

**STATEMENT OF GREGORY H. FRIEDMAN
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BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

FOR RELEASE ON DELIVERY

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I. EXECUTIVE SUMMARY

Good morning, Mr. Chairman and members of the Subcommittee. I am Gregory H. Friedman, Inspector General, U.S. Department of Energy. I am pleased to be here today to testify on our February 2002 report entitled, “U.S. Department of Energy’s Purchase Card Programs—Lessons Learned.” Since 1998, the Office of Inspector General has conducted over 20 audits, inspections, and criminal investigations involving 12 different offices and sites in which Federal, contractor, or grantee employees were found to have misused purchase cards. Our work in this area includes the SmartPay program and other similar purchase card programs. Many of the allegations we investigated were prompted by information from the Department, contractor and grantee officials, and contractor internal auditors.

Our recent reviews have resulted in ten investigations being accepted for criminal prosecution; seven criminal convictions; nine disciplinary actions; and over \$325,000 in recovered property, fines, and restitutions. Improper purchases have included home improvement products, computer equipment, hunting equipment, electronics, lawn equipment, and tools.

Several practices were used to facilitate these fraudulent purchases. They included:

- Generating fraudulent invoices or purchase records to mask the nature of the actual purchases;
- Making “ghost” purchases—that is, processing paperwork as though a purchase had been made when, in fact, no products were actually ordered or delivered;
- Providing kickbacks to suppliers who agreed to furnish false or fictitious invoices;

- Circumventing Department policies and procedures by allowing employees to approve and/or audit their own purchase card transactions; and,
- Purchasing goods for personal use that were delivered to non-Department locations, such as an employee's home.

During the course of our reviews, we identified several systemic improvements that would enhance the integrity of the purchase card programs at the Department. For example,

- Ensuring separation of responsibilities regarding the processing of purchases, approval authority, verification of receipts, and reconciliation of monthly statements;
- Ensuring that contractor, grantee, and Federal employees have a clear understanding of unallowable and non-reimbursable items that should not be acquired with purchase cards;
- Adhering to prescribed policies and procedures designed to prevent abuses; and,
- Developing adequate safeguards with respect to the distribution and control of purchase cards.

II. HISTORY OF PURCHASE CARD PROGRAMS

During the past several years, the Federal Government has promoted the use of purchase cards. These cards provide the Government with a means to simplify its small purchase procedures and improve its cash management.

In 1998, the General Services Administration (GSA) awarded five contracts under its SmartPay program to provide purchase, travel and fleet card services for the Federal Government. As of March 2002, the SmartPay program spanned all Department Federal activities and was utilized at many sites. In addition to SmartPay, several of the Department's contractors operate programs with other banks. The most recent data available to us indicates that approximately 14,000 Federal and contractor cardholders participate in the various purchase programs, including approximately 6,100 cardholders who participate under the SmartPay program. Approximately 11,700 of the identified cardholders are contractor employees. The significant number of contractor cardholders is a reflection of the manner in which the Department is operated.

As of fiscal year 2001, purchase card activity at the Department, through the SmartPay program, reached approximately one quarter of a billion dollars. We believe this dollar amount understates purchase card expenditures in general because many of the cards in use are not part of the formal SmartPay program.

III. LESSONS LEARNED

A. INDEPENDENT RECEIPT AND ACCEPTANCE

During our reviews, we found that some contractors did not provide clear guidance on the separation of responsibilities with respect to processing, approving, and validating purchases. This resulted in an absence of checks and balances. For example, during an audit at the Department's Idaho Operations Office, we found that a contractor did not generally employ internal control methods of separating key duties to reduce the risk of loss or unauthorized use of

assets. In particular, we found that the contractor did not have independent verification of the receipt and acceptance of goods and services. We also found that established procedures did not require that approving officials review actual purchase receipts when examining reconciled statements. In this case, my office recommended, in part, that the Department require the contractor to make improvements to its internal controls over the purchase card process. Management concurred with the recommendations and agreed to take corrective action.

A separate investigation at Idaho disclosed that a contractor project manager was allowed to approve and process his own purchase card orders. The investigation focused on an allegation that the manager misused a purchase card for personal items in the amount of \$85,000. The items included generators, clothing, and welding equipment. Our investigation revealed that a supply vendor facilitated the fraud by altering invoices in exchange for gifts acquired by using the project manager's purchase card. The project manager entered inaccurate descriptions of the actual property in the purchase card tracking system to disguise the transactions. In addition, he allowed a co-worker to buy personal items with the card. When the fraudulent transactions were discovered, the contractor fired both employees. The employees subsequently pled guilty to theft of government property. The project manager was sentenced to six months incarceration followed by six months home detention. The Government recovered over \$30,000 in fines and penalties and retrieved the property.

In another case, we determined that a contractor employee devised a scheme to make \$113,000 in non-existent "ghost" purchases from her personal business. The employee described the transactions in the purchase card system as awards, presentation supplies, and certificates.

However, no items were delivered to the contractor and payment for the invoices was made to her personal business bank account. The employee then funneled the money from her business for personal use, including home remodeling and paying personal bills. The employee also made purchases for personal household items totaling approximately \$25,000. The items included food, a television, appliances, lawn equipment, and family vacations. The investigation revealed that the employee's supervisor was not conducting an independent review of the employee's purchases. The employee has pled guilty to theft and is awaiting sentencing.

B. UNALLOWABLE AND NON-REIMBURSABLE PURCHASES

Generally, Department contracts and grant agreements contain a clause that addresses costs that are unallowable and non-reimbursable. However, we noted examples in which some contractors or grantees did not comply with this contract clause. In these cases, the contractor or grantee utilized purchase cards to acquire the unallowable items. At the Department's Ohio Field Office, for instance, a contractor did not provide adequate guidance to employees on items considered unallowable under the terms of the contract. In fact, our audit questioned \$42,000 in purchase card charges. Purchases included employee morale, recognition, and incentive items such as awards and plaques. In response to our audit report, the contractor issued more specific guidelines on unallowable costs, and subsequently reimbursed the Department. The Department also instituted a more thorough review and approval process for purchase card transactions.

C. ADHERENCE TO POLICIES AND PROCEDURES

Our reviews also revealed instances in which existing Department policies and procedures were circumvented. For example, each cardholder has specific single purchase spending limits.

Departmental policies state that cardholders may not "split" purchases in order to avoid exceeding these spending limits. An example of this would be a cardholder splitting an \$11,000 acquisition into two separate \$5,500 purchases to avoid a \$10,000 single transaction limit. If a purchase exceeds a cardholder's single transaction limit, the acquisition must be accomplished using other acquisition procedures. We found that some cardholders utilized split purchases to circumvent cardholder single transaction limits or to avoid competition requirements. In fact, the Office of Inspector General reviews revealed split purchases at various offices and sites. One audit within the Office of Environmental Management revealed that officials split purchases to avoid Government card limits and competition requirements. In this case, web-hosting services were acquired via a purchase card. The review revealed that an official did not adhere to Government purchase card guidance. Management concurred with our recommendation to develop controls for card use. In addition, the Department revoked the purchase cards from the Federal officials who engaged in this activity.

In other instances, contractor employees did not comply with established policies regarding approval authority. For example, a supervisor at the Idaho Engineering and Environmental Laboratory provided his password identification to a purchase cardholder. The cardholder, in turn, was able to approve her own purchases without limits or scrutiny. The employee's supervisor was reprimanded and received a 13-day suspension without pay.

D. INADEQUATE PURCHASE CARD SAFEGUARDS

The Department was unable to provide us with an accurate accounting of the number of Federal and contractor purchase cardholders. Specifically, we found that Headquarters provides central oversight of SmartPay activities and can readily access the number of cardholders under that program. However, until recently, the Department had not conducted a coordinated effort to account for the total number of cardholders in programs other than SmartPay.

To illustrate the potential magnitude of this problem, Department data significantly understated the number of purchase cardholders at one national laboratory. Although the Department's centralized records identified 14 cardholders at the Lawrence Livermore National Laboratory, we found approximately 300 cardholders during our review. As a result of our Lessons Learned report, Department management recently began a review to determine the total number of purchase cardholders in the Department. Approximately 14,000 cardholders have been identified among the various purchase card programs.

During our reviews, we noted at least one example where purchase card abuse may have occurred due to inadequate safeguards with respect to distribution and control. The investigation at the Bonneville Power Administration disclosed that an employee used several purchase cards, including one that was inadvertently mailed to her home, to make fraudulent purchases. The employee used the purchase cards to acquire \$11,000 in unauthorized items including electronics. The employee pled guilty to making false claims, and was ordered to reimburse the

Government. The employee was sentenced to four months home detention and five years supervised probation.

IV. PROACTIVE INITIATIVE AND CURRENT AUDIT

Regarding prospective Office of Inspector General activities, my office has initiated a proactive evaluation of purchase card records in order to identify additional indicators of misuse and fraud by examining purchase card transaction databases. The specific objectives of the initiative are to:

- Identify potential fraudulent and questionable transactions using purchase cards;
- Assist the Department with promoting effective and economical management of the program, which is vulnerable to fraud, waste and abuse; and,
- Identify potential instances of non-adherence to the Department's prescribed policies, procedures and regulations.

We are also auditing the purchase card program at Sandia National Laboratories. We believe these efforts will help the Department in strengthening its internal controls associated with purchase card programs.

V. CONCLUSION

In conclusion, although we recognize the potential benefits resulting from purchase card programs, we remain concerned that abusive practices may undermine the viability of such

programs. Department management acknowledged the importance of the issues identified in our purchase card report, indicating its intent to ensure that adequate controls are in place to provide reasonable assurance against abuse and misuse. The Department identified several steps to correct internal control weaknesses and to help strengthen controls over the purchase card programs, one of the most important of which was to complete an assessment of contractor policies and procedures for the use and control of purchase cards. We believe the actions recently taken and proposed by the Department are a good first step in strengthening internal controls.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions that you or members of the Subcommittee may have. Thank you.