

First Friday Fraud Facts+

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QUESTIONS OR COMMENTS:

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The Idaho State Controller's Office distributes this newsletter as a cost-effective method of increasing awareness about ways to detect and prevent fraud, waste, and abuse in government.

Welcome to First Friday Fraud Facts+ (F4+). This edition will discuss cross charging.

Cross Charging

Cross charging is a common form of contract and procurement fraud. Also known as co-mingling of contracts, cross charging arises when a contractor performs labor or incurs an expense on one contract and then improperly bills said labor or expense to a different contract. All forms of government frequently enter into agreements with contractors to serve and protect their citizens. There are two general contract categories used: fixed-price contract and cost-plus contract.

A fixed-price contract is a contract in which the government and the contractor agree upon a fixed price regardless of the cost or time it takes the contractor to complete the job. Typically, no adjustments or change orders are made because the contract price is fixed. This class of contracts places the greatest risk on the contractor, which is ultimately responsible for their potential profit or loss. This contract type may be advantageous because minimum burden is placed upon the government and incentive is provided to the contractor to control costs and complete the work responsibly and effectively. In March 2009, President Obama officially endorsed a preference for fixed-price contracts writing, "There shall be a preference for fixed-price type contracts. Cost-reimbursement contracts shall be used only when circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price contract."¹

A cost-plus contract is a contract in which the government reimburses the contractor the cost of the work performed (time and materials) plus an additional payment. Commonly, a pre-determined fee is agreed upon to guarantee the contractor makes a profit. To avoid cost overruns, a maximum dollar limit is typically set on the contract. This type of contract offers minimal motivation for the contractor to control costs; nonetheless, cost-plus contracts are common when long-term quality is more important than cost or the level of effort required to complete the job is unknown. Federal agencies that typically use this type of contract are U.S. Department of Defense and National Aeronautics and Space Administration (NASA).¹



The most common example of cross charging is when the contractor improperly removes costs from a fixed-price contract and apportions the cost to a cost-plus contract. This can be artfully done by directing employees to record their time spent working on the fixed-price contract as time spent working on a cost-plus contract.² This act benefits the contractor by keeping costs under control with the fixed-price contract while maximizing profits. A contractor with both government and private commercial contracts could easily commingle contracts, so that the government ends up paying the bulk of the overhead costs.³

Cross charging is very relevant to state agencies because many agencies enter into agreements with contractors to complete various projects, such as roads, bridges, computer system implementation, or emerging technologies. Cross charging can be quite profitable to a deceptive contractor when bearing in mind the hefty size of particular government contracts. It is imperative for government employees to beware of cross charging to ensure taxpayer dollars are not wasted or stolen.

Indicators

According to the Department of Defense Office of the Inspector General, fraud indicators in reference to cross charging include, but are not limited to:⁴

- Multiple awards for similar work are given to the same contractor.
- The contractor submits several invoices for the same or similar expense of work under different jobs or contracts.
- The contractor submits the same or similar documentation to support billings on different contracts.
- Similar work orders are issued to the same contractor under more than one contract.
- Contractor receives multiple awards for similar work.
- Frequent errors/correction of errors on invoices and other documents.
- Contractor costs on fixed-priced contract are unusually low.
- Costs on the cost-plus contract are considerably higher than those expected or budgeted.
- Same employee billed to more than one job for the same time period.

Best Practices

The Association of Certified Fraud Examiners provide the following procedures to help identify and deter cross charging:⁵

- Review contracts prior to their award to ensure that statements of work to be performed are not duplicated in other contracts.
- Identify contractors holding more than one contract that have similar work statements.
- Closely monitor billings for high rates of errors or duplicate payment.
- Identify whether contract personnel are billed to more than one contract for the same time periods.
- Examine payment records to determine if the contractor billed for the same expenses under more than one contract.
- Evaluate the number of contract change requests.
- Evaluate the billing costs in comparison to budgeted costs.

Fraud Case

Lockheed Martin Corporation (Lockheed Martin) is the world's largest defense contractor with headquarters in Bethesda, Maryland. The company specializes in aerospace and defense, information technology, space, and emerging technologies. The United States government, specifically the Department of Defense, is its primary customer.⁶

To capitalize financially and maximize profits, Lockheed Martin's aircraft manufacturing division located in Marietta, Georgia "inflated the overhead rates that it used to price and bill government contracts performed for the U.S. Air Force and U.S. Navy."⁶ The government claimed this fraudulent activity took place from 1996 to 2000. During that period, Lockheed Martin also retained a commercial contract with Alenia Aerospazio (Alenia), an Italian aeronautics company known for its design, development, assembly, and support of commercial and military, training, and unmanned aircraft systems. Lockheed Martin was tasked by Alenia to develop an aircraft termed as the "C27J," a twin-engine turboprop plane with a large cargo cabin specially developed for ground-attack missions and electronic warfare. The "C27J" has been ordered by a number of military air forces, including Italy, Greece, Bulgaria, Lithuania, Morocco, and the United States.

Purportedly, Lockheed Martin mischarged business development, proposal, and other selling costs that were incurred to develop the "C27J" to government contracts. Lockheed Martin agreed to pay \$10.28 million to the United States to resolve the allegations under the False Claims Act in December 2010. The False Claims Act of 1863 imposed liability on persons or companies (typically government contractors) who defraud governmental programs. This case clearly demonstrates cross charging, as Lockheed Martin should not have billed government costs from commercial contracts.⁶

¹ "Types of Government Contracts: A primer on four common types found in RFPs." Deltek, Inc., 2012. Web. <<http://iq.govwin.com/corp/downloads/GW-Types-Govt-Contracts-2012.pdf>>. Accessed May 4, 2015.

² "Cross Charging." *Defense Contractor Fraud*. Phillips and Cohen LLP, 2015. Web. <<http://www.phillipsandcohen.com/Defense-Contractor-Fraud/Cross-Charging.shtml>>. Accessed May 4, 2015.

³ "Qui Tam Actions Based on Cross Charging & Mischarging." *Contractor Fraud Overview*. Vogel, Slade & Goldstein, LLP, 2014. Web. <<http://vsg-law.com/contractor-fraud-overview/cross-charging-mischarging/>>. Accessed May 4, 2015.

⁴ "Cross Charging (Comingling of Contracts)." *Fraud Red Flags & Indicators*. Office of Inspector General United States Department of Defense, 2014. Web. <<http://www.dodig.mil/resources/fraud/redflags.html#tabs>>. Accessed May 4, 2015.

⁵ "Contract and Procurement Fraud." Association of Certified Fraud Examiners, Inc., 2012. Web. <http://www.fraudconference.com/uploadedFiles/Fraud_Conference/Content/Course-Materials/presentations/23rd/ppt/post-07-Performance-Schemes.pdf>. Accessed May 4, 2015.

⁶ "Lockheed Martin Corporation reaches \$10.28 million settlement with U.S. to resolve false claims act allegations." Department of Justice, 17 Dec. 2010. Web. <http://www.contractormisconduct.org/ass/contractors/38/cases/1534/2239/lockheed-martin-mischarged-costs-on-c27j-_dojpr.pdf>. Accessed May 5, 2015.

