

Creating a Culture of Procurement Integrity

The obligations of public service to place loyalty to the Constitution, the law, and ethical principles above private gain, are well established principles that are reiterated in Government standards of conduct training programs. Such training tends to consist of reviewing the various laws, policies, and processes that have been established to maintain public trust and confidence in Government and the federal acquisition system. Some procurement integrity training programs include fictional scenarios. Such scenario-based training, when combined with reviews of regulatory requirements and agency processes, can be very effective in providing an awareness of the underlying statutes and the consequences for any violations. But is such awareness training sufficient to ensure that those entrusted with acquisition and contracting authority refrain from improper and illegal acts? How do we prevent our public servants from starting down a path of behavior that may spin out of control to include unethical or illegal activities? Sadly, given recent reports on incidents of abusive practices and fraudulent conduct in federal acquisition, it is clear that more than standard training programs are needed. We must move beyond viewing integrity as a training subject to be cyclically emphasized, to ensuring that integrity and ethical core values are engrained in our day-to-day actions. We must respect and enforce established processes which protect the fairness of the acquisition system, and be ever vigilant to detect and deter abuses of the system and positions of trust.

The following is a real example of the integrity lapses that take place more often than we realize.

A high level procurement official was recently accused of conspiring to influence contract awards and inflate prices on several high visibility contracts; splitting the difference with the contractor, thus defrauding the government of millions of dollars. He apparently made this deal with not just one, but approximately fifteen contractors and subcontractors providing services and furnishings for a resort hotel built for our military personnel and their families.

The procurement official was charged with receiving thousands of dollars in bribes and gifts in the form of home renovations, automobile maintenance, airline tickets, hotel rooms, and furniture. In addition, he was charged with filing false income tax returns. When he was finally caught by the local investigative authorities, he decided to cooperate with them in return for leniency. This resulted in jail time for his co-conspirators, which included U.S. and foreign contractors. He has now pled guilty to bribery and tax evasion charges. As of this writing he has not been sentenced, but faces up to 15 years in prison and a \$250,000 fine for the bribery charge, and three years in prison and a \$100,000 fine for each count of filing false tax returns.

This high level procurement official was a Director of Contracting, a very influential position. He used his influence to manipulate contract awards and payments under his control. What would entice him to risk his career by defrauding the government? Was he in debt, struggling to make ends meet? Was he overwhelmed by a delusion of power

and invincibility? Was this a case of just plain greed? Regardless of the underlying motivation for his criminal acts, this individual's life and reputation are ruined.

In our daily activities, we must be mindful to uphold the trust that is given to us as public servants. We must be aware of the ruinous consequences of violating that trust. Just as petty larceny often leads to grand theft, little violations of the public trust can lead to larger ones. Accepting gratuities in violation of standards of conduct is a step toward bribery and contract fraud. Fraud is like a drug. One may think trying a little is harmless and will not be addictive. However, just like drugs, fraudulent schemes often start on a small scale, followed with the perpetrators taking on greater risks, believing their plans are flawless—that is, until they are caught.

To detect and deter fraud, we need to be aware of behaviors that indicate something is not right and promptly report any apparent ethical violations. Is there someone who has authority over a contract, such as a program manager, contracting officer (procuring or administrative), quality assurance specialist, or engineer that appears to always favor a contractor's position rather than the Government's? Does this person participate in meetings concerning specific contractors and does he/she tend to irrationally defend or dismiss the contractor's actions/inactions? Does this person's opinion vary depending on the contractor involved? Does this person suddenly appear to have more money to spend? Is this person traveling more frequently? Is the person frequently meeting away from the office? Is someone of influence trying to steer an award a particular way or working exclusively with a particular contractor (not treating others equitably)?

Although appearances can be deceiving and we need to be respectful of employee rights to privacy, we should be alert to indications of fraudulent behaviors and report any concerns of possible ethical violations to competent authority (e.g., Agency Ethics Official, Agency Inspector General, Fraud Hotlines.) As public servants in positions of trust, we must accept our civic duty to report any apparent fraud or other illegal activity.

The Government has recently stepped up measures to prevent fraud, particularly procurement fraud, and increase public awareness. Yet, recent reports of contract fraud abound in the media. Several high profile fraud cases involve personnel working in Iraq or Afghanistan, where the perception of lesser oversight may have led the perpetrators to believe they were less likely to get caught. In October 2006, the National Procurement Fraud Initiative was announced by then Deputy Attorney General Paul J. McNulty. The initiative is designed to promote the early detection, identification, prevention and prosecution of procurement fraud associated with the increase in contracting activity for national security and other government programs. As a result of this initiative, the National Procurement Fraud Task Force was created, which encompasses U.S. Attorneys' Offices, the Federal Bureau of Investigation, the U.S. Inspectors General community, and other federal law enforcement agencies. Furthermore, the Department of Defense Inspector General has created a Procurement Fraud Handbook, an excellent guidebook for the detection and prevention of procurement fraud. The Defense Acquisition University recently added a training module to their venue on procurement fraud; an excellent learning tool for acquisition personnel.

Procurement integrity is everyone's responsibility, including our industry partners. It must be woven into our day-to-day activities, reinforced through education, and be regarded as the cornerstone of our profession, our culture, and personal ethos.

Procurement Fraud: Ammunition Contract for the Afghan Army and Police

Introduction:

Since 2001, the United States has been engaged in a comprehensive program to train and equip Afghan National Army (ANA) and Afghan National Police (ANP) for the purpose of promoting stability and the rule of law in Afghanistan. As part of this process, the U.S. Army has overseen the purchase of weapons and ammunition suitable for use by the ANA and the ANP. Based on the legacy of the former Soviet Union's involvement in Afghanistan, the Army decided in April 2006 to procure weapons and ammunition manufactured in former Warsaw Pact nations instead of U.S. manufactured equipment. Contracting officers had to consider other alternatives to traditional suppliers of weapons and ammunition to the Department of Defense (DoD) and looked to brokers of non-standard ammunition on the international arms market. The result was one of the most visible procurement fraud cases out of Afghanistan and multiple lessons-learned on contractor performance evaluations and quality controls used in the procurement of non-standard goods by the DoD.

Background

After an evaluation of the ANA's and ANP's munitions needs, the U.S. Army Sustainment Command (ASC) issued a request for proposals (RFP) on July 28, 2006. This RFP required the delivery of various types of non-standard ammunition to ANP and ANA ammunition stocks in Kabul, Afghanistan, within three to six months of ASC issued task orders. Included in the contract was a requirement to deliver 7.62x39mm ammunition for AK-47 assault rifles for delivery to the ANP and ANA via transport arranged by the contractor according to international standards. The ammunition was to be packaged according to commercial "best practices." The evaluation criteria in reviewing responses to the RFP were price, use of small businesses and past performance, to include ability to deliver ammunition on time to international locations, and quality of performance. Ten proposals were received, of which eight were deemed complete and eligible for consideration. Following pre-award surveys of the bidders and evaluation of the award criteria, contract number W52P1J-07-D-0004, valued at approximately \$298 million, was awarded to AEY, Incorporated on January 26, 2007.

AEY, Inc., (AEY) was a small Miami Beach, Florida based company. In its best year of business, AEY received contracts valued at \$7,238,329, divided among 59 separate Government contracts. Operating from a single location with eight employees, AEY's management consisted of Efraim Diveroli, the company's 22-year-old President and primary point of contact for Government contracts; David Packouz, the company's Vice-President and former licensed masseuse; Alexander Podrizki, AEY's representative in Tirana, Albania; and Ralph Merrill, a business associate of Mr. Diveroli and financial backer of AEY. The majority of the company's revenue came from providing miscellaneous weapons, ammunition, clothing and tactical equipment to organizations and individuals. As a result of the award of the ASC ammunition contract, AEY went from a moderately successful small business to a major supplier of munitions to a key U.S. ally. Even before the first task order was placed, however, questions

were surfacing in the law enforcement community and at the Department of State (DoS) about AEY's management and its contacts in the global arms marketplace.

Since April 2006, AEY and Mr. Diveroli had been under investigation by the U.S. Immigration and Customs Enforcement Service (ICE) for Arms Export Control Act violations, contract fraud and illegal firearms transactions. The DoS placed both AEY and Mr. Diveroli on its watch list of international arms dealers due to the suspicious nature of AEY's arms transactions and parties that it did business with. Because all information surrounding that investigation was restricted to law enforcement personnel, the contracting community was unaware of the evidence compiled by ICE investigators. Furthermore, as AEY had provided Army Materiel Command (AMC) with data that indicated a good record of past performance and compliance with applicable regulations, no inquiries were made by the source selection team with the ICE or other criminal investigative agencies that may have been privy to the details of the investigation. This omission continued even after Defense Criminal Investigative Service (DCIS) joined ICE in the AEY investigation. On the surface, AEY appeared to be a qualified supplier of non-standard ammunition that had the additional benefit of meeting the solicitation's requirement for award to a small business.

Unbeknownst to AMC, however, AEY's basic qualifications were also in question due to a series of terminations for default for failure to perform several DoD and DoS contracts. Between April 2005 and the end of 2006, AEY failed to adequately perform at least nine contracts for the supply of weapons, tactical equipment, and non-standard ammunition. On five occasions in 2005 and 2006, AEY either failed to deliver or delivered substandard rifle mounts and scopes ordered by the Army as part of foreign military sales contracts, despite multiple opportunities from contracting officers to cure defects in the company's performance. One of these contracts was terminated on March 1, 2007, a little more than a month after AMC's award of the ANA and ANP ammunition contract. On other occasions in 2005, AEY provided 10,000 helmets that failed to provide ballistic protection for use by the Iraqi army, failed to deliver 10,000 9mm pistols for use by the Iraqi police and delivered defective ammunition to the Army Special Operations Command.

AEY responded to repeated requests for improved quality control and delivery standards by suggesting that there was bias present on the part of inspectors against the company, that as a small business it should be given additional opportunities to perform, or it should be allowed to offer non-conforming, substitute equipment to meet contract requirements. In extreme cases, Mr. Diveroli blamed failures to perform on plane crashes, Government interference and a fictitious hurricane that devastated AEY's offices in Miami. None of this information regarding AEY's past performance was made available or discovered by the source selection team for the ANA and ANP ammunition contract. The only past performance evaluated related to three contracts identified by AEY despite the fact that over 90 contracts had previously been awarded to the company. All three of these contracts indicated that the company had satisfactorily performed in all respects. Based on what appeared to be a history of good contract performance, AEY received an "excellent" rating by the source selection team for on-time delivery and performance and by the contracting officer as "good" for international delivery history and experience as a systems integrator.

With contract in hand, AEY soon began receiving task orders for the delivery of ammunition to Afghanistan. With each task order received, the company procured the ammunition and shipped it via air transport to Bagram Airbase, Afghanistan using a civilian subcontractor airline, Silkway Airways. A contracting officer's representative accepted shipments that were then driven via truck to the ANA and ANP ammunition storage facility called the "22 Bunkers Complex." From that facility, the ammunition was issued directly to ANA and ANP units. AEY obtained surplus ammunition from a variety of sources in Eastern Europe, including Albania, in its efforts to procure ammunition that met contract requirements.

This ammunition, in most cases, had been manufactured during the Cold War and stored in sealed metal boxes that provided data on the origin and manufacture dates, as well as protection from corrosion. As their investigation continued, it became clear to ICE and DCIS investigators that AEY was repackaging ammunition originating in Albania by removing it from metal storage containers and placing it into paper and cardboard boxes. This repackaging allowed AEY to conceal the fact that the ammunition supplied to the ANA and ANP had been manufactured in the People's Republic of China. This repackaging also prevented the casual observer from determining the date of manufacture and allowed AEY to save the costs associated with shipping the metal storage containers via air to Afghanistan.

AEY apparently began this practice in April 2007, after Mr. Diveroli received notice from the DoS that AEY would not be issued an export license from the U.S. Government for the brokering of ammunition stored in Albania for a twenty-year period. In addition, Mr. Diveroli provided certificates of conformance to the contracting officer stating that the manufacturer of the ammunition was MEICO (Military Export and Import Company), a company operated by the Albanian Ministry of Defense. Between June 26 and October 31, 2007, Mr. Diveroli provided 35 certificates of conformance that falsely certified MEICO as the manufacturer of ammunition provided under contract W52P1J-07-D-0004. These fraudulent certificates of conformance resulted in payments totaling \$10,331,736.44 to AEY from the Government.

Prior to the award of the ANA and ANP ammunition contract, numerous questions were received from potential offerors regarding contract requirements and performance. Amendment 3 to the solicitation for this contract included a question from one offeror asking if "ammunition from China [is] acceptable for this contract – assuming that it meets the technical specifications." In response, the source selection team stated that "statutory or regulatory restrictions . . . that may effectively prohibit supplies from any source are the responsibility of each offeror to both identify and resolve." This response was clarified by Amendment 6 to the solicitation, through the express incorporation of DFARS 252.225-7007 into the solicitation, entitled "Prohibition on Acquisition of United States Munitions List Items from Communist Chinese Military Companies." DFARS 252.225-7007 specifically states in subparagraph b that:

"Any supplies or services covered by the United States Munitions List that are delivered under this contract may not be acquired, directly or indirectly, from a Communist Chinese military company."

Subparagraph (a) of this section defines "Communist Chinese Military Company" as "any entity that is part of the commercial or defense industrial base of the People's Republic of China" or

any company that is owned, controlled or affiliated with the Government of the People's Republic of China. The incorporation of the prohibition found in DFARS 252.225-7007 into Section A of the contract resulted in a prohibition against the use of ammunition from the People's Republic of China by AEY to meet contract requirements.

Contract language problems also existed which allowed AEY to ship substandard ammunition to Afghanistan. The contract only specified that the ammunition be "serviceable" but did not specify the age of the ammunition. The allowance for using surplus ammunition to meet contract requirements also added to the questions about what, if any, age limit on the ammunition would be imposed by the Government on AEY as surplus ammunition tends to be of older manufacture than ammunition recently purchased. Furthermore, the ammunition was not inspected by the Defense Contract Management Agency (DCMA) at any point during shipment to Bagram Airbase or after its arrival, preventing adequate quality control. Had DCMA or the contracting officer attempted to inspect the ammunition after its arrival at the 22 Bunkers Complex, they would have found that it was impossible to match the ammunition with a specific task order or certificate of conformance due to AEY's use of identical lot numbers and conflicting transportation control numbers. Because the ammunition was procured as Commercial Off The Shelf (COTS) ammunition, the normal DCMA inspection process tracked acceptance for other COTS items. This primarily consists of kind, count and condition acceptance of sample lots at the delivery point. DCMA delegated this inspection to Army personnel considered experts in non-standard small arms ammunition. The contract contained no specific acceptance instructions or Quality Assurance Letter of Instruction (QALI) for these items

In addition to the other issues with the contract, AEY, on par with their history of non-performance in other contracts, was four months behind in ammunition deliveries by early January 2008. The company's lack of managerial ability, deceptive practices and, by its own admission to the contracting officer, unreliable sources of supply from the international arms market, resulted in a contract that was behind schedule and a contractor that was failing to supply the required ammunition.

During early 2008, the Army Procurement Fraud Branch (PFB) requested the Army Criminal Investigative Command (CID) to visually inspect AEY-provided ammunition. On January 25, 2008, CID agents took 335 digital photographs of ammunition, ammunition pallets and shipping documents in 15 storage containers containing ammunition supplied by AEY. Of those 15 containers, 14 contained various types of ammunition packaged in brown paper and cardboard boxes, wrapped in plastic, with AEY shipping documents attached to them. The only identification markings regarding the origin of the ammunition consisted of headstamps showing the numbers 31, 61, 71, 81 and 661 and dates of manufacture ranging from 1962 to 1974. Based on unclassified information available from the Defense Intelligence Agency, the headstamp numbers indicated that the 7.62x39mm ammunition in these 14 containers was manufactured at factories in the People's Republic of China. Based on the discovery that the ammunition was manufactured in China, the Army suspended AEY from contracting with the Government on March 25, 2008. Further deliveries of ammunition and payments on previously issued task orders were suspended on March 31, 2008. AMC terminated the contract with AEY for default on May 23, 2008, following its own investigation into the circumstances surrounding the award of the contract and the company's performance to date.

On June 19, 2008, AEY, Mr. Diveroli, Mr. Packouz, Mr. Podrizki and Mr. Merrill were indicted in the U.S. District Court for the Southern District of Florida, on one count of conspiracy, 35 counts of false statement, and 35 counts of Major Fraud Against the United States. These indictments were based on the repackaging of Chinese ammunition to hide its origin, the fraudulent certificates of conformance that accompanied the deliveries of this ammunition, and the subsequent payments by the Government based on the delivery of non-conforming ammunition. In August 2009, Mr. Diveroli pled guilty to one count of conspiracy. He is scheduled to be sentenced in November 2009.

Discussion

A review of the award of the ANA and ANP ammunition contract shows two distinct points where the contracting system failed. First, the initial source selection team did not venture beyond the information presented to it. The team took into consideration only information presented by AEY or as part of routine reviews of financial responsibility by the Defense Contract Audit Agency (DCAA). Had the source selection committee taken steps to seek out other instances of AEY's performance or delve into the company's background, it would have found a history of non-performance and a company that had been tied to illegal activity.

Had the source selection team taken steps to actively contact organizations outside of the contracting community, it would have found that there is no single repository for contractor information within the Government. While the DoD maintains a database of prime contractors and their contracts that shares data regarding contractor performance, subcontracts and contracts with organizations outside the Department of Defense are not included. This is true even for contracts and subcontracts that are in direct support of ongoing DoD activities. While suspicion of illegality will not support a defacto debarment, had all the negative information been readily available to the Source Selection Evaluation Board, they most assuredly would have made a different award decision. The formulation of a single database that consolidates past performance information and lowering of the dollar threshold requiring the reporting of such information would prevent a repeat of the issues arising here.

The second point where the contracting system failed relates to the lack of quality control and documentation of shipments after AEY began deliveries of ammunition to Bagram Airbase. The first indications that the ammunition did not meet contract requirements and was of Chinese origin came several months after AEY began performing and was not confirmed until January 2008, a year after contract award. This is due to the skill required to differentiate COTS ammunition of one country from another. In addition, the ammunition could not be tracked upon delivery due to a lack of specific identifying shipment documentation, as AEY used the same lot numbers for all deliveries. Specific quality control instructions relating to the provenance of the ammunition may have led to the early detection of non-conforming ammunition. As it happened, the initial halt to AEY's continued performance was based on a suspension action initiated by PFB due to the use of Chinese ammunition in violation of the DFARS to meet contract requirements, not the quality control issues or the criminal investigation by ICE and DCIS.

The lack of coordination between law enforcement and the contracting community also played a factor in the failures to detect problems with AEY's history of performance. Since at least April

2006, ICE had been investigating AEY's sources of weapons and ammunition, a fact not shared outside the law enforcement community, thus preventing full disclosure of the risks involved with selecting AEY to the source selection team and the DCAA auditors charged with reviewing the company's financial history. Lacking this information, the source selection team erroneously reached the conclusion that there were no criminal allegations pending against the company or its management.

Conclusion

In conclusion, the ANA and ANP ammunition contract awarded to AEY was flawed from the beginning due to a faulty review of AEY's contracting background and a lack of quality control at the point of delivery. Source selection teams should be required to actively seek out information regarding the past performance of companies in conjunction with DCAA and other agencies responsible for providing data on companies seeking Government contracts. Reliance on information provided by contractors, readily available to a single agency, may not provide a complete history in some cases to make proper source selection determinations. In the case of AEY, had the source selection team inquired with the DoS, the agency charged with monitoring the international traffic in arms, it would have found that AEY, its management, and several of its affiliates were on a watch list due to suspicion of illegal activity. In addition, companies should have an affirmative duty to provide complete contracting histories as part of their contract bids. This would shift the requirement to provide complete performance histories onto the contractor, not the contracting officer, and would include performance on subcontracts and contracts outside the DoD that are presently not readily available via existing databases.

The final lesson is that when contracting for non-standard items, greater care must be taken to ensure that quality control is maintained as those items are not regularly purchased by the Government, or manufactured based on specifications established by third parties or for the commercial market. Quality control should be flexible enough to accommodate the type of non-standard goods yet provide for adequate inventory tracking and ensure that the needs of the end user are met. The goal of quality control in these contracts should be to handle a non-standard item using standardized and meaningful management controls at all times.

This case serves as a useful tool in reviewing the issues involved with how to evaluate contractor performance and use quality controls in the procurement of non-standard goods by the DoD. It also serves as an excellent example of how a contractor can manipulate the contacting system by failing to disclose its performance history and substituting prohibited goods for those required under the contract. Fortunately for the Government, AEY's deception was discovered and the company was prevented from doing any further damage to the procurement system through its suspension from contracting with the Government and subsequent criminal prosecution.