

## **GOVERNMENT PROCUREMENT FRAUD**

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## **Government Procurement Fraud**

### **Abstract**

The United States government is the largest consumer of prime contracts (Berriso 2006). “Between 2000 and 2005, the federal government’s annual procurement spending rose by \$174.4 billion dollars, from \$203.1 billion dollars in 2000 to \$377.5 billion dollars in 2005. The largest annual increase occurred between 2004 and 2005, when procurement spending jumped by \$48 billion dollars” (Waxman 2006 p. 3-4). Over the last five years, spending on federal contracts has been the fastest-growing part of the discretionary budget. In fact, between 2000 and 2005, procurement spending rose 86%, twice as fast as the remaining discretionary spending, which itself has increased 43%. Indeed, federal contract expenditures now consume almost 40 cents of every dollar of discretionary spending (Waxman 2006 p. 3). For the fiscal year ending September 30, 2005, the United States recouped over \$1.4 billion dollars in settlements and judgments pursuing allegations of fraud (USDOJ November 2005). For the fiscal year ending September 30, 2006, the United States recovered a record total of more than \$3.1 billion dollars in settlements and judgments from cases involving claims of fraud against the government. In 2006, defense procurement fraud accounted for \$609 million dollars in settlement and judgment awards (USDOJ Nov 2006). This discussion reviews the types of procurement fraud and what is being done to prevent and discover these types of fraud. *The views contained herein do not purport to reflect the position of the DCAA or Department of Defense.*

### **Introduction**

Government funds are a limited resource expended to benefit the country’s citizens in areas such as social issues, national defense, homeland security and natural disasters. The United States government is the largest consumer of prime contracts (Berriso 2006 p. 120). “Between 2000 and 2005, the federal government’s annual procurement spending rose by \$174.4 billion, from \$203.1 billion in 2000 to \$377.5 billion in 2005. The largest annual increase occurred between 2004 and 2005, when procurement spending jumped by \$48 billion” (Waxman 2006 pp. 3-4).

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For the fiscal year ending September 30, 2005, the United States recouped over \$1.4 billion dollars in settlements and judgments pursuing allegations of fraud (USDOJ November 2005). For the fiscal year ending September 30, 2006, a record total of more than \$3.1 billion in settlements and judgments from cases involving claims of fraud against the government was recovered. In 2006 defense procurement fraud accounted for \$609 million in settlement and judgment awards (USDOJ November 2006).

Not only does procurement fraud squander limited funds, it threatens safety and national defense. “Procurement fraud cheats American taxpayers and harms the government’s efforts to obtain the goods and services needed for its mission. At a time of heightened concern for our nation’s security, every tax dollar is precious” (USDOJ October 2006).

### **Types of Procurement Contracts**

The government utilizes a mixture of contract types to purchase materials and services. The types of contracts vary according to “(1) the degree and timing of the responsibility assumed by the contractor for the costs of performance; and (2) the amount and nature of the profit incentive offered to the contractor for achieving or exceeding specified standards or goals” (Federal Acquisition Regulation 2005).

Contracts fall into two categories: fixed-price and flexibly-priced. Flexibly-priced contracts are also often referred to as cost-type or cost-reimbursable contracts. Fixed-priced contracts are utilized when an agreed upon cost for the goods or service has been

established. “Fixed-price contracts provide for a firm price or, in appropriate cases, an adjustable price. Fixed-price contracts providing for an adjustable price may include a ceiling price, a target price (including target cost), or both. Unless otherwise specified in the contract, the ceiling price or target price is subject to adjustment only by operation of contract clauses providing for equitable adjustment or other revision of the contract price under stated circumstances” (Federal Acquisition Regulation 2005).

From the government’s point of view, fixed-price contracts are preferable because the contractor accepts more of the risk. Under this method “maximum risk and responsibility is borne by the contractor, who assumes full responsibility for profit or loss” (Berrios 2006 p. 121). The contractor is paid the agreed upon amount regardless of the final costs. Thus, the contractor has an incentive to perform the work efficiently and to control costs.

“Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract” (Federal Acquisition Regulation 2005). As a result, a cost-reimbursable contract results in the government assuming more risk with payments increasing if the contractor spends more than initially projected (Berrios 2006 p. 121). However, a cost-reimbursement contract may only be used if the “(1) the contractor’s accounting system is adequate for determining costs applicable to the contract; and (2) appropriate Government surveillance during performance will provide reasonable assurance that efficient methods and effective cost controls are used” (Federal Acquisition Regulation 2005).

### **Government Acquisition Methods**

The procurement process begins with a request for acquisition of goods or services. There are three methods of acquisition or bidding processes that the United States utilizes to procure goods or services, namely (1) competitive or advertised bidding, (2) competitive proposals/negotiations, and (3) sole source. At any stage of the procurement process, “anyone who has the knowledge, opportunity, and need can take advantage of the contract” (May 2005). Of course, the goal is to purchase the most appropriate and highest quality good or service for the lowest cost (Bartle & LaCourse Korosec 2003).

### **Competitive/Advertised Bidding**

Competitive or advertised bidding is the method used when the government has exact specifications of the product or service required. When evaluating bids, “consideration is given to both price and other important factors such as experience, past performance, approach to the problem posed by the jurisdiction and staffing” (Qaio & Cummings 2003). In the competitive bidding process, requests for procurement must specify the government’s requirements clearly, accurately and completely. There is no negotiation between the government and the responding bidders. This procurement method promotes competition. Fair and honest consideration is implied and given to all bidders soliciting the government contract. By bidding on the contract, the contractor agrees to all conditions that have been specified (Lansing & Burkard 1991 p. 357-358).

A low bid could be rejected for legitimate reasons. For instance, the low bid price may be considered unrealistic, the bidder may be deemed unresponsive (such as having a poor reputation for the follow-up parts market), or may fail to conform to standards, or

there might be a conflict of interest or appearance of favoritism prohibiting the award (Lansing & Burkard 1991 p. 358).

While the traditional method of selecting the lowest responsible bid is still the dominant selection method, other methods have been introduced to public procurement in response to the increasingly complex nature of the goods and services purchased by the government (Qiao & Cummings 2003). Some of the more non-traditional methods include competitive proposals/negotiations and sole source.

### **Competitive Proposals/Negotiations**

The second type of acquisition, competitive negotiation, is also referred to as competitive proposals. Competitive negotiations are a more flexible method of contracting (Berrios 2006 p. 120). It usually begins with a government agency request. In a competitive negotiation, the government has an idea of what it requires, but lacks the resources to establish exact specifications and costs. As a result, contractors have a degree of liberty in the development of the procurement proposal, as well as an opportunity to sway the government into paying an unreasonably higher price. After an agreement is reached, a contract is written and signed by both parties (Lansing & Burkard 1991 p. 359).

### **Sole Source**

The third method of procurement is sole source. In this type of procurement, the government contacts the contractor it wants to supply the product or service. By its nature, the sole source process vests a significant amount of power in the contracting officers. However, the reason a contractor is chosen must be justified to the responsible oversight individual, committee, or governmental agency, such as the United States

Congress. In addition, awarding sole source contracts must be warranted as the best and/or only way for the contracting agency to acquire the quality goods and services needed in a timely fashion. A request for a proposal to the contractor selected is delivered and answered by the contractor. Additional issues are then negotiated, such as price and delivery terms. Finally, a contract is written and signed by both parties (Lansing & Burkard 1991 p. 359).

Detractors believe that the government has turned toward more and more contracting that is increasingly least favorable to the government, “the government increasingly eschews the proven benefits of competitive bidding for negotiated deals that tend to cost more” (Berrios 2006 p. 121). Noncompetitive awards rose from \$7.5 billion in 2000 to \$145 billion in 2005, an increase of 115% (Waxman 2006 p.7). Much of this increase could be attributed to the rebuilding of Iraq and recovery from Hurricane Katrina. Federal acquisition law does provide for exemptions from competitive sourcing requirements under certain circumstances, such as emergencies, or if there is only one source for the required service. Still, the use of these types of contracts has increased from 33% of Federal contract dollars in 2000, to 38% in 2005 (Waxman 2006 p.7-8).

In response to the significant increase in procurement spending, Representative Leonard Boswell (D-IA) introduced the Competitiveness in Contracting Act on July 28, 2006. The “proposed legislation aims to limit the noncompetitive award of federal contracts in response to major disasters and emergencies” (Dees 2006 p. 46). This bill is currently before the House Government Reform Committee (H.R. 5981).

## **Government Contract Fraud**

Once a contract has been awarded, the potential for fraud exists. This discussion will examine: (1) product substitution, (2) cost mischarging, (3) defective pricing, (4) progress payment fraud and (5) antitrust violations.

### **Product Substitution**

Product substitution, as the name implies, occurs when a contractor delivers “nonconforming goods or services without informing the government of the deficiencies” (Procurement fraud 2006). The contractor then knowingly bills and receives payment for conforming goods.

### **Cost Mischarging**

Cost mischarging occurs with large cost-reimbursement type contracts. These contracts present an opportunity to contractors who are willing to take the risk of mischarging costs knowingly and willfully after an award. Cost mischarging can be further divided into three categories: (1) accounting mischarging, (2) material cost mischarging and (3) labor mischarging.

Of the three types, accounting mischarging is the most likely to be found by auditors. It occurs when a contractor knowingly charges or conceals unallowable costs within allowable expenses or in accounts that are not closely monitored. In addition, rather than trying to hide unallowable costs, cost mischarging may occur because the appropriate account categories have reached their limit (Procurement fraud 2006).

As is the case for all companies, material costs are vulnerable to fraud since material is susceptible to physical loss. Government contracts are additionally at risk due to the contractor’s mix of government and commercial work. Fraud indicators for

materials include shifts of materials from government contracts to commercial jobs after the cost has been charged to the government contract, transfers of costs that are substantially different from actual costs, and reassignment of materials from fixed-price to cost-type contracts (Inspector General 1993).

Labor mischarging occurs when the contractor charges the government for work that was not actually performed. Some of the more common methods include: transfer of labor costs from fixed price contracts to cost-type contracts; billing the government for undocumented labor time; destroying time cards and creating new ones; and altering time cards (Procurement fraud 2006).

Certainly, fraud indicators related to procurement contracts are similar to signs of fraud in any audit. However, government procurement is unique in that the most significant costs may also be the most difficult to review, namely, labor. Labor costs are particularly sensitive since supporting third party documentation does not exist (Weisman 1987 p. 28). For this particular cost, there are no invoices and purchase orders to verify the expense. Thus, an understanding of the contractor's labor accounting system is vital. Examples of fraud indicators are: distinctive charging patterns, significant swings in labor costs, reclassification of employees from direct to indirect or reverse, and weak internal controls (Inspector General 1993).

### **Defective Pricing**

Defective pricing is the result of inflating costs by intentionally using old or inaccurate cost data (May 2005). Under the "Truth in Negotiations Act contractors are required to submit cost or pricing data prior to negotiations and to certify that such data is accurate, complete and current as of the close of negotiations. The submission of

defective data, i.e., inaccurate, incomplete or noncurrent data, entitles the government to a price reduction under a contract clause included whenever certified cost or pricing data is required” (Procurement fraud 2006). The existence of defective pricing data does not in itself indicate fraudulent behavior by the contractor, and recovery under the contract clause is not based on fraudulent intent. However, contractors who knowingly submit defective information to the government during negotiations commit fraud (Procurement fraud 2006).

Some of the most significant fraud indicators in defective pricing cases are: “(1) falsifications or alterations of supporting data; (2) failure to update cost or pricing data when past activity indicates that prices have decreased; (3) failure to make complete disclosure of data known to responsible contractor personnel; (4) distortion of overhead accounts or base line information by transferring charges or accounts that have a material impact on government contracts; (5) protracted delay in release of data to the government to preclude possible price reductions; (6) repeated denials by responsible contractor employees of the existence of historical records that are subsequently found; (7) submitting fictitious documents; (8) failing to disclose internal documents on vendor discounts; and (9) nondisclosure of actual costs for follow-up contracts” (Procurement fraud 2006).

### **Progress Payments**

Payments made to contractors based on costs incurred or on a percentage or phase of completion offer the opportunity for progress payment fraud. Because the government relies heavily on the integrity of the contractor, progress payments are not always audited before payment. Progress payment fraud cases usually entail erroneous labor charges for

work not yet performed, charges for materials that were not actually purchased, or false documentation of the percentage or phase of completion (Procurement fraud 2006).

This fraud is perpetrated to receive more money in a cost-type contract but could also be committed to influence future contract awards (May 2005). For example, contracts are often awarded in phases with the release of funds for the second phase dependent upon completion of the first.

### **Antitrust Violations**

Yet another type of procurement fraud is antitrust violations. Collusive bidding, price fixing, or bid rigging are other terms used to describe illegal antitrust or anticompetitive activity. They all involve agreements or informal arrangements among independent competitors intended to limit competition (Procurement Fraud 2006). For example, a contractor might set the price artificially low with the intent to raise the price via submission of higher costs. Another possibility is intentional high bids by contractors for the “purpose of arranging for one company to win the contract and then hire the other companies as subcontractors” (May 2005).

The result of antitrust violations is increased costs as well as weakening of the government’s efforts to utilize competitive contracting processes. Antitrust violations can also damage public trust in the integrity of the contracting process (Procurement fraud 2006).

### **Preventive/Detective Legislation and Organizations**

The United States government has implemented procurement fraud preventive and detective legislation such as, the Procurement Integrity Act and the False Claims Act Qui Tam Action. A number of organizations also exist which aid in the prevention and

detection of procurement fraud such as the National Procurement Fraud Task Force, the Inspector General, the Special Inspector General for Iraq Reconstruction, and the Defense Contract Audit Agency.

### **Program Integrity Act**

Private consultants are often utilized to assist in the procurement process and who better to seek advice from than a former governmental employee. These private consultants serve as liaisons between government officials and the contractor (Lansing & Burkard 1991). However, the government has strict rules regarding re-employment by contractors after leaving a governmental position.

In addition, government employees are required to take annual ethical training regarding this issue and are encouraged to contact the government's human resource department before accepting a position with a contractor in order to avoid the appearance of conflict of interest. Failure to comply with the government's ethical guidelines can result in blacklisting in addition to criminal charges.

The basis for these strict guidelines is the Procurement Integrity Act, originally passed in 1988, and amended several times. The Act focuses on inappropriate contacts between contractors and government officials. It expressly addresses offers of employment, disclosure of information and compensation of former officials. A variety of remedies are available for punishing violators including criminal prosecution, civil suits and administrative ramifications. The Act specifies that, "any government employee with access to contractor bid or proposal information or source selection information may not, except as provided by law, disclose that information prior to awards" (Procurement Fraud 2006).

Moreover, no one may knowingly obtain this type of information before an award. These prohibitions apply regardless of the dollar value of the proposed contract. A government employee “participating personally and substantially” in procurement must report any offer for non-Federal employment made by a contractor. The employee has two choices; the offer of employment can be rejected, or the employee can exclude him/herself from further participation in the procurement process (Procurement fraud 2006).

### **False Claims Act Qui Tam Actions**

The False Claims Act was passed by the Lincoln administration during the Civil War as a way to punish military contractors who cheated the government. In 1986, Senator Charles Grassley, R-Iowa, led an effort to strengthen the legislation. One of Congress's objectives in modifying the act was to encourage the use of qui tam actions in which citizens would be authorized to bring, as ‘private Attorneys General,’ lawsuits on behalf of the government. Qui Tam is an abbreviation of the Latin phrase “qui tam pro domino rege quam pro se ipso in hoc parte sequitur,” meaning he who sues for the king sues for himself (Wikipedia 2007). Under the new provisions, whistleblowers potentially benefit by filing cases against government contractors who commit fraud. Any violation of federal law can result in a false claim under the act (Zeller 2005 p. 26).

The whistle blower begins the qui tam process by retaining a private attorney. The attorney investigates the whistleblower's allegations and, if appropriate, files the qui tam lawsuit acting on the government's behalf alleging violations of the False Claims Act. Qui tam suits are filed secretly so the defendant and others do not learn of the lawsuit. The Department of Justice is served a copy of the complaint, along with a

written disclosure statement detailing the alleged fraud, to provide the government with an opportunity to investigate the allegations (Lewis 2000 p. 41).

The Justice Department proceeds to investigate the allegations and may or may not decide to work with the whistleblower's attorney. If the Justice Department declines to proceed, the whistleblower and the attorney can still move forward. A contractor found guilty of making false claims for federal funds is liable for three times the government's loss plus a civil penalty of \$5,500 to \$11,000 for each false claim (USDOJ November, 2005).

If the contractor settles, or is found to have made false claims, the award is shared with the whistleblower (Zeller 2005 p. 26). For example, government participation in a qui tam action results in the whistleblower receiving 15 to 25 percent of any settlement or judgment attributable to the fraud. On the other hand, lack of government participation increases the whistleblower's share up to 30 percent. For whistleblowers, the potential reward is enticing. Whistleblowers were awarded \$166 million for fiscal year 2005. (USDOJ November 2005).

“Almost half of fraud investigations in federal agencies are instigated by a tip from someone who notices something isn't quite right” (Palmer 2006 p. 54). The increase in false Claims Act lawsuits may be attributed to the increased incentives for whistleblowers to come forward since the 1986 legislation. Indeed, the number of cases filed under the law jumped from 60 in 1988 to more than 400 in 2004. “Awards rose from less than \$1 million in 1988 to more than \$1 billion in 2003, with some cases now yielding judgments in the hundreds of millions” (Zeller 2005). Nevertheless, federal government employees are limited in their ability to act as whistleblowers. “The courts

generally reason that federal employees should not personally benefit for simply doing what they are required and paid to do--which is to report fraud” (Lewis 2000 p. 41).

“Of the \$1.4 billion in settlements and judgments received in 2005, \$1.1 billion is associated with suits initiated by whistleblowers under the False Claims Act’s qui tam provisions” (USDOJ November 2005). In 2006, of the \$3.1 billion recovered by the government for fraud, \$1.3 billion was from suits brought by whistleblowers under the provision (USDOJ November 2006). The largest payment ever received under the False Claims Act was from Oracle who agreed to pay \$498.5 million for false pricing information provided by PeopleSoft to obtain a government contract. The whistleblower will receive \$17, 730,000 of the total recovery as a reward (USDOJ October 2006).

### **National Procurement Fraud Task Force**

Deputy Attorney General Paul J. McNulty announced on October 10, 2006 the establishment of a new national procurement fraud initiative by the Justice Department’s Criminal Division. The mission of the task force is to detect, prevent and prosecute procurement fraud resulting from increased contracting activity for national security and other government programs. Deputy McNulty stated, “Procurement fraud cheats American taxpayers and harms the government’s efforts to obtain the goods and services needed for its mission” (USDOJ October 2006).

The task force is expected to reinforce the government’s efforts against procurement fraud and increase criminal enforcement. The focus will be on defective pricing, product substitution, misuse of classified and procurement sensitive information, false claims, grant frauds, labor mischarging, accounting fraud, foreign military sales

fraud, ethics and conflict of interest violations, and public corruption associated with procurement. Specifically, the priorities are:

- “Identification and prosecution of viable procurement fraud cases through coordination with United States Attorneys’ Offices and Office of Inspector General field offices;
- Ensuring adequate resources are available to successfully investigate and prosecute procurement fraud cases;
- Standardization of ‘best practices’ (e.g., recruitment of sources, consensual calls, and witness interviews);
- Better coordination between agency auditors and investigators to ensure that red flags and badges of fraud are promptly reported to criminal investigators for follow-up;
- Better identification and resolution of investigative and coordination issues as they arise in joint cases (e.g., audit support and expanded efforts to share information);
- Specialized training for Office of Inspector General agents and auditors on the development and prosecution of procurement fraud cases;
- Examination of existing laws and policies to determine if they need to be strengthened or changed;
- Development of strategies encouraging agencies to refer more cases for civil and criminal prosecution; and
- Better coordination of targeted civil, regulatory and criminal enforcement actions” (USDOJ October 2006).

### **Inspector General**

The Inspector General Act established the inspector general as the primary advisor to the Secretary of Defense for issues related to prevention of fraud and abuse in the Department of Defense (Inspector General Act of 1978). Further, Congress instituted the Special Inspector General for Iraq Reconstruction (SIGIR) to oversee the \$18.4 billion reconstruction fund. As a result, the Department of Defense Inspector

General has limited its audit role to prevent duplication of efforts due to the oversight provided by the SIGIR, the Department of Defense audit community and the Government Accountability Office (Gimble 2005 p. 2-3).

### **Defense Contract Audit Agency**

Established in 1965, the Defense Contract Audit Agency (DCAA) centralized audit functions for the various branches of the military that had previously been separate. The Agency performs standardized contract audits for the Defense Department and certain other government agencies along with accounting and financial advisory services related to procurement contracts. Audit services offered by the DCAA include pre and post award contract audits along with contractor internal control systems audits. In addition, DCAA auditors provide negotiation assistance in the form of procurement liaison services and fact-finding analysis of contractor information after audits (DCAA 2006).

In conformity with Government Auditing Standards, DCAA auditors are not responsible for proving fraud. "DCAA's mission is to perform contract audits of commercial companies, and not to perform investigations," said a Pentagon official, in explaining the audit agency. When auditors suspect unlawful activity, they "make a referral . . . to the appropriate investigative organization" (King, Jr., 2004). Yet auditors are required to design audit steps to reasonably assure detection of irregularities and illegal acts. Auditors must report fraud indicators to investigators, but in turn cannot automatically conclude that an indication of fraud means fraud exists (Inspector General 1993).

Indeed, as in the case of all audits, professional skepticism is a necessary skill.

In fiscal year 2006, the DCAA audited \$121.1 billion of incurred costs on contracts and reviewed forward pricing proposals amounting to \$182.3 billion. American taxpayers saved a net \$2.3 billion due to audit findings. Thus, the return on investment in the DCAA was approximately \$5.20 for each dollar expended for the Agency's operations (DCAA 2006).

### **Procurement Fraud: Rebuilding Iraq**

The government began contracting with private companies and individuals to support the military in the 1950s during the Korean War (Kopecki 2006). Rep. Henry Waxman of California, ranking member of the House Government Reform Committee, issued a report identifying three major contracting events since 2001: Iraq reconstruction, Hurricane Katrina and homeland security (Osgood 2006). The rebuilding of Iraq and the Gulf Coast hurricane-rebuilding efforts have resulted in cases of fraud committed in various phases of the procurement process by private companies and individuals. In fact, the rebuilding of the Gulf Coast mirrors the experience in Iraq (Soloway 2005 p 44). This discussion focuses on rebuilding Iraq.

In a quarterly audit, Stuart Bowen, Special Inspector General for Iraq Reconstruction, stated, "the Iraqi government estimates that corruption costs the country at least \$4 billion a year" (Dreazen 2006). He reported in July 2006 "that there are 70 corruption investigations underway in Iraq, of which 23 involve allegations of contract fraud, overcharging, product substitution, or false claims. In addition, 50 cases have been brought by whistleblowers under the False Claims Act" (Osgood 2006).

Moreover, the report also stated that Iraq's anticorruption agency had opened 1,400 criminal cases alleging the theft of \$5 billion by Iraqi officials, including a former defense minister who is accused of stealing or mispending more than \$1 billion

(Dreazen 2006). A spokesperson from the Defense Department's criminal investigations reported that their office expects a "rise in referrals of potential fraud or corruption cases [in Iraq]" (Kopecki 2006).

Meanwhile, the Government Accountability Office reported in July 2006 that the Defense Department had "recovered about \$2 billion since 2001 from all outside contractors and government procurement officials accused of dishonesty or mismanagement, but the GAO didn't isolate those working in Iraq" (Kopecki 2006).

The Department of Justice announced on February 7, 2007 that a federal indictment had been unsealed that charged five people for their part in the theft of millions of dollars from the Coalition Provisional Authority by rigging the bids on contracts. The Coalition Provisional Authority was created by the United States and the United Kingdom to rebuild Iraq. More than \$3.6 million are estimated to have been lost from the fraud. Still, more than \$2 million has been recovered. "This indictment is part of the first major investigation being prosecuted by the Department of Justice to root out corruption and fraud in the awarding of Iraq reconstruction contracts (USDOJ February 2007).

Recently, a hearing of the House Committee on oversight and government reform indicated that the DCAA director will testify that there are more than \$10 billion in questioned and unsupported costs relating to the Iraq reconstruction and military support contracts. This estimate is a result of a review of \$57 billion of Iraq contract spending. "There's \$300 billion still to audit" (Hearing of the House Committee 2007).

Mentioned often in the news in connection with the Iraq rebuilding effort is the single fastest-growing federal contractor between 2000 and 2005, Halliburton. "In 2000,

Halliburton was the 20<sup>th</sup> largest federal contractor, receiving \$763 million in federal contracts. By 2005, Halliburton had become the 6<sup>th</sup> largest federal contractor, receiving nearly \$6 billion in federal contracts” (Waxman 2006 p. 5). Indeed, Halliburton has a long history as a government contractor, dating back to World War II (Kahn, 2003).

In 2001, Halliburton’s subsidiary Kellogg, Brown & Root (KBR) was awarded the single largest cost-type contract known as LOGCAP, the Logistics Civil Augmentation Program, valued at \$16.4 billion to provide food, shelter, and other support services to U.S. troops in Iraq, Afghanistan, and elsewhere. “In 2005 alone, Halliburton was paid over \$5 billion on this contract” (Waxman 2006 p. 18).

By July 2006 the Army confirmed that they were ending the 10-year multibillion-dollar contract with Halliburton’s subsidiary KBR to supply food, water, shelter, and other basic needs to U.S. troops. The Pentagon has paid KBR \$15 billion since 2001, and now plans to divide the contract between four contractors. Nevertheless, KBR will be permitted to submit a bid for a portion of the contract (Kopecki 2006).

KBR came under scrutiny when Defense Department auditors indicated “\$1.2 billion in KBR charges were ‘excessive,’ ‘duplicative,’ or otherwise questionable. KBR officials say its costs were reasonable considering that the work was done under ‘extraordinarily hostile conditions.’ KBR also said it had resolved most of the audit disputes with the Army” (Kopecki 2006).

DCAA government auditors found several problems with the work conducted by Halliburton under the LOGCAP contract. “After identifying ‘significant unsupported costs’ and ‘numerous, systemic issues’ with Halliburton’s ‘inadequate proposals,’ DCAA recommended on three occasions that the Army begin withholding a portion of contractor

payments until Halliburton corrected the deficiencies as federal law requires. In total, DCAA identified over \$1.1 billion in questioned and unsupported costs under this contract” (Waxman 2006 p. 60).

Still, “a recent study by the nonpartisan Congressional Budget Office concluded that in 2004 the U.S. reduced its costs by one-third for feeding and housing troops by paying one contractor to do the work -- a savings of nearly \$3 billion. Such findings point to the conclusion that even with a lot of fraud and waste, outsourcing may still pay off” (Kopeck, 2006).

Another contract awarded to Halliburton, known as RIO, was approved in March 2003 for KBR to restore and operate Iraq’s oil infrastructure, in a no-bid process. “Halliburton charged approximately \$2.4 billion under the RIO contract, split generally between oil infrastructure projects and fuel importation” (Waxman 2006 p.60).

The selection of Halliburton was “an emergency process that did not involve competitive bidding. In a similar fashion, the Army Corps of Engineers awarded a contract to extinguish oil well fires to KBR because it had the expertise and specialized resources. KBR, for example, helped douse approximately 300 Kuwaiti oil fires after the first Gulf War in 1991” (Dwyer & Balfour 2003).

USAID, the principal U.S. agency to extend assistance to countries recovering from disasters and engaging in democratic reforms, reported that competition for rebuilding Iraq was limited due to the time frame. It took just 63 days to complete a process that usually takes 6 months. “For political and humanitarian reasons, the Iraq project couldn't wait, says USAID Administrator Andrew S. Natsios: We wanted it all in place so we could begin construction immediately” (Dwyer & Balfour 2003).

Many skeptics have criticized Halliburton and have accused them of inflating costs. Pentagon auditors concurred with the concerns. In audits of the ten task orders under the RIO contract, DCAA identified \$219 million in questioned costs and \$60 million in unsupported costs. DCAA auditors found exceptions with nearly every aspect of Halliburton's work, including excessive charges to import fuel into Iraq from Kuwait and unnecessary retroactive payments to its Turkish fuel subcontractors. Consequently, since March 2005, multiple Halliburton officials have been indicted or convicted of corruption-related charges involving contracts in Iraq (Waxman 2006).

### **Conclusion**

The importance of detection and prevention of procurement fraud has been a focus of the United States government since the Civil War with the passing of the False Claims Act by the Lincoln administration. This objective has been continued by subsequent administrations with the strengthening of the False Claims Act with the qui tam provision, the passing of the Procurement Integrity Act, the formation of the National Procurement Fraud Task Force, the efforts of the Inspector General and the Defense Contract Audit Agency.

The attention given to detection and prevention of fraud is justifiable as spending on federal contracts has increased by 86% over the last five years. Additionally, the increase in recovery, \$3.1 billion dollars in settlements and judgments from cases involving fraud against the government in fiscal year 2006 alone, provides incentive for both the government and civilians. After all, \$1.3 billion was due to whistle-blowers who shared in the recovery.

Moreover, increasing financial penalties with the qui tam provision under the False Claims Act is a step in the right direction to mitigate fraud losses. However, fines are not enough. Taxpayers have a right to expect long-term incarceration for contractors found guilty of procurement fraud. Managers of companies who decide to do the crime must also be seen to do the time in order to discourage others from defrauding the government. The financial cost and loss of personal freedom must be severe in order to discourage those who are tempted by opportunity.

Indeed, prior to the 1980s, all cases brought under the False Claims Act were prosecuted as criminal, not civil, cases. However, early 1980s research revealed that criminal prosecution did little to stop procurement fraud. Moreover, the Justice Department was limited in the number of cases it could litigate due to the high cost of federal prosecution. As a result, the majority of contractors committing procurement fraud were off the hook (U.S. General Counsel 1993). However, the recent formation of the National Procurement Fraud Task Force and its plans to increase criminal enforcement along with the strengthening of the False Claims Act may create too great a risk of prosecution.

Certainly, increased spending on government contracts magnifies the opportunity for procurement fraud. Consequently, it is in the taxpayers' best interest to expand funding for fraud detection agencies and increase the number of qualified auditors in proportion to procurement spending. "Beyond preventing obvious abuse, the government has an obligation to modernize its priorities, practices and processes to cope with the demands and needs of today's changing world" (Ramamoorti & Curtis 2003 p. 24).

*The views contained herein do not purport to reflect the position of the DCAA or  
Department of Defense.*

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