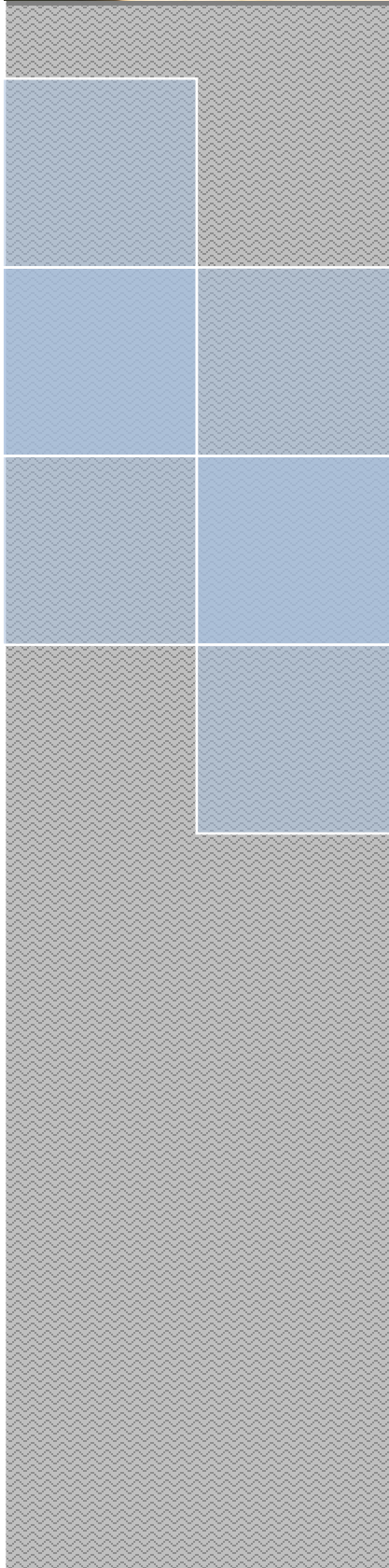




# PROCUREMENT FRAUD HANDBOOK



**U.S. General Services Administration  
Office of Inspector General  
Office of Audits**

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GSA OIG PROCUREMENT FRAUD HANDBOOK

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# INTRODUCTION

This handbook, prepared by the General Services Administration (GSA) Office of Inspector General (OIG), aims to increase awareness of auditor responsibilities related to procurement fraud and to provide guidance in addressing fraud risk in contract audits. The goal of this handbook is to provide contract auditors with the necessary knowledge to identify fraud indicators and make referrals when appropriate.

The handbook is divided into three sections. The first section details the auditor's responsibilities related to fraud throughout the audit process. The second section summarizes the types of audits GSA OIG performs, describes common types of procurement fraud, and provides specific indicators that may be encountered. The third section describes common criminal charges, civil remedies, and administrative actions that may be applicable if fraud has occurred. Audit checklists and pertinent contract clauses are included as appendices.

Designing audits to detect fraud indicators and recognizing those indicators requires creativity and knowledge, along with an attitude of professional skepticism.<sup>1</sup> Approaching each audit with fraud indicators in mind provides the auditor with the proper alertness and awareness needed to assess different situations.<sup>2</sup> Auditors are not responsible for proving fraud. However, auditors are responsible for identifying and reporting fraud indicators.

In late 2009, GSA Inspector General Brian Miller approved a proposal to adopt examination-level auditing standards for attestation engagements covering contract audits.<sup>3</sup> The change affects preaward and postaward contract audits, as well as construction cost or pricing audits of claims, change orders, terminations and architect/engineer proposals and requires additional steps to address the risk of fraud.

The Government Auditing Standards, commonly referred to as the Yellow Book, state that, for examination-level engagements,

“Auditors should design the engagement to detect instances of fraud and noncompliance with provisions of laws, regulations, contracts and grant agreements that may have a material effect on the subject matter or the assertion thereon of the examination engagement. Auditors should assess the risk and possible effects of fraud and noncompliance with provisions of laws, regulations, contracts and grant agreements that could have a material effect on the subject matter or an assertion about the subject matter of the examination engagement. When risk factors are identified, auditors should document the risk

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<sup>1</sup> The Government Auditing Standards published by the Comptroller General of the United States defines professional skepticism as “an attitude that includes a questioning mind and a critical assessment of evidence.”

<sup>2</sup> Department of Defense OIG Handbook on Fraud Indicators for Contract Auditors: <http://www.auditnet.org/Guides/fraudcontractindicators.pdf>

<sup>3</sup> The Office of Audits implemented the change in April 2010. Prior to this change, the Office of Audits had been performing at review-level standards, allowing the auditor to only express negative assurance. Under examination-level standards, auditors may express an opinion on the subject matter to provide positive assurance.

factors identified, the auditor's response to those risk factors individually or in combination, and the auditors' conclusions."

The Inspector General Act of 1978 established the OIGs' primary responsibilities to the American public: detect and prevent fraud, waste, abuse, and violations of law; and promote economy, efficiency, and effectiveness in the operations of the federal government. GSA OIG's mission is to help GSA effectively carry out its responsibilities and to protect the public interest by bringing about positive change in the performance, accountability, and integrity of GSA programs and operations. Thus, as OIG employees, it is our responsibility to ensure that taxpayer money is spent in the public's best interest. This includes addressing the possibility of fraud in GSA operations.

## THE FRAUD AUDIT PROCESS

The specific definition of fraud varies by legal jurisdiction. Generally, fraud is defined as a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment, a misrepresentation made recklessly without belief in its truth to induce another person to act, and unconscionable dealing.<sup>4</sup> A common law act of fraud must contain the following elements: false representation or concealment of a material fact, knowledge of a statement's falsity, intent to deceive, reliance by the deceived party, and damage to the deceived party. The civil False Claims Act modifies this definition to include reckless disregard.<sup>5</sup>

Each year, potentially billions of dollars in federal funds are lost as a result of procurement fraud. As OIG employees, it is our job to prevent and detect this waste of taxpayer dollars. To do so, the auditor should approach each audit with an attitude of professional skepticism.

Thinking about and addressing fraud risk is a continuous process throughout the contract audit. At the inception of each audit, the audit team should hold a brainstorming conference to stimulate ideas related to fraud, specific to the contractor under audit. During the site visit, the auditor should obtain risk information to determine the likelihood of brainstormed risks. After risk information is obtained, the auditor should assess the risks and corresponding controls to determine if additional action is required. If deemed necessary, the auditor should respond to the risks by creating tests to confirm their presence.

Finally, the auditor should evaluate the risks and communicate them to the appropriate parties. As always, it is imperative that the auditor clearly document all procedures, analysis, and discussions related to the assessment of fraud.<sup>6</sup>

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<sup>4</sup> Black's Law Dictionary (9<sup>th</sup> ed. 2009)

<sup>5</sup> 31 U.S.C. § 3729(b)

<sup>6</sup> The fraud audit process diagram is based off a presentation located on the Palmer College website, titled SAS 99 – Consideration of Fraud in a Financial Statement Audit:  
[http://www.palomar.edu/fiscal\\_services/NewWebsite/pdfs/Fraud\\_SAS\\_99\\_Power\\_Point1.pptx](http://www.palomar.edu/fiscal_services/NewWebsite/pdfs/Fraud_SAS_99_Power_Point1.pptx).  
[http://www.palomar.edu/fiscal\\_services/NewWebsite/LeftNav/PoliciesAndProcedures.html](http://www.palomar.edu/fiscal_services/NewWebsite/LeftNav/PoliciesAndProcedures.html)



Brainstorming is the first step in addressing the risk of fraud in the audit process. A brainstorming session should be held during the planning phase, prior to the fieldwork phase, and should be revisited, as necessary, throughout the audit.

Brainstorming is defined as “a conference technique of solving specific problems, amassing information, stimulating creative thinking, developing new ideas, etc., by unrestrained and spontaneous participation in discussion.”<sup>7</sup> The purpose of a brainstorming session is to stimulate a free flow of ideas from all levels of the audit team related to fraud. This should include the Regional Inspector General for Auditing (RIGA),<sup>8</sup> audit manager, auditor in-charge, and staff auditors. The more individuals present, the more ideas will be generated, and the more productive the discussion will be. Furthermore, it is highly recommended that objective third parties be invited to the conference to provide a fresh perspective to the discussion.

It is important to stimulate an open and comprehensive discussion among conference members. Therefore, the audit team should create an environment that encourages the sharing of ideas, as well as personal experiences. It is recommended the audit team allot at least one hour for discussion.

<sup>7</sup> Statement on Auditing Standards (SAS) No. 99: *Consideration of Fraud in Financial Statement Audits*

<sup>8</sup> or Deputy Assistant Inspector General for Auditing (DAIGA)

Prior to holding a brainstorming session, the audit team must perform extensive research into the contractor. Preparation for the brainstorming conference can be found in the Teammate audit guide.<sup>9</sup> Auditors should conduct online research, run a Dun and Bradstreet (D&B) report, review financial disclosures, search for prior investigations/referrals for investigation, read prior audit reports, and contact contracting officials.<sup>10</sup> Additionally, on construction contract audits, consideration of a contractor's deficient proposal submission, such as inconsistent treatment of costs or submission of expressly unallowable costs, should be scheduled for discussion. On American Recovery and Reinvestment Act (Recovery Act) projects, the Recovery Act Accountability and Transparency Board (RAAT Board) web site should be accessed to identify reported problem areas with the procurement. Results of the preliminary research should be discussed in detail during the brainstorming conference.

#### *Helpful Research Hints:*

- In the D&B report, pay attention to the risk ratios, addresses, ownership, officers, and public filings (lawsuits); however, auditors should not rely solely on the D&B report as information may be incomplete or out dated.
- If the contractor is publicly traded, auditors can find financial statements online through the Securities and Exchange Commission Electronic Data Gathering, Analysis, and Retrieval system (EDGAR) at [www.sec.gov/edgar.shtml](http://www.sec.gov/edgar.shtml).
- Internet searches are very important as there is a vast amount of information available at no cost on the web. Auditors should access common search engines to look for fraud indicators such as current and past litigation, allegations of fraudulent activity, etc. A few suggested searches are: "Company Name + Lawsuit + Litigation", "Company Name + Fraud + Allegation" or "Company Name + Bankruptcy".
- The Office of Investigations (JI) maintains the Investigative Documentation Electronic Administrative System (IDEAS) that compiles all investigations initiated after the office's transition to electronic files. Auditors should have audit managers with access or agents in JI search the database for the contractor under audit, parent/subsidiary, as well as key officials.
- Auditors should contact GSA OIG's Office of Planning, Policy, and Operations to determine if JA has issued any referrals to JI, called Suspicion of Irregularities (SOIs), on the contractor.
- There is a short checklist located in Appendix A that may assist auditors during the brainstorming conference.

During the brainstorming session, the audit team should discuss the following: results of aforementioned research, elements of the fraud triangle, internal controls in place to

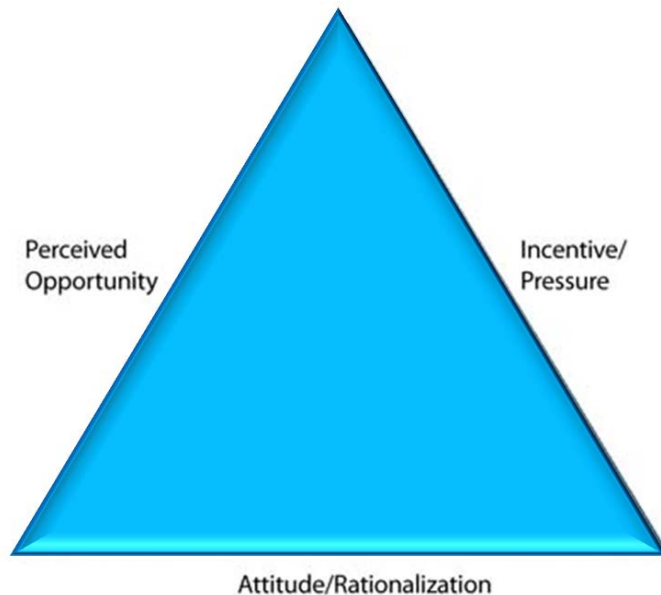
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<sup>9</sup> Teammate is the program that GSA OIG auditors use to document each step of the audit process. The step related to brainstorming is located in Teammate Step 13 (B.1.PS).

<sup>10</sup> Contracting officials can provide information on complaints or areas of concern associated with the contract under audit.

prevent/detect fraud (or lack thereof), segregation of duties<sup>11</sup> (or lack thereof), and areas to concentrate on during fieldwork. The need for professional skepticism throughout the audit process should be reiterated and stressed.

The Fraud Triangle was developed by one of the nation's leading experts on the sociology of crime, Donald Cressey. It identifies three conditions that, generally, are present when fraud occurs: Incentive/Pressure, Opportunity, and Attitude/Rationalization. During the brainstorming conference, the audit team should apply the results of their research to elements of the fraud triangle. A brief discussion of each element follows:



- Incentive/Pressure: The audit team should discuss why contractor management or personnel may feel pressure to commit fraud. Some examples include recent layoffs due to poor economic conditions or executive bonuses tied to performance.
- Opportunity: The audit team should discuss what someone may want to steal and how they would do it. They should discuss weaknesses in, or lack of, internal controls that provide an opportunity for fraud to occur. For example, lack of segregation of duties may provide an individual the chance to commit fraud.
- Attitude/Rationalization: The audit team should discuss how those committing fraud may justify their actions, bearing in mind that rationalization is the element that auditors are least likely to determine. While auditors can contemplate what is behind a person's actions, it is ultimately the responsibility of special agents to prove intent.

Contract auditors will mainly encounter organizational fraud, defined as fraud committed for the direct benefit of the organization and, therefore, the indirect benefit of the individual. Individuals who commit organizational fraud may have different motives from those who commit fraud for their own individual benefit, such as through bonuses, raises, promotions, or

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<sup>11</sup> The authorizing, recording, and custody functions should all be held by separate individuals within the organization.



job retention. A more subtle motivation relates to increased self-esteem or co-worker/supervisor praise or envy.<sup>12</sup>

Fraud indicators are only characteristics of possible fraud. An indicator may be caused by the fraudulent act itself, may result from an attempt to conceal the fraudulent scheme, or may be simply due to human error or incompetence. Thus, it is possible to encounter several fraud indicators throughout an audit but not find fraudulent activity. However, when fraud indicators are identified, it is our professional responsibility to obtain risk information to determine the cause of such indicators.

Possible responses to identified indicators (if already known) should be brainstormed with the audit team during the brainstorming session. Upon completion of a successful brainstorming session, the auditor will have generated several areas of fraud risk to focus on during the fieldwork phase of the audit.

## Obtaining Risk Information

During the brainstorming session, the audit team should generate ideas as to where and why fraud may occur in the audited organization. After potential risks are identified, the auditor should obtain information to gauge the materiality and likelihood of those risks actually taking place.

The auditor may determine the status of internal controls by asking contractor management about internal policies for maintaining ethical standards, as well as any current fraud issues with the organization. The auditor should bear in mind that contractor management very seldom will incriminate itself or the company. So, often times, information regarding internal investigations or other fraud related issues can be obtained from staff-level employees.<sup>13</sup>

The auditor should obtain management's understanding of the risk of fraud and areas it believes are most vulnerable. The auditor should also discuss management's understanding of programs and controls established to mitigate the risk of fraud.

Finally, the auditor should discuss the company's corporate culture by addressing the company's ethical standards. In doing so, the auditor should discuss management's actions to foster an environment encouraging ethical behavior (i.e., establishing ethics and compliance programs). The auditor should verify the existence of management's written code of ethics. Also, the auditor should determine whether the code is signed by each employee, how often it is signed, and if employees are required to attend regular training on ethical expectations.<sup>14</sup>

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<sup>12</sup> Department of Defense OIG Handbook: <http://www.auditnet.org/Guides/fraudcontractindicators.pdf>

<sup>13</sup> While staff-level employees may have valuable information, the auditor must keep in mind that these employees do not typically interact with external auditors. For this reason, it is essential for the auditor to build rapport with the subject in order to gain trust and ease tension.

<sup>14</sup> If interviews of staff-level employees are conducted, the auditor should ask about company culture and ethical standards to determine whether expectations are adequately communicated.

*Helpful Hint:* There are two sample questionnaires for inquiries of management and staff-level employees located in Appendix B. It is at audit management’s discretion whether to use the questionnaires and to what extent; however, it is important to note that adding additional questions specific to contractor operations may be necessary. Conversely, if the risk of fraud for the contractor under audit does not appear high, the auditor may consider omitting questions. At this point in the audit, the auditor should **not** confront management with potential fraud risks that have been identified.

In addition to inquiry of management, the auditor should obtain a copy of the contractor’s written internal control procedures and/or flow charts.<sup>15</sup> When reviewing the procedures, the auditor should determine who performs each function and whether the contractor has adequate segregation of duties. The auditor should discuss controls in place for each procedure.<sup>16</sup> In addition, the auditor should consider whether members of management may have the ability to override controls.

*Helpful Hint:* For each audit, the auditor is required to complete a fraud checklist. Fraud checklists are located in Teammate<sup>17</sup> for each type of contract audit: MAS products, MAS services, claims, change orders, terminations, and architect/engineering proposals. These checklists ask the auditor to answer a variety of questions related to fraud risk. The answers to some questions may be obtained throughout the ordinary course of the audit, while others require inquiry of management.

## Assessing Risk

After all risk information is obtained, the auditor must assess the risks identified to determine whether further action is required. When assessing risk, the auditor must employ professional judgment to decide how best to react considering the information obtained thus far in the audit. The auditor should assess risks based on materiality and likelihood.

Materiality is defined as “important; more or less necessary; having influence or effect.”<sup>18</sup> In addition, the civil False Claims Act further defines “material” as “having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property<sup>19</sup>.” The Yellow Book states that “materiality include[s] quantitative as well as qualitative measures in relation to the subject matter of the audit.” Furthermore, the AICPA states that “the auditor’s consideration of materiality is a matter of professional judgment and is influenced by the auditor’s perception of the needs of users.”<sup>20</sup> It is important to note that, in governmental

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<sup>15</sup> If the contractor is Sarbanes Oxley (SOX) compliant (required for publicly-traded companies), the contractor should have written control procedures.

<sup>16</sup> No additional work is required to review the company’s internal controls, as the steps in Teammate adequately address this area. The review of internal controls is limited to the audit objectives. The review of the entire organization’s internal controls is not required.

<sup>17</sup> Teammate is the audit management software employed by JA for electronic working papers.

<sup>18</sup> Black’s Law Dictionary (9<sup>th</sup> ed. 2009)

<sup>19</sup> 13 U.S.C. § 3729(b)

<sup>20</sup> AICPA Statement on Auditing Standards No. 107, *Audit Risk and Materiality in Conducting an Audit*

audits in which taxpayer funding is used, the threshold of materiality is typically lower than in other non-governmental audits.

The Merriam-Webster dictionary defines likely as “having a high probability of occurring or being true.” Again, the auditor may be required to use his/her professional judgment in order to infer the likelihood of a risk. Below is a useful diagram in assessing risk:

	Material	Immaterial
Likely	<b>Additional Testing Required</b>	<b>Additional Testing At Audit Team's Discretion</b>
Unlikely	<b>Additional Testing At Audit Team's Discretion</b>	<b>No Additional Testing Required</b>

When assessing the risk of fraud, the auditor must consider the complete picture to properly determine materiality. Some indicators, such as falsified documents, may be considered material in and of themselves, and would immediately trigger additional action, such as referral to JI. In other cases, the auditor may need to recognize the interrelationship of several seemingly unrelated indicators which, when combined, may warrant additional analysis.<sup>21</sup>

Once the assessment of identified risks is complete, the auditor will need to determine whether to proceed with additional work to respond to the risks. If deemed significant, additional procedures and analysis may be warranted. On the other hand, if deemed insignificant, the risk may not require any additional work in response. This assessment of risk should involve audit management to ensure agreement of perceived significance and be clearly documented.

## Responding to Risk

Once the auditor determines that the risk of fraud requires further action, the auditor should decide on the appropriate response to address the risk. Generally, there are three ways to respond to identified risks.

First, the auditor may decide to modify the scope of the audit, such as expanding the scope to include review of documents not typically examined through the ordinary course of the

<sup>21</sup> Department of Defense OIG Guidance: <http://www.dodig.mil/inspections/apo/fraud/fraudReferrals.html>

audit or other procedures outside the standard objectives. This requires management's approval as additional audit resources must be committed.

Second, the auditor may decide to modify the nature, extent, or timing of the audit procedures. For example, the auditor may modify the nature of testing for a services audit by switching the focus of the audit from commercial sales<sup>22</sup> to the use of cost build-up.<sup>23</sup> The auditor may also choose to modify the extent of audit procedures by obtaining a more encompassing, substantive sample.

Third, the auditor could develop tests and procedures to address the risks. For example, the auditor may create a spreadsheet to analyze quantity discounts for products sold to commercial customers versus to the government. The auditor may contact customer agencies to determine whether they have any complaints related to products/services purchased.

There is no standard way to respond to fraud risk. The auditor must develop appropriate options based on professional judgment, experience, and knowledge of the situation. For some risks, the appropriate response may require a combination of the aforementioned responses. Proposed responses should be discussed with audit management to ensure agreement as to the chosen course of action. Once the risks have been responded to, the auditor should be able to reassess their materiality and likelihood. Based on the auditor's assessment, fraud risks may require communication to other parties within the OIG.

## Communicating

Communication is a key step throughout the audit process and must be clearly documented. The auditor must consistently communicate with both the audit manager as well as the contractor.

The auditor should communicate frequently with the audit manager or audit team and keep the manager informed of all new developments. Furthermore, the auditor is encouraged to seek guidance from the audit manager and must ensure mutual agreement on all chosen courses of action.

The auditor must also maintain communication with the contractor throughout the audit. This includes correspondence related to obtaining usable data; requesting, reviewing, and understanding documents obtained; management inquiry related to internal controls; as well as conferences to brief management on the progression and findings of the audit.

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<sup>22</sup> Commercial sales refers to the comparison of GSA contract prices to those charged to a non-GSA or commercial customer (or group of customers) to determine if GSA is receiving a fair and reasonable price on purchases in accordance with the contract.

<sup>23</sup> Cost build-up is an alternative to commerciality and consists of examining the contractor's costs to develop a fair and reasonable price for products/services. Cost build-up data is different from cost of pricing data, which requires certification.

**If the auditor believes the contractor is involved in fraudulent activity, under no circumstances should the auditor confront the contractor with the suspected fraud before providing notice to, and obtaining legal advice from, the Office of Counsel (JC) and discussing the situation with the Office of Investigations (JI).**

When the auditor's procedures suggest the contractor may be involved in fraudulent activity, the auditor must bring the matter to the attention of audit management. The audit team should discuss whether information obtained warrants a formal referral to JI. If agreed, the audit team must create a Suspicion of Irregularities (SOI) written referral.<sup>24</sup> If the team is unsure whether a referral is warranted, it is recommended that the audit team meet with special agents and obtain their opinion on the information found.

Depending on the nature of issues found, it may be necessary to make a referral to JC for civil litigation or to the responsible contracting officer for administrative action (discussed on pages 31-32).

Once referred to the appropriate parties, the auditor may be required to continue the audit, assist in the investigation, or classify the audit as "in suspense" if it may conflict with the potential investigation.

## Documenting

It is always essential that the auditor clearly document all procedures, analysis, and discussions related to fraud. All key documents, including the entire process of evaluating, addressing, and responding to risks, should be documented, scanned, and stored in a secure location, such as within Teammate.

Throughout the audit process, it is preferable for communications to be in writing. However, if communications are verbal, it is essential that the auditor take detailed notes of discussions. Notes should include the time and date of discussion, means of discussion (via telephone, in person, etc), location (if applicable), individuals present, and topics discussed.

When discussions relate to sensitive topics or information material to the audit, the auditor should take notes as close as possible to word-for-word. To prevent loss of information, it is suggested that write-ups be saved on a computer in a safe location, as well as imported into Teammate.

The auditor's documentation can be extremely important if the audit is referred to JI or JC. If the matter results in legal/judiciary proceedings, auditor documentation may be used as evidence in court or as a basis for seeking monetary recoveries. Additionally, everything should be documented with the understanding that it may ultimately be disclosed to third parties. For this reason, it is essential that communication not only be clearly documented but also professional in nature.

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<sup>24</sup> Subchapter 705 of the GSA OIG Policy and Procedures Manual

## TYPES OF AUDITS AND AREAS OF FRAUD RISK

Annually, GSA OIG pursues multiple cases of criminal and civil fraud. For example, in the first half of fiscal year 2010, GSA OIG was involved in the \$400 million criminal fine imposed upon defense contractor, BAE Systems, for conspiring to defraud the United States.<sup>25</sup> During the same period, GSA OIG was also involved in recovering almost \$14 million in contract fraud settlements.<sup>26</sup>

Many fraud cases actively pursued are cases of civil fraud. Civil fraud cases are more frequently prosecuted because they require a lower burden of proof and do not require evidence of criminal intent. Criminal cases, while harder to prosecute, are also actively pursued. While many cases that GSA OIG pursues originate from Qui Tam complaints<sup>27</sup> or other allegations, a significant number of cases are initiated based on referrals from JA.

In order to actively prevent and detect fraud within the organization, auditors must be aware of common fraud schemes that relate to GSA operations. The next section of the handbook briefly describes the types of contract audits GSA OIG auditors perform, explains common procurement fraud schemes, and identifies specific fraud indicators of those schemes. As fraud is always evolving and schemes become increasingly complex, this portion of the handbook is not intended to encompass all possible fraudulent situations. Rather the purpose is to raise auditor awareness of common types of procurement fraud seen by the office and indicators of such fraudulent activity.

## TYPES OF AUDITS

While fraud detection is not a stated audit objective all contract audits are performed as examination-level attestation engagements.<sup>28</sup> The examination-level auditing standards require that auditors “design the engagement to provide reasonable assurance of detecting fraud, illegal acts, or violations of contract provisions....that could have a material effect on the subject matter of the attestation engagement.” The following discussion summarizes the audit objectives relative to both Multiple Award Schedule and Construction Cost or Pricing Audits.

### **Preaward and Postaward Multiple Award Schedule Contract Audits**

JA performs both preaward and postaward examinations of GSA Multiple Award Schedule (MAS) federal procurement contracts. The primary difference between preaward and

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<sup>25</sup> BAE pled guilty to conspiring to defraud the U.S. by making false statements about its Foreign Corrupt Practices Act compliance program and violating the Arms Export Control Act and International Traffic in Arms Regulations.

<sup>26</sup> GSA OIG Semiannual Report to the Congress (October 1, 2009 to March 31, 2010)

<sup>27</sup> A Qui Tam complaint, provided for in the civil False Claims Act, is one in which a citizen brings a legal action, on the government's behalf, alleging fraud.

<sup>28</sup> Yellow Book section 6.13

postaward audits is the timeframe examined. Preaward audits aim to determine the adequacy of pricing and disclosures for upcoming contracts and contract extensions. On the other hand, postaward audits typically examine the contractor's practices in previous time periods, examining transactions already completed. Regardless of whether the audit is preaward or postaward, the key objectives remain unchanged. The auditor should determine whether the contractor adequately disclosed all of its sales pricing practices and abided by the terms of its GSA contract. The audit procedures are slightly different depending on if the contractor under audit sells products, services, or a combination thereof. The complete audit objectives for each type of MAS contract audit are located in Appendix C.

## **Construction Contract Cost or Pricing Audits**

Construction contract audits include the evaluation of submitted cost or pricing data relative to architecture and engineering proposals (A&Es), construction claims, change orders, and contract terminations. The objectives of these audits are to determine whether proposed costs are allowable, allocable, and reasonable; supported by appropriate accounting records; and in accordance with the contract provisions and cost principles set forth in the Federal Acquisition Regulation (FAR).<sup>29</sup> This is typically accomplished through the examination of costs and records maintained by the contractor.

For construction audits, FAR 15.403-4 incorporates elements of the Truth in Negotiations Act (TINA) requiring the contractor to certify its cost or pricing data for accuracy, currency, and completeness on pricing proposals totaling \$700,000 or greater, as of the date of agreement on price. The certification of incomplete, inaccurate, or non-current data may result in administrative, civil, or criminal liability.

The auditor is not responsible for performing a technical analysis of the proposal, such as evaluating the types of direct material proposed. For this reason, the contracting officer may be required to consult a specialist to conduct a technical evaluation.

The following contains a brief description of the types of construction cost or pricing audits:

### Audits of Architecture and Engineering Proposals (A&Es):

Audits of A&Es take place before a contract is awarded. An A&E is a proposal for professional services of an architectural or engineering nature. Generally, the architecture or engineering firm submits proposed overhead and labor rates for a variety of cost categories along with supporting documentation. In most cases, JA is asked by Public Buildings Service (PBS) officials to verify the estimated costs submitted. Auditors verify the pricing data and ensure that the calculated rates are in compliance with FAR. The auditor's determinations will be used by the contracting officer for negotiation purposes.

### Audits of Claims:

Audits of claims typically take place after a contract has already been awarded by PBS and after the contractor has performed the contracted work. A claim is defined as a contractually stipulated demand for payment or work related to a construction project. Construction claims

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<sup>29</sup> FAR Section 31.2.



are often filed under the Disputes Clause of the contract and may be resolved by legal determination (by the Board of Contract Appeals or U.S. Court of Federal Claims). The claimed increased costs usually result from alleged government-caused delays and disruptions. Auditors are asked to verify the costs of the claim through examination of submitted pricing data and to ensure compliance with FAR and contractual provisions. Auditors are not asked to determine which party is at fault.

#### Audits of Change Orders:

Similar to audits of claims, audits of change orders take place after a contract has been awarded; however, audits of change orders generally occur while contracted work is still in progress. A change order is defined as a written order to the contractor, issued after execution of the contract, which authorizes a change in the scope of work or extension of contract time and/or amount of funding. Change orders are commonly issued to modify the scope of a contract which is the right of GSA pursuant to the Changes Clause. Auditors are asked to examine change orders to verify submitted pricing data and to ensure compliance with FAR and the governing contractual provisions.

#### Audits of Contract Terminations:

Like audits of change orders, audits of terminations occur after the contract has been awarded but before all contracted work is complete. As the name implies, a termination results when the contract is terminated, and all work (or a portion of the work) on the contract is discontinued. The contract normally gives GSA the contractual right to terminate the contract for its convenience or as a result of default of the contractor.

Termination proposals audited by the OIG relate to construction contracts terminated for convenience of the government. The auditor is not responsible for determining the reasonableness of the termination action or determining fault. Rather the auditor is responsible for reviewing pricing data and supporting documents associated with the termination proposal.<sup>30</sup>

Contract termination proposals resulting from contractor defaults generally are not subject to audit as these actions are contract breaches and subject the contractor to damages including re-procurement costs.

## Areas of Fraud Risk

Fraud is characterized by acts of deceit, trickery, concealment, or breach of confidence used to gain some unfair or dishonest advantage. The objective may be to obtain money, property, or services; to avoid the payment or loss of money, property, or services; or to secure a business or a personal advantage.<sup>31</sup> Fraud, by nature, is hard to detect as

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<sup>30</sup> The criteria governing the audit of terminations are FAR Chapter 49, contract provisions, and the cost principles set forth in FAR 31.205

<sup>31</sup> Department of Defense OIG: Handbook on Indicators of Fraud in DOD Procurement <http://www.cohenseglias.com/government-contracts.php?action=view&id=343>



perpetrators go to great lengths to conceal their fraudulent actions. For this reason, unfortunately, the majority of organizational fraud goes undetected. Educating our auditors on common fraud schemes and indicators of their presence may aid in our fraud detection efforts.

Below is a list of general fraud indicators applicable to all audits. This list, as well as the others that follow, is not intended to be all-inclusive and should not limit the consideration of other factors not explicitly listed.

#### General Fraud Indicators:

- Contractor intentionally delays inception of audit
- Contractor delays in producing requested data or documents
- Contractor documents are all photocopies rather than originals
- Contractor files, reports, data, or invoices are “missing”
- Contractor refuses to provide access to records
- Contractor has high turnover of management
- Key personnel have been reassigned or terminated
- The organizational structure is overly complex
- Contractor has a lack of segregation of duties
- Contractor has experienced financial difficulties/layoffs
- Financial assertions lack support
- Unusual variances between estimates and actual assertions
- Documents have been altered
- Attorney involvement relative to routine audit matters and access to records

The remainder of this section provides information pertaining to specific fraud schemes related to federal procurement contracts as well as indicators and examples of such schemes.<sup>32</sup> It is important to remember that fraud indicators are only characteristics of possible fraud. An indicator may be caused by the fraudulent act itself, result from an attempt to conceal the fraudulent scheme, or simply be due to human error or incompetence.

## **BID RIGGING**

Bid rigging is defined as fraud that involves the impeding of competitive bidding. Competitive bidding depends on free and open competition in order to obtain the best goods and services at the lowest prices. The competitive process, however, is only effective if competitors set prices honestly and independently. When competitors collude, prices are inflated and the customer is cheated. Intentionally restricting competition to artificially inflate prices is illegal and constitutes an antitrust violation<sup>33</sup> subject to criminal or civil prosecution.

Generally, bid rigging involves an agreement among competitors to limit competition by agreeing in advance who will submit the winning bid. The purchaser, which depends on

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<sup>32</sup> All examples obtained from press releases or other publicly available information at Department of Justice website: [www.justice.gov](http://www.justice.gov)

<sup>33</sup> The Sherman Antitrust Act was enacted in 1890 to protect against the impairment of free trade and competition.

market competition to generate the lowest competitive price on purchased goods or services, instead receives a “lowest bid” that is higher than the competitive market would bear.

While it is not the auditor’s job to prove the legal elements of a crime or violation, it is important to note that to prove bid rigging, evidence of a formal written or express agreement is not required. Rather, testimony of a participant or circumstantial evidence, such as suspicious bid patterns, may be sufficient. Thus, it is essential that the auditor look for such bidding patterns.

There are four common bid rigging schemes. Each is briefly described below:

- Bid Suppression: One or more competitors agree not to bid, or withdraw a previously submitted bid, so a designated bidder is ensured to win. In exchange, the non-bidder may receive a lucrative subcontract or payoff.
- Complementary Bidding: Bidders submit bids which are intentionally high or which intentionally fail to comply with bid requirements in order to give the appearance of competition where it does not exist.
- Bid Rotation: Competitors, based on a pre-established agreement, take turns submitting the lowest (winning) bid on a series of contracts.
- Customer or Market Division: Competitors divide customers or geographic locations. Competitors do not bid or submit only complimentary bids for customers or geographic areas not assigned to them.<sup>34</sup>

These schemes result in the restriction of competition and the customer unknowingly paying a higher price for contracted products or services.

In December 2010, a former purchasing official at Mount Sinai Medical Center and School of Medicine in New York pleaded guilty to participating in bid rigging and fraud conspiracies. The official, a former associate director of plant services at Mount Sinai, was responsible for obtaining bids from vendors and awarding contracts on a competitive basis; however, he pleaded guilty to entering into a conspiracy with co-conspirators to rig bids on maintenance and insulation services contracts by submitting intentionally high, non-competitive bids to make it appear that there had been competition for the contracts when, in fact, there had not been. In doing so, he awarded work to a co-conspirator’s company and received cash kickbacks from the co-conspirator. The bid rigging charge carries a maximum penalty of 10 years in prison and a \$1 million fine for an individual. Furthermore, the fine may be increased to twice the gain derived from the crime or twice the loss suffered by the victims of the crime, if either of those amounts is greater than the statutory maximum fine.

Indicators of Bid Rigging:

- Companies submit bids with identical individual line items or lump sums

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<sup>34</sup> Department of Justice Antitrust Division, *Preventing and Detecting Bid Rigging, Price Fixing, and Market Allocation in Post-Disaster Rebuilding Projects*. [http://www.justice.gov/atr/public/guidelines/disaster\\_primer.htm](http://www.justice.gov/atr/public/guidelines/disaster_primer.htm)

- Bids greatly exceed the agency's estimate of contract value or exceed comparable bids by the same companies in other areas similar in demographics
- Winning bidder awards subcontracts to one or more of the losing bidders
- There is an indication of last minute alteration of bids
- A large gap exists between the winner's proposed pricing and losing bidders' pricing
- All bids are very close in price (indicates that competitors may be communicating and sharing bidding information)
- All bids are consistently high
- Multiple bids have relatively the same increment in pricing
- A company gives different bids for the same line item on different contracts that are close in time
- Evidence indicates that multiple bids may have come from the same individual (such as same spelling or mathematical errors, same handwriting, same address, same fax or phone numbers, or bids appear poorly prepared)
- Qualified bidders inexplicably withdraw valid bids, especially if multiple bids are withdrawn in the same time frame
- Qualified bidders do not submit bids
- Prices inexplicably drop when a new bidder (most likely uninvolved in the scheme) enters the bid
- Competitors seem to interact and communicate with each other frequently when bids are due
- Patterns in behavior exist such as a certain contractor always or never wins a bid, or all contractors win an equal volume of business/contracts over time
- Patterns exist in which contractors seem to win most contracts in specific geographical area
- Same bidders always bid against each other or never bid against each other
- Different bidders appear to specialize in government jobs exclusively
- Contractors bid as joint ventures when either contractor had the capability of performing the job individually

Note: While these indicators may arouse suspicion of bid rigging, they are not sufficient proof of illegal or fraudulent behavior. For example, bids that come in well above the estimate may indicate complementary bidding or may simply result from an incorrect estimate. Similarly, a bidder may legally submit an intentionally high bid to ensure not being awarded the contract because the contractor cannot handle additional work but may want to stay on the bidder's list. Thus, auditors should be careful not to immediately assume fraudulent activity has occurred, but rather should devote additional time to determine the cause of the indicator.

## **COLLUSION**

Collusion, also an antitrust violation, is defined as "a secret combination, conspiracy, or concert of action between two or more persons for fraudulent or deceitful purpose."<sup>35</sup> Collusion occurs when competitors set prices they will charge for goods or services, set a minimum price they will not sell below, or reduce or eliminate discounts. While collusion can occur in almost any industry, certain characteristics can make industries more vulnerable to collusive behavior than others. Two characteristics in specific lend themselves to collusive behavior: an industry dominated by a few major players (it is easier to get a few sellers

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<sup>35</sup> Black's Law Dictionary, Revised Fourth Edition

together to agree on prices, discounts, etc) and an industry that sells standardized products/services (similar products/services make it easier to reach agreement on a common price structure; it is much harder when products/services have unique features, quality, etc). In addition, when products or services are standardized, the determining factor in the award is price rather than some other competitive factor.

Collusion, similar to bid rigging in that it reduces competition, is typically harder to detect and even more difficult to prove as it often occurs without any written agreements and provides no paper trail to be examined. However, also similar to bid rigging, collusive behavior may be proven through circumstantial evidence such as suspicious pricing patterns or through testimony of a participant.

The U.S. brought an antitrust case to prevent the proposed acquisition of Borden/Meadow Gold Dairies Holdings, Inc, a contractor providing milk to public school districts in Louisiana, by agricultural cooperative association Mid-America Dairymen, Inc (Mid-America). Mid-America, through its affiliate Southern Foods Group LP, and Borden/Meadow Gold competed head-to-head in the supply of fluid milk for school lunch and breakfast programs throughout Eastern Texas and Louisiana.

The proposed transaction would reduce competition and create a school milk monopoly in the already highly concentrated markets of Eastern Texas and Louisiana. As a result, many school districts would likely pay higher prices for milk. This was one of many cases related to U.S. dairy markets plagued with ongoing collusion; however, while the U.S. has intervened in several transactions aimed to restrict competition, criminal cases related to collusive activity are rarely successfully prosecuted.

Indicators of Collusion:

- Market characteristics such as a concentrated market dominated by a few major players and high barriers to entry
- Markets involve standardized products or common product substitution
- Competitors announce price increases at the same time, for the same amount, or have staggered price increases with some common pattern, such as appearing to take turns going first
- Competitors all offer the same discount and refuse to negotiate lower discounting
- Competitors have same pricing for line items
- All suppliers' prices appear uniform and suppliers refuse to negotiate those prices

Note: Many of the indicators for bid rigging may also be applicable to collusive activity.

## **DEFECTIVE PRICING AND PRICE REDUCTION VIOLATIONS**

One of the requirements to obtain a GSA procurement contract is that the prospective contractor must meet a level of responsibility. Accordingly, FAR states that “purchases shall be made from, and contracts shall be awarded to, responsible prospective contractors only.”<sup>36</sup> This is essential because the contracting officer must be able to trust in, and rely on, the contractor to act ethically and according to contract terms. The Defective Pricing and

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<sup>36</sup> FAR Section 9.103

Price Reduction Clauses are two terms within GSA contracts that are of concern that heavily rely on contractor ethics.

#### Defective Pricing Violations:

When contracting officers negotiate GSA MAS contracts, their goal is to obtain the most advantageous pricing for the federal government. In order to do this, contracting officers must rely on the accuracy of contractor disclosures related to pricing practices. However, contractors may provide incomplete, inaccurate or not current disclosures during contract negotiations. This is known as defective pricing as the contracting officer relies on the defective disclosures to negotiate future rates on contracted products/services.

The Price Adjustment Clause, General Services Administration Acquisition Regulation (GSAR) clause 552.215-72, addresses contractors' failure to provide current, accurate or complete information which results in the government paying significantly higher prices. This clause allows GSA to reduce its contract prices if it determines that the contractor failed to provide current, accurate and complete information which the contracting officer relied upon to negotiate prices before contract award. If the contractor intentionally provided inaccurate information or failed to disclose necessary information, the contractor may be subject to criminal and/or civil penalties and damages.<sup>37</sup>

Oracle Corporation (Oracle) agreed to pay the U.S. \$98.5 million in a settlement for defective pricing disclosures made by PeopleSoft Incorporated (PeopleSoft) during negotiation of its GSA MAS contract. The settlement resolves allegations that PeopleSoft made pricing disclosures to GSA that were not current, accurate and complete concerning the sale of software licenses and related maintenance services. As a result of the defective disclosures, most federal purchasers under PeopleSoft's MAS contract paid inflated prices for purchases of software and services. Due to Oracle's acquisition of PeopleSoft, it inherited PeopleSoft's liability under the GSA contract.

EMC Corporation agreed to pay the U.S. \$87.5 million in a settlement for defective pricing disclosures, as well as illegal kickbacks. During MAS contract negotiations, EMC represented that it would conduct a price comparison to ensure that the government received the lowest price provided to any of the company's commercial customers making a comparable purchase. The settlement resolved allegations that EMC knew it was not capable of conducting such a comparison and that EMC's representations during negotiation, as well as subsequent representations that it was conducting the required comparisons, were false or fraudulent.

#### Price Reduction Violations:

Price reduction violations occur when the contractor fails to notify the government of pricing changes while the contract is in effect. The Price Reduction Clause (PRC), GSAR clause 552.238-75, establishes a relationship between GSA MAS contract pricing and the pricing offered to an identified customer (or category of customers) referred to as the Basis of Award (BOA) customer(s). If the contractor grants a more favorable price, discount, or concession to the BOA customer(s), the same must be offered to GSA with the same terms and

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<sup>37</sup> For civil fraud cases under the Federal False Claims Act, proving intent is not required. Rather, proving reckless disregard is sufficient to obtain a judgment.

conditions and for the same period of time. It is the contractor's responsibility to report such changes in pricing practices to the contracting officer.<sup>38</sup>

Price reductions not reported and later identified by GSA (typically during an audit), may be applied retroactively to all GSA transactions from the time of the initial incident. While price reduction issues generally constitute contract violations, reckless disregard can support a civil fraud action, and proving intent can lead to criminal as well as civil fraud charges. Evidence of the contractor intentionally concealing price reductions or omitting transactions in which it offered better pricing to BOA customers from audited data can be used to prove such charges.

Oracle Corporation and Oracle America Inc. (Oracle) agreed to pay the U.S. Government \$199.5 million (plus interest) to settle a case related to false and incomplete disclosures relating to its pricing and discounting practices and price reduction clause violations. Oracle, a GSA Multiple Award Schedule holder, manufactures, markets, and distributes software and hardware. The Government alleged that Oracle knowingly failed to provide current, accurate, and complete information regarding company discounting practice. Oracle granted higher discounts to commercial customers and did not pass on the discounts to government customers.

The U.S. reached a settlement with NetApp Inc. and NetApp U.S. Public Sector Inc. (collectively NetApp), following an investigation of alleged false claims and contract fraud. NetApp agreed to pay \$128 million, plus interest—one of the largest contract fraud settlements GSA has obtained to date. The settlement relates to NetApp's GSA MAS contracts to sell computer hardware, software and storage management services to government entities. The settlement resolves allegations that, in contract negotiations and over the course of the contracts' administration, the contractor knowingly failed to provide GSA with current, accurate and complete information about its commercial sales practices, including discounts offered to other customers, and that NetApp knowingly made false statements to GSA about its sales practices and discounts.

The settlement also resolves allegations that NetApp knowingly failed to comply with the price reduction clauses of its GSA contracts by failing to disclose higher discounts provided to its commercial customers and by failing to pass those discounts on to government purchasers. Because of these allegedly fraudulent dealings, the U.S. accepted lower discounts and paid far more than it should have for NetApp products.

Indicators of Defective Pricing or Price Reduction Violations:

- Reoccurring or standard discounts or concessions are found that were not disclosed
- There were delays in releasing data to the government
- Contractor failed to update pricing data
- Contractor failed to disclose favorable customer agreements, including rebates
- Better pricing is available on the open market for comparable products or services
- Data for the period examined does not tie to financial statement information without viable explanation of deviation

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<sup>38</sup> The PRC also applies if the contractor changes its pricelist or other document upon which pricing is based.

## MISCHARGING COSTS

Cost mischarging occurs when a contractor charges the government for costs which are not allowable, reasonable, or allocated directly or indirectly to the contract. Cost mischarging can often be encountered through accounting mischarges. Accounting mischarging is when contractors knowingly charge unallowable costs, concealing or misrepresenting them as allowable costs, or hiding them in accounts (such as office supplies) which are not closely audited.

Another potential form of cost mischarging is when a contractor intentionally shifts costs and expenses between contracts. This typically occurs when contractors incur expenses related to firm fixed price (FFP) contracts but charge the expenses under time and materials (T&M) contracts or other non-FFP contracts. A brief discussion of each type of contract follows:

- FFP: FFP contracts reduce government risk by shifting it to the contractor. The government pays a set price for contracted goods or services, regardless of the actual costs incurred by the contractor. The government is not required to pay for contractor inefficiencies or delays. For this reason, FFP contracts encourage the contractor to be efficient in its operations. If the contractor completes the contract spending less than the contract denotes, the remaining amount is profit. On the other hand, if the contractor has unnecessary delays or expenses that increase costs over the contracted amount, the contractor must bear the loss.
- T&M: In T&M contracts, the contractor is reimbursed for time spent and materials used. As opposed to FFP contracts, the price of a T&M contract cannot be adequately estimated at its inception. As the contractor incurs additional costs related to executing the contract, it is entitled to reimbursement. Thus, T&M contracts do not encourage contractor efficiency and result in the government bearing more risk than in FFP contracts.

Contractors that hold both types of contracts have a strong financial incentive to shift costs to obtain reimbursement for items they otherwise would not, thereby increasing profit. This is often accomplished by altering records to shift costs from FFP to T&M contracts. Or, the contractor may give an unusually low bid for future work in order to obtain a contract. To meet its low bid, the contractor may charge a portion of that contract's costs to other contracts. In some cases, the contractor may charge costs related to non-federal contracts to its federal contracts. The contractor may also intentionally inflate actually incurred costs under T&M contracts.

**ISX Corporation, a National Aeronautics and Space Administration (NASA) contractor, agreed to pay \$100,000 related to a cost mischarging allegation. ISX Corporation received funds under NASA's Small Business Innovation Research (SBIR) Program. The contractor allegedly applied cost overruns on its SBIR fixed-price contracts to a NASA cost-plus contract<sup>39</sup>. ISX Corporation paid \$100,000 as a result of an administrative settlement related to its unallowable costs.<sup>40</sup>**

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<sup>39</sup> Cost-plus contracts reimburse the contractor for actual costs plus a set fee.

<sup>40</sup> NASA OIG Hearing of the Senate Committee on Commerce, Science, and Transportation [http://oig.nasa.gov/congressional/SBIR\\_Testimony.pdf](http://oig.nasa.gov/congressional/SBIR_Testimony.pdf)



## Indicators of Mischarging Costs:

- Costs billed under T&M contracts greatly exceed estimates
- Incurred costs billed under FFP contracts fall considerably below estimates
- Contractor has a mix of T&M and FFP contracts
- Proposed costs do not seem directly related to the contract under which they were submitted (may relate to one of the other contracts)
- Proposal documentation uses old, outdated prices for support
- Vague terms used to bid materials based solely on management judgment or rough estimates
- Material specified in the contract exceeds that which is required for the job
- Delivery documents show addresses different from the specified job site
- Documents (such as purchase orders and timecards) appear to be altered
- Supporting documentation is poor quality or illegible
- Approval signatures on purchase orders or timecards are missing
- Contractor employees rarely charge leave or vacation
- Increase in labor hours with no corresponding increase in materials used or shipped
- Actual hours and dollars consistently at or close to budgeted amount
- There are discrepancies in handwriting on purchase orders or timecards
- Labor time and charges seem inconsistent with project progress
- Time cards are made out by the supervisor and not by the individual employees

## **CHARGING FOR PRODUCTS NOT USED OR SERVICES NOT RENDERED**

Charging for products not used or services not rendered typically occurs with projects that require a level of expertise or those that do not have a concrete work product. This includes construction, engineering, consulting, janitorial, or inspection type services. Charging for products not used or services not rendered is one of the simplest ways for contractors to steal funds, yet one of the hardest schemes to prove. In these cases, products or services are billed but not used under any contract, with all money collected as profit for the company. Unfortunately, often times it is easier to prove that work was performed incorrectly than to prove it was not performed at all, unless there is cooperation from an informant.

For instance, contractor management may alter timecards for construction employees to increase hours billed by ten percent. All employees that worked on a project for 30 hours per week would be billed to the government for having worked 33 hours per week. In this case, the fraud would likely go undetected unless one of the employees approached the government stating that they did not work the additional hours. However, over time, frauds like these that go undetected often become more egregious and, thus, easier to detect.

The likelihood of detection increases as the dollar amounts embezzled become greater. For instance, the auditor may discover that an employee was billed for work on a construction site in Chicago for eight hours and on a site in Los Angeles for seven hours the same day. Further, the auditor may find that the employee billed on average 27 hours per day. Cases like these have been found and prosecuted by GSA OIG in the past.

**Two men were indicted on criminal charges related to the submittal of fraudulent other direct cost (ODC) invoices to the government. The Director of GSA Federal Technology Service, IT Solutions in New York conspired with a Senior Configuration Manager for**



System Integration and Management, Incorporated (SIM). The indictment alleged that the two conspired by knowingly obtaining payment of false, fictitious and fraudulent claims submitted to GSA, in the form of invoices, which billed for fraudulent ODCs. They did this by submitting the same receipts more than once for payment in different ODC reports and task orders as well as billing for ODCs incurred by other employees not working on the contract. The co-conspirators agreed to split the fraudulently obtained money.

Indicators of Charging for Products Not Used or Services Not Rendered:

- Costs greatly exceed estimates
- Duplicate billings for the same products or services
- Inexplicable delays
- Goods purchased are in excess of needs
- Delivery location is not the office, plant, or job site
- Contractor cannot explain why certain amount of materials were required for the job
- Equipment on job site appears to be inoperable
- Timecards are not signed by respective employees
- Timecards are not approved by employees' supervisors but rather a member of management not typically responsible for such work
- Employees bill at multiple distant job sites on same day
- Employees bill for more hours than typically worked in a work day

## **BRIBERY, KICKBACKS, AND CONFLICTS OF INTEREST**

Bribery, kickbacks, and conflicts of interest are forms of public corruption commonly investigated by GSA OIG.

Bribery:

Bribery is defined as “the offering, giving, receiving, or soliciting of any thing of value to influence action as official or in discharge of legal or public duty.”<sup>41</sup> An example of bribery is a contractor paying a contracting officer in exchange for being awarded a lucrative contract. The payment does not have to be in the form of money; rather, it can also take the form of items or services, including those given to someone designated by the contracting officer.

Over the years, there have been advances in the sophistication of mechanisms used to commit bribery. Generally, the pattern has changed from the classic suitcase filled with cash to more subtle scenarios involving intermediaries, complex transactions, and misstatements of business or promotional expenses.<sup>42</sup> These cases pose a challenge for auditors and special agents in that they are often more difficult to detect.

Five former GSA officials and nine GSA contractors were charged with bribery and false claims related to GSA contracts at the Dirksen Federal Courthouse in Chicago. A former GSA mechanical supervisor responsible for the selection of contractors for the award of GSA supplies and services contracts in the Dirksen Courthouse was charged with bribery

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<sup>41</sup> Law Dictionary, Revised Fourth Edition

<sup>42</sup> <http://www.justice.gov/criminal/fraud/fcpa/docs/oecd-Phase-2-report.pdf>

and false claims. The investigation revealed that he had received more than \$10,000 in cash from contractors, in addition to plumbing supplies and other equipment, which were falsely billed to GSA, in return for favorable treatment in the award of GSA contracts. A building manager was also charged for receiving new windows and siding on her private residence in exchange for providing favorable treatment to a GSA contractor.

The former CEO of Holiday International Security, Inc (HIS)<sup>43</sup> was sentenced to four years in prison in a bribery scheme involving \$130 million in federal contracts. His company, at one time, had provided armed and unarmed security guards for 18 federal agencies in 32 states and territories. The former CEO was charged with bribing a former employee of GSA who was responsible for contracting on GSA's behalf with private companies for security services in GSA-managed buildings. The CEO allegedly provided the former GSA official with a shopping bag containing \$35,000 in cash, an envelope containing \$10,000 in cash, Caribbean cruise vacations and other benefits in exchange for assistance in awarding three multi-million dollar contracts to HIS.

#### Kickbacks:

FAR defines kickbacks as "any money, fee, commission, credit, gift, gratuity, any item of value, or compensation of any kind that is provided, directly or indirectly, to any prime contractor, subcontractor or employee of either for the purpose of improperly obtaining or rewarding favorable treatment in connection with a prime contractor in connection with a subcontract relating to a prime contract."<sup>44</sup> In short, a kickback is providing something of value in exchange for preferential treatment.

The Anti-Kickback Act of 1986 modernized and closed the loopholes of previous statutes applicable to government contractors. The act expanded the definition of prohibited conduct and made the statute applicable to a broader range of individuals involved in government subcontracting.<sup>45</sup> According to FAR, the Anti-Kickback Act of 1986 was passed "to deter subcontractors from making payments and contractors from accepting payments for the purpose of improperly obtaining or rewarding favorable treatment in connection with a prime contract or a subcontract relating to a prime contract."<sup>46</sup> The act prohibits providing, attempting to provide, or offering to provide a kickback or favorable treatment; and soliciting, accepting, or attempting to accept any kickback. The law also imposes civil and criminal penalties for both the company and individuals involved in such activity. A common kickback scenario occurs when a prime contractor instructs the subcontractor to inflate the cost of materials. When the prime receives payment for the materials used, it kicks back a portion of the profit to the subcontractor.

**Oracle America Inc. and Sun Microsystems (Sun) agreed to pay the US Government \$46 million to settle a case related to kickbacks. Sun, a GSA Multiple Award Schedule holder, merged with Oracle in 2010. The Government alleges that Sun knowingly paid system integrators kickbacks for recommending the purchase of Sun products to government**

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<sup>43</sup> Also known as USProtect Corporation

<sup>44</sup> FAR Section 3.502-1

<sup>45</sup> Department of Justice: United States Attorney Manual, Criminal Resource Manual 927  
[http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title9/crm00927.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/crm00927.htm)

<sup>46</sup> FAR Section 3.502-2

customers. This case also settled defective pricing allegations that Sun provided inaccurate and incomplete pricing information with other federal contracts.

Hewlett-Packard Company (HP) agreed to pay the U.S. \$55 million to settle allegations of defrauding GSA and other federal agencies. The U.S. alleged that HP knowingly paid kickbacks, or “influencer fees”, to systems integrator companies in return for recommendations that federal agencies purchase HP products. Also included in the allegation was that HP provided incomplete information to GSA contracting officers during contract negotiations, a defective pricing violation. HP denied the allegation and executed the aforementioned settlement.

#### Conflicts of Interest:

Federal employees can have a criminal conflict of interest or an administrative conflict of interest under ethics regulations. A criminal conflict occurs when an employee participates substantially in a particular matter where he has a financial interest, if the particular matter will have a direct and predictable effect on that interest.<sup>47</sup> Under the ethics regulations, an employee should not participate in a matter involving parties which he knows is likely to affect his financial interests, if he determines that a reasonable person with knowledge of the relevant facts would question his impartiality in the matter.<sup>48</sup>

Conflicts of interest compromise independence and provide for biased decision making. A common conflict of interest is conducting business with related parties, as it often leads to favoritism. A contracting officer awarding a contract to her husband’s father’s company, for example, might be an administrative conflict of interest. GSA employees involved in the contracting process are required to disclose their financial interests on Financial Disclosure Reports.

The Boeing Company agreed to pay a \$615 million settlement to resolve criminal and civil allegations that the company improperly secured contracts for launch services. In part, the government’s investigation focused on Boeing’s relationship with a former procurement official with the Air Force. Before 2002, the official served as the Air Force’s top career procurement officer and wielded influence over billions of dollars in contracts. In 2000, at the Air Force official’s request, Boeing hired her daughter and future son-in-law. From 2000 to 2002, the former Air Force official was responsible for dozens of Boeing contracts and offered the contractor favorable treatment as a result of the favors they granted her. Following her retirement in 2002, Boeing’s then Chief Financial Officer (CFO) recruited the Air Force official for an executive position with Boeing. Both the former Air Force official and Boeing’s former CFO pled guilty to violations of the conflict of interest statutes. Furthermore, in documents filed with the criminal court, the former Air Force official admitted that Boeing’s favors in hiring her children and in offering her a position influenced her contracting decisions.

#### Indicators of Bribery, Kickbacks, or Conflicts of Interest:

- Overly friendly relationship between government employees and contractors

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<sup>47</sup> This also applies to spouses, minor children, or other persons whose interests are imputed to the employee.

<sup>48</sup> This also applies to a member of his household, or in which he knows a person with whom he has a covered relationship is or represents who has financial interests.

- Socializing outside of the work environment
- Employees living beyond their means
- Employment of family members by a contractor
- Unexplained increases of business with one contractor or subcontractor
- Many change orders
- Change orders with a high percent of original costs
- Indications of unreported poor performance of contractor
- Defining statements of work and specifications to fit the products or capabilities of a single contractor
- Government personnel or their families acquiring stock or a financial interest in a contractor or subcontractor
- Government personnel discussing possible employment with a contractor or subcontractor for themselves or a family member
- Improperly disqualifying the bids or proposals of qualified contractors

## **PRODUCT/SERVICES SUBSTITUTION**

Due to the volume of federal government purchases, it is impossible and impractical to perform quality reviews on each item purchased. In most cases, the government relies on purchasing from responsible contractors to provide products and services that meet contract specifications. Even so, product and services substitution is often discovered by GSA OIG. Depending on the extent of such substitutions, the repercussions can be severe. Product/services substitution occurs when a contractor delivers products or services that do not meet contract specifications without the government's prior consent. Although honest mistakes are certainly possible, there are also cases in which contractors intentionally provide the government with substituted products or labor to generate additional profit. These cases generally consist of contractors providing inferior products or labor, or products that are not Buy America Act (BAA) or Trade Agreements Act (TAA) compliant.

### **Inferior Products or Labor:**

Substitution of inferior products or labor often occurs when contractors provide cheaper materials or labor than specified in the contract without notifying the government and bill as if they provided compliant products or services. Both cases are commonly discovered through customer complaints. For example, roofing work that is performed using inferior products is more prone to problems such as leaks, cracks, failures, etc. Similarly, work that is performed by unqualified employees may result in errors or take drastically more hours than estimated. To review employee qualifications for unqualified labor, contract auditors generally select a sample of resumes for individuals whose work was billed under government projects. While undergoing these reviews, auditors should bear in mind that resumes may contain inaccurate information or may have been altered by management.

**Hexcel Corporation paid the United States \$15 million to resolve allegations related to defective Zylon bulletproof vests. The U.S. alleged that Hexcel knew the Zylon material it wove into bulletproof vests was defective and degraded quickly when exposed to heat, light, and humidity. The bulletproof vests manufactured by Hexcel were sold to multiple corporations, who, in turn, sold them to federal, state, local and tribal law enforcement agencies. Since 2007, the body armor industry has paid the U.S. more than \$54 million to**

resolve allegations of knowingly manufacturing and selling defective Zylon bulletproof vests. This case was worked by GSA OIG among other agencies.

## Buy American Act Violations:

The BAA is the major domestic preference statute governing procurements by the federal government. The act requires the federal government to buy domestic “articles, materials, and supplies” when they are acquired for public use unless a specific exemption applies.<sup>49</sup> It attempts to protect domestic labor by providing a preference for American goods in government purchases.

The BAA differentiates between manufactured and un-manufactured articles in the determination of whether an article is deemed a domestic end product or construction material. To be considered domestic: (1) an un-manufactured article must be mined or produced in the U.S., or (2) for manufactured end products, the article must be manufactured in the U.S. and at least 50 percent of its components, by cost, must be domestic.<sup>50 51</sup>

The following is a partial, most commonly used, list of exemptions from the act:

- (1) Public Interest: BAA can be waived if the agency head determines the restrictions would be impractical or inconsistent with the public interest.
- (2) Nonavailability: A nonavailability determination may be made if articles are not mined, produced, or manufactured in the U.S. in sufficient and reasonably available commercial quantities and of a satisfactory quality.
- (3) Unreasonable Cost: BAA is not required if the CO deems the cost of domestic articles to be unreasonable. The cost of a domestic article is considered unreasonable if it exceeds the cost of the foreign article by over six percent (over 12 percent if the domestic company is considered a small business).<sup>52 53</sup>

Another major exemption to the BAA is the TAA. TAA waives BAA’s requirements over a certain dollar threshold as they apply to products from countries that have entered into reciprocal trade agreements with the US.<sup>54</sup> TAA is discussed in detail in the next section.

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<sup>49</sup> Congressional Research Service- *Report to Congress The Buy American Act: Requiring Government Procurements to come from Domestic Sources* [http://www.seia.org/galleries/pdf/CRS\\_Report\\_-\\_The\\_Buy\\_American\\_Act\\_3.13.09.pdf](http://www.seia.org/galleries/pdf/CRS_Report_-_The_Buy_American_Act_3.13.09.pdf)

<sup>50</sup> FAR 25.101(a)

<sup>51</sup> The Recovery Act created more stringent standards for construction materials used in contracts funded by Recovery Act appropriations by modifying the definition of “domestic construction material.” Instead, 100 percent of components must be made in the United States. In addition, if a construction material is “predominantly” iron or steel, all iron or steel has to be from the U.S., in addition to the manufacture of the finished part having to occur in the U.S.

<sup>52</sup> FAR 25.105(b)

<sup>53</sup> ARRA modifies the price reasonableness test for domestic construction material. The cost is unreasonable if the overall price would increase by more than 25 percent if domestic manufactured construction material were used.

<sup>54</sup> TAA waives BAA for supplies with an estimated acquisition value at \$202,000 or more and for construction contracts estimated at \$7,777,000 or more. FAR 25.402(b), FAR 25.202(c)

In order to increase profits, or simply to sell to the government, contractors sometimes falsely certify BAA compliance. When procurements are made based on these misrepresentations, the government is not supporting its goal of protecting domestic labor and may be overpaying for products, as products and production are often cheaper outside the U.S.

### **Trade Agreements Act Violations:**

Under TAA, end products that the U.S. government purchases must be TAA compliant unless the government can show that the products cannot be purchased from TAA compliant countries. A product is "TAA compliant" if it is made in the United States or a "Designated Country." Designated Countries include those with a free trade agreement with the U.S., countries that participate in the World Trade Organization Government Procurement Agreement, "least developed" countries, and Caribbean Basin countries.<sup>55</sup>

It is important to note that TAA, unlike BAA, applies to end products only. An end product is defined as "those articles, materials, and supplies to be acquired for public use."<sup>56</sup> Therefore, a U.S. contractor may purchase parts from non-designated countries as long as the parts are substantially transformed, including by transformation into a "system" of multiple components, in the U.S. or a designated country, into a new and different article.<sup>57</sup>

Notably absent from the list of designated countries are several countries that are major suppliers of goods or services to the U.S. market, such as China, India, Malaysia, and Thailand. Therefore, items that are considered end products of those countries are not eligible for placement on GSA schedules. Government agencies may only purchase TAA-noncompliant products when it is determined that U.S./designated country products are not available. This is known as a "nonavailability determination."<sup>58</sup>

In order to ensure TAA compliance, GSA contracts typically include a TAA Certification which requires the contractor to certify that "each end product... is a U.S.-made [or designated country] product."<sup>59</sup> However, in order to increase profits, contractors will sometimes purchase products from non-designated countries, usually at a lower cost, and sell those products to the government under false pretenses. These cheaper, noncompliant products are not necessarily inferior in quality; however, the contractor misleads the government into believing the products came from designated countries and does not pass on the reduced costs, thus creating intentional overcharges and violating the law.

### **Indicators of Inferior Products/Labor or BAA/TAA Violations:**

- Country of origin not shown or removed
- Standardized products or services
- Materials not tested in accordance with contract terms
- Signs that test results may be falsified
- Tests performed by a related party

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<sup>55</sup> FAR 52.225-5

<sup>56</sup> FAR 25.003

<sup>57</sup> FAR 25.001(c)(2)

<sup>58</sup> FAR 25.103(b) and FAR 25.502(b)(3)

<sup>59</sup> FAR 52.212-3(g)(4)



- Tests performed by supplier, using its own resources
- Contractor attempts to limit or avoid inspection of goods or services
- Contractor refusal to provide documentation regarding manufacture, shipment, or production of products
- Missing or altered documentation related to inspection or shipment
- Contractor attempts to select samples for testing and resistant to random selection by auditor or agent
- Certification and/or shipping documents photocopies rather than originals
- Certification signed by low level employee that is not involved with quality assurance
- Documentation incomplete or lacks approval signatures
- Discrepancy between the product's description and actual appearance
- Machines with identification or specification plates removed
- Resubmission of previously rejected goods
- Irregularities in signatures, dates, or quantities on delivery documents
- Complaints by customers related to purchased products or services
- High rate of product failures, rejections, or returns
- Higher maintenance costs
- Requests to modify contract requirements
- Contractor employees' experience on resume does not match position requirements
- Reluctance to sign or omission of required labor certifications or other supporting documents
- Multiple resumes contain similar words, phrases, or typos (appear to be created by the same individual)
- Services greatly exceed time estimates

## **OTHER SCHEMES TO DEFRAUD THE U.S. GOVERNMENT**

### **Progress Payments Fraud:**

A progress payment is a payment made by the government based on percentage of work completed or on an incurred cost basis. The percentage of completion method of payment is generally used for construction projects. Progress payments fraud occurs when a contractor submits a request for payment with a false certification of work completed or falsified costs such as direct labor not rendered and materials not purchased.<sup>60</sup> As progress payments fraud is similar to charging for products not used or services not rendered the indicators are generally the same.

### **Formation of a New Company to Conceal Previous Violations, Debarments or Debarred Officials:**

A company with previous violations, debarments or debarred officials may create a new corporate entity in order to conduct business with the government.<sup>61</sup> In most cases, when this happens, the officials, employees, and products/services sold remain essentially unchanged. In substance, the newly formed company is one and the same as the original.

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<sup>60</sup> USAID Office of Inspector General/Investigations – Fraud Indicators  
[http://www.usaid.gov/oig/hotline/fraud\\_awareness\\_handbook\\_052201.pdf](http://www.usaid.gov/oig/hotline/fraud_awareness_handbook_052201.pdf)

<sup>61</sup> In the case of concealing debarred principals, the newly formed corporation may intentionally hide the employment of those individuals by putting them on the payroll as non-principal employees.

When a company forms a new corporate entity to circumvent the system and deceive the government, it can result in the government contracting with irresponsible contractors.

Small Business or Disability/Minority/Women/Service-Disabled Veteran-Owned Front:

Contractors certified as Small Business or Disability/Minority/Women/Service-Disabled Veteran-Owned are often given preferential treatment related to contract awards. For this reason, some contractors have been inclined to falsely certify themselves, or obtain legitimate certifications, through invalid means. One such example is having a male officer's wife serve as a figurehead officer to obtain women-owned status. This scheme is extremely difficult to detect without the help of an informant, but has been found in GSA operations in the past.

## REMEDIES

The following section describes common criminal charges, civil remedies, and administrative actions that may be applicable if fraud has occurred.

## COMMON CRIMINAL CHARGES

Information pertaining to common criminal charges is based on the United States Attorneys' Manual (USAM)<sup>62</sup> and the Department of Defense (DOD) OIG Handbook on Indicators of Fraud in DOD Procurement.<sup>63</sup>

### **False Statements (18 U.S.C. § 1001)**

This statute makes it illegal to (1) knowingly falsify, conceal, or cover up a material fact by any trick, scheme, or device; (2) make false, fictitious, or fraudulent statements or representations; or (3) make or use any false document or writing within the jurisdiction of any department or agency of the U.S. For example, a CEO who signs that the information he provided is accurate to the best of his knowledge, when he knows it is false, could be charged with making false statements.

### **False Claims (18 U.S.C. § 287)**

This statute makes it illegal to knowingly present or make any false, fictitious, or fraudulent claim against any agency or department of the U.S. The violation occurs when the claim is presented for payment regardless of whether it was actually paid. For example, a construction claim that contains false information could constitute a criminal violation. However, the case is rarely prosecuted when no damages have been sustained due to lack of payment.

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<sup>62</sup> USAM accessed at: [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/index.html](http://www.justice.gov/usao/eousa/foia_reading_room/usam/index.html)

<sup>63</sup> Handbook accessed at: <http://www.cohenseglias.com/government-contracts.php?action=view&id=343>



## **Mail Fraud or Wire Fraud (18 U.S.C. § 1341 or 18 U.S.C. § 1343 respectively)**

These statutes make it illegal to engage in any scheme to defraud in which mail or wire mediums of communications are utilized. There are two elements in mail fraud: having devised or intending to devise a scheme to defraud (or to perform specified fraudulent acts) and the use of the mail for the purpose of executing, or attempting to execute, the scheme. The elements of wire fraud directly parallel those of the mail fraud statute, but require the use of an interstate telephone call or electronic communication made in furtherance of the scheme. For example, receiving payment from the government which has been sent through the mail or by interstate wire in connection with a scheme to defraud would constitute a violation of this statute.

## **Conspiracy to Defraud the U.S. Government (18 U.S.C. § 371)**

This statute prohibits any agreement between two or more persons to defraud the U.S. or to violate any federal law or regulation when at least one act is taken in furtherance of the agreement.

## **Other Common Charges**

- Bribery, Graft, and Conflicts of Interest, Generally, 18 U.S.C. § 201-209.
- Theft, Embezzlement, or Conversion of Public Money, Property, or Records, 18 U.S.C. § 641.
- Obstruction of Justice or Audit, 18 U.S.C. § 1505, 1510, and 1516.
- Anti-kickback Act, 41 U.S.C. § 53 & 54.
- Sherman Antitrust Act, 15 U.S.C. § 1.
- Racketeering, 18 U.S.C. § 1962.

# CIVIL REMEDIES

## **False Claims Act (31 U.S.C. § 3729 et seq.)**

The civil statute routinely used by GSA OIG is the civil False Claims Act, 31 U.S.C. § 3729 et seq. The False Claims Act provides, among other things, that persons who knowingly (including with reckless disregard) submit or cause the submission of false claims for payment, or who knowingly make or use false records or statements material to false claims, are liable for treble damages plus civil penalties of \$5,500 to \$11,000 per false claim. Under the “reverse” False Claims Act provision, a person who “knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the government” also may be liable.

## **Other Civil Remedies**

In addition to the civil False Claims Act, DOJ may use other civil remedies such as unjust enrichment or payment by mistake in connection with a False Claims Act case. If, for any

reason, DOJ declines to pursue a matter civilly, it may be referred to the cognizant contracting officer for possible administrative action.

## ADMINISTRATIVE ACTIONS

### Loss of Contract

The cognizant contracting officer (CO) has the authority to make the determination to cancel, partially cancel, or allow an existing contract to expire. Generally, GSA MAS contracts contain the following clauses: GSAM 552.238-73 Cancellation and I-FSS-163 Option to Extend the Term of the Contract (Evergreen). These clauses establish the CO's authority in regards to canceling or expiring existing contracts.

GSAM clause 552.238-73 allows for both the CO and the contractor to cancel the contract at anytime by providing written notice. The contract expires 30 days after the notice has been received.

Clause I-FSS-163, generally located within the contract solicitation, relates to the expiration of evergreen contracts. The majority of GSA MAS contracts function as evergreen contracts. Evergreen contracts have a base period of five years with three possible options to extend. Each option is for five additional years, giving the contractor the option to hold its contract for a total of 20 years. Clause I-FSS-163 allows the CO to exercise the contract's option to extend when the CO finds the contract benefits the government, bearing a few conditions in mind. If the CO determines that it is not advantageous for the government to continue with the contract, the CO has the authority to elect not to exercise the option to extend, thus allowing the contract to expire. Both GSAM 552.238-73 Cancellation and I-FSS-163 Option to Extend the Term of the Contract (Evergreen) clauses can be found in Appendix D.

### Suspension and Debarment

More serious than loss of contract, suspension and debarment result in an entity's exclusion from receiving government grants and contracts for a set period of time. The former Acting Chief Acquisition Officer of GSA stated, "Suspension and Debarment is not a punishment. Instead, suspension and debarment is a prophylactic measure intended to prevent the Government from doing business with companies or individuals who demonstrate a lack of present 'responsibility...'"<sup>64</sup>

A suspension or debarment may be based on indictments, convictions, civil judgments, information or adequate evidence involving crimes, contract fraud, embezzlement, theft, forgery, bribery, false statements, other crimes, poor performance, non-performance, as well as other causes.<sup>65</sup>

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<sup>64</sup> GSA's Suspension and Debarment Program and the Excluded Parties List System (EPLS) <http://www.gsa.gov/portal/content/103455>

<sup>65</sup> FAR 9.406-2 and FAR 9.407-2 which can be found in Appendix D

A suspension is a temporary action which may last up to one year and is effective immediately.<sup>66</sup> The time period for debarment is decided on a case by case basis commensurate with the seriousness of the cause but generally does not exceed three years.

When an audit indicates that suspension or debarment may be appropriate as a result of a suspected wrong-doing, the matter should be referred to JI in accordance with standard GSA OIG procedures.<sup>67</sup> Recommendations for potential suspension and debarment actions are handled by the regional investigative offices and should be discussed with JI as early as possible.

The decision to suspend or debar a contractor is based on the final determinations of the Suspension and Debarment Official. Suspensions and debarments can also be extended to include subsidiaries, parent companies and other individuals. In this regard, relevant information can be found on the "Excluded Parties List System" (EPLS) which contains a listing of individuals and entities excluded from eligibility for receipt of government grants and contracts. The contracting officer is responsible for accessing this GSA operated, web-based database before contract award to ensure the proposed contractor is not an excluded party.

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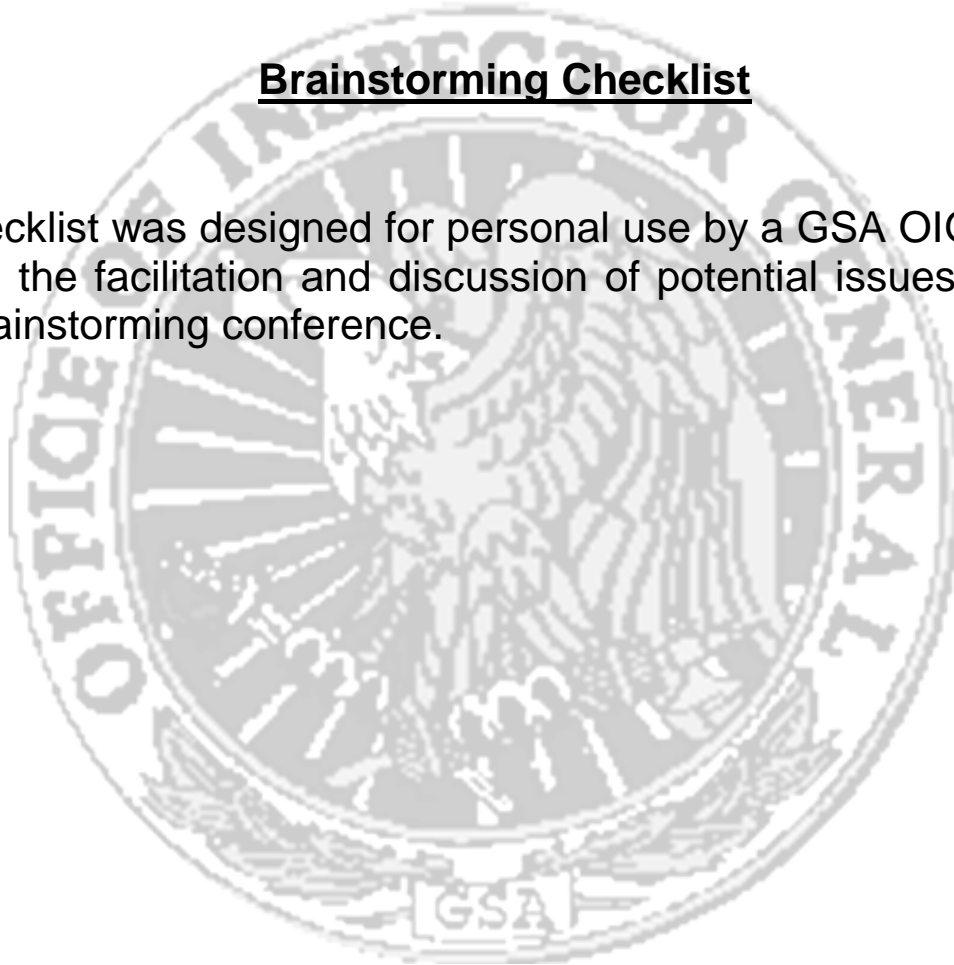
<sup>66</sup> U.S. Department of Transportation, Senior Procurement Official: Suspension and Debarment Program [http://www.dot.gov/ost/m60/Financial\\_Assistance\\_Management\\_Home/Suspension\\_Debarment\\_Program.htm](http://www.dot.gov/ost/m60/Financial_Assistance_Management_Home/Suspension_Debarment_Program.htm)

<sup>67</sup> Subchapter 705 of the GSA OIG Policy and Procedures Manual

# Appendix A

## Brainstorming Checklist

This checklist was designed for personal use by a GSA OIG auditor to assist in the facilitation and discussion of potential issues during the fraud brainstorming conference.



## Fraud Conference

The following is a checklist of what should be discussed in a fraud conference in the planning phase of an examination or audit to address the possibility of fraud and to customize audit techniques to minimize fraud risk.

- ✓ Discuss the fraud triangle to assess which elements may exist.
  - Fraud triangle:
    - Incentives/Pressure: a reason to commit fraud
    - Opportunity: a lack of effective controls
    - Rationalization/Attitude: an attempt to justify fraudulent behavior
- ✓ Discuss the internal controls in place to prevent and detect fraud as well as the strength of the internal controls identified. Also discuss areas lacking sufficient internal controls that may represent fraud risk. Focus your audit testing on the areas identified.
  - Consider the possibility for management override of controls
- ✓ Discuss the company's segregation of duties (or lack of) and individuals that are responsible for multiple tasks.
  - Segregation of Duties:
    - Authorization
    - Recording
    - Custody

All of these functions should be performed by separate individuals. This is slightly different in an IT intensive environment: Control Group, Operators, Programmers, Analysts, and Librarian functions should all be separate.
- ✓ Discuss any past allegations of fraud or legal action related to the company (through prior research of past audit reports, Dun & Bradstreet, JI Database, internet searches, etc.)
- ✓ Discuss the importance of professional skepticism.

# Appendix B

## Contractor Inquiry Questionnaires

### Fraud Questions for Contractor Personnel

After the brainstorming session and the audit team agrees that potential areas of fraud risk may be present, consideration should be given to using Contractor Inquiry Questionnaires. These questionnaires may be administered to management or staff-level employees that have a direct relationship to the contract proposal being audited. Contractor management should be informed of the intent to employ the use of these questionnaires.

Note: These questions were developed based on standard AICPA<sup>68</sup> and ACFE<sup>69</sup> questions.

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<sup>68</sup> American Institute of Certified Public Accountants

<sup>69</sup> Association of Certified Fraud Examiners

## Upper Level Management Questions

1. We're required to assess the risk that material fraud exists in every company, not just yours. This is a sensitive area for everyone but our professional responsibilities dictate that we address this area. Do you have any questions?
2. Immaterial misstatements (mistakes), material misstatements, and even fraud may exist in companies. How do you think your company compares with others in the same industry?
3. What controls are in place in your company to detect and prevent material misstatements and fraud?
4. In the past, has fraud been committed against your company by employees or executives?
5. What is your overall impression of the company's ethics and corporate culture?
6. How do you think this company stacks up with others in terms of honesty of its employees and managers?
7. Do you train employees about ethical behavior?
  - a. How? Documentation?
8. What are your internal procedures for fraud reporting?
  - a. Do you have any whistleblower programs?
9. Has anyone you work with ever asked you to do something you felt wasn't legal or ethical?
  - a. How would you handle that situation if someone asked you?
10. Has anyone in a position of authority ever asked you to withhold information from the auditors or alter documents?
11. Is there adequate monitoring over internal controls?
  - a. Who is responsible for designing and monitoring these controls?
12. Does the organization have an independent and/or active internal audit department?
13. How does the company prevent conflicts of interest (i.e. awarding contracts to relatives and friends)?
14. Is management's compensation primarily performance based?
15. How is the company's performance compared to previous years?
  - a. Do you believe that the current economic conditions and company performance are putting more financial pressure on employees?

- b. (IF GROWTH) Is there an unusually rapid growth or profitability, especially compared with that of other companies in the same industry?
- 16. Is the company in any kind of financial trouble that would motivate management to misstate the company's profits?
- 17. Does management set unduly aggressive or unrealistic financial targets?
- 18. Are key individuals or the company currently involved in any ongoing litigation?
  - a. Has the company had any ongoing litigation within the past five years?
  - b. Could any of this litigation severely or adversely affect the company's financial results?
- 19. Has the company been the subject of any ongoing internal or external investigations?
- 20. Have any key members of management had past regulatory or legal problems, either personally or with organizations they have been associated with?
- 21. How is your company's employee turnover?
  - a. What do you believe were the reasons for employees leaving the company?
- 22. Have there been significant changes in the makeup of management?
- 23. Has there been a high turnover of management?
- 24. To your knowledge, have any of your employees been disciplined, dismissed, reassigned, charged, or prosecuted because of purported fraudulent acts?
- 25. Has the ethics program identified any potential fraud indicators?



## **Questions for Staff Members**

1. As an auditor, it is my job to discuss matters such as fraud within a company. These are just standard questions that we are going to ask people within your company. Do you understand?
2. Did you receive any training about ethical behavior?
  - a. What kind?
3. Do you know of the company's internal procedures for reporting unethical behaviors?
  - a. Are you aware of any whistleblower programs?
  - b. Do you know of any incentives to encourage employees to report instances they believe may be fraudulent?
  - c. Do you feel comfortable reporting suspected unethical events?
4. Has anyone you work with ever asked you to do something you felt wasn't ethical?
  - a. How would you handle that situation if someone asked you?
  - b. What if the person asking you held a position of authority or was your direct superior?
5. Has anyone in a position of authority ever asked you to withhold information from the auditors or alter documents? If yes, please explain.
6. How do you think the company is currently performing compared to previous years?
  - a. Do you believe that the current economic conditions and company performance are putting more financial pressure on management and employees to act in an unethical manner?
7. Is the company having any financial difficulties that you are aware of?
8. Have any key members of management had past regulatory or legal problems, either personally or with organizations they have been associated with?
9. Do you know if the company is or has had any recent ongoing litigation or law suits?
10. Do you know if the company or company employees are or have been the subject of any ongoing internal or external investigation?
11. How is your company's employee turnover?
  - a. What do you believe were the reasons for employees leaving the company?
12. Have there been significant changes in the makeup of management?
13. Has there been a high turnover of management?
14. Is there any reason that someone in the company might say that management had a motive to misstate the financials?
15. Does management set unduly aggressive or unrealistic financial targets?

16. What is your overall impression of the company's ethics and corporate culture?
17. How do you think this company stacks up with others in terms of honesty of its employees and managers?
18. If fraud were going to occur in your company, where do you think it is most likely to happen?
19. During our assessment of risk of fraud in your company, are there any specific areas you'd like to discuss with us?

# Appendix C

## **Multiple Award Schedule Contract Audit Objectives**

Audit objectives are found in section 805.13 of the OIG Policy and Procedures Manual commonly referred to as the “Blue Book”.

While fraud detection is not a stated audit objective, all contract audits are performed as examination-level attestation engagements (Yellow Book section 6.13). Our auditing standards require that; “auditors should design the engagement to provide reasonable assurance of detecting fraud, illegal acts, or violations of contract provisions....that could have a material effect on the subject matter of the attestation engagement”.

The following discussion summarizes the audit objectives relative to Multiple Award Schedule Contract Audits.

## **Multiple Award Schedule Contract Audit Objectives**

Preaward Multiple Award audits are conducted generally before the award of the contract or prior to a contract's option to extend. Preaward audits can be divided into service contracts, product contracts, and contracts that contain both. All contract types follow at least three main audit objectives. The audit objectives are to determine if:

1. The Commercial Sales Practice (CSP-1) information submitted by the company is current, accurate and complete;
2. The company's sales monitoring and billing systems ensure proper administration of the price reduction provisions and billing terms of the contract; and,
3. The company adequately accumulates and reports schedule sales for Industrial Funding Fee (IFF) payment purposes.

Audits of service contracts and those that contain both products and services add two additional objectives:

4. Employees assigned to work on task orders placed under the GSA schedule are qualified for the billable positions; and
5. The company has an adequate accounting system for the segregation and accumulation of labor hours, material costs and other direct costs (ODCs) on time and material task orders.

Postaward audits are similar to preaward audits but performed after the contract has been awarded. These audits have two main objectives:

1. The company complied with the price reduction clause and billing provisions of the contract; and
2. All GSA schedule sales were accurately complied and reported in accordance with the IFF provisions of the contract.

Audits of service contracts and those that contain both products and services add two additional objectives:

3. The hours billed to government customers on time and material (T&M) task orders are adequately supported with appropriate labor time-keeping records; and
4. The employee's qualifications meet or exceed the contractual requirement for the labor disciplines offered and billed on T&M task orders.

# Appendix D

## Pertinent Clauses for Administrative Actions

The following clauses are contained in this appendix:

- GSAM 552.238-73 Cancellation
- I-FSS-163 Option To Extend The Term Of The Contract (Evergreen) (Apr 2000)
- FAR 9.406-2 Causes for debarment
- FAR 9.407-2 Causes for suspension

**GSAM 552.238-73 Cancellation.**

As prescribed in 538.273(a)(4), insert the following clause:  
CANCELLATION (SEP 1999)

Either party may cancel this contract in whole or in part by providing written notice. The cancellation will take effect 30 calendar days after the other party receives the notice of cancellation. If the Contractor elects to cancel this contract, the Government will not reimburse the minimum guarantee.

(End of clause)

**I-FSS-163 OPTION TO EXTEND THE TERM OF THE CONTRACT (EVERGREEN) (APR 2000)**

- (a) The Government may require continued performance of this contract of an additional 5 year period when it is determined that exercising the option is advantageous to the Government considering price and other factors. The option clause may not be exercised more than three times. When the option to extend the term of this contract is exercised the following conditions are applicable:
  - (1) It is determined that exercising the option is advantages to the Government considering price and other factors covered in (2 through 4 below).
  - (2) The Contractor's electronic catalog/price list has been received, approved, posted, and kept current on GSA Advangate!™ in accordance with clause I-FSS-600, Contract Price Lists.
  - (3) Performance has been acceptable under the contract.
  - (4) Subcontracting goals have been reviewed and approved.
- (b) The contracting Officer may exercise the option by providing a written notice to the contractor within 30 days, unless otherwise noted, prior to the expiration of the contract or option.
- (c) When the Government exercises its option to extend the term of this contract, prized in effect at the time the option is exercised will remain in effect during the option period, unless an adjustment is made in accordance with another contract clause (e.g., Economic Price Adjustment Clause or Price Reduction Clause).

## **FAR 9.406-2 Causes for debarment.**

The debarring official may debar—

(a) A contractor for a conviction of or civil judgment for—

(1) Commission of fraud or a criminal offense in connection with—

(i) Obtaining;

(ii) Attempting to obtain; or

(iii) Performing a public contract or subcontract.

(2) Violation of Federal or State antitrust statutes relating to the submission of offers;

(3) Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, violating Federal criminal tax laws, or receiving stolen property;

(4) Intentionally affixing a label bearing a “Made in America” inscription (or any inscription having the same meaning) to a product sold in or shipped to the United States or its outlying areas, when the product was not made in the United States or its outlying areas (see Section 202 of the Defense Production Act (Public Law 102-558)); or

(5) Commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor or subcontractor.

(b)(1) A contractor, based upon a preponderance of the evidence, for any of the following—

(i) Violation of the terms of a Government contract or subcontract so serious as to justify debarment, such as—

(A) Willful failure to perform in accordance with the terms of one or more contracts;

or

(B) A history of failure to perform, or of unsatisfactory performance of, one or more contracts.

(ii) Violations of the Drug-Free Workplace Act of 1988 (Pub. L. 100-690), as indicated by—

(A) Failure to comply with the requirements of the clause at 52.223-6, Drug-Free Workplace; or

(B) Such a number of contractor employees convicted of violations of criminal drug statutes occurring in the workplace as to indicate that the contractor has failed to make a good faith effort to provide a drug-free workplace (see 23.504).

(iii) Intentionally affixing a label bearing a “Made in America” inscription (or any inscription having the same meaning) to a product sold in or shipped to the United States or its outlying areas, when the product was not made in the United States or its outlying areas (see Section 202 of the Defense Production Act (Public Law 102-558)).

(iv) Commission of an unfair trade practice as defined in 9.403 (see Section 201 of the Defense Production Act (Pub. L. 102-558)).

(v) Delinquent Federal taxes in an amount that exceeds \$3,000.

(A) Federal taxes are considered delinquent for purposes of this provision if both of the following criteria apply:

(1) *The tax liability is finally determined.* The liability is finally determined if it has been assessed. A liability is not finally determined if there is a pending administrative or judicial challenge. In the case of a judicial challenge to the liability, the liability is not finally determined until all judicial appeal rights have been exhausted.

(2) *The taxpayer is delinquent in making payment.* A taxpayer is delinquent if the taxpayer has failed to pay the tax liability when full payment was due and required. A taxpayer is not delinquent in cases where enforced collection action is precluded.

(vi) Knowing failure by a principal, until 3 years after final payment on any Government contract awarded to the contractor, to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a subcontract there under, credible evidence of—

(A) Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code;

(B) Violation of the civil False Claims Act (31 U.S.C. 3729-3733); or

(C) Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001.

(2) A contractor, based on a determination by the Secretary of Homeland Security or the Attorney General of the United States, that the contractor is not in compliance with Immigration and Nationality Act employment provisions (see Executive Order 12989, as amended by Executive Order 13286). Such determination is not reviewable in the debarment proceedings.

(c) A contractor or subcontractor based on any other cause of so serious or compelling a nature that it affects the present responsibility of the contractor or subcontractor.

#### **9.407-2 Causes for suspension.**

(a) The suspending official may suspend a contractor suspected, upon adequate evidence, of—

(1) Commission of fraud or a criminal offense in connection with—

(i) Obtaining;

(ii) Attempting to obtain; or

(iii) Performing a public contract or subcontract.

(2) Violation of Federal or State antitrust statutes relating to the submission of offers;

(3) Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion, violating Federal criminal tax laws, or receiving stolen property;

(4) Violations of the Drug-Free Workplace Act of 1988 (Pub. L. 100-690), as indicated by—



(i) Failure to comply with the requirements of the clause at 52.223-6, Drug-Free Workplace; or

(ii) Such a number of contractor employees convicted of violations of criminal drug statutes occurring in the workplace as to indicate that the contractor has failed to make a good faith effort to provide a drug-free workplace (see 23.504);

(5) Intentionally affixing a label bearing a “Made in America” inscription (or any inscription having the same meaning) to a product sold in or shipped to the United States or its outlying areas, when the product was not made in the United States or its outlying areas (see Section 202 of the Defense Production Act (Public Law 102-558));

(6) Commission of an unfair trade practice as defined in 9.403 (see section 201 of the Defense Production Act (Pub. L. 102-558));

(7) Delinquent Federal taxes in an amount that exceeds \$3,000. See the criteria at 9.406-2(b)(1)(v) for determination of when taxes are delinquent;

(8) Knowing failure by a principal, until 3 years after final payment on any Government contract awarded to the contractor, to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a subcontract there under, credible evidence of—

(i) Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code;

(ii) Violation of the civil False Claims Act (31 U.S.C. 3729-3733); or

(iii) Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001; or

(9) Commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor or subcontractor.

(b) Indictment for any of the causes in paragraph (a) of this section constitutes adequate evidence for suspension.

(c) The suspending official may upon adequate evidence also suspend a contractor for any other cause of so serious or compelling a nature that it affects the present responsibility of a Government contractor or subcontractor.