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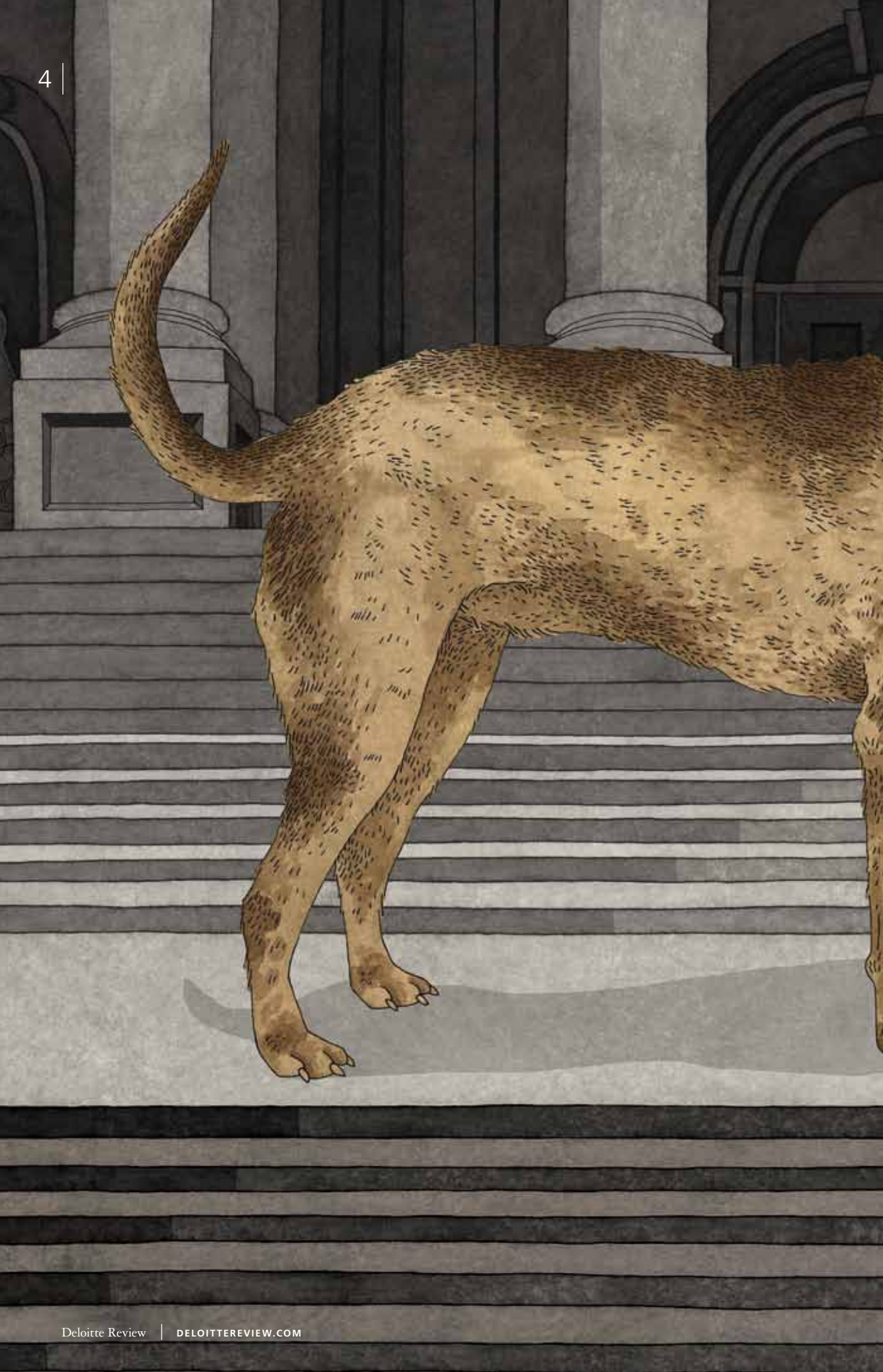
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Stimulus Spending and Transparency: A False Sense of Security?

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Many companies may be underestimating the government's intent to show accountability to the American people and to weed out fraud. Whether by miscalculation or simple misunderstanding of how far the government mandates extend, failure to comply could put unsuspecting companies in jeopardy.

The flow of government funds to revive the U.S. economy becomes a rolling river in 2010. Federal officials expect annual outlays under the \$787 billion American Recovery and Reinvestment Act (ARRA) of 2009 to crest at nearly \$220 billion dollars in the government's 2010 fiscal year. Total outlays of \$236 billion will follow over the 2011-2019 timeframe.¹

With hundreds of billions of dollars of the stimulus package potentially presenting opportunities for businesses, how effective are the government mandates related to the ARRA in terms of transparency and fraud prevention? Many companies may be underestimating the government's intent to show accountability to the American people and to weed out fraud. Whether by miscalculation or simple misunderstanding of how far the government mandates extend, failure to comply could put unsuspecting companies in jeopardy.

We explored these and other stimulus spending-related questions by surveying the business community across a spectrum of industries, with a focus on sectors likely to be recipients of stimulus spending, either directly or indirectly.² We also analyzed stimulus spending data and antifraud enforcement information from government and other sources to assess how general opinion corresponded with program developments.³

The participants in the survey revealed traits often associated with conversations about public issues: contradiction and misperception. For example, most respondents believe the ARRA should have been smaller, yet half believe that additional stimulus may be needed. Half the respondents think funds should be spent faster despite data indicating that spending actually is on pace with the government's aggressive timetable for putting funds to use. Such misconceptions may fuel miscalculation of, or at least indifference toward, government antifraud efforts (see sidebar, "*Stimulus spending is speeding along – isn't it?*").

Encouragingly, most respondents claim some familiarity with the stimulus program's antifraud provisions. But are they concerned enough to fully understand these measures and make sure their companies comply with them?

Based on other survey responses described in this article, companies may find themselves lulled into underestimating how serious the government is about pursuing fraud and using the regulatory tools at its disposal. In fact, it's not just those companies receiving stimulus funds directly from federal, state and local government agencies that are at risk – any organization receiving ARRA funds indirectly, such as through a prime contractor or intermediate grantee, can also be held accountable.

Companies already receiving stimulus funds, those considering participation in the program, and those that may become associated with stimulus spending projects, intentionally or otherwise, should pay particular attention to understanding

the depth and details of the government's antifraud offensive and take steps to anticipate and comply with the rigorous requirements.

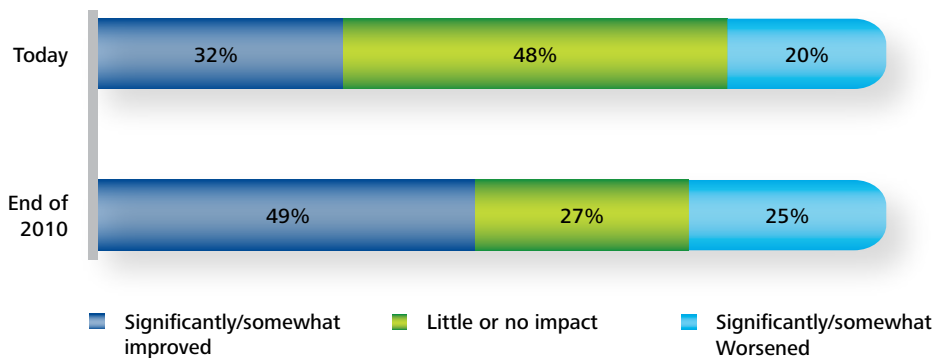
STIMULUS SPENDING IS SPEEDING ALONG – ISN'T IT?

Misperceptions among businesses about stimulus spending in general may lead to complacency in their antifraud efforts – a potentially serious mistake.

While ARRA allocations in 2009 focused on family financial relief, human services and unemployment benefits, a large share of the spending this year and beyond could present significant opportunities for businesses in an array of industries. Nearly \$300 billion was earmarked at the outset for contract projects under the act. These projects would be allocated through federal, state and local programs that include major investments in infrastructure, education, health-care, information technology, energy, conservation programs and other initiatives.

Participants of Deloitte's stimulus spending survey indicated modest near-term expectations for the stimulus program. About one-third believe the program has had a positive impact on economic conditions so far, with the number expecting a positive impact by year-end 2010 growing to almost one-half (see Figure 1).

Figure 1. Impact of economic stimulus program on economic conditions



Puzzlingly, a majority of respondents (71%) believe the ARRA should have been smaller, yet half believe additional stimulus may be needed.

Moreover, half of respondents think funds should be spent faster, while publicly available data indicate that spending is generally on pace with the government's aggressive timetable for putting funds to use. In February 2009 the Congressional Budget Office estimated expenditures of \$120 billion for the federal fiscal year ending September 30, 2009.⁴ Spending is scheduled to ramp up to \$219 billion in fiscal 2010, reach \$126 billion in 2011, and total \$110 billion over the remainder of the decade.⁵

THE GOVERNMENT SIGNALS IT MEANS BUSINESS

Enhanced financial accountability, transparency and reporting requirements embedded in the ARRA are a clear sign of the government's intent to keep a tight rein on stimulus-related fraud (*See Key Stimulus Antifraud Provisions*). Even before the ARRA became law, the Obama administration served notice that federal agencies and funding recipients would be held to higher standards in distribution and use of stimulus funds.

White House Chief of Staff Rahm Emanuel and Office of Management and Budget Director Peter Orszag established this “tone at the top” in a memorandum to the heads of federal departments and agencies. Their memorandum drove home the administration's message, saying “... the president and Congress are committed to spending recovery dollars with an unprecedented level of transparency and accountability so Americans know where their tax dollars are going and how they are being spent.”⁶

KEY STIMULUS ANTIFRAUD PROVISIONS

The ARRA includes funding to strengthen antifraud oversight and investigations through several avenues. The act requires that inspectors general review as appropriate any concerns raised by the public about specific investments using funds made available.

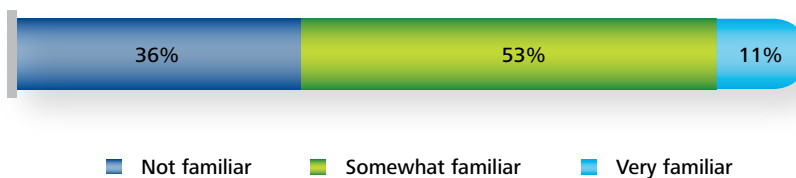
The Government Accountability Office (GAO) is receiving ARRA funds to hire accountants, lawyers, economists and policy analysts to look for fraud and abuse at every level of government. The Recovery Act Accountability and Transparency (RAAT) Board has oversight over whether funds are being awarded and distributed promptly, fairly and reasonably and is charged with establishing and maintaining transparency of fund recipients and uses.

The ARRA also extends whistle-blower protection to contractors carrying out stimulus-funded projects for federal, state and local government entities. And, it expresses the government's preference for fixed-price contracts.

Predictably, considering the publicity about the transparency and antifraud measures, a majority of Deloitte* survey respondents indicate they are familiar with those ARRA provisions (see Figure 2).

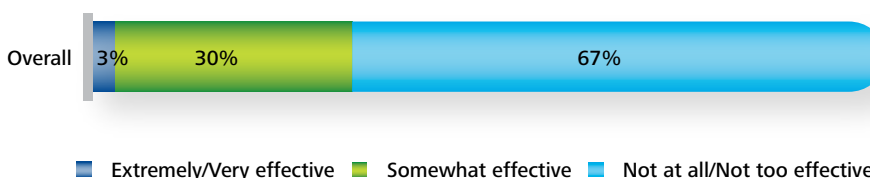
* As used in this article, “Deloitte” means Deloitte Financial Advisory Services LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Figure 2. Familiarity with requirements of economic stimulus program designed to increase transparency and prevent fraud



However, two-thirds of respondents believe the transparency and fraud prevention requirements will not be very effective or will not be effective at all (see Figure 3).

Figure 3. Effectiveness of economic stimulus program in increasing transparency and preventing fraud



On the surface, this view might seem justified. An online search of information available from the Recovery.gov website, the Department of Justice, the Securities and Exchange Commission, other agencies and news reports found no indication of an uptick in investigations being launched specifically relating to stimulus spending fraud. However, it's still early in the game, and the depth and breadth of stimulus fraud may not yet have manifested. Another possibility, contradicting the opinion of most people surveyed, is that the government's transparency and fraud prevention initiatives are, in fact, working.

Either way, we believe companies should be careful not to ignore or downplay the government's clear signals about its seriousness in promoting transparency and preventing fraud. In addition to the executive branch memo establishing a strong tone at the top, Congress has equipped government agencies with the tools they need to detect and enforce the provisions of the ARRA. Executives of companies receiving stimulus funding or contemplating opportunities to participate in stimulus projects can benefit from a closer look at the government's arsenal – and willingness to use it.

ANTIFRAUD PROVISIONS FLASH SHARPER TEETH

Concurrent with passage of the ARRA and reflecting the government's transparency commitment, Congress strengthened federal law in 2009 to help root out fraud and abuse by government contractors. The Fraud Enforcement and Recovery Act of 2009 (FERA), enacted last May, significantly expands the government's fraud-fighting efforts in several ways.

The FERA extends federal fraud laws that previously only addressed government procurement to now cover mortgage lenders, recipients of funds under the federal Troubled Asset Relief Program (TARP), and ARRA fund recipients. The act also more precisely defines what constitutes money laundering in the government's eyes.

The FERA's most significant impact on ARRA projects is in expanding the scope of the False Claims Act (FCA), the statute that imposes liability on businesses for making false statements or claims for government reimbursement.

These changes make it more important for companies receiving federal funds to have effective compliance programs and processes in place. FERA violations can result in fines of \$1 million (and up to \$10 million for multiple counts) and 10 years in prison.

The FCA, a statute dating back to the Civil War, is widely used to root out fraud and abuse in government contracting. The act empowers the U.S. Department of Justice to pursue violations for a variety of alleged actions including fraud or misrepresentation in accepting government money, presenting an inflated claim for payments, or using a false record or statement to get a claim paid.

It is also an FCA violation to deliver less property or service than the amount indicated on a customer receipt or to deliver a product or service that is different from what was promised. Greater enforcement of the FCA is likely as the economic stimulus program progresses.

The ARRA includes funding for inspectors general who serve as watchdogs over federal departments and agencies. The FERA authorizes \$500 million for additional antifraud investigations and prosecutions.⁷

The FERA amends the FCA in three noteworthy ways. First, it expands the universe of companies potentially liable for FCA violations. Second, it dramatically increases the consequences of failing to return overpayments to the government. Finally, it extends whistle-blower protection to government contractors and subcontractors.

It is important to note that more than half of all states also have their own false claims statutes.⁸ Thus, stimulus fund recipients can be subject to a pincer of false claims litigation from two government instrumentalities.

Separately, but leveraging antifraud provisions of the FERA, President Obama created the Financial Fraud Enforcement Task Force in November 2009. The task force, formed under executive order, was prompted by a growing public outcry over fraud perpetrated on Wall Street through market manipulation, insider trading and Ponzi schemes. It brings together the U.S. Departments of Justice, Treasury, and Housing and Urban Development, along with the SEC and state and local authorities to fight fraud. The White House has authorized \$245 million annually in 2010 and 2011 for the hiring of hundreds of new prosecutors, agents and other officials at the federal level to pursue financial fraud.⁹



The Fraud Enforcement and Recovery Act of 2009 amends the False Claims Act in three noteworthy ways by:

- Expanding the universe of companies potentially liable for FCA violations
- Dramatically increasing the consequences of failing to return overpayments to the government
- Extending whistle-blower protection to government contractors and subcontractors

Each of these areas represents a potential landmine for unwary companies.

Expansion of liability

Prior to passage of the FERA, several court rulings culminating in the Supreme Court's decision in *Allison Engine Co. v. United States ex rel. Sanders* had narrowed the circumstances in which a company would face FCA liability. A false claim had to be directly presented to the federal government, or a false statement had to be presented to an intermediary, such as a prime contractor or state or local government, with the intent of using the false statement to get the federal government to pay a false claim.

In the wake of the Supreme Court decision, the U.S. Congress was concerned that the "presentment" requirement and the "intent" standard would mean the FCA was not broad enough to cover false claims submitted to intermediate entities receiving ARRA and TARP funds. As a result, the FERA includes several changes that have the effect of extending FCA liability not only to claims presented directly to the United States, but also to claims presented to entities administering government funds.

This expansion of liability is likely to have limited effect on federal government contractors and subcontractors, who are already subject to false claims sanctions. However, the FERA amendments now extend liability to companies and entities that do business with federal funds grantees such as state governments, local governments and universities. As long as the grantees are dispensing federal money on the government's behalf, false claims seeking such funds are now clearly actionable under the FCA.

Overpayment sanctions

A controversial provision of the FERA with potentially dramatic implications relates to government overpayments that occur routinely. Retention of an overpayment can now serve as the basis for “reverse false claims” liability under the FCA if it is done knowingly and improperly or if an overpayment is knowingly concealed. The FCA requires proof of a knowing false record or statement, knowing concealment, or knowing and improper acts to avoid or decrease an obligation to pay back money to the government.

Guidance provided by lawmakers at the time of FERA passage directs that liability should not be imposed for retaining overpayments pending their return through normal processes, including contract, grant and other reconciliation processes. However, someone would be liable who falsified information during a reconciliation period or otherwise acted knowingly and improperly to avoid repayment. Also, it is unclear whether failure to return an overpayment during an administrative or judicial appeal might be actionable under the FCA.

The impact of the new overpayment provisions will become clearer as cases wend through the courts. It is likely that attorneys for people initiating whistleblower cases will seek to expand overpayment reverse false claims liability in the years ahead.

Expanded whistle-blower protection

Historically whistle-blower laws have focused on protecting employees from retaliation by their employer for reporting fraud, as well as other issues such as unsafe work conditions and environmental violations. The FERA amends the FCA to expand whistle-blower protection to anyone who brings a potential FCA violation to the attention of authorities.

The implications of this change are potentially far-reaching. Now, not only employees, but government contractors and subcontractors, and anyone else for that matter, can file suit alleging discrimination for bringing an FCA violation to the attention of authorities. Such protection could encourage more *qui tam* lawsuits, in which a plaintiff referred to as a “relator” files suit alleging fraud against the

government and, if successful, can receive typically 15 to 25 percent of any money recovered.

With the law change, a subcontractor could file a *qui tam* action against his or her prime contractor and, if subsequently terminated, have a cause of action. In addition, companies can now file *qui tam* actions against a competitor with the knowledge that they have protection as a whistle-blower should the competitor retaliate in some fashion.

A troubling aspect of the FERA-amended FCA is the lack of a definition of overpayment. The statute is enforced not only by the Department of Justice but by attorneys representing whistle-blowers, who are likely to argue for expansive interpretations of what an overpayment means. These could include, for example, poor estimates of future costs.

WHISTLE-BLOWER PROVISIONS AND FIXED-PRICE CONTRACTS: DISLIKED BUT NOT DISRESPECTED

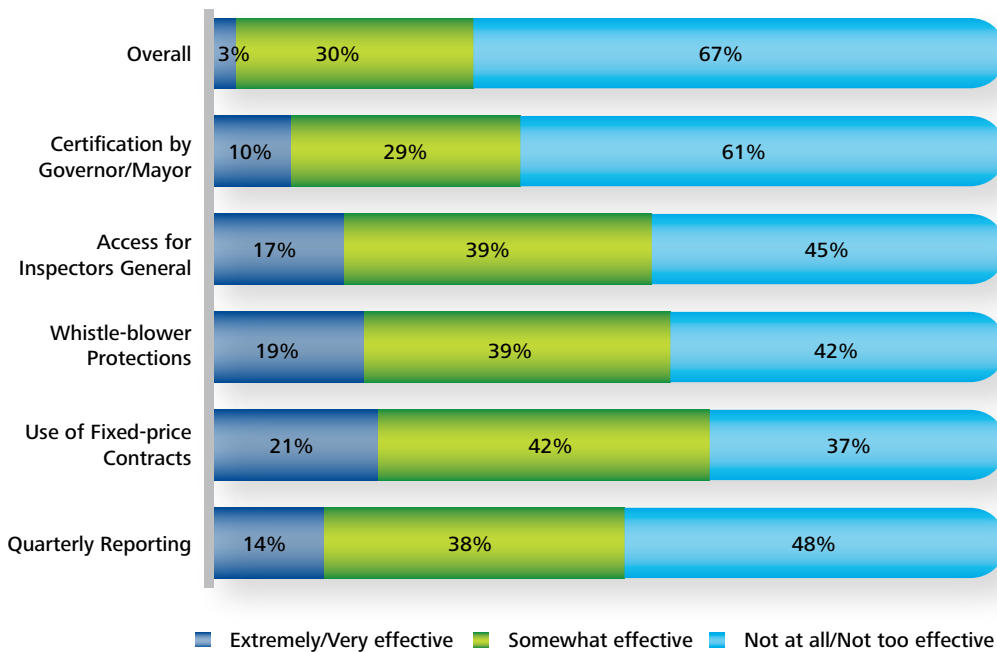
As mentioned previously, two-thirds of the respondents surveyed by Deloitte doubted that the stimulus program's transparency and antifraud provisions overall would be effective. However given the opportunity to think about it in narrower terms, many took a different view.

Survey respondents were asked whether they thought specific requirements would be effective in stemming fraud:

- Certification by a governor, mayor or other chief executive that a project is an appropriate use of taxpayer dollars.
- Authorization for federal department inspectors general to examine contractor and subcontractor records and interview contractor officers and employees.
- Whistle-blower protections.
- Awarding of fixed-price contracts.
- Quarterly contractor reports on funded projects disclosing the amount of funds expended or obligated, completion status, job impact and information on major subcontracts.

In contrast to their overall opinions of antifraud efficacy, the majority of respondents indicated that, with the exception of governor, mayor or other chief executive certifications, these provisions would be somewhat or very effective in increasing transparency and preventing fraud (see Figure 4).

Figure 4. Effectiveness of economic stimulus program in increasing transparency and preventing fraud: overall and specific requirements



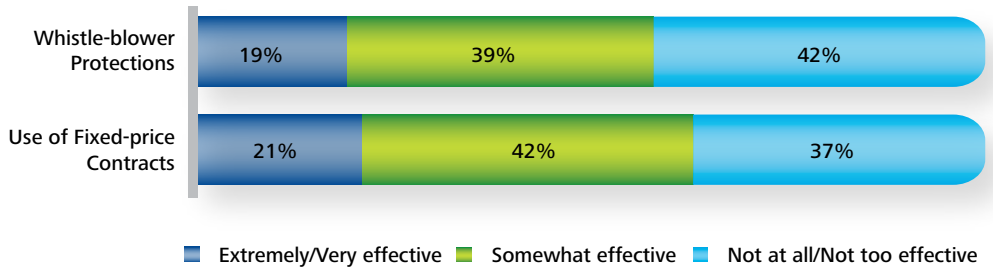
Notably, the two provisions regarded as potentially most effective, least costly, and delivering the most favorable cost-benefit return are historically unpopular among many business executives – fixed price contracts and whistle-blower provisions.

Executives often fear that fixed-price contracts will lead to losses should cost overruns occur that cannot be recouped. Despite studies showing that tips are the number one way in which fraud is discovered, executives may also express concerns that whistle-blowing is plagued with a large number of false alarms and encourages allegations from people with axes to grind or seeking to make money.¹⁰ The latter concern is generally contradicted by analyses of whistle-blower hotline call data published in recent years.¹¹

Despite these general views, many survey respondents believe the whistle-blower protections and fixed-price contracts:

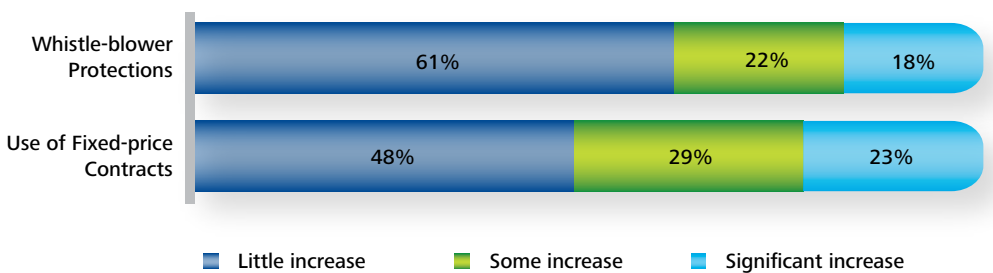
- Will be most effective in increasing transparency and preventing fraud; 58 percent and 63 percent respectively see the provisions as extremely to somewhat effective (see Figure 5).

Figure 5. Effectiveness of economic stimulus program in increasing transparency and preventing fraud



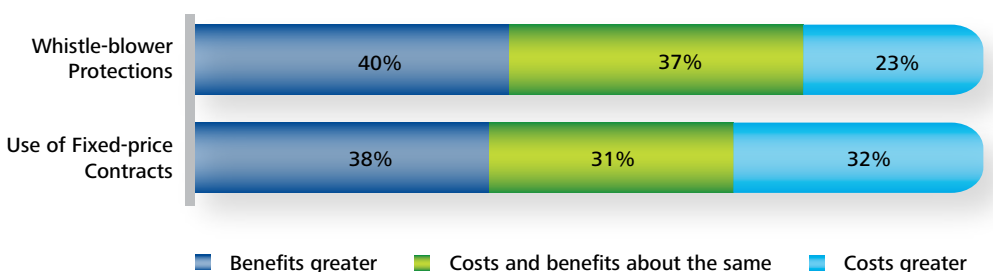
- Are least likely to increase project costs; 61 percent and 48 percent respectively see little cost increase (see Figure 6).

Figure 6. Increase in project costs due to effort in economic stimulus program to increase transparency and prevent fraud



- Offer the most favorable cost-benefit tradeoff; 77 percent and 69 percent respectively see benefits greater than or equal to costs (see Figure 7).

Figure 7. Benefits vs. costs of requirements in economic stimulus program designed to increase transparency and prevent fraud



HOW COMPANIES CAN PREPARE

The Obama administration, supported by Congress, has significantly expanded the U.S. government's fraud-fighting authority and capabilities. From the top down, the government is serious about wielding them.

Companies receiving stimulus dollars can benefit from responding to this new emphasis with a serious commitment to governance and fraud prevention. Such measures certainly make sense if a company intends to pursue stimulus projects and avoid noncompliance with ARRA transparency provisions. But strong corporate governance and fraud prevention, supported from the highest levels of the organization, can help companies avoid other potential regulatory problems, such as the Foreign Corrupt Practices Act and industry-specific mandates. Over time, too, such governance is simply proving to be good business.

Steps companies can take to help bolster their fraud prevention programs include:

Strengthening the tone at the top – Just as the government is emphasizing accountability and transparency, so should companies participating in the stimulus program or doing business with those companies. It is important that executives seriously commit to compliance and antifraud efforts and imbue the corporate culture with their importance.

Understanding exposure – Identify the circumstances in which your company is receiving federal money, some of which may not be apparent. Liability under the FCA is obvious when a company is serving as a prime contractor or subcontractor on a government project. Less obvious is a situation in which a company is doing work for a university laboratory that is receiving federal funds. A careful, companywide evaluation will help determine which lines of business and which projects are subject to the FCA.

Evaluating the compliance profile – Once FCA exposures have been identified, it is important to evaluate how well you are meeting the compliance requirements related to government work. Projects should likely be viewed and monitored both in terms of performance and risk management.

Establishing a governance framework – Compliance programs need to address all regulatory, statutory and contractual requirements. Creating a program management office may help address oversight and reporting requirements. Effective and well-documented fraud prevention policies and procedures may also help both agencies and vendors meet new requirements. Such policies and procedures can reflect the organization's intention to meet the spirit and letter of the law in terms of transparency.

Assessing project management systems – Consider the cost, performance and

scheduling requirements imposed on systems by stimulus projects. Determine whether the systems can handle the demand in addition to the existing workload.

Addressing overpayments – The costs of knowingly accepting overpayments can be steep. The FCA mandates the awarding of treble damages and penalties of up to \$11,000 per violation, costs that can add up quickly. A \$100 overcharge spread over 1,000 invoices—10 cents per invoice—could result in \$300 in damages and \$11 million in penalties. “Detect, report and return” overpayments should become watchwords for companies receiving federal funds.

A NEW LEVEL OF SCRUTINY

Stimulus spending will surge to nearly \$250 billion dollars in 2010 as the federal government ramps up economic recovery efforts. The stimulus program should provide considerable opportunities for businesses across an array of industries. However, those opportunities will be accompanied by unprecedented scrutiny of how funds are being disbursed, spent and accounted for. Companies participating in the program will do well to take the government’s accountability pronouncements to heart and make a serious commitment to transparency and fraud prevention.

David Williams is CEO and a principal of Deloitte Financial Advisory Services LLP.

Endnotes

1. Table 1. Summary of Estimated Cost of the Conference Agreement for H.R. 1, The American Recovery and Reinvestment Act of 2009, as posted on the website of the House Committee on Rules; Letter from Douglas W. Elmendorf, Director, Congressional Budget Office, to Nancy Pelosi, Speaker, U.S. House of Representatives, February 13, 2009.
2. Deloitte conducted an online survey to assess views of the economic stimulus program. A total of 343 respondents from a variety of management and executive positions and across industries participated in the survey in September-October 2009.
3. Deloitte conducted secondary research of government sources and media reports regarding ARRA spending, related transparency requirements, and reports of fraud related to stimulus spending.
4. Table 1. Summary of Estimated Cost of the Conference Agreement for H.R. 1, The American Recovery and Reinvestment Act of 2009, as posted on the website of the House Committee on Rules; Letter from Douglas W. Elmendorf, Director, Congressional Budget Office, to Nancy Pelosi, Speaker, U.S. House of Representatives, February 13, 2009.
5. Ibid.
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