United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Administrative Oversight and the Courts, Committee on the Judiciary, U.S. Senate

February 1996

DOD PROCUREMENT

Use and Administration of DOD's Voluntary Disclosure Program

GAO/NSIAD-96-21

GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-258881

February 6, 1996

The Honorable Charles Grassley
Chairman, Subcommittee on Administrative
Oversight and the Courts
Committee on the Judiciary
United States Senate

Dear Mr. Chairman:

In response to your request, we developed information on the Department of Defense's (DOD) Voluntary Disclosure Program, a program to encourage defense contractors to voluntarily disclose potential civil or criminal procurement fraud to the government. More specifically, this report provides information and observations on (1) the extent of defense contractor participation in the program, (2) the amount of money that has been recovered, (3) the time taken to close cases, (4) the most common type of disclosures, and (5) the extent of overlap between voluntary disclosures and qui tam actions.[1] DOD and Department of Justice policies and practices, along with statutory and court restrictions, precluded our access to many individual case files, negating our ability to fully evaluate the program.

Results in Brief

Although 48 of the top 100 defense contractors have made voluntary disclosures, the total number of disclosures under the program has been relatively small and the dollar recoveries have been modest. From its inception in 1986 through September 1994, DOD reported that, of the thousands of defense contractors, 138 contractors made 325 voluntary disclosures of potential procurement fraud. DOD reported recoveries from these disclosures to be $290 million, about 17 percent of total reported DOD procurement fraud recoveries between fiscal years 1987 and 1994. However, our review indicated that DOD's reported recoveries of $290 million were overstated because they included $75 million in premature progress payments and amounts from disclosures made prior to the program. Further, DOD accepted some disclosures into the program that the Justice Department believed were triggered by imminent government discovery and thus did not meet the criteria for admission.

[1]A qui tam action is a civil action filed under the False Claims Act on behalf of the government by an individual, called a "relator," to recover damages resulting from alleged fraud.

Voluntary disclosure cases took an average of about 2.8 years to close, with about 25 percent taking over 4 years. Open cases are taking longer. As of September 1994, DOD data showed that open cases averaged 3.5 years, with over half of the cases disclosed in fiscal year 1990 still open. Less than full contractor cooperation with the government and low priority given by DOD and other investigative agencies to managing cases expeditiously may be problems in some cases.

Most disclosures did not result in significant dollar recoveries for the government. Of 129 closed cases, 81 cases, or about 63 percent, had reported recoveries of less than $100,000, of which 52 cases, or 40 percent, had no dollar recoveries. Forty-eight cases had reported recoveries of $100,000 or more, of which 15 cases had reported recoveries of $2 million or more.

There is little overlap between voluntary disclosures and qui tam actions. Of the 129 voluntary disclosure cases closed since the program began, 4 involved qui tam actions. In one case, the qui tam action identified additional fraudulent activity and substantially increased the amount recovered by the government.

Background

In 1986, a report to the President on defense management concluded that the defense industry needed to promote principles of ethical business conduct, detect acts of procurement fraud through self-governance, and voluntarily report potential fraud to the government. The report noted that DOD awarded contracts worth about $164 billion in 1985, 70 percent of which went to a group of 100 contractors. Twenty-five contractors reportedly did business of $1 billion or more, 147 contractors did $100 million or more, and almost 6,000 contractors did $1 million or more. In fiscal year 1994, the number of contractors doing business with DOD did not substantially change. Total DOD contracting for goods and services over $25,000 in fiscal year 1994 amounted to $118 billion.

In response to the 1986 report, a number of defense contractors established self-governance programs that included monitoring compliance with federal procurement laws and voluntarily disclosing violations to government authorities. These efforts became known as the Defense Industry Initiative on Business Ethics and Conduct.

To facilitate contractor self-governance and to encourage contractors to adopt a voluntary disclosure policy, DOD established the Voluntary

Disclosure Program in July 1986. This program provides general guidelines, policy, and processes to enable DOD and its contractors to address matters of wrongdoing the contractors discover. At the time, DOD recognized that there was a need for a process to deal in a consistent manner with matters disclosed by contractors. In return for voluntarily disclosing potential wrongdoing and cooperating in any government audit and investigation, the government generally allows a contractor to conduct its own investigation, which the government then attempts to verify expeditiously.

Upon receipt of an initial contractor disclosure, the DOD Inspector General's office (1) makes a preliminary determination as to whether the disclosure satisfies the program's requirements, (2) coordinates the execution of the standard voluntary disclosure agreement, (3) assigns the disclosure to a DOD criminal investigative organization for verification and to a suspension and debarment authority, and (4) coordinates the disclosure with the Justice Department for potential civil and criminal action.

The Justice Department reviews all voluntary disclosures. It conducts, either through its Defense Procurement Fraud Unit or through referral to the appropriate U.S. Attorney's Office, a preliminary inquiry to determine if there is credible evidence suggesting prosecutable violation of federal laws. The Justice Department has sole responsibility to initiate or decline prosecution. It also has an opportunity to concur in the voluntary disclosure agreement between the contractor and DOD.

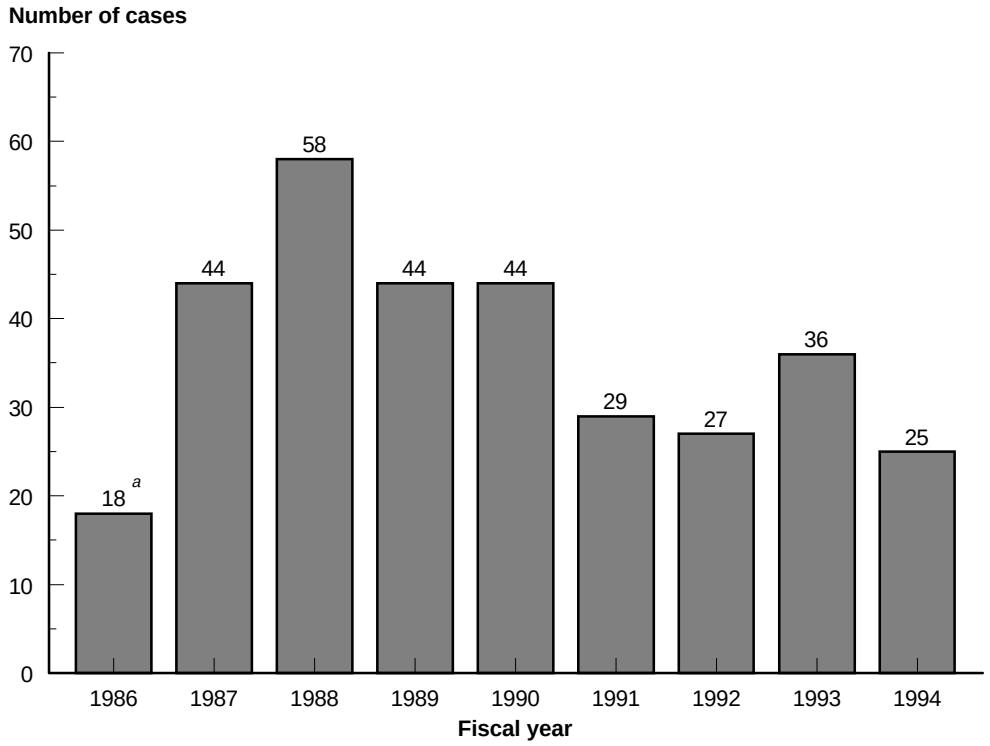
Acceptance of a voluntary disclosure into the program by DOD is based on four criteria. The contractor voluntarily disclosing the potential fraudulent action must (1) not be motivated by the recognition of imminent detection, (2) have status as a business entity, (3) take prompt and complete corrective actions, and (4) fully cooperate with the government in any ensuing investigation or audit.

Defense Contractor Participation in the Program

The number of voluntary disclosures under the program has been relatively small and the dollar recoveries have been modest. From its inception in 1986 through September 1994, DOD reported that 138 defense contractors made 325 voluntary disclosures of potential procurement fraud, of which 129 have been closed. According to DOD, 48 of the top 100 defense contractors made 222 disclosures. The remaining 103 disclosures were made by 90 contractors from among the more than

32,000 contractors doing business with DOD. Many contractors were one-time users, but one large contractor accounted for 23 of the closed cases. Figure 1 shows the annual number of disclosures reported since the program's inception.

Figure 1: Voluntary Disclosure Cases Since Program Inception



Source: GAO analysis of DOD database.

[a]Disclosure in 14 cases was made prior to July 1986. The earliest was May 1984.

Acceptance into the program has its benefits for contractors. For example, a contractor can expect (1) its liability in general to be less than treble damages, (2) action on any suspension to be deferred until after the disclosure is investigated, (3) the overall settlement to be coordinated with government agencies, (4) the disruption from adversarial government investigations to be reduced, and (5) the information may be kept confidential to the extent permitted by law and regulation.

The program also benefits the government. For example, DOD commented that the existence of a structured format for addressing contractual and legal violations encourages contractor ethics and internal review programs. The Justice Department pointed out that the program promotes corporate compliance with laws and regulations.

DOD/Justice Department Disagree on Some Admissions Into Program

According to DOD, the key to deciding if a disclosure is voluntary is whether a contractor was aware of information the government possessed or was about to discover, thus motivating the contractor to make a disclosure. In a 1992 DOD review of the program, DOD noted cases in which it had determined that contractors' disclosures were eligible for admission into the program, but the Justice Department disagreed and recommended that the disclosures not be admitted into the program.

In 1992, when this disagreement was noted, the Justice Department proposed that it and DOD establish a working group to resolve the issue. To date, we were told, this has not occurred.

According to officials from the two departments, disagreements continue over whether some disclosures should be admitted into the program. In fact, two of the three cases that were the basis of the concerns reflected in the 1992 review remain in the program as open cases, and the Justice Department still has not concurred with DOD's acceptance of these disclosures into the program. The disagreement between the two departments revolves around whether disclosures were triggered by knowledge of imminent discovery by the government. In this regard, DOD believes that it is its prerogative, not the Justice Department's, to accept or reject a contractor's voluntary disclosure.

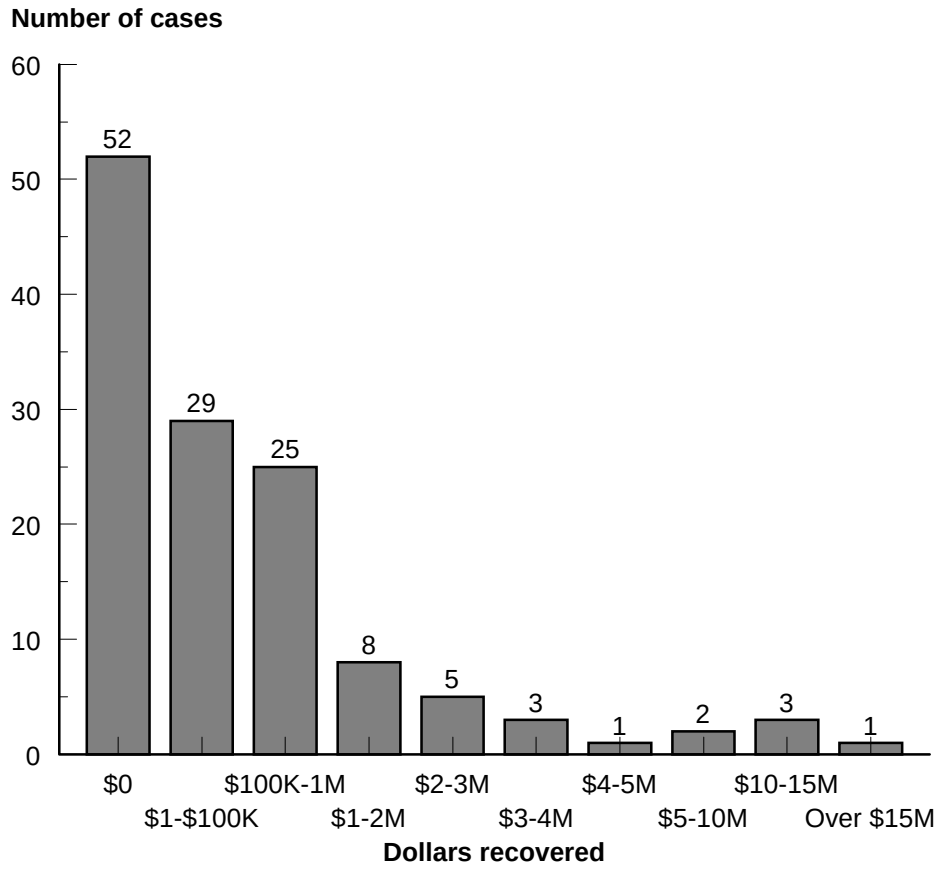
DOD stated that it did not always agree with the Justice Department on whether a company should be admitted into the program. However, DOD stated that it and the Justice Department have worked well together in resolving the questions on a factual basis and that this cooperation has grown significantly over the last 2 years. DOD stated that the DOD Inspector General staff and representatives of the Defense Procurement Fraud Unit meet every 6 weeks to discuss the status of disclosures. During our review, we were told that these meetings were to resolve cases that had been open for an extended period, not to address whether disclosures should be accepted into the program.

DOD-Reported Recoveries Overstated

Through September 1994, DOD reported recoveries from the program of about $290 million, of which about 38 percent is associated with cases that are still open. The $290 million represents about 17 percent of the Justice Department's $1.7 billion in reported settlements on DOD procurement fraud cases between fiscal years 1987 and 1994.

While the value of the voluntary disclosure program may well extend beyond the amount of dollar recoveries, we note that most disclosures did not result in significant dollar recoveries for the government. Of 129 closed cases, 81 cases, or about 63 percent, had reported recoveries of less than $100,000, of which 52 cases, or 40 percent, had no dollar recoveries. Forty-eight cases had reported recoveries of $100,000 or more, of which 15 cases had reported recoveries of $2 million or more. Figure 2 shows the distribution of DOD-reported dollar recoveries for closed cases.

Figure 2: Distribution of Reported Recoveries



Source: GAO analysis of DOD database.

The $290 million attributable to the program is overstated because it includes an amount that should not be considered a recovery from the program, as well as amounts related to disclosures made prior to the formal initiation of the program. The reported recoveries include (1) $75 million representing a contractor's premature billings of progress payments and (2) recoveries from voluntary disclosure cases that predated the beginning of the program by up to 2 years. One case was closed before the program began.

With regard to the progress payments, both the contractor's disclosure report and the government's subsequent investigative report showed the contractor prematurely billed the government by about $75 million. The Justice Department commented that the contractor then withheld approximately $75 million in billings at the time of the voluntary disclosure to rectify the premature billings. However, since DOD subsequently paid the contractor in full the amounts due under the contract, we believe the $75 million should not be claimed as a program recovery.

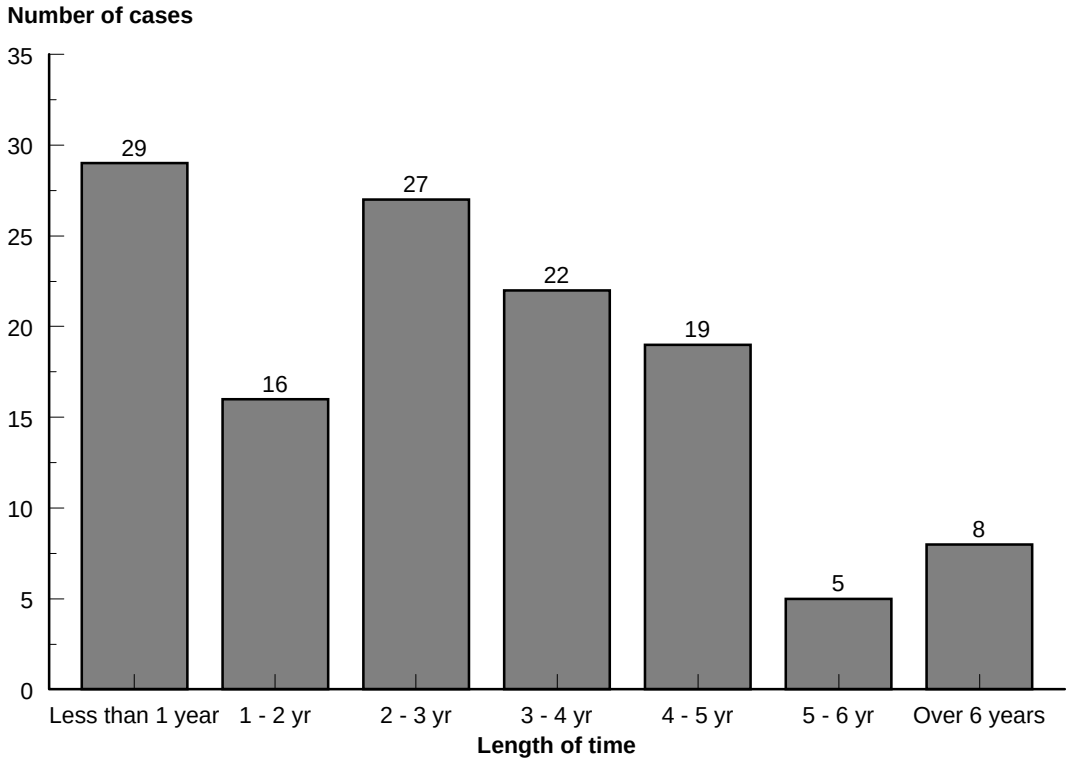
DOD considers the submission of a claim for unearned progress payment to be a false claim and thus appropriate for reporting under the program. The Justice Department commented that there was no "recovery" of $75 million and that the government was damaged by the interest lost on the premature payments, the amount of which was included in the final settlement with the contractor. In our view, a recovery properly attributable to the voluntary disclosure program would be the interest cost on the $75 million premature payment.

For 14 cases that predated the program, the DOD official responsible for the program told us that in 8 cases, although the disclosures predated the program announcement letter to industry, agreements were signed after the announcement and recoveries were resolved under the program. He said recoveries were made in three other cases after the program began. The DOD official believes, therefore, that these 11 cases were appropriately included in the program. However, he agreed that recoveries related to the three remaining cases should not be attributed to the program and indicated that DOD would reduce its reported recoveries—about $900,000—for these three cases.

Voluntary Disclosures Take an Average of 2.8 Years to Complete

For closed cases, DOD records show that it took an average of 2.8 years to complete a voluntary disclosure case, with about 25 percent taking over 4 years. DOD records also show that the contractors' investigation took about 21 percent of the time and that the federal audit/investigation took about 52 percent of the time. Figure 3 shows the time to complete the closed cases.

Figure 3: Time to Complete Voluntary Disclosure Cases



Source: GAO analysis of DOD database.

Note: Data on three cases was insufficient to calculate lapsed time.

More than half the disclosures made since the program began are still reported as open. As of September 30, 1994, there were 173 open cases that have been open an average of 3.5 years. Twenty-nine of 44 cases disclosed in fiscal year 1990 and 13 cases disclosed in fiscal year 1987, the first full year of the program, were still reported as open. Further, the open case load is growing. The number of open cases at the end of fiscal year 1994 was greater than it was at the end of fiscal year 1990, despite a

decline in the number of disclosures over the past 4 fiscal years. A Justice Department official suggested that some open cases may have been completed but not shown as closed in DOD's records. Between October 1994 and the end of June 1995, only 2 cases were closed while 15 were accepted into the program.

Contractor Cooperation May Be a Problem in Some Cases

A Justice Department official responsible for the program commented that not all contractors fully cooperate with the government and that this is one factor that makes investigations a time-consuming process and delays settlements. The official stated that few companies provide the government all its witness interview memoranda and that fewer still agree to provide the government a "road map" of the cases, believing that they are not obliged to serve as the government's investigator. According to this official, companies making voluntary disclosures tend to provide more assistance in a government investigation when the potential business and legal risks to the contractor are greater or when they want to give the impression that the company is turning over "a new leaf."

Our review identified two instances of less than full contractor cooperation. In one case, the company official destroyed records related to its disclosure. According to DOD, this company was successfully criminally prosecuted and fined, the official was sentenced to jail, and the company was debarred. The government's investigation took 13 months, according to DOD information. In the other case, the contractor denied documents to government investigators, and the DOD Inspector General ultimately issued a subpoena to obtain the information. The government's investigation took about 5 years, according to DOD information. The Justice Department said that the investigation included not only the disclosure but an additional series of allegations made in the related qui tam case, which was filed almost simultaneously with the company's report. DOD officials considered removing this contractor from the program due to lack of cooperation but did not.

The DOD official responsible for the program, however, stated that while there have been instances of less than total, or in a few cases very little, cooperation, they have been the exception rather than the rule. He added that disclosing a wrongdoing, conducting an internal investigation, and providing an internal investigative report without resorting to subpoenas or grand juries, were far more cooperative than would be present in any adversarial investigation.

Case Management Is a Low Priority

To ensure that each case is processed adequately and expeditiously, DOD guidelines require the investigative agencies to prepare a case progress report every 90 days summarizing the ongoing investigation and discussing case management issues, such as the status of the investigation and the level of contractor cooperation, and to forward the report to the DOD program manager. DOD also requires the investigative agencies to schedule a meeting with other appropriate program officials, such as those from the Justice Department and other DOD criminal investigative agencies, within 14 days of the progress report. The purpose of the meeting is to review the status of the case and determine what more needs to be done on each open investigation.

According to the DOD program manager, investigative agencies are not systematically sending in the progress reports, and, in some cases, the reports that are submitted do not meet the program's reporting requirements. Further, he told us that the meetings are not taking place because staffing is limited and priority is given to new cases over open cases. He also said DOD had not been following up to ensure that the DOD requirements were met and cases were handled expeditiously.

Most Disclosures Were for Contract Mischarging and Product Substitution

According to DOD data, the most frequent violation types disclosed were for contract mischarging and product substitution. Contract mischarging is applying material or labor charges to the wrong contract; product substitution is delivering products other than those specified in the contract. Other disclosures dealt with violations relating to overpricing of contracts negotiated under the Truth in Negotiations Act, false claims or statements, and excessive progress payment. Table 1 shows the number and types of violations disclosed for the closed cases.

Table 1: Number and Types of Disclosures for Cases Closed Through September 1994

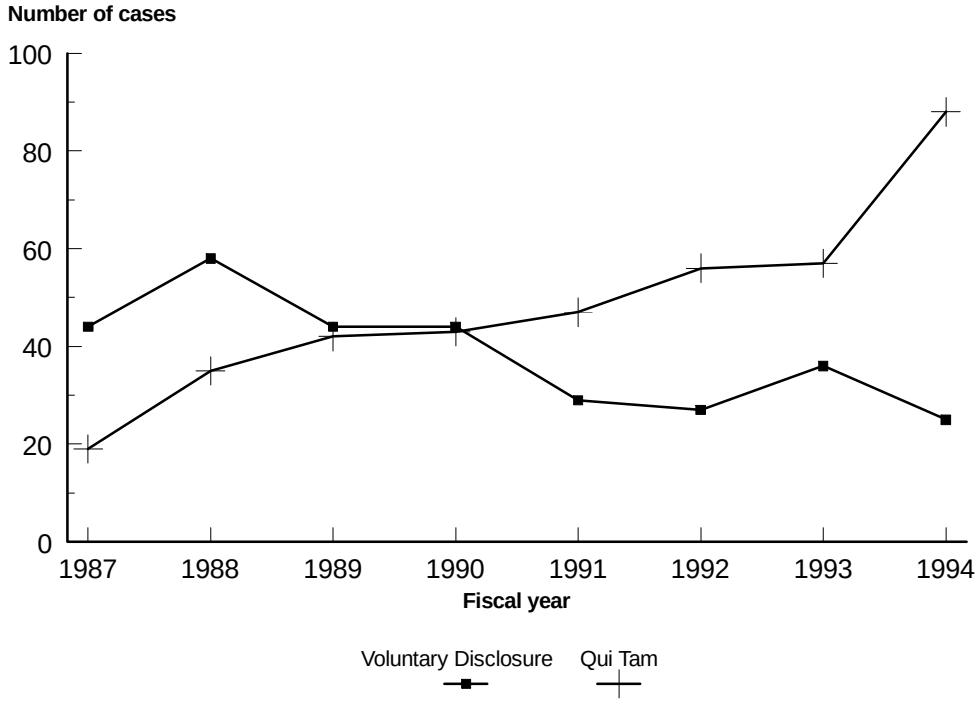
Category of violation	Number of cases
Contract mischarging	57
Product substitution	32
Overpricing	14
Progress payments	3
False claims/statements	12
Other	11
Total	**129**

Source: GAO analysis of DOD database.

Little Overlap Exists Between Qui Tam Actions and Voluntary Disclosures

In 1986, the False Claims Act was amended to increase the qui tam relator's share of recovery in fraud settlements. Since that time, DOD procurement-related qui tam actions have steadily increased, while voluntary disclosures have decreased. Figure 4 shows the number of DOD-related qui tam actions filed and the number of DOD voluntary disclosures made since 1987. While the increase in qui tam actions may be related to the increase in a relator's share of the recovery, we found no data to explain the decrease in disclosures.

Figure 4: DOD-related Qui Tam and Voluntary Disclosure Cases Since 1987



Source: GAO analysis of DOD database.

There is little overlap between voluntary disclosures and related qui tam actions. For the 129 voluntary disclosure cases closed since the program began, only 4 involved qui tam actions. In one case we examined, the

government benefited because the qui tam action (1) provided a road map essential to the government's case, (2) identified additional fraudulent activity, and (3) increased the amount of money recovered by the government.

According to a DOD official, some contractors claim that the threat of a qui tam action might discourage voluntary disclosures because the company's investigation creates potential qui tam relators as more employees become aware of the potential fraud. He added that a contractor runs the risk of an employee filing a qui tam action before it can complete its investigation or even adequately define the issue to make a sufficiently complete voluntary disclosure for acceptance into the program. On the other hand, this DOD official remarked that other contractors indicated they would make disclosures in spite of possible qui tam actions. Other reasons cited for a contractor not making a voluntary disclosure include (1) contractor management conflicts between disclosing potential fraud to the government and the contractor's perceived duty to protect stockholder value; (2) contractor uncertainty of prosecution outcome from disclosing potential fraud; (3) the high cost of internal investigations, which is usually stipulated to be an unallowable cost for government reimbursement purposes; and (4) differences between contractor disclosure policies and its practices.

According to an official in the DOD Inspector General's office, voluntary disclosures and qui tam actions complement each other and qui tams act as a "check and balance" to the program and contractor honesty.

Agency Comments

In commenting on a draft of this report, DOD emphasized that the program generates positive results and is clearly in the government's best interest. DOD's comments are presented in their entirety in appendix I, along with our evaluation of them.

The Justice Department said that it is committed to the program and that the program has been remarkably effective in nurturing business honesty and integrity and in bringing good new cases to the government's attention. It believes the program to be a model for government voluntary disclosure programs. The Justice Department's comments are presented in their entirety in appendix II, along with our evaluation of them.

Scope and Methodology

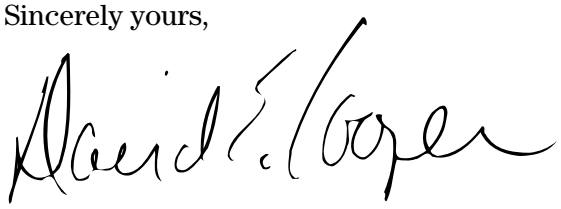
We reviewed overall statistical information on the program's accomplishments, as well as information on qui tam actions and their relationship to voluntary disclosures. We also reviewed limited information on one of four qui tam cases. In addition, we talked to experts inside and outside of the government on the program's merits and on its relationship to qui tam actions. We performed limited tests of the data reviewed and found some inaccuracies. Thus, while we have concerns about the reliability of the data, it represents the only source of comprehensive information on the program's accomplishments other than individual case files.

DOD and Justice Department policies and practices prevented our access to open voluntary disclosure case files. Our access to closed case file information was also limited when, according to Justice Department officials, it contained information covered by rule 6(e) of the Federal Rules of Criminal Procedure, which governs secrecy requirements of grand jury proceedings. As a result, the Justice Department would not provide us with the bulk of several closed case files we initially selected for review. Furthermore, according to the Justice Department, some of the documents in two of three closed cases we selected for initial review were unavailable because of a court-imposed protective order in one case and a confidentiality agreement between the U.S. Attorney's Office and the company in the other case. We conducted our review from May 1994 to July 1995 in accordance with generally accepted government accounting and auditing standards.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to the Secretary of Defense; the Attorney General, Department of Justice; the Director, Office of Management and Budget; and other interested congressional committees. Copies will also be made available to others upon request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix III.

Sincerely yours,



David E. Cooper
Associate Director,
Defense Acquisitions Issues

Contents

Abbreviations

DOD Department of Defense

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

OCT 13 1995

Mr. David E. Cooper
Director, Acquisition Policy,
Technology and Competitiveness Issues
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, dated September 11, 1995 (GAO Code 705079/OSD Case 1020), entitled "DOD PROCUREMENT: Use and Administration of DOD's Voluntary Disclosure Program."

The DoD partially concurs with the GAO draft report. The DoD reemphasizes that the Voluntary Disclosure Program generates positive results and is clearly in the Government's best interests.

The detailed DoD comments on the report observations are provided in the enclosure. The DoD appreciates the opportunity to comment on the draft report.

Sincerely,

Eleanor Hill

Eleanor Hill
Inspector General

Enclosure

GAO DRAFT REPORT, DATED SEPTEMBER 11, 1995
(GAO CODE 705079) OSD CASE 1020

"DOD PROCUREMENT: USE AND ADMINISTRATION OF DOD'S VOLUNTARY DISCLOSURE PROGRAM"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

OBSERVATIONS

Now on pp. 1 and 3.

OBSERVATION A: Defense Contractor Participation in the Program. The GAO reported that the number of voluntary disclosures under the program has been relatively small and the dollar recoveries have been modest. From its inception in 1986 through September 1994, the DoD reported that, of the tens of thousands of Defense contractors, 138 Defense contractors made 325 voluntary disclosures of potential procurement fraud, of which 129 have been closed. (pp. 2, 5-6/GAO Draft Report)

See comment 1.

DOD RESPONSE: Partially concur. The GAO conclusion that the number of voluntary disclosures have been relatively small and the dollar recoveries modest is misleading. The report comes to this conclusion by comparing the number of voluntary disclosures to the total number of contractors with which the DoD does business (see pages 2 and 6). It is not reasonable to assume that every DoD contractor is equally likely to make a voluntary disclosure. First, the Voluntary Disclosure Program is available only to business entities, not to individuals. Thus small businesses--which comprise a large percentage of the DoD contractor base--would be reluctant to make a voluntary disclosure. Second, because 70 percent of DoD contracting dollars go to 100 contractors (see page 3 of the report), these contractors represent the most likely and significant source of voluntary disclosures. When using the Top 100 contractors as the base, the number of voluntary disclosures is significant (48 of the Top 100 contractors have made voluntary disclosures, see page 6 of the report).

See comment 2.

In addition, the DoD strongly believes that the value of the program is considerably broader than can be measured by the amount of dollars recovered. The existence of a structured format for making and resolving contractual and legal violations positively contributes to the ability of contractors to have effective ethics and internal review programs. Thus, fraud prevention efforts are enhanced through encouraging contractor self-governance.

Now on pp. 1 and 5.

OBSERVATION B: The DoD and the Justice Department Disagree on Some Admissions into Program. The GAO reported that, according to officials from the DoD and the Department of Justice (DoJ), disagreements continue over whether some voluntary disclosures should be admitted into the program. The disagreement between the two Departments revolves around whether a contractor was aware of and motivated to make a disclosure by information the Government possessed or was about to discover. In 1992, the Justice Department proposed that it and the DoD establish a working group to resolve the disagreements, but the GAO was told that this has not occurred. (pp. 2, 6-8/GAO Draft Report)

See comment 3.

DOD RESPONSE: Partially concur. The DoD and DoJ do not always agree on whether a company should be admitted to the Voluntary Disclosure Program. The draft report should note that, although there are still questions about some admissions, the two Departments have worked well together in resolving the questions on a factual basis, and further, that this cooperation has grown significantly over the last two years. The draft should present a more balanced picture of the cooperation and coordination between the DoD and the DoJ offices as the program is currently administered.

See comment 3.

The draft report mischaracterizes the nature of the 1992 letter from the Deputy Secretary of Defense to the Attorney General. The draft omits the facts surrounding the Justice Department proposal that a working group be established to resolve policy issues raised in the 1992 letter from the DoD to the DoJ. The situation has changed considerably since January 1992. For example, DoD Inspector General staff and representatives of the DoJ's Defense Procurement Fraud Unit meet every 6 weeks to discuss the status of voluntary disclosures. These meetings are in addition to regular telephone conferences between the two offices.

Now on pp. 6-8.

OBSERVATION C: DoD-Reported Recoveries Overstated. According to the GAO, through September 1994, the DoD reported recoveries of about $290 million attributable to the program. The $290 million is overstated because it includes $75 million relating to a premature progress payment billing and $900,000 from disclosures made prior to the formal initiation of the program. Also, most voluntary disclosures did not result in significant dollar recoveries for the Government--of 129 closed cases, 81 had recoveries of less than $100,000. (pp. 8-10/GAO Draft Report)

See comment 4.

DOD RESPONSE: Partially concur. The DoD does not agree that $75 million should be removed from recoveries reported under the program because the Department did in fact recover $75 million that had been claimed prematurely. The DoD considers the submission of a claim for unearned progress payment to be a false claim. The fact that the contract was later completed and the company received full payments for work actually done is irrelevant.

The Department agrees that approximately $900,000 of claimed recoveries in three cases should be subtracted from recoveries attributed to the program. Two cases occurred early in the program and lacked sufficient documentation in the file either to substantiate acceptance into the program or receipt of the claimed recovery. One case involved a disclosure that was made and resolved prior to the formal announcement of the program.

With respect to the report's conclusion that the dollar recoveries were not significant, the report cites that of the 129 closed cases, 81 (or about 63 percent) closed cases had reported recoveries of less than $100,000; 52 closed cases (or 40 percent) had no recoveries. This data is misleading because it cites data for only 81 closed cases (the 52 cases with no recoveries are included within the 81 cases showing recoveries of less than $100,000). What the report ignores are the remaining 48 closed cases--25 of those cases recovered over $100,000 and 23 of those cases recovered over $1 million. In cases where there were recoveries, far more were over $100,000 (48 cases) than under $100,000 (29 cases).

See comment 5.

OBSERVATION D: Voluntary Disclosures Take an Average of 2.8 Years to Complete. The GAO reported that for cases which have been closed, DoD records show that it took an average of 2.8 years to complete a voluntary disclosure case with about 25 percent taking over 4 years. (pp. 10-11/GAO Draft Report)

Now on pp. 8-10.

DOD RESPONSE: Concur.

OBSERVATION E: Contractor Cooperation May Be a Problem in Some Cases. The GAO reported that a Department of Justice program official stated that few companies gave the Government all its witness interview memoranda and fewer still agree to provide the Government a "road map" of the cases, believing that they were not obliged to serve as the Government's investigator. On the other hand, a DoD program official stated that while there have been instances of less than total, or in a few cases very little, cooperation, they have been the exception rather than the rule. The DoD official also stated that disclosing a wrongdoing, conducting an internal investigation, and providing an internal investigative report without resorting to subpoenas or grand juries, were far more cooperation than would be present in any adversarial investigation. (pp. 12-13/GAO Draft Report)

Now on p. 10.

DOD RESPONSE: Partially concur. Overall, contractor cooperation in voluntary disclosure cases exceeds that which would occur in an adversarial investigation, and, as such, enhances the Government's ability to ultimately resolve these cases.

See comment 6.

OBSERVATION F: Low Priority to Case Management. The GAO reported that, according to the DoD program manager, investigative agencies are not systematically sending in 90-day case progress reports, nor holding case status meetings to determine what more needs to be done on each open investigation because staffing is limited and priority is given to new cases over open cases. The DoD program manager also said the DoD had not been following up to ensure that the DoD requirements are met and cases are handled expeditiously. (pp. 13-14/GAO Draft Report)

Now on p. 11.

DOD RESPONSE: Concur. It should be noted that the case progress reports and case status meetings are provided for in the Inspector General, Department of Defense, pamphlet describing the Voluntary Disclosure Program. They are not mandatory, but rather are intended as general guidelines, policy, and processes to be used by the DoD and the DoJ, who share responsibility in the resolution of fraud matters. The need for additional support of the program was recognized by management. In November 1994, an additional staff person was assigned to the Voluntary Disclosure Program to assist in processing disclosures and to close matters that remain open for only administrative reasons.

OBSERVATION G: Most Disclosures Were for Contract Mischarging and Product Substitution. The GAO found that of 129 closed cases, most were for contract mischarging (57) and product substitution (32). Other disclosures were for defective pricing (14), false claims/statements (12), and progress payments (3). (pp. 14-15/GAO Draft Report)

Now on p. 11.

DoD RESPONSE: Concur.

OBSERVATION H: Little Overlap Between Qui Tam Actions and Voluntary Disclosures. The GAO found that there was little overlap between voluntary disclosures and *qui tam* actions. Only 4 voluntary disclosures involved facts that were related to a qui tam action. The GAO also stated that companies take differing views on whether the possibility of a *qui tam* suit influences its decision to submit a voluntary disclosure. Also, the GAO cited other reasons why contractors might not make disclosures. (pp. 15-17/GAO Draft Report)

Now on pp. 12-13.

DOD RESPONSE: Partially concur. While there may be any number of possible reasons that a contractor might choose not to disclose, the record shows that the program generates positive results. It is clearly in the Government's best interest to maintain the Voluntary Disclosure Program.

See comment 7.

The following are GAO's comments on the Department of Defense's (DOD) letter dated October 13, 1995.

GAO Comments

1. The Voluntary Disclosure Program is available to all DOD contractors regardless of size. Even if individuals were eliminated from consideration, there would still remain thousands of "business entities" to which the program is available. Thus, the number of voluntary disclosures has been relatively small and the dollar recoveries modest.

2. We recognize that the program's value may extend beyond that which can be measured by dollar recoveries alone and that fraud prevention efforts may be enhanced through encouraging contractor self-governance. In this regard, the importance of fraud prevention is highlighted by a DOD Inspector General reported in March 1993 that stated that,

"The number of current investigative cases and resulting recoveries of money to the Government and convictions of defense contractors being conducted by the Defense Criminal Investigative Service shows that fraud is still increasing. The Federal Bureau of Investigations statistics shown for the United States substantiate the same trend. Losses due to fraud are approximately $200 billion a year."

Although our report notes that the program represented about 17 percent of the Justice Department's $1.7 billion in reported settlements on DOD procurement fraud cases between fiscal years 1987 and 1994, actual program recoveries were a matter of disagreement.

3. We modified the report's text to incorporate DOD's comments.

4. We continue to disagree with DOD on reporting the $75 million in premature progress payments as a recovery of the program since the amount was ultimately paid to the contractor.

5. We modified the report's text to incorporate DOD's comments.

6. We modified the report's text to incorporate DOD's comments.

7. We modified the report's text to incorporate DOD's comments.

Comments From the Department of Justice

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

U. S. Department of Justice

Criminal Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

October 11, 1995

Mr. Norman J. Rabkin
Director, Administration
of Justice Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Rabkin:

This letter constitutes the Department of Justice's comments and suggested technical edits to the General Accounting Office (GAO) draft report entitled "DOD Procurement: Use and Administration of DOD's Voluntary Disclosure Program."

At the outset, we believe it is important to point out that the Department of Justice shares a strong commitment to the Department of Defense's Voluntary Disclosure Program. Almost a decade ago, the Department formally endorsed the program as a significant step forward in the federal government's efforts to encourage meaningful self-governance among the nation's defense contractors. Today, more than ever, we reaffirm that support. The program continues to be a model for government voluntary disclosure programs.

The GAO's analysis of the program indicates that the government has had a lower level of efficiency and "modest" dollar recoveries on voluntary disclosure cases in the past four years. The GAO also found that the numbers of defense-related qui tam cases increased dramatically in the same period and the dollar recoveries in these cases were greater than the totals recovered for voluntary disclosures. Nevertheless, there are reasons to be cautious about generalizing from the data. In this area of obvious significance to Congress, we are concerned that the draft report offers only tepid support for the program. We think the program has been remarkably effective in nurturing business honesty and integrity and in bringing good new cases to our attention.

See comment 1.

A comparison of qui tam and voluntary disclosure statistics does not support the conclusion that the Voluntary Disclosure

Program is not a useful or effective means of identifying or combatting fraud. Any measure that adds to the government's ability to address fraud, whether it is traditional criminal and civil prosecution, qui tam, or an established voluntary disclosure program, is a welcome measure. If some techniques have yielded more dollars than others, this fact alone does not detract from the success or importance of any other law enforcement tool. We support the qui tam statute as a means of encouraging individuals with knowledge of fraud to come forward and assist our law enforcement efforts. By the same token, the Department has always believed that the DOD Voluntary Disclosure Program is a valuable supplement to other remedies we have available, and that remains the case today.

See comment 2.

The report's singular focus on numbers overlooks significant attributes of the Voluntary Disclosure Program that cannot be measured by statistics alone. Corporations are expected to take corrective actions as part of their disclosures. For example, corporate compliance that comes out of voluntary disclosure can have long term effects on business honesty and integrity -- which serve the interests of both government and industry. A corporation's compliance efforts go a long way in demonstrating the contractor's present responsibility and fitness to do business with the government.

The current public perception is that corporations must develop and strengthen their compliance efforts in order to become good corporate citizens. A broad range of industries in corporate America have learned valuable lessons from the experience of the defense industry with voluntary disclosure, most notably the need to take more responsibility for monitoring and policing their own operations, and promptly to report misconduct which is discovered through these efforts. The new Organizational Sentencing Guidelines, which took effect on November 1, 1991, have increased the importance of voluntary disclosure and self-governance by effectively requiring corporations to implement standards and procedures that are reasonably designed to prevent illegal and unethical employee conduct. This includes developing codes of conduct, hotlines, and training programs, as well as other preventive strategies and mechanisms that are designed to ensure compliance with the laws and protect against future employee misconduct. Without attention to such efforts, companies cannot hope to raise the level of business conduct or respond to the need for greater social responsibility and accountability. From the government's point of view, in voluntary disclosure cases, companies are given the opportunity to implement compliance programs and policies and to prove that they work.

Voluntary disclosures have also been valuable in identifying the scope and impact of fraudulent activities that otherwise would have gone undetected. In fact, the Department of Defense

will not accept companies into the program if the government is aware of the conduct that the company is disclosing, or if the government determines that the disclosure was motivated by the expectation of imminent discovery by government auditors or investigators. Both the Departments of Defense and Justice agree that the program requirements should be scrupulously observed. No disclosure will be accepted into the program without the concurrence of the Department of Justice and a fully executed XYZ agreement. While Justice initially questioned the Defense Department's determination in a few of the disclosures, upon further review and discussion, the issues were resolved and Justice was happy with the results. To our knowledge there are no open disclosures which do not meet the program admission requirements.

See comment 3.

This finding is encouraging because it gives some indication that the program has been an effective instrument for developing a consistent national policy with respect to voluntary disclosures. In today's culture of corporate self-governance and corporate good citizenship, it is essential that the defense contractor community have access to a workable voluntary disclosure process that companies will feel comfortable using. It is equally important for companies to know and understand that they can rely on the history and established policies under the program to ensure the best coordinated review of their disclosures of which this government is capable.

A concern is raised in your report involving difficulties with respect to GAO's request for grand jury and other sensitive Department information. We are aware that your auditors were unable to obtain requested information in some of our closed civil and criminal case files that they initially had asked to review. We realize that in a few cases we could not provide the auditors with materials based upon our exercise of certain privileges. However, as we also indicated at the time, our files were permeated with different types of case-sensitive documents that presented legitimate concerns beyond the exercise of privilege, particularly grand jury material and other judicially protected information. Your staff agreed to accommodate these issues and allow for redaction of such materials. Although the actual redaction process was cumbersome, we fulfilled our agreements with the auditors and produced the redacted files as quickly as we could. We wish to assure you that it was never our intention to delay the work of your auditors or to evade any obligation on the part of the Department.

See comment 4.

Finally, there are a few additions and corrections that we feel should be added to the Department's comments on the overall report. Our comments are as follows:

1. Page 5, first full sentence: The report states that "Contractors are not legally or contractually required to

disclose potential fraud to the government." We think this is an overly broad and unnecessary statement. First, there may in fact be agreements (such as administrative agreements with suspension and debarment authorities) that require contractors to disclose potential past fraud on the government. Second, where there is ongoing fraud, no one would question the obligation of the contractor to stop the conduct and take steps to inform the government. We think the statement thus should be deleted or at least modified to limit itself to the obligation to disclose past wrongdoing in the absence of express contractual requirements.

See comment 5.

2. Page 5, second full paragraph: To avoid any misstatements, we suggest that the criteria be quoted from the Taft letters.

Now on p. 3.
See comment 6.

3. Pages 6-7, benefits of acceptance: The report states that the contractor can expect its liability to be limited to no more than double damages. As the False Claims Act provides that a volunteer, as defined in the statute, is liable for "not less than double damages", we would prefer that this statement be changed to read: "(1) its liability in general to be less than treble damages, pursuant to § 3729(a)(1)(A)-(C) of the False Claims Act."

Now on p. 4.

See comment 7.

Also, we take issue with paragraph (5), page 7. While the XYZ agreement provides certain protection to information produced pursuant to the agreement (XYZ agreement at C.1), that provision applies to DOD only and not to the Department of Justice. Moreover, nothing allows "the case to be kept confidential" (emphasis added); the XYZ agreement only applies to the information provided under the agreement. The draft report should be clarified in this regard.

Now on p. 4.

See comment 8.
See comment 9.

4. Page 9, last paragraph: Our understanding is that the company withheld approximately $75 million in progress billings at the time it made its disclosure in order to rectify the fact that it had prematurely billed the government on prior progress payments billings. While this did not represent a "recovery" in the sense that the government ultimately paid the progress billings as they became properly due, the government was indeed damaged by the interest lost on the premature payments to the contractor. The government settled these claims for damages in an agreement with the company for $150 million, which was paid to the government in 1994.

Now on p. 8.

See comment 10.

5. Page 13, second full sentence: This statement indicates that the investigation, presumably referring to a matter that was the subject of both a qui tam case and a voluntary disclosure, took five years. This statement should be clarified to reflect the fact that the investigation included not only the disclosure itself, but an additional series of allegations made in the

Now on p. 10.

See comment 11.

related qui tam case, which was filed almost simultaneously with the company's report.

Now on p. 12.
See comment 12.

6. Page 16, graph: It should be made clear that the chart compares DOD related qui tam cases (not all qui tam cases) with DOD voluntary disclosures.

Now on p. 13.

See comment 13.

7. Page 17, end of the first full paragraph: We would clarify (3) to read: "the high cost of internal investigations, which are usually included as unallowable costs for government contract accounting purposes pursuant to settlement agreements that resolve the contractor's civil liability for the disclosed matters."

Now on p. 14.

See comment 14.

8. Page 19, first full sentence: We would amend to read: "Furthermore, according to the Justice Department, some, but not all, of the documents in two of the three closed cases we selected for initial review were unavailable because of a court-imposed protective order in one case and a confidentiality agreement between the United States Attorney's Office and the company in the other case."

The Department appreciates the opportunity to comment on the draft report. We are available to discuss to this further at your convenience.

Sincerely,

John C. Keeney
Acting Assistant Attorney General

The following are GAO's comments on the Department of Justice's letter dated October 11, 1995.

GAO Comments

1. We do not make the conclusion that the Voluntary Disclosure Program is not a useful or effective means of identifying or combatting fraud.

2. We agree that statistics alone do not tell the whole picture of the potential contribution of the program. We recognize that the program's value may extend beyond that which can be measured by available statistics and that corporate compliance that comes out of voluntary disclosures can have long-term effects on business honesty and integrity.

3. DOD continues to report two open cases in which the Justice Department did not concur because it believed the contractor was motivated by recognition of imminent detection.

4. While we attempted to work with the Justice Department in obtaining information from closed case files, the length of time it took to obtain information did not allow us to complete our audit in a timely manner. Further, without knowledge of the information withdrawn from the files, we could not effectively evaluate the administration of the program.

5. We have deleted this sentence based on the Justice Department's comments.

6. For purposes of background and brevity, we summarized the criteria for program acceptance. A full presentation of the criteria does not, in our view, add to the background presentation.

7. We have modified the report based on the Justice Department's comments.

8. We have modified the report based on the Justice Department's comments.

9. We have modified the report based on the Justice Department's comments.

10. Although the government was damaged by the amount of lost interest on the premature payment to the contractor, the $75 million represents the amount of the progress payment and does not include interest lost.

11. We have modified the report based on the Justice Department's comments.

12. We have modified the report based on the Justice Department's comments.

13. We have modified the report based on the Justice Department's comments.

14. We have modified the report based on the Justice Department's comments.

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.	Phillip A. Goulet Charles W. Thompson
Office of General Counsel, Washington, D.C.	William T. Woods Raymond J. Wyrsch
Dallas Regional Office	John E. Clary Joe D. Quicksall Ronald J. Salo

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested