

TACKLING Governmental Contract Fraud

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Back to School DAZE

Q. What is big, yellow and comes every morning to brighten Mom's day?

A. A school bus!



Back to School DAZE

Q. Why did the teacher have to wear glasses?

A. Because her students were so bright!



Back to School DAZE

Q. Why did the boy ask his dad to take his quiz?

A. It was a POP quiz!



Back to School DAZE

Q. Why is a math book so unhappy?

A. It has a lot of problems.



Back to School DAZE

Q. What is a pirate's favorite subject?

A. Aarrrrrrrt.



Back to School DAZE

Q. What kind of school do you go to if you're a surfer?

A. A boarding school.



Back to School DAZE

Q. What kind of school do you go to if you're a giant?

A. A high school.



Back to School DAZE

Q. What kind of school do you go to if you're ice cream?

A. Sundae school



II. Recent Actions – Contractor Fraud

December 2018: The Department of Defense commissioned a study over a five year period

- ▶ **1,059 cases** resulted in criminal convictions of **1,087 defendants**
 - » 678 individuals, 409 business entities
 - » \$368,670,000 recovered through fines and penalties
 - » \$360M in restitution
 - » \$53M in forfeitures



Enforcement and penalization were go-forward priorities.

II. Recent Actions – Contractor Fraud



February 2019: CO's U.S. Attorney pursued charges against CO and Maryland vendors for defrauding their SBA programs.

1. Socially and economically disadvantaged owners
2. "Term" limits
3. VMJ Construction vs. Vigil Contracting (John and Michael Vigil)

II. Recent Actions – Contractor Fraud



What could have been done?

1. Background checks
2. References
3. Interviews and questionnaires
4. Employee and vendor training

II. Recent Enforcement Actions

US Attorney's Office – New Jersey, October 29, 2015

- ▶ *A compliance officer with the Union City Community Development Agency (UCCDA) was indicted today for allegedly manipulating the contractor selection process for federally-funded residential rehabilitation and sidewalk replacement projects, causing losses of at least \$250,000.*

Two additional SEC enforcement actions have raised concerns that the agency will penalize compliance and finance officers who are tasked with creating rigorous programs, leading to potentially perverse incentives to avoid responsibility for those programs.

II. Recent Enforcement Actions

Varieties of fraud found in government contracting include:

- ▶ Fraudulently providing products or services that do not match the contract or regulatory specifications, or products that have failed or not been through required quality assurance and testing procedures
- ▶ Making a violation of “most favored customer” or “best pricing” requirements, price reduction clauses and Truth in Negotiation Act requirements
- ▶ Submitting false claims for inflated material costs or rates
- ▶ Cross charging by shifting costs from one government contract to a different government contract, or misallocating costs between government and private contracts
- ▶ Concealing cybersecurity vulnerabilities, computer hacks and data breaches

II. Recent Enforcement Actions

In September 2015, the Department of Justice issued what has been referred to as "**The Yates Memo**."

The goal was to:

1. Deter corporate misconduct by putting individuals at risk of criminal and civil prosecution
2. Set clear expectations on what qualifies as "cooperation credit" for DOJ leniency

Deputy Assistant Attorney General for Criminal Enforcement, Brent Snyder, reported that the Antitrust Division DOJ has prosecuted "*almost three times as many individuals (352) as corporations (123)*" in the last five years.

In addition, prison terms for individuals have increased significantly, "*from an average of 8 months in the 1990s, to an average of 24 months for fiscal years 2010 through 2015.*"

II. Recent Enforcement Actions

These actions make it very clear:

The use of third-party
relationships does NOT
relinquish responsibility of
management



III. Managing Third Party Relationships

The following steps should be taken in managing third party relationships:

1. **Conduct due diligence** to verify that the service provider understands and is capable of complying with federal consumer laws
2. **Establish internal controls** and on-going monitoring to determine whether the service provider is complying with federal consumer financial law





On-Boarding

1. What is the company's history with providing goods and services?
2. What items/elements within the statement of work will be outsourced or sub-contracted?
3. What performance metrics are in place to ensure contract compliance?
4. What are the remedies for noncompliance?
5. What about your end – what are your responsibilities?
6. Is there a common ground on acceptable behavior?

1. Conducting Due Diligence

Right to Audit Clauses

- ▶ Grants rights to access and analyze books and accounts and confirm performance and accuracy of the licensees records.
- ▶ **Provides:**
 - ▶ Access by a third party or group of investors
 - ▶ Remedies, such as payment of the legal and audit expenses of the offended party
 - ▶ Process to resolve disputes to avoid unnecessary litigation that may harm the future of the agreement between the parties



1. Conducting Due Diligence

Right to Audit Clauses (cont'd)

The following issues should be considered for inclusion:

- ▶ Is notice of an audit required? If so, how much time is appropriate?
- ▶ Who bears the costs of the audit? Will there be a cost-shifting scheme based on findings?
- ▶ What is the scope of the audit?
- ▶ How will data (and other) privacy concerns be addressed?
- ▶ How frequently can audits occur?
- ▶ Will employees be made available for interviews?
- ▶ What accounting files will be made available electronically or in hard-copy – master payee files, general ledger, internal audit materials, cash controls, travel expenses?

1. Conducting Due Diligence

Right to Audit Clauses (cont'd)

- ▶ Will electronically stored information be made available for review during the audit?
- ▶ Can the auditor make site visits?
- ▶ Who chooses the auditors?
- ▶ Is there a time limit on the amount of time an audit can take?
- ▶ How long must the relevant records be retained?
- ▶ What can trigger an audit?
- ▶ How and when should materials provided pursuant to the audit be returned once the audit is complete?
- ▶ Will the audited company be notified of communications with DOJ and SEC by the auditor? If so, can the audited company review the materials that will be shared with the Government?

2. Establishing Internal Controls & On-going Monitoring

- A. Identify Your Third-party Providers
- B. Perform Risk Assessment
- C. Contract Review & Assessment
- D. Performance Monitoring



A. Identify Your Third-Party Providers



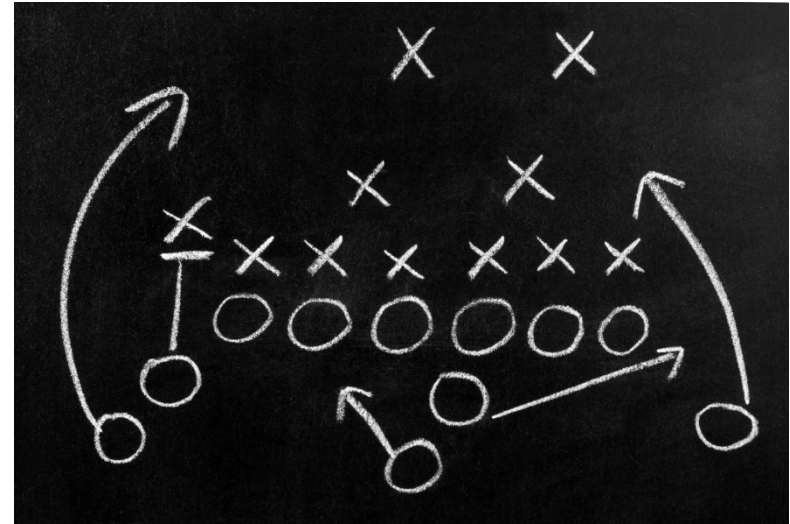
- ▶ Consultants/Lobbyists
- ▶ Contractors and Sub-contractors
- ▶ Joint venture partners (P3)
- ▶ Other agency relationships
 - » Accountants
 - » Attorneys

2. Establishing Internal Controls & On-going Monitoring

B. Risk Assessment

Determine whether the vendor is a high, medium or low risk based on **YOUR** criteria

- ▶ Document rationale for risk ranking
- ▶ If medium or high risk, then a deeper review must be done in comparison to vendors who are determined to be low risk
- ▶ Consideration must be given to industry-specific risks and how these risks can be mitigated



2. Establishing Internal Controls & On-going Monitoring

B. Risk Assessment

Each company's risk profile is unique and requires a tailored risk management approach appropriate for:

- ▶ The scale of its particular third-party relationships
- ▶ The materiality and type of the risks present
- ▶ The ability of the institution to manage those risks

Organizations must use their financial and operational knowledge to determine whether the relationship is "**significant**."

2. Establishing Internal Controls & On-going Monitoring

B. Risk Assessment

Guidance suggests that, among other things, factors such as the following could be used to determine whether the relationship is “**significant**.”

- ▶ Involves new activities
- ▶ Has material effect on the institution’s revenues or expenses
- ▶ The third party performs critical functions
- ▶ Stores or has access to sensitive customer data
- ▶ Is subject to regulatory guidance and compliance requirements

Studies show an organization may also analyze:

- ▶ Whether the service provider delivers customer facing products or services
- ▶ How much reliance is being placed on the service provider
- ▶ The difficulty in monitoring/overseeing the operations of the service provider

2. Establishing Internal Controls & On-going Monitoring

C. Contract review and assessment:

- ❑ Does the contract adhere to internal policies and procedures?
- ❑ What services/goods are being provided?
- ❑ How is performance measured?
- ❑ What representations and warranties exists?
- ❑ What are the available methods to cure a breach?
- ❑ Do the financial statement balances look reasonable based on the contract?

2. Establishing Internal Controls & On-going Monitoring

D. Performance Monitoring - Planning

Before launching a third-party audit, determine:

- ▶ Whether you have sufficient and qualified resources to undertake the audit
- ▶ Whether there have been previous audits and/or unresolved issues
- ▶ Whether you have requested, and they provided sufficient documentation to compile a work plan
- ▶ Local/International concerns
 - » Holidays
 - » Employee rights
 - » Legal rights
 - » Language/Cultural
 - » Health concerns

2. Establishing Internal Controls & On-going Monitoring

D. Performance monitoring – Document Requests

- ▶ Audited financial statements
- ▶ Significant issues, complaints and lawsuits
- ▶ Qualifications and experience of those significant to the vendor's operations and yours
- ▶ Their use of third parties, contractors or others
- ▶ Evidence of regulatory compliance

Note: The manner in which funds are exchanged can complicate your document requests.

2. Establishing Internal Controls & On-going Monitoring

D. Performance Monitoring – Red Flags

- ▶ Refusal to provide certifications or agree to policies
- ▶ Unusual delays in providing documentation
- ▶ Incomplete responses to due diligence questionnaires
- ▶ Lack of requisite qualifications or operations to satisfy duties and responsibilities
- ▶ Close relationship between third party and government official or entity
- ▶ Constant quality and quantity issues
- ▶ Attorneys taking a “management” role



2. Establishing Internal Controls & On-going Monitoring

D. Performance Monitoring – Red Flags

- ▶ Invoices that appear “homemade”
 - ▶ Sequential or limited numbers
 - ▶ Templates found online
- ▶ Multiple businesses operating out of the same office
- ▶ Difficulty in finding background information on company or its operators
 - ▶ Lack of references
 - ▶ Online anonymity

...Sometimes, it's just a feeling.



IV. Parting Shots - Tips

Be Careful

- ▶ Identify “reporting” risks, both internal and external
- ▶ Acknowledge the dependency on the vendor
- ▶ Establish a “plan b”

Be Responsive

- ▶ Monitor internal complaints and react **swiftly** as they come in
- ▶ Get the right people involved

Be Disciplined

- ▶ Develop an audit **plan that is repeatable and defensible**
- ▶ Adhere to your investigative protocols
- ▶ Do not lose sight of issues related to **business implications**, privilege and potential self-reporting obligations

Be Committed

- ▶ It is **not** enough to implement the framework of a system
- ▶ Companies must devote **appropriate resources to compliance** programs and obtain buy-in of key stakeholders



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Accounting Method Changes





Changes to Business Deductions

Key Changes for Businesses

