
Statement of Brian D. Miller
Inspector General
General Services Administration

Before the

Subcommittee on Government Management, Organization and Procurement
Committee on Oversight and Government Reform
United States House of Representatives

New Contracting and Property Bills

Tuesday, April 15th, 2008



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Chairman Towns, Ranking Member Bilbray, and Members of the Subcommittee, thank you for your invitation to present my views on the regulatory efforts that would strengthen contractor ethics and protect the United States and the American taxpayer from fraudulent conduct in the award and performance of Federal contracts and subcontracts. I commend the Subcommittee and Representative Welch, Chairman Towns and Chairman Waxman for introducing H.R. 5712, the *Close the Contractor Fraud Loophole Act*. This legislation is needed to ensure that contractors report crimes and overpayments, and I strongly support it.

In addressing H.R. 5712, you asked that I address the exemptions for contracts performed overseas and commercial item contracts that appeared, to my surprise, in a recently proposed Federal Acquisition Regulation (FAR) rule (FAR Case 2007-006).

Support by Inspectors General

As the public comments indicate, the Inspectors General (IGs) strongly support the proposed reporting requirement. This strong support is only natural because of the IGs' commitment to protecting American taxpayer dollars. IGs also support this rule because they are an integral part of the National Procurement Fraud Task Force (Task Force), and as members of the Task Force, they participated in formulating the proposed rule. Since the formation of the Task Force, IGs chaired all but one of the Task Force's

committees and have been working more closely with the Department of Justice (DOJ) than ever before. I am honored to serve as the Task Force Vice Chair. As Vice Chair, I direct the Task Force along with the Chair, Assistant Attorney General (AAG) Alice Fisher, Principal Deputy Assistant Attorney General Barry Sabin, and Executive Director Steve Linick (all of DOJ's Criminal Division).

A proposed amendment to the FAR requiring contractors to report crimes and overpayments, FAR Case 2007-006, was part of an initiative of the Legislation Committee of the Task Force, chaired by Department of Homeland Security Inspector General Richard Skinner and me. The Legislation Committee began meeting on a weekly basis in February 2007, culminating in the circulation to the Task Force of a draft white paper on July 9, 2007. Task Force Chair, AAG Fisher, sent the regulatory proposal to OMB on May 23, 2007 with the Legislation Committee's approval (Attachment A).

Inspectors General expressed the need for this proposed rule and legislation through the letters they sent to the Regulatory Secretariat in support of the proposed FAR rule in FAR Case 2007-006. The Inspector General of the Department of Interior, Earl Devaney, appealed to the Guiding Principles for the Federal Acquisition System, which refers to a "team." He states: "As team members, our partners in industry must display the same commitment to honesty and integrity in the procurement process as the Federal government does." Letter from Inspector General Devaney to Regulatory Secretariat, January 11, 2008.¹ Unfortunately, contractors -- our team members -- have not been reporting crimes and overpayments. Voluntary disclosure programs are infrequently used. In Fiscal Year 2007, the DoD Voluntary Disclosure program had only three contractors participate. The simple fact is that the vast majority of crimes involving contractors are not reported. This rule and this legislation would change this problem.

The type of reporting requirement proposed is not unusual. In fact, it is much less exacting than reporting requirements for health care providers, who face criminal sanctions for failing to report overpayments. *See* 42 U.S.C. § 1320a – 7b. The Defense

¹ See also Letter from Inspector General Robert W. Cobb to Regulatory Secretariat, January 11, 2008. He states: "But crimes do occur in carrying out of NASA contracts, and we note that some of these crimes threaten the safety of NASA employees, contractor employees, and the public. . . .But, the vast majority of crimes involving contractors . . . are not reported to us by the companies themselves. . . .In the larger context of increased Government-wide outsourcing over the past several years, the institution of an internal control that provides assurance criminal abuse associated with Government contracts will be reported is not only reasonable and logical *but necessary* to protect the public." (Emphasis added.).

Contract Management Agency put it simply: “I’m surprised that government contractors are not held to the same standard [as health care providers and banking]. With tax dollars at risk, the idea that contractors can profess to have a partnership with the government and then fail to alert us when fraud occurs or overpayments have been made makes no sense.” Letter from DCMA Acting Director Keith Ernst to Regulatory Secretariat, January 8, 2008. Unlike other industries, FAR Case 2007-006 imposes only minimal, common sense requirements on Federal government contractors. These requirements are more crucial with the rapid growth of government-wide reliance on contractors.

The Federal Acquisition Institute’s Annual Report on the Federal Acquisition Workforce, Fiscal Year 2006, reported 12% fewer contracting officers in Fiscal Year 2006 than in Fiscal Year 1992. Over the last seven fiscal years, while contracting dollars have doubled, the Federal workforce of contracting officers has not changed. The average contracting officer now supervises twice the volume of contracting dollars as his/her counterpart in Fiscal Year 2000. For some contractors and vendors who may be unscrupulous in their adherence to contracting rules and regulations, such a decrease in oversight capacity may represent an opportunity for improper conduct.

The relative decrease in Federal contracting officers needs to be balanced with safeguards to ensure the proper conduct of Federal contractors. Encouraging contractors to assess themselves for contract violations may reduce the need for increased Federal assessment, so the goal of less intrusive contracting procedures may be more fully realized.

The taxpayer simply cannot afford a “finders-keepers” or “catch-me-if-you-can” approach to overpayments and crimes.² It would be irresponsible to advocate more government contracting without safeguards such as those provided in FAR Case 2007-006 and H.R. 5712.³

² From Letter from Taxpayers against Fraud Education Fund to Regulatory Secretariat, January 9, 2007.

³ The Subcommittee may want to consider defining “covered contract” as “any contract or subcontract.” This would flow down the reporting requirement to covered subcontractors to make disclosure. It has been standard Federal practice to require recipients of government grants, for instance, to pass down certain Federal accountability requirements to subrecipients. Because the safeguarding of the use of public funds is involved, the principle should be maintained with respect to contractors and subcontractors as well. While it may be difficult in some cases to expect foreign based suppliers performing subcontracts wholly overseas (e.g., a bakery supplying bread) to report to the U.S. government about fraud and overpayments, the requirement should still be imposed to maintain the clear intention of the U.S. Government to protect its taxpayers from fraud, waste, and abuse.

The Exemptions Should be Eliminated

As stated above, the reporting requirements are absolutely necessary to protect public funds and the integrity of Federal contracting. The overwhelming, common sense need for the rule makes the presence of the two exemptions all the more puzzling and mysterious.

Overseas Contract Exemption

The exemption for overseas contracts was not proposed by the Task Force, and I oppose it now. GSA leadership working with the FAR Council and other participants in the process may be able to explain how and why the exemption was inserted.

Other IGs share my views. For example, Inspector General Don Gambatesa wrote that contracts performed overseas “need greater contractor vigilance because they are performed overseas, where U.S. government resources and remedies are more limited.”⁴ He added that including overseas contracts under the proposed rule “would operate ultimately to reduce the vulnerabilities that often plague overseas programs and increase the effectiveness of those programs for which my office [U.S. AID Office of Inspector General] has oversight responsibility.”⁵

Exemption for Commercial Item Acquisitions

There is simply no good reason not to expect contractors to alert their customer in the event a fraud, defective product or overpayment is discovered. That is not asking much more than basic ethical behavior from contractors doing business with the government.

In the original proposal forwarded to OMB on May 23, 2007, it was specifically stated that we saw no reason for a commercial item exemption. See Letter from AAG Fisher to the Hon. Paul Dennett, May 23, 2007 (last sentence of attachment). It was inserted anyway. AAG Fisher gave the FAR Council the benefit of the doubt in her

⁴ From Letter from Inspector General Gambatesa to Regulatory Secretariat, January 11, 2008.

⁵ *Id.*

January 14, 2008, letter⁶ that there were possibly good reasons for this exemption. Now that we have reviewed public comments and reasons for the exemption, it is clear that the commercial item exemption is unjustified.

Fraud is prevalent in commercial item contracts as in other forms of government contracting, and there is simply no good reason to exclude commercial item acquisitions. The FAR's definition of commercial items is extremely broad and even includes services.⁷ The potential impact of this exemption could be far-reaching.

If this exemption is not eliminated, it is likely to be expanded by application. While some public comments suggest that the exemption should apply to FAR Part 13, Part 14, and Part 15, others suggest that FAR Part 8 should be included in the exemption. Tyco, Inc., for example, argues that the exemption (FAR Part 12) should be expanded to commercial item acquisitions under policies and procedures prescribed by FAR Part 13, Part 14, and Part 15. See Letter from Bruce Ramo to Regulatory Secretariat, January 10, 2008. Attorney Angela B. Styles argues that GSA schedule contracts are awarded and executed under FAR Part 8, not FAR Part 12 identified in the exemption.⁸ Likewise, the Coalition for Government Contractors notes that "billions of dollars in commercial item acquisitions also take place each year through the Multiple Award Schedule program, which are covered under FAR Part 8." Letter from Director Barbara Marola to Regulatory Secretariat, January 14, 2008.

No good reason has been given to exempt billions of dollars in Federal contracts from a rule requiring the self-reporting of crimes and overpayments by contractors. Approximately \$70 billion dollars worth of commercial item acquisitions occurred last fiscal year. The exemption takes on greater significance when the growth in the use of commercial acquisition procedures is contemplated. The value of commercial item contracting increased 117%, compared to an aggregate increase of 4% in non-commercial

⁶ Letter from AAG Fisher to Regulatory Secretariat, January 14, 2008.

⁷ This overly broad definition of "commercial item" has led to problems identified by the DoD IG. See *Army Lawyer*, "Commercial Items," at 48 (January 2007), citing U.S. Dept. of Def. Office of Inspector General, D-2006-115, Commercial Contracting for the Acquisition of Defense Systems (29 Sept. 2006); See also "AF Announces C-130J Contract Conversion," Air Force Press, Release Number 051006 (October 25, 2006)(Attachment B).

⁸ Styles, "The Department of Justice's Call for Integrity: Will Federal Contractors Answer?," BNA Federal Contracts Report, February 5, 2008.

procurement between Fiscal Year 2005 and Fiscal Year 2007.⁹ In other words, over the last three fiscal years, commercial item acquisitions increased at a rate nearly 30 times that of non-commercial acquisition.

To apply the commercial item acquisition exemption demands a suspension of common sense. It makes no sense to require a contractor who finds out about a fraud against the United States to examine what part of FAR the acquisition is under. Clearly, all contractors should be required to report fraud involving Federal contracts. Fraud is fraud, and a contractor should not be able to hide behind the complexities of the FAR. Common sense tells us that a good partner with the United States reports crimes. It is part of the public trust that we all share as partners in the procurement process.

First and foremost, American taxpayers need to be protected. If a contractor is aware of a fraud or crime against the United States, it should be that contractor's duty to disclose it to the government. As the Department of Defense Inspector General wrote: "All Government contractors should have an affirmative duty to report potential violations of Federal criminal laws related to Government work, especially safety issues." Letter from Acting Deputy Inspector General Patricia A. Brannin to Regulatory Secretariat, January 14, 2008.

The Experience of the NRO Proves the Rule Without Exemptions Works

Dire predictions by industry (that mandatory fraud reporting cannot work) are contradicted by the experience of the Office of Inspector General (OIG) of the National Reconnaissance Office (NRO). The NRO is the agency within the intelligence community that conducts the research and development, acquisition, launch, and operations of the U.S. spy satellite system. In 2004, the NRO OIG convinced the agency's Office of Contracts that more needed to be done to prevent and detect fraud in high value NRO contracts. That year, the NRO amended its acquisition manual to include, in all contracts, a requirement that contractors report any and all instances of fraud or other illegal acts to the Office of Inspector General. The penalties for not

⁹ Reports were created for Fiscal Years 2005-2007 using the Federal Procurement Data System on April 14, 2008.

complying with the provision can include administrative remedies up to and including termination of the contract by the NRO Director.

NRO Inspector General Eric Feldman also co-chairs the Private Sector Outreach Committee of the Task Force. Inspector General Feldman's success with the NRO contract clause originally served as a basis for the DOJ's proposed changes to the FAR. The NRO OIG has developed reporting protocols with NRO's prime contractors, who are also some of the nation's largest defense contractors. Issues regarding the nature of offenses to be reported, the timing of contractor reporting, and the respective roles of the OIG and their corporate investigative counterparts have been worked out in an environment of mutual cooperation.

Consequently, fraud reporting by major NRO contractors has increased dramatically as a result of mandatory reporting requirements. Equally important, the NRO OIG and the respective business ethics and compliance offices of the major contractors also engage in proactive fraud education and training efforts designed not just to detect fraud early in the process, but to prevent it in the first place. While some industry groups view this program as an anomaly, there is nothing unique about the NRO experience with mandatory fraud reporting that cannot be applied to other Federal IGs in their relationships with contractors through the proposed changes to the FAR.

The Imperative of a Dual Track: Both Legislative and Regulatory

As originally contemplated by the Task Force Legislation Committee, a dual track approach was developed. First, regulatory reform was attempted. Second, legislative reform was proposed. The Legislation Committee of the Task Force has always recognized the value of this dual approach. The regulatory approach has been marred by the addition of unwanted exemptions, which slowed the process down and complicated it with consideration of other factors.

The FAR Council has received significant public comment on the proposed rule and exemptions to justify issuing the rule as an interim final rule or a final rule pending comments. This is especially true if OMB agrees that the exemptions were a mistake. The reporting of possible civil False Claims Act violations is not a significant addition and is implied in the reporting of overpayments and crimes. DOJ recommended that

additional disclosure requirements be added to obligate contractors to report possible violations of the civil False Claims Act. Obviously, a possible civil False Claims Act violation falls somewhere in between overpayments and criminal fraud. Surely, this alone would not prevent the FAR rule from becoming an interim final rule as requested by AAG Fisher in her May 23, 2007 letter. As an alternative, the rule could be made final except for this provision, which could be held for public comment.

Without legislation, potential opposition may slow down the regulatory process so much that no rule is ever finalized. Finally, the regulatory process can proceed as slowly or as quickly as OMB directs. There is nothing inherent in the regulatory process that requires delay.

Conclusion

H.R. 5712 is indispensable. FAR Case 2007-006 should be made an interim final or a final rule pending comments as soon as possible. To protect taxpayers' money from a "finders-keepers" approach to overpayments, it is essential to protect the government from being victimized by fraud and crime in connection with Federal contracts. A "catch-me-if-you-can" approach to reporting crime is dangerous to everyone. Basic duties of common sense and integrity should be the foundation of our partnership with contractors. Strengthening the foundations of government contracting is a common executive branch and legislative branch goal to protect the United States and our taxpayers from fraud in government contracting. Thank you for the opportunity to present my views.



U.S. Department of Justice

Criminal Division

Assistant Attorney General

Washington, D.C. 20530

Honorable Paul A. Denett
Administrator
Office of Federal Procurement Policy, OMB
Eisenhower Executive Office Building
1650 Pennsylvania Avenue NW, Room 263
Washington, DC 20503

May 23, 2007

Re: Proposed Changes to the Federal Acquisition Regulation

Dear Mr. Denett:

I am writing to propose some additions and modifications to the Federal Acquisition Regulation (FAR) that the Department of Justice believes are consistent with the purpose of the FAR System "to deliver on a timely basis the best value product or service to the customer, while maintaining the public's trust and fulfilling public policy objectives." To better fulfill this purpose, we propose that the FAR be modified to require that contractors establish and maintain internal controls to detect and prevent fraud in their contracts, and that they notify contracting officers without delay whenever they become aware of a contract overpayment or fraud, rather than wait for its discovery by the government.

Our proposal is modeled on existing requirements found in other areas of corporate compliance such as the Sarbanes-Oxley Act of 2002, and it expands slightly on the Contractor Standards of Conduct set out by the Department of Defense at DFARS 203.7000. We have been careful not to ask contractors to do anything that is not already expected of their counterparts in other industries, and we have avoided imposing any unnecessary burdens on small businesses or creating any expensive paper work requirements. We note also that the National Reconnaissance Office (NRO) through a contract clause recently has begun requiring its contractors to disclose contract fraud and other illegal activities. The NRO reports that this requirement has improved its relationships with its contractors and enhanced its ability to prevent and detect procurement fraud.

While we recognize that many government contractors have taken steps to establish corporate compliance programs, our experience suggests that few have actually responded to the invitation of the Department of Defense (DOD) that they report or voluntarily disclose suspected instances of fraud. Moreover, unlike healthcare providers or financial institutions, there is at present no general requirement that contractors alert the government immediately as a matter of routine when overpayments or fraud are discovered. We believe that if the FAR were more explicit in requiring such notification, it would serve to emphasize the critical importance of integrity in contracting. In deference to the expertise of the Office of Federal Procurement Policy ("OFPP"), the attached outline prepared by our prosecutors merely suggests the recommended language and possible locations in the FAR for these proposed changes.

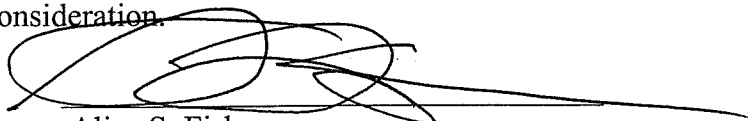
In October, the Deputy Attorney General and I announced the formation of the National Procurement Fraud Initiative. To fulfill the goals set by that initiative, we have committed ourselves to working for the consideration of any policy and regulatory change that would effectively reduce the exposure of federal contracts to fraud and corruption. I greatly appreciate the participation of your Deputy, Rob Burton, in this effort.

As you know, the 1980's witnessed significant innovations in the federal procurement system. Many of those reforms, including corporate compliance programs and corporate self-governance, were adopted with industry cooperation, and were later incorporated into evolving regulatory schemes in other business sectors and industries. In fact, the United States Sentencing Guidelines' treatment of corporations, adopted in 1991, borrowed heavily from reforms that were first instituted for government contractors in 1986. However, since that time, our government's expectations of its contractors has not kept pace with reforms in self-governance in industries such as banking, securities and healthcare.

Consistent with OFPP's existing procedures, I ask that you take the necessary steps to open a FAR case and expedite the review of these proposed changes. Note the proposal excludes small businesses from the administrative demands associated with establishing a compliance program, but we believe all contractors, regardless of size, should be expected to report fraud when they become aware of it. I have asked Steve Linick, the Director of our National Procurement Fraud Initiative, to work with you and your staff as this matter proceeds. Steve can be reached at 202-353-1630, or at steve.linick@usdoj.gov.

Finally, I have been advised that the review and approval process in the defense and civilian agencies can sometimes be lengthy, so I am hopeful that you will pursue all means at your disposal to fast track the consideration of this proposal. I believe reforms of this sort present a sufficiently "urgent and compelling circumstance" to support a determination that any rule issuance resulting from this process be considered as an "interim" rule.

Thank you very much for your consideration.



Alice S. Fisher
Assistant Attorney General
Criminal Division, Department of Justice

cc. Paul J. McNulty, Deputy Attorney General
Rachel Brand, Assistant Attorney General
Robert Burton, Deputy Administrator, OMB
Steve A. Linick, Director, NPFTF
National Procurement Fraud Initiative Members

OUTLINE OF DOJ's PROPOSED FAR CHANGES

As part of its National Procurement Fraud Initiative, the Department of Justice is proposing several changes to the Federal Acquisition Regulation (FAR):

1. Modify FAR Part 3 or 9 to provide that as part of a contractor's obligation to maintain "a satisfactory record of integrity and business ethics," all contractors with more than \$5 million in federal contracts in the prior two consecutive calendar years are required to have a compliance program or other internal controls to detect and prevent fraud and other criminal violations as described in the United States Sentencing Guidelines, Section 8B2.1 Effective Compliance and Ethics Program, Attachment A. We intend to propose similar language in our written comments to FAR case 2006-007, which currently is pending at OMB.
2. Expand on FAR Part 3 or Part 9 with a new section "Contractor Integrity Reporting" requiring that all responsible contractors:
 - a) notify the contracting officer in writing whenever the contractor becomes aware of an event affecting its initial or continuing right to receive any payment(s) under the contract. *{modeled on existing requirements for healthcare providers found at 42 U.S.C. 1320a-7b(3), Attachment B. Essentially, this provision would require a contractor to disclose any overpayments without waiting for government discovery. To limit the scope of this provision, it may be necessary to include a materiality requirement. Currently, it appears that the FAR only requires notification of overpayments for acquisition of commercial items, see FAR 52.212-4(i)(5)}.*
 - b) notify the contracting officer in writing whenever the contractor has reasonable grounds to believe an officer, director, employee, agent, or subcontractor of the contractor may have committed a violation of federal criminal law in connection with the award or performance of any government contract or subcontract. *{modeled on Suspicious Activity Reports required by the Office of the Comptroller of the Currency found at 12 CFR 21.11, Attachment C, the Anti-kickback disclosures currently required by FAR 3.502-2(g) and Sarbanes-Oxley reporting requirements, Section 302(a)(5), Attachment D. To limit the scope of this provision, it may be necessary to include guidance that defines terms such as "reasonable grounds"}.*
3. Modify FAR 9.406-2, Causes for Debarment and 9.407-2 Causes for Suspension to include "knowing failure to timely disclose an overpayment or violation of federal criminal law as described above."
4. The contracting officer shall insert a clause at FAR 52.203 reflecting these requirements in all its solicitations and contracts.
5. The above language requiring notification of overpayments and fraud should be included

in all subcontracts valued over \$1 million.

6. Note that the requirement for a compliance program is limited in paragraph 1 above to contractors with over \$5 million in contracts for two consecutive years in order to exclude small contractors from any unnecessary administrative burden. The proposal does not relieve such contractors from the duty to report fraud as described in paragraph 2 above. OFPP may elect to increase or decrease that threshold amount based on their experience in addressing small business needs in other contractual requirements. There may also be a request to exclude so-called commercial contracts from the compliance program requirement, but there would be no reason to exclude those contractors from the reporting requirement.



AF announces C-130J contract conversion

Release Number: 051006

10/25/2006 - **WASHINGTON, D.C.** -- U.S. Air Force officials announced today the multiyear procurement contract for the C-130J has been converted from a Federal Acquisition Regulation (FAR) Part 12 to a FAR 15 contract.

In order to comply with the fiscal year 2006 National Defense Authorization Act, the C-130J contract has been converted from the existing commercial item procurement to a traditional military procurement to purchase aircraft in fiscal year 06. The conversion involved repricing 39 aircraft, resulting in institutional net savings of \$168M.

"The Air Force, with the Congressional leadership and support of Senator John McCain and in conjunction with Lockheed Martin, has made this a better contract vehicle that provides the government the cost insight it needs to procure aircraft for the Air Force and Marine Corps," said Sue Payton, Assistant Secretary of the Air Force for Acquisition. "The Air Force acquisition community looks forward to working closely with Congress in future acquisition reform initiatives."

The C-130J is a key component of the intra-theater airlift modernization effort and brings a variety of capabilities to joint war fighter and humanitarian operations. Those capabilities include: worldwide airland, assault (including semi-prepared surfaces), tactical arrival/departure, single ship/Night Vision Goggle low-level, NVG airland, NVG assault, Container Delivery System airdrop, personnel airdrop, and heavy equipment airdrop.

Lockheed Martin is the contractor for the C-130J.

For more information about the C-130J please call the Air Force Press Desk at (703) 695-0640.