coalitions" or "community activists." Sabotage can occur either as punishment to a contractor or developer, or to serve as a means for creating more work for union workers. In either case, the contractor must incur additional costs to address threats and acts of sabotage.

- **Collusive bidding/bid rigging:** In its "Guidelines for Fighting Bid Rigging in Public Procurement", the Organisation for Economic Co-operation and Development (OECD) states that "bid rigging" (or collusive tendering) occurs when businesses that would otherwise be expected to compete secretly conspire to raise prices or lower the quality of goods or services for purchasers who wish to acquire products or services through a bidding process. Public and private organizations often rely upon a competitive bidding process to achieve better value for money. Low prices and/or better products are desirable because the result is resources either being saved or freed up for use on other goods and services. The competitive process can achieve lower prices or better quality and innovation only when companies genuinely compete (i.e., set their terms and conditions honestly and independently).

  Bid rigging can be particularly harmful if it affects public procurement. Such conspiracies take resources from purchasers and taxpayers, diminish public confidence in the competitive process, and undermine the benefits of a competitive marketplace, including work for honest contractors and their employees." As noted below, organized crime has most often been identified as the source behind much of the anti-competitive practices plaguing the industry.

BEST PRACTICE: INTEGRITY MONITORING PROGRAM

Real-time monitoring prevents errors and improprieties

The best way to address corruption, fraud, waste, and abuse is to prevent it from happening in the first place. A system is needed to create synergies among agencies; one that leverages government resources and utilizes private sector capabilities to oversee activities, define accountability, and leverage the sizeable resources devoted to public construction as a means to directly and indirectly influence the conduct and integrity of construction projects.

Utilizes the skills of multiple disciplines such as auditing, legal, investigative, engineering, project management, and loss prevention, an integrity monitoring program can be an effective way of addressing problems before they occur. It can also be employed by an entity on either a voluntary or compulsory basis to help ensure compliance with laws and regulations, and to deter, prevent, uncover, and report unethical and illegal conduct by, within, and against an organization. In addition, an integrity monitoring program can be used as a strategy in any industry or organization that has problems related to unethical behavior. Integrity monitors have been used in the construction, financial, environmental, aircraft, gambling, pharmaceutical, insurance, and garment industries, to name a few.

Even police departments have been subject to an integrity monitor. In fact, there are few industries that have not been subject to an integrity monitor since the concept first came into use in the early 1990s.

An effective strategy for preventing and detecting fraud, waste, and abuse

An integrity monitor is responsible for assessing the project, program, or organization, and determining the potential for corruption, fraud, waste, abuse, and violations of laws and regulations. An integrity monitor's responsibility includes developing an integrity monitoring program that considers the current internal control environment of the subject being monitored. Using the information from its initial assessment, the integrity monitor identifies weaknesses or vulnerabilities in the current internal control environment, and makes recommendations on how to address these shortcomings, and monitors the implementation of the recommended solutions.

If done correctly, the integrity monitor can utilize the work of various professionals, such as auditors, investigators, legal professionals, and loss prevention professionals, to create an integrated monitoring program and approach. For example, legal and loss prevention professionals will identify violations of laws and regulations, and develop policies, procedures, and strategies to prevent these violations from occurring in the future. The implementation of these activities then becomes the responsibility of the auditors and investigators.

An integrity monitor serves to make a good organization better or to change the ethical culture of an entity in need of that change. Corporations may use integrity monitors to help ensure that they are not defrauded or exploited by others, particularly in industries that have had a history of corruption and racketeering. The integrity monitor can provide services that prevent a corporation from being extorted by commercial entities and corrupt public officials, and to help ensure that it receives the goods and services for which it has contracted.

A solution for government-funded programs oversight and transparency

Government agencies are using integrity monitors to oversee federal and state program funds, provide transparency of these programs and their outcomes, and prevent and detect fraud, waste, and abuse. Any state agency administering a contract in excess of a certain dollar threshold is required to use an integrity monitor to oversee its administration of these federal funds.

The integrity monitor's work includes:

- Monitoring the agency's compliance with federal and state laws and regulations in administering the federal funds
- Monitoring the activities of contractors conducting work on behalf of the agency
- Monitoring whether the programs are operating accurately, efficiently and effectively
- Monitoring the effectiveness of the agency's internal controls
- Monitoring the agency's fraud prevention and detection activities

For example, for a state grant program, the integrity monitor may test grant recipients' eligibility while monitoring the providing of grants to help ensure fraud is not committed at any level.

The integrity monitor is responsible for reporting the results of its monitoring activities to various state and federal government stakeholders, and for referring any potential instances of fraud or wrongdoing to a state's comptroller and attorney general. In short, federal and state governments are turning to integrity monitors as a way of managing the risks associated with overseeing federal and state program funds.

A solution for dealing with organizations challenged by integrity issues

Integrity monitors have been utilized to promote organizational integrity in organizations under court decrees resulting from civil or criminal prosecution by companies unable to pass rigorous pre-qualification requirements, by those who face public relations difficulties, and as part of a deferred prosecution agreement, which serves as an alternative to a corporate indictment resulting from the illegal activities of the corporation's employees. Integrity monitors have been required as a condition of performing certain exclusive government contracts and as a means of fulfilling the monitoring requirements of federal

sentencing guidelines. The integrity monitors' objectives are to deter and detect misconduct by the monitored firm, rehabilitate the vendor in both fact and perception, and assure corporate adherence to high ethical standards. Integrity monitors serve as compliance monitors and assure the adequacy of internal controls and the adherence to business ethics. Integrity monitors fulfill their roles by conducting monitoring activities that include monitoring ethics compliance through systems compliance audits, fraud prevention hotlines, and, if necessary, investigations and financial audits.

A solution for companies working internationally

Integrity monitors can be effective in helping companies operating internationally by protecting the domestic organization from illegal activities by its employees, other corporations, and extortive demands by foreign corrupt public officials. They can also provide assurance to domestic and foreign governments that the company is free from organized crime ownership and influence, and that it has appropriate controls to make sure its operations conform to local laws and regulations.

Project integrity consultants

An integrity monitor may be hired as an owner's representative in certain instances. The integrity monitor works closely with the project owner and their operations, operates as part of the owner's management team (but assumes no operational responsibilities), has a project-wide/site-wide focus, and is paid directly by the owner. In this role, the integrity monitor is focused exclusively on assuring that integrity breaches do not derail project budgets, operations, or reputations.

DEVELOPING AN INTEGRITY MONITORING PROGRAM

An integrity monitoring program should be tailored to the scope and objectives of the particular integrity monitoring engagement. However, an integrity monitoring program typically will include the following five major phases in some shape or form:

1. Gain an understanding of the scope and primary objectives

The first phase is focused on obtaining a clear understanding of the business environment, organizational structure, company culture, key objectives, communication channels, points of contact, and how the internal control structure is designed to operate in order to mitigate risk. This phase is accomplished by meeting with key management and other necessary stakeholders, and reviewing appropriate documentation such as top-level corporate policies and procedures, codes of conduct, contracts, funding mechanisms, financial plans, budgets, and schedules. This scoping exercise will provide a solid foundation for gaining a comprehensive understanding of the internal control environment, conducting the integrity risk assessment, and preparing the Project Work Plan (PWP)

2. Conduct an integrity risk assessment

A proactive risk management program is a key element contributing to the successful management of large, complex projects or programs. As projects grow larger and more complex, it is becoming common practice for the project team to establish a risk management process that is able to identify, track, manage, and mitigate potential risks. It is also important to recognize that risk management is an ongoing project management function that is imperative because risk drivers evolve over the lifecycle of a project, requiring new strategies to manage and mitigate the threats.

In this phase, the integrity monitor will conduct risk assessments and workshops and develop a well-defined and integrated risk management process that provides the project team the tools and procedures needed to manage risk. Depending on the project risk profile, the project team may decide to use a relatively simple and straightforward qualitative approach, or a more rigorous quantitative assessment using modeling and simulation techniques. In either case, the process involves identifying and categorizing potential risks, assessing the likelihood of occurrence and magnitude of risk impacts, and prioritizing and managing risks (i.e., avoid, mitigate, transfer, insure, or accept). Typically, a risk register (matrix or spreadsheet) is developed to document, monitor, and control risks during the project.

Risk workshops require the project team to develop qualitative risk assessment matrices for allocating contractual risks to the party best able to control and manage them. Other risk exercises involve assessing risk impacts to budget, schedule, and project integrity.

Risk is defined as an internal or external force that could impact the achievement of an entity's business objectives. The use of a risk assessment methodology allows risks to be more efficiently targeted and controlled while providing senior management assurance that the internal audit plan has been properly designed to assist in mitigating risk.

To perform an integrity risk assessment, the integrity monitor will interview key internal management personnel, and review policies and procedures and other relevant information obtained from the organization's staff and management. The integrity monitor will seek to determine whether the internal controls are operating as represented by management and are working effectively to protect critical business processes and mitigate integrity risks. Based on the information obtained from the business functions interviewed, the integrity monitor will prepare a summary and ranking of important risk areas.
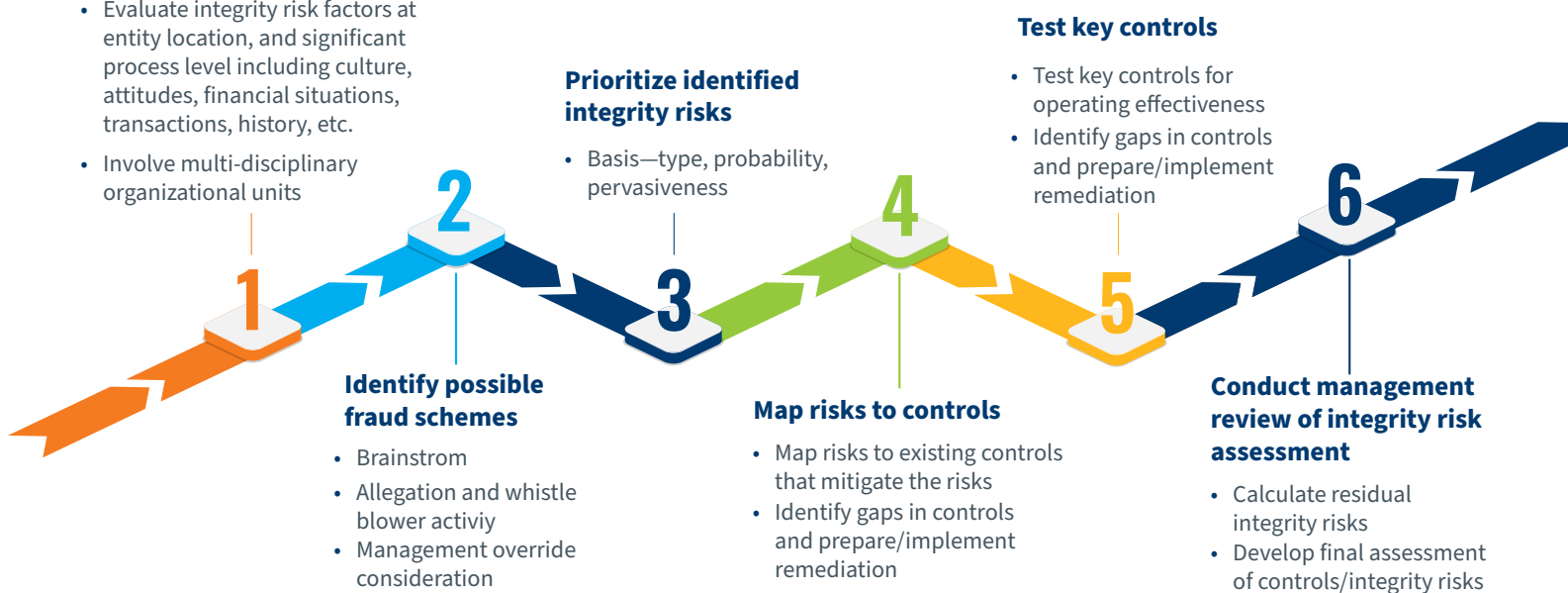
Integrity risk assessment process

An integrity risk assessment is a collaborative process intended to analyze risk exposure and the controls that mitigate such risk. The integrity monitor works with the stakeholders to address the primary areas of concern with regard to integrity risk exposure – irrespective of functional boundaries – and identify the controls in place to mitigate the risks. Where controls are weak or absent, the integrity monitor will brainstorm ways to efficiently and effectively remediate the control deficiencies, and improve the overall fraud prevention program. The diagram below depicts the key steps in this approach.

The integrity/risk assessment process utilizes a standardized, qualitative, and quantitative methodology to evaluate the integrity risk exposure of each relevant business process, and is designed to provide the organization's management with a tool to quantify the relative risk of specific business processes and functions. The purposes of the risk assessment are to:

- Identify the threats and vulnerabilities from both internal and external forces that could create opportunities for fraud, waste, corruption, and abuse
- Identify integrity risk items that should be addressed by management
- Provide the foundation for developing the integrity monitoring program
- Provide assurance that the integrity monitoring program has been properly designed to assist in mitigating risk
- Identify key areas of risk and make recommendations for improvement and for future audit priorities

Evaluate integrity risk factors

- Evaluate integrity risk factors at entity location, and significant process level including culture, attitudes, financial situations, transactions, history, etc.
- Involve multi-disciplinary organizational units

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2

Identify possible fraud schemes

- Brainstrom
- Allegation and whistle blower activiy
- Management override consideration

Prioritize identified integrity risks

- Basis—type, probability, pervasiveness

3

4

Map risks to controls

- Map risks to existing controls that mitigate the risks
- Identify gaps in controls and prepare/implement remediation

Test key controls

- Test key controls for operating effectiveness
- Identify gaps in controls and prepare/implement remediation

5

6

Conduct management review of integrity risk assessment

- Calculate residual integrity risks
- Develop final assessment of controls/integrity risks

An example of potential integrity risk areas on a typical infrastructure project include, but are not limited to:

- Vendor selection/bidding
- Payroll fraud
- Fraudulent/inaccurate requisitions
- Fraudulent billing for equipment and/or materials
- Insurance and bonding fraud
- General conditions
- Other direct costs and reimbursable expenses
- Change order fraud
- Charge back fraud
- Lien releases
- MBE/WBE/DBE fraud
- COI mitigation
- Bribing of oversight personnel
- QA/QC material substitutions and workmanship
- Schedule manipulation
- Environmental compliance
- Site security

3. Develop a project work plan for the monitoring activity

Once the integrity risk assessment is complete, the integrity monitor will develop a PWP based on the finalized audit universe and corresponding integrity risk audit and mitigation plan. The PWP will identify each integrity risk area along with an assigned risk rating, mapping of the risk to key controls, and recommended audit cycle. During this phase, the integrity monitor will communicate closely with the stakeholders to ensure that the plan will meet their goals and objectives. During the project, the integrity monitor will continue to review the PWP and update it as necessary to address evolving conditions.
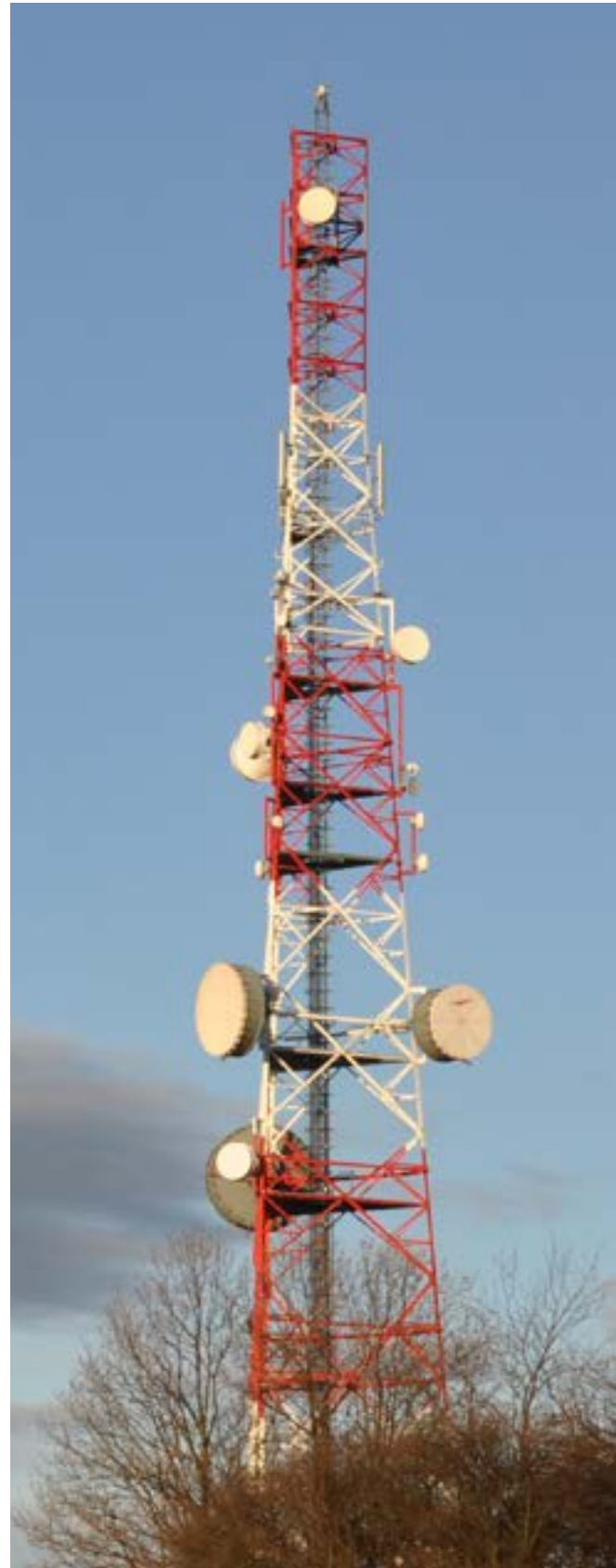
PROJECT INTEGRITY RISKS

1. Bid Rigging
2. Collusion
3. Change Order Fraud
4. M/WBE Fraud
5. Labor Racketeering
6. Material Substitutions
7. Inflated Invoicing
8. Time and Material Fraud
9. Kickbacks
10. Bribery
11. Self dealing/Conflicts of Interest
12. Insurance Fraud
13. Vandalism
14. Theft
15. Sabotage

RISK MANAGEMENT

Enhanced Integrity contract provisions
• Breach of Integrity Sanction Provision
• Fair and Ethical Business Practices
• Enhanced Audit/Investigation Clause
• Non-Collusive Bidding Certification
• Subcontractor Approval
Code of Ethics
Ethics and Compliance Traning
Ethics Hotline
Ubiquitous Ethics/Integrity Signage Contractor and Vendor Screening

• Contractors on Notice that "Integrity Counts"
• Elimination of Integrity Imparied Firms
Integrity Certifications
Integrity Compliance Audits
• Audit of controls and Compliance
• Spot Monitor Bid Solicitation and Levelling
• Spot Audit of Payment Regs
Spot Audit of Change Orders
Onsite Presence
Investigation as Required

PREVENTION, DETECTION AND REMEDIATION

Minimizes Fiscal and Reputational Risks

Enhances Financial Recoveries

4. Execute the project work plan

In accordance with the PWP, the integrity monitor will monitor selected areas of concern throughout the various phases of the project. Based on the initial assessment of the business under review and discussions with stakeholders, the integrity monitor will execute the planned monitoring activity. Below is an example of procedures that can be implemented to prevent and mitigate integrity risks.

5. Report on the results of the monitoring activity

During the development and implementation of the integrity monitoring program, the integrity monitor will deliver status reports and key documents, such as the risk assessment and PWP, to the stakeholders. During the course of any integrity monitoring program, however, issues will arise that were not anticipated. When such issues arise, the integrity monitor communicates these issues, as well as the program's progress, to the stakeholders through each phase of the integrity monitoring program. If requested, a report concerning such issues is prepared. At the conclusion of monitoring activity, the integrity monitor will prepare and submit to the stakeholders a monitoring, audit, or investigative report describing the scope of the activity, background information, procedures, findings, conclusions, and recommendations.

WHAT DOES COHNREZNICK THINK?

To combat fraud, waste, and abuse in infrastructure programs, government agencies and private companies can reduce their risk of exposure by utilizing the services of integrity monitors. Since the introduction of the concept in the early 1990s, integrity monitors have been used successfully on a number of major disaster recovery and infrastructure efforts. These independent advisors serve as stewards of program and project funds, helping ensure funds are used as originally intended. As evidenced by the daily headlines, the imagination of the criminal mind is limitless. Consequently, fraud, waste, and abuse will continue to challenge even the most fortified of projects. However, by employing the services of an integrity monitor, companies and agencies can save significant project or program dollars by preempting and/or uncovering fraudulent behaviors. Moreover, integrity monitors can help private and public entities avoid the consequences of a tarnished image and breach of trust that threaten organizations tainted by fraudulent practices. When implemented correctly, an integrity monitoring program can be cost effective.

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Information from Ronald Goldstock's book, "Corruption and Racketeering in the New York City Construction Industry: The Final Report of the New York State Organized Crime Taskforce" was used to write this whitepaper.

About CohnReznick

As a leading advisory, assurance, and tax firm, CohnReznick helps forward-thinking organizations achieve their vision by optimizing performance, maximizing value, and managing risk. Clients benefit from the right team with the right capabilities; proven processes customized to their individual needs; and leaders with vital industry knowledge and relationships. Headquartered in New York, NY, with offices nationwide, the firm serves organizations around the world through its global subsidiaries and membership in Nexia International.

For more information, visit www.cohnreznick.com

America's Infrastructure Advisor

With combined expertise in key infrastructure industries (Construction, Energy, Transportation, Broadband, Housing, and Water) and federal funds administration ($50B+) CohnReznick is committed to its role as "America's Infrastructure Advisor." Our multidisciplinary infrastructure team understands the many complexities of government funding, major programs like IIJA and ARPA, and how federal, state, and local government agencies can work with private companies and investors to improve communities across the United States.

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