

# CONTRACTING AND THE INVESTIGATIVE REPORTER

## A quick guide to uncovering contract fraud in your community

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Contracting is one of the most prevalent methods utilized in the expenditure of public funds. The various procedures by which public contracts are advertised and awarded offer some of the most tempting opportunities for fraud and corruption. Sadly, most reporters don't understand what to look for.

Where the government is concerned almost anything can happen. When it comes to making a fast buck, bureaucrats and other government employees are just as prone to engineering a scam or ripoff as the next guy. The sad aspect to this is simply that detection of fraud on the part of government employees often falls short due to the lack of auditing personnel, or just plain laxity on the part of those charged with the responsibility of rooting it out.

While every federal agency in America has an Office of Inspector General and all states have auditors, despite the fact that these entities are responsible for investigating fraud most are understaffed and many of their employees are inexperienced. On the federal level, another obstacle to ferreting out fraud and corruption lies with the Department of Justice, the United States Attorneys and local prosecutors who frequently decline prosecution of cases after looking at the cost-benefit -- and determining it will cost more to prosecute than the amount of money stolen.

That's where the press comes in. All reporters cover a beat of some kind and unless a reporter is relegated to exclusively writing obituaries, their beat will bring them into contact with at least one government agency -- on the local, regional, state or national level. This day-to-day contact should give reporters at least some opportunity to monitor contracting procedures and activities conducted by the agency they cover.

You won't find a rat's nest every time you turn a rock over. But if you keep your eyes open there are good pickings at all levels of government.

### **Where do you look?**

Right under your nose! Most reporters don't need to be reminded how many times they've squirmed at city council, county supervisors or other public meetings where a good deal of the time was spent approving page after page of contracts for sewer work, road work, office supplies or any number and variety of other goods or services, not to mention long lists of "change orders" on existing contracts.

The question is whether any of these reporters went beyond the agenda items.

- Did they look at the contract specifications?
- Did they examine the bid documents?
- Did they look carefully at the contract award itself?
- Most importantly: Did they follow up on any of the contracts. Did they go back after the contract was completed to examine change orders, cost overruns and contractor performance?

Many reporters have probably done this on the big, controversial contracts. How about the run-of-the-mill stuff? Those contracts let without bid (most commonly those for professional services or designated as “sole source”) or those contracts that don’t generate headlines but involve large sums of money. These might include the purchase of tires for police cars, gasoline for public vehicles, even sand or salt for winter road maintenance.

Investigating public contracts is made easier by the fact that virtually every document related to the governmental contracting process is a public record and thus accessible to the press.

Here’s an elementary primer on what to look for in your community to determine whether contract fraud exists. Not every contract is fraudulent. The majority are legitimate and award through honest processes. Some are awarded on a strictly political basis and others are questionable. You’ll be surprised at what you might discover with a little digging.

### **Who can perpetrate contract fraud?**

- 1.) Any employee making a purchase
- 2.) Any vendor/supplier/contractor
- 3.) Any certifying official and/or accounting personnel
- 4.) Any contracting officer and/or his technical representative
- 5.) Any program official, such as a project manager
- 6.) Any shipping or receiving personnel

Now that you have some idea of who can engage in contract fraud, here are examples of some of the more common types of fraud.

### **Contracting procedure falls into four major categories:**

- 1.) The solicitation phase
- 2.) The contract bidding and award phase
- 3.) The contract performance phase
- 4.) The billings and payment phase

## **COMMON OPPORTUNITIES FOR CONTRACT FRAUD**

Each of the four primary contracting procedure categories presents its own unique opportunities for contract fraud. These are the most common:

### **SOLICITATION PHASE**

- 1.) Rigged specifications
- 2.) Incomplete specifications
- 3.) Split purchases

### **BIDDING & AWARD PHASE**

- 1.) Unbalanced bidding
- 2.) Collusive bidding
- 3.) Awards to contractors on barred bidders list
- 4.) Awards to fraudulent Minority Business Enterprises
- 5.) Conflict of Interest situations

### **CONTRACT PERFORMANCE PHASE**

- 1.) Abuse of Change Orders
- 2.) Failure to meet specifications

**BILLINGS & PAYMENTS PHASE** - Of 12 real potentials under this category here are the most common:

- 1.) Billing and acceptance of payments for work not performed
- 2.) Phantom contractors
- 3.) False invoices
- 4.) False claims and statements
- 5.) Duplicate contract payments
- 6.) Excessive small purchases (tools, supplies)
- 7.) Fraudulent or inflated change orders

Here are some of the things reporters should look for:

### ***SOLICITATION, BIDDING & AWARD PHASES***

**RIGGED SPECIFICATIONS** - Situations where somebody in collusion with a bidder tailors the specifications to meet the qualifications of one particular individual or company. Frequently you'll find tailoring of commercial item descriptions to meet a standard product that only one company supplies.

**Detection:** Compare the specifications or CIDs with a contractor's own description of its product or services. If you find a nearly identical match, you've got the possibility of fraud. Other telltale signs would include: (1.) Only one bidder responded to the bid announcement; (2.) One bid is significantly lower than all others; (3.) A contract is awarded to a company that is claimed to be the sole source of supply for a particular item or service; (4.) Complaints or challenges filed by other bidders.

**NOTE:** Another area that requires particular attention is whether the contract is “hard dollar” -- meaning that the price bid is intended to be the total price, including the contractors profit margin – or “cost-plus” – meaning the contractor will receive his profit no matter what the “cost” of supplies and labor end up being. Cost-plus contracts can get out of hand and generally are not awarded by public agencies in the United States.

**INCOMPLETE SPECIFICATIONS** - These are contract specifications designed so general in nature that it permits bid manipulation, non-performance or partial performance of work expected under the contract.

**Detection:** Look for whether the specifications are clearly and succinctly written and are fully descriptive. Also, again look for only one bidder, one bid significantly lower than others, and for competing bidder protests or challenges.

**SPLIT PURCHASES** - These are situations where procurement is split into two or more purchase orders to circumvent legal requirements.

**Detection:** If the law or regulations require competitive bidding on all contracts of \$10,000 or more, was the actual procurement split into two \$5,000 purchase orders? Try to obtain a complete breakdown of payments by vendor, group them and look for trends or obtain actual copies of the purchase orders and sort them by vendor. A computer can be extremely valuable here. However, most government agencies maintain a list of all vendors and their purchases from these vendors each fiscal year. Look for “even-dollar” purchases or “close-to-ceiling” purchases, i.e. where \$10,000 is the threshold for bidding, look for purchases of \$9,900 or \$9,998.99.

**UNBALANCED BIDDING** - To be successful, fraud in this area generally requires collusion. Unbalanced bidding is often found where contracts are awarded in the aggregate. For example, a bid invitation might provide for five different items and the bidder knows that one or two of those items will not actually be called for so he bids unreasonably low on those items and thus becomes the “lowest aggregate bidder.” Typically, after the contract is awarded, the work actually performed, or the goods actually called for turn out to be in excess of the amount bid.

**Detection:** Examine line items on bid invitations and compare those with the actual contract performance to see if there are unusual or excessive variances. Look for unreasonably low bids and examine the contract award history of the successful bidder.

**COLLUSIVE BIDDING** - Speaks for itself. Some indicators: (1.) Whether a small number of companies do similar work, or bid on a rotating basis; (2.) Whether contract awards indicate a geographical division of territory; (3.) If unsuccessful bidders become subcontractors after the award. Don't forget to examine the actual bid documents for similar names, addresses and handwriting.

**AWARDS TO DEBARRED CONTRACTORS** - Always keep an eye open for awards to companies who have been disqualified or barred from bidding do to past violations or criminal convictions. This may include simply a corporate name change or something more complicated, such as the establishment of dummy companies, etc.

**CONFLICTS OF INTEREST** - Always look at the corporate makeup of successful bidders: Try to identify the officers, directors and stockholders. Pay particular attention to any involvement by public officials – whether or not these public officials had any connection with the particular contracting process. If a public official is involved you'll likely hear about it sooner or later. You might consider running the names of the successful bidders officers and employees against a list of public officials or employees.

### ***CONTRACT PERFORMANCE PHASE***

**ABUSE OF CHANGE ORDERS** - Frequently an outgrowth of collusion, this type of fraud is encouraged by contract officer laxity. Change orders almost always involve additional cost and should be monitored closely. Many communities require change orders to be approved by governing bodies, something that's mostly a perfunctory action. Yet approvals are always supported by copies of the change order requests that can be found in "agenda packets" distributed to city councilmen, etc. Too often reporters don't bother to examine their own packets because of the sheer volume of documents they contain. For example: Did a sewer project specifications call for Class 1 gravel bedding, yet after the contract was awarded did a change order permit use of a more expensive class of gravel bedding? Always attempt to confirm what actually was used.

**Detection:** (1.) Is the same official or employee responsible for determining both specifications and performs the actual procurement? (2.) Did a government official or employee suddenly go to work for the contractor? (3.) Was the request for a change order signed by an individual at a higher level than the individual involved in the initial procurement request, i.e. does the individual who oversees contract compliance also approve change order requests? (4.) Do specific procurement personnel or program management personnel have a history of change orders if their projects are compared with other similar projects supervised by different people?

**FAILURE TO MEET SPECIFICATIONS** - Is there evidence a contractor has failed to meet specifications and been allowed to get away with it?

**Detection:** Look at project inspection reports, or if you can't find any, or discover that there are less inspections being made of a project than other projects of a comparable nature, DIG DEEPER.

### ***BILLINGS AND PAYMENT PHASE***

Receiving payment for work not performed or supplies not delivered is the classic contract ripoff.

**FALSE BILLINGS** - Generally the result of collusion, this type of contract fraud is frequently successful in cases where more than one person must certify completion of work or delivery of supplies – where the right hand frequently doesn't know what the left hand is doing. In cases where a single individual is responsible for certification it may indicate direct corruption.

**Detection:** (1.) Verify the work and supplies against invoices and billings; (2.) Match documentation if you can get it; (3.) Perform a physical inventory if you can gain access. If you can't try and have some government official conduct an inventory for you. (4.) Always check complaints related to "service" contracts; (5.) Interview workmen, subcontractors and suppliers. In many cases if they "aren't getting their share," they'll talk.

**RETAINAGE MANIPULATION** - Most public contracts require the governmental entity to “retain” a certain percentage of the contract payments as insurance that the project will be completed on time and according to specifications. Generally retainage is 10 percent of the amount of the contract retained from each “milestone” or periodic payment required under terms of the contract.

**Detection:** Watch whether retainages have been waived and who approved the waiver. At the same time attention should be paid to whether extensions of time to complete the project were granted and who granted the extensions. Many contracts contain penalty clauses that provide contractors must pay predetermined monetary penalties if the project is not completed within certain time limits spelled out in the contract.

**PHANTOM CONTRACTORS** - This form of contract fraud commonly manifests itself through invoicing or other billing submitted for dummy or non-existent corporations, usually by program personnel looking for extra pocket money.

**Detection:** (1.) Check the histories of vendors, especially if other contractors or subcontractors have never heard of the company; (2.) Check corporation records; (3.) Review the contractor’s address, telephone numbers, etc.; (4.) Make sure a valid performance bond is in effect for the contractor and that it hasn’t been waived for some reason. If it has been waived determine who waived the bond and why.

**FALSE INVENTORIES, CLAIMS & STATEMENTS** - False inventories and the claims or statements supporting them are difficult, and sometimes impossible for reporters to prove due to lack of access to a contractor’s premises. However, where a continuing stream of supplies or other merchandise are provided to contractors over a long period of time, reporters can often make determinations by looking for inflates or totally falsified invoices. Check catalog list prices and compare them against contractor invoicing, keeping in mind discounts. Reporters may find it equally difficult to uncover and prove false claims and statements because they frequently involve payroll, which is considered confidential information in some jurisdictions. If you suspect something, try to develop a source on the inside.

**Detection:** Watch for (1.) Any modifications of the contract because of a contractor’s inability to perform; (2.) Subcontracting without the knowledge or approval of the government authority; (3.) Use of non-union labor and subsequent payment of lower wages when a contract calls for payment of prevailing union wages; (4.) Large expenditures by a contractor prior to the contract award these are called “anticipation costs” and will be included in the amount bid; (5.) Cases where the prime contractor requires the subcontractor to use the prime contractor’s labor and equipment; (6.) Inflated unit prices from a contractor’s stock; (7.) Minority fronts.

**EXCESSIVE SMALL PURCHASES OF TOOLS AND SUPPLIES** - This is another common contract scam where tools and other items are purchased and then diverted to personal use, or resold. This type of contract fraud would include material ordered which is not needed or ordered in quantities in excess of those required to complete the contract according to specifications.

**Detection:** (1.) Obtain a list of all small purchases over a period of time and catalog them by name of organizational unit purchaser and vendor (i.e. 500 hammers were purchased and there are only 200 carpenters on the job.); (2.) Once you've cataloged the list, analyze it with a view toward whether purchases are reasonable under the circumstances; (3.) Compare stock numbers from catalogs to make certain the item described in the purchase order, invoice or other billing document matches the item purchased.

## **SUMMARY**

A word of caution: Although you might uncover the telltale signs of contract fraud, be certain to do your homework. Make sure you've got all the facts nailed down and documents in hand. Then go ahead and write or broadcast. Don't hesitate to go outside for support or assistance. Check around your community, state and the country to compare similar projects and costs. This makes it easier to assess what you've got.

There's a lot of public money floating around. The press has a responsibility to do everything it can, within the constraints of specific media outlets, to force government to publicly account for its expenditures. Contrary to what many bureaucrats would have us believe, the public business is the public's business. Period! Government is supposed to be the servant of the people – not the other way around.

As you pursue your reporting activities, don't take "no" or "no comment" for an answer.

The contents of this handout were derived from a variety of sources, including federal and state audit manuals, federal financial law enforcement training material and actual experience of reporters at the *Boston Globe* and *Newsday*.