

Inspector General

United States
Department *of* Defense



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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

July 22, 2011

MEMORANDUM FOR DIRECTOR, OFFICE OF SMALL BUSINESS
PROGRAMS

SUBJECT: DoD Indian Incentive Program Payments to Related Parties and Rebates to
Excluded Parties (Project No. D2010-D000FJ-0180.000)

We are providing this report for your information and use. We reviewed incentive requests made by the Office of Small Business Programs (OSBP) to prime contractors under the DoD Indian Incentive Program. As requested by your office, we reviewed the list of contractors that submitted incentive requests in FY 2010.

Our audit objective was to determine whether sufficient guidance exists to ensure DoD's Office of Small Business Programs properly approves and awards incentive payments under the DoD Indian Incentive Program.

OSBP did not have sufficient qualification guidance regarding requests made by related and excluded parties. We identified incentive requests totaling \$4.17 million from prime contractors who were inappropriately subcontracting to a related party and prime contractors on the Excluded Parties List System (EPLS). We notified OSBP of these instances in two memorandums issued in May 2010. The OSBP Acting Director responded by implementing new guidance and denying the requests in June 2010. OSBP put to better use \$3.02 million in FY 2010 requests from prime contractors appearing related to their subcontractors, and OSBP put to better use \$1.15 million in FY 2010 requests made by a prime contractor who was on EPLS.

BACKGROUND

Section 1544, title 25, United States Code (25 U.S.C. § 1544 [1988]), "Additional compensation to contractors of Federal agency," established an incentive payment for contractors that subcontract to Indian-owned enterprises based on 5 percent of the amount payable to the subcontractor. DoD began the Indian Incentive Program (IIP) in FY 1997, for which Congress appropriated \$8 million each fiscal year, and for FY 2008 and thereafter, appropriated \$15 million each fiscal year. The Under Secretary of Defense for Acquisition, Technology, and Logistics (USD[AT&L]), OSBP, administers the IIP.

Prime contractors initiate the IIP application process by submitting to their contracting officers:

- Copies of 51-percent ownership certifications from eligible subcontractors; copies of certifications of tribal, Native Alaskan, or Native Hawaiian enrollments from eligible subcontractors; or subcontractors' completed self-certification forms;

- Copies of all eligible subcontractors' invoice receipts;
- Invoice summary sheet, listing invoices by number and explaining the 5-percent rebate amount; and
- Rebate request letter stating subcontractors' eligibility as Indian-, Native Alaskan- or Native Hawaiian-owned enterprises and citing Defense Federal Acquisition Regulation Clause 252.226-7001.

The DoD contracting officer then collects, reviews, and verifies the request and documentation received from prime contractors. After verification, the contracting officer submits a funding request letter and the supporting documentation to OSBP. Finally, OSBP personnel process the request and determine whether to approve payment, if funding is available.

REQUESTS BY RELATED PARTIES

OSBP did not have a formal definition of "related or affiliated" at the start of our review. Related parties, as discussed here, are prime contractors and Indian-owned subcontractors whose apparent relationship would diminish the need to compensate risk, such as a relationship of common corporate organizational structure, common management personnel, family relationship, or a teaming arrangement. We reviewed 208 FY 2010 IIP requests, valued at \$15 million, and identified 11 requests submitted by two prime contractors, valued at \$3.02 million, where the prime and the subcontractor met the definition of related parties.

Although not specifically prohibited in formal guidance, OSBP had denied requests for IIP payments to related parties on a case-by-case basis. OSBP posted this policy on its Web site's "Frequently Asked Questions" section and then more formally implemented it in an August 2009 information memorandum. The OSBP Acting Director stated that although 25 U.S.C. § 1544 (1988) does not formally restrict such requests, in her opinion, a "prime contractor should not need an incentive to subcontract to an affiliated company." She added that the decision to withhold payments to related parties complies with 25 U.S.C. § 1544 (1988) and making IIP payments to a related party would be an inappropriate use of program funds and not in the best interest of the taxpayer.

In a memorandum to OSBP, we suggested suspending payments (see Attachment 1). The OSBP Acting Director agreed and denied the funding, which resulted in \$3.02 million of funds put to better use for FY 2010 (see Attachment 2 for OSBP's response).

RELATED PARTIES CORRECTIVE ACTION TAKEN

To address the related-party issues, the OSBP Acting Director:

- initially denied payment to the prime contractors that appeared related or affiliated with Indian-owned enterprises; however, she agreed to reconsider incentive payments if the prime contractors certify to DoD that no affiliations exist with their subcontractors;

- contacted the responsible DoD contracting officer to obtain certification of non-affiliation;
- updated the OSBP August 2009 memorandum, clarifying the policy regarding payments to related parties and posted the memorandum online; and
- updated OSBP request procedures to require certification of non-affiliation from the prime contractor as part of the request package.

The OSBP Acting Director also further defined “affiliated” in the non-affiliation certification to mean a “subcontractor that is not owned or affiliated as a subsidiary, joint venture, partnership or mutual/co-ownership by the prime contractor.”

REQUESTS BY EXCLUDED PARTIES

Of the 208 FY 2010 IIP requests, valued at \$15 million that we reviewed, 50 requests, valued at \$1.15 million, were submitted by one prime contractor, who was added to EPLS on November 16, 2009. EPLS provides information about parties that are excluded from receiving Federal contracts, certain subcontracts, and certain Federal financial and nonfinancial assistance and benefits.

On November 9, 2009, a criminal indictment was issued, accusing the prime contractor of defrauding the Government by submitting inflated bills and false claims while under contract with the Defense Logistics Agency Defense Supply Center Philadelphia. The indictment listed the prime vendor contracts as those which the prime contractor allegedly submitted inflated bills and false claims.

Because the prime contractor listed on the EPLS had requested IIP funding, it is possible that the contractor could have inflated the subcontractor invoices to determine the 5-percent incentive payment. Therefore, it is plausible that the requested amounts were affected by inflated bills and false claims.* In a memorandum to OSBP, we informed the Acting Director that the prime contractor was listed in the EPLS and was under indictment.

In our memorandum, we suggested suspending the FY 2010 IIP payments to the prime contractor (see Attachment 3). The OSBP Acting Director agreed, resulting in \$1.15 million of IIP funds put to better use (see Attachment 4 for OSBP’s response).

* Because of the ongoing criminal and civil investigations by the Department of Justice, Defense Logistics Agency (DLA), and Defense Criminal Investigative Service, we could not review the submitted invoices to confirm.

EXCLUDED PARTIES CORRECTIVE ACTION TAKEN

During the audit, the OSBP Acting Director:

- denied payment to the prime contractor until the case is resolved;
- contacted the responsible DoD contracting officers regarding these decisions;
- directed that contracting officers review the EPLS before submitting requests for incentive payments to OSBP; and
- established internal procedures to ensure OSBP personnel also review the EPLS before approving incentive payment requests and processing payments.

AUDIT STANDARDS

We conducted this performance audit from March 2010 through May 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT METHODOLOGY

We visited and interviewed officials from the USD(AT&L) Office of Small Business Programs. These officials provided program information, guidance, a data extract, and incentive request packages. The data depicted incentive requests (both paid and approved for payment) dating back to FY 1997. The database also included requests for FY 2010 and a few for FY 2011 that were not approved or paid during our audit. This database was an in-house tracking system created and maintained by OSBP personnel.

We compared OSBP data with open-source information to determine whether a relationship existed between a prime contractor submitting the request for incentive payment and the qualifying subcontractor and whether either contractor was excluded from Federal contracting. Examples of the open-source information we used include contractor Web sites, registration with states' Secretary of State Business Filing Web sites, and the Excluded Parties List System.

We coordinated with the Department of Justice, DoD Defense Criminal Investigative Service, and Defense Logistics Agency to gather information on the prime contractors' debarment or exclusion from Federal contracting. These agencies are performing the ongoing civil and criminal investigations into the prime contractor we identified as having pending incentive requests while also listed in EPLS and, as such, we limited our review into these requests.

USE OF COMPUTER-PROCESSED DATA

We relied on computer-processed data on DoD IIP application requests and payments. The data was obtained directly from OSBP personnel, who created and maintained the database to organize hardcopy requests. During our review, we reviewed select hardcopy requests, verified contractor names with public Web sites, and on the EPLS. We determined the computer-processed data to be reliable.

PRIOR AUDIT COVERAGE

During the last 5 years, the Government Accountability Office (GAO) and Small Business Administration Inspector General (SBA IG), have issued four reports discussing contracting with Indian Organizations and Indian-owned economic enterprises. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted SBA IG reports can be accessed over the Internet at <http://www.sba.gov/ig/>.

GAO

GAO Report No. 06-399, "Contract Management: Increased Use of Alaska Native Corporations' Special 8(a) Provisions Calls for Tailored Oversight," April 27, 2006

SBA IG

SBA IG Report No. 10-11, "Irregularities Involving Alaska Native Technologies, LLC," April 29, 2010

SBA IG Report No. 9-15, "Participation in the 8(A) Program by Firms Owned by Alaska Native Corporations," July 10, 2009

SBA IG Report No. 8-14, "Non-Native Managers Secured Millions of Dollars From 8(A) Firms Owned by Alaska Native Corporations Through Unapproved Agreements That Jeopardized the Firms' Program Eligibility," August 7, 2008

We appreciate the courtesies extended to the staff. Please direct questions to me at (614) 751-2913. If you desire, we will provide a formal briefing on the results.

Amy J. Frontz, CPA
Principal Deputy Inspector General
for Auditing

Attachments:
As stated

Memorandum: Related Parties



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

MAY 06 2010

MEMORANDUM FOR ACTING DIRECTOR OFFICE OF SMALL BUSINESS PROGRAMS

SUBJECT: DOD Indian Incentive Program – Payments to Related Parties

As part of the “Audit of the DOD Indian Incentive Program (Project No. D2010-D000FJ-0180.000),” we are reviewing incentive payments made by the Office of Small Business Programs (OSBP) to prime contractors under the DOD Indian Incentive Program. As requested by your office, we reviewed the list of companies that submitted pending rebate requests in FY 2010. This memorandum serves as a formal follow-up to our discussion with your office on March 23, 2010, regarding payments to related parties.

The purpose of the DOD Indian Incentive Program is to provide a five percent rebate to prime contractors on subcontracted work performed by an Indian organization or Indian-owned economic enterprise. Through the authority delegated to the OSBP in DOD Directive 4205.01, “DOD Small Business Programs,” OSBP has restricted prime contractors from receiving the incentive payment if they appear to be related to the otherwise qualifying subcontractor.

In August 2009, the Acting Director of the OSBP established a written policy in a Memorandum of Information stating, “Prime contractors are restricted from receiving an incentive payment if the subcontractor or supplier is legally affiliated with that contractor, even if it would otherwise be eligible for the incentive payment.”

Based on our review of publicly available information and pending rebate payments, it appears two prime contractors are subcontracting to a related party and consideration should be given as to whether payment should be denied. We defined related as bound by way of a teaming arrangement, corporate, management, or family ties. Specifically:

- In FY 2010, JMC Construction requested incentive payments of \$302,033.55 for subcontracting to [REDACTED]. It appears both companies may be run by either the same owner or possibly family members (father/son or brothers).
- In FY 2010, Kwajalein Range Services (KRS), LLC, requested incentive payments of \$2,717,221.63¹ for subcontracting to [REDACTED]. It appears the two companies entered into a teaming arrangement for the purpose of competing for a large cost-plus, cost-term award fee contract in 2002. KRS, along with its major subcontractor [REDACTED] provides

¹ For FY2011, a request has been submitted for \$306,049.70. OSBP noted due to increased participation in the program, some rebates cannot be paid until additional program funding is available, during the next fiscal year.

logistics support and integrated range engineering with the potential value of \$2.7 billion over 15 years.

Although we agree with the practice of restricting payments to related parties, we are concerned that the August 2009 Memorandum of Information was a temporary measure that should be formalized in policy to ensure continued future compliance.

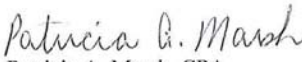
According to DOD Instruction 5025.01, "DoD Directives Program," DOD issuances shall consist of directives, instructions, memorandums, publications, directive type memorandums (DTMs), and administrative instructions. In this case, DTMs, according to the DOD Instruction, "shall not be used to permanently change or supplement existing issuances; [and] shall be effective for no more than 180 days from the date signed, unless an extension is approved, during which time they shall be incorporated into an existing DOD issuance, converted to a new DOD Issuance, reissued, or canceled."

The August 2009 Memorandum for Information, as currently issued: (1) does not have a date stamp on the document, only the OSBP website link indicates the date; (2) has exceeded 180 days since issuance and may no longer be effective; and (3) may not be authoritative guidance for which to implement policy.

We recommend your office: (1) postpone FY 2010 payments, which total \$3,019,255.18, to these two prime contractors until your office can conduct more in-depth research to determine whether an affiliation exists between the prime contractors and subcontractors²; and (2) issue policy that formalizes the restriction of denying payments to related parties.

We request you provide comment to this memorandum within 15 days describing actions to be taken by your office.

We appreciate the courtesies extended to the staff. If you have any questions about the content of this memorandum, please contact [REDACTED] at (614) 751-[REDACTED] or [REDACTED]@dodig.mil. Your assistance in this matter is appreciated.


Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

cc: Deputy Under Secretary of Defense For Acquisition and Technology

² Consequent correspondence with OSBP indicated that FY 2010 payments totaling \$2,717,221.63 to the prime contractor, Kwajalein Range Services, LLC, will be suspended until additional research can be completed.

OSBP Response to Memorandum Regarding Related Parties



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

2 JUL 2010

MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Comment to Department of Defense (DoD) Inspector General memorandum on DOD Indian Incentive Program-Rebates to Related Parties dated May 06, 2010

This memorandum addresses actions taken in response to recommendations made by the Department of Defense (DOD) Office of the Inspector General regarding companies requesting rebates under the DOD Indian Incentive Program.

Specifically, recommendations were made to 1) postpone FY2010 payments to JMC Construction and Kwajalein Range Services until it is determined whether an affiliation exists between the prime and subcontractor and, 2) issue policy that formalizes the restriction of denying payments to related parties.

Our office has denied FY2010 payments to JMC Construction and Kwajalein Range Services and contacted the responsible government contracting officer to obtain certifications of non-affiliation between the prime and subcontractor. The affected rebate requests may be reconsidered if the prime contractor certifies to the government that no affiliation exists with its subcontractor.

The DOD Office of Small Business Programs (OSBP) memorandum clarifying the policy regarding payments to related parties will be updated and posted to the OSBP website. Rebate request procedures have been updated to require a certification of non-affiliation from the prime contractor as part of the rebate request package.

A handwritten signature in black ink that reads "Linda B. Oliver".

Linda B. Oliver
Acting Director
Office of Small Business Programs

Memorandum: Excluded Parties



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

MAY 06 2010

MEMORANDUM FOR ACTING DIRECTOR OFFICE OF SMALL BUSINESS PROGRAMS

SUBJECT: DOD Indian Incentive Program – Rebates to Excluded Parties

As part of the "Audit of the DOD Indian Incentive Program (Project No. D2010-D000FJ-0180.000)," we are reviewing incentive payments made by the Office of Small Business Programs (OSBP) to prime contractors under the DOD Indian Incentive Program. As requested by your office, we reviewed the list of companies that submitted pending rebate requests in FY 2010. This memorandum serves as a formal follow-up to our discussion with your office on March 23, 2010, regarding rebates to excluded parties.

The purpose of the DOD Indian Incentive Program is to provide a 5 percent rebate to prime contractors on subcontracted work performed by an Indian organization or Indian-owned economic enterprise.

Data provided by the OSBP indicated Public Warehousing Company submitted 50 rebate requests totalling \$1,154,104. During our review, we gathered information indicating Public Warehousing Company had defrauded the Government at various times over the past 6 years by submitting inflated bills and false claims while under contract. A criminal indictment was issued against this contractor on November 23, 2009, naming prime vendor contract SPM300-05-D-3128¹, the same contract under which many of the rebate requests were submitted. We further confirmed this contractor (and its other name variations) was added to the Excluded Parties List on November 16, 2009.

Based on discussions with your office, it is the responsibility of the contracting officer to review and submit an application requesting a rebate payment from the DOD Indian Incentive Program. However, there is the potential for a delay between the time the application is submitted by the contracting officer and the time of payment. In this example, applications were pending payment prior to Public Warehousing Company being added to the Excluded Parties List. Current OSBP business practices and policy does not appear to address this issue.

We recommend your office: (1) postpone FY 2010 payments, totalling \$1,154,104, to Public Warehousing Company until your office can conduct further research to determine whether the indictment encompasses these FY 2010 Public Warehousing Company rebate

¹ Contract SPM300-05-D-3119 is also identified within the indictment and is referred to as "Bridge Contract."

requests² and (2) consider issuing program policy that addresses potential payments to excluded parties and procedures to review pending payments.

We request you provide comment to this memorandum within 15 days on actions to be taken.

We appreciate the courtesies extended to the staff. If you have any questions about the content of this memorandum, please contact [REDACTED] at (614) 751-[REDACTED] or [REDACTED]@dodig.mil. Your assistance in this matter is appreciated.


Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

cc: Deputy Under Secretary of Defense For Acquisition and Technology

² Consequent correspondence with OSBP indicated that FY 2010 payments, totalling \$1,154,104, to Public Warehousing Company will be suspended until additional research can be completed.

OSBP Response to Memorandum Regarding Excluded Parties



OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

2 MAY 2010

MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Comment to Department of Defense (DoD) Inspector General memorandum on DOD Indian Incentive Program-Rebates to Excluded Parties dated May 06, 2010

This memorandum addresses actions taken in response to recommendations made by the Department of Defense (DOD) Office of the Inspector General regarding companies requesting rebates under the DOD Indian Incentive Program.

Specifically, recommendations were made to 1) postpone payments to Public Warehousing Company for requests made under contract SPM300-05-D-3128, until it is determined whether the indictment issued on November 9, 2009 encompasses the FY2010 Public Warehousing Company rebate requests, and 2) consider issuing program policy that addresses potential payments to excluded parties and procedures to review pending payments.

Our office has denied payment to Public Warehousing Company until their case is resolved, and the responsible government contracting officer has been notified of this decision. If the contracts under which the rebates were requested are closed out prior to the resolution of the case, the rebate requests will be rendered ineligible for future payment consideration.

No policy regarding payments to parties on the Excluded Parties List is necessary. However, internal procedures have been established to ensure this review is conducted for all rebate requests prior to final approval and processing of payment. We have also included this review as a task to be performed by the contracting officer when submitting the rebate request.


Linda B. Oliver
Acting Director
Office of Small Business Programs



Inspector General Department of Defense

