

DOCUMENT RESUME

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[Payment of Kickbacks by Subcontractors and Purchasing System Weaknesses at Raytheon Company's Microwave and Tube Division, Waltham, Massachusetts]. PSAD-77-166; B-177748. October 6, 1977. 2 pp. + enclosure (8 pp.).

Report to Secretary, Department of Defense; by Richard W. Gutmann, Director, Procurement and Systems Acquisition Div.

Issue Area: Federal Procurement of Goods and Services:
Reasonableness of Prices Under Negotiated Contracts and Subcontracts (1904).

Contact: Procurement and Systems Acquisition Div.

Budget Function: National Defense: Department of Defense - Procurement & Contracts (058).

Organization Concerned: Raytheon Co.

Congressional Relevance: House Committee on Armed Services;
Senate Committee on Armed Services.

Authority: Anti-Kickback Act, sec. 3, as amended (41 U.S.C. 51-54). A.S.P.R. 23.

Three subcontractors admitted paying an estimated \$125,000 in kickbacks to the buyer for the Raytheon Company, Microwave and Power Tube Division, Microwave Tube Operation, in return for purchase orders placed in support of negotiated defense contracts awarded to Raytheon. The three subcontractors admitted paying kickbacks to the Raytheon buyer from about 1962, 1970, and 1971, respectively, until April 1975.

Findings/Conclusions: About \$46,000 of the \$125,000 paid to the Raytheon buyer by the subcontractors may be recoverable on behalf of the United States. This is the amount which can be documented as kickbacks paid from 1970 through April 1975 related to negotiated Government prime contracts. Much of the documentation for the period prior to 1970 was destroyed by the time of the review of the case. Inadequacies in some company procurement policies and procedures, failure to follow others, and general inattention by Raytheon's management to its purchasing operation contributed to the creation of an environment in which the kickbacks were paid for 13 years.

Recommendations: The Secretary of Defense should initiate action to recover the \$46,000 in kickbacks which has been documented. The Secretary should also circulate this case to all Defense contract administration offices as an illustration of serious internal control and procurement problems. There is a need for an anti-kickback contract clause prohibiting gifts and gratuities to serve as a means of fostering public policy against giving kickbacks, gifts, and gratuities. (SC)



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

03848

PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION

B-177748

OCT 06 1977

The Honorable
The Secretary of Defense

Dear Mr. Secretary:

We have reviewed selected purchase orders placed by the Raytheon Company, Microwave and Power Tube Division, Microwave Tube Operation, Waltham, Massachusetts, in support of negotiated Defense contracts awarded to Raytheon. The U. S. attorney's office in Boston referred this matter to us after a Raytheon buyer pleaded guilty to four charges of receiving kickbacks from subcontractors. Our authority for the review is section 3 of the Anti-Kickback Act, as amended (41 U.S.C. 51-54).

Three subcontractors admitted paying an estimated \$125,000 in kickbacks to the buyer, one for as long as 13 years, to secure or retain Raytheon business. However, only about \$46,000 may be recoverable for the United States because pertinent contractor and subcontractor records prior to 1970 are no longer available. We recommend that you initiate action to recover the \$46,000 in kickbacks we were able to document. (See enc. 1, p. 4.)

In our opinion, inadequacies in some company procurement policies and procedures, failure to follow others, and general inattention by Raytheon's management to its purchasing operation contributed to the creation of an environment in which kickbacks were paid for 13 years. We recommend that you circulate this case to all Defense contract administration offices as an illustration of serious internal control and procurement problems. (See enc. 1, p. 8.)

In the past we have made recommendations to you concerning the need for a contract clause prohibiting gifts and gratuities. This case is further evidence that an anti-kickback clause is needed as a means of implementing public policy prohibiting kickbacks, gifts, and gratuities. (See enc. 1)

PSAD-77-166
(950335)

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement to the House Committee on Government Operations and the Senate Committee on Governmental Affairs on actions taken on our recommendations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this letter are being sent to the Director, Office of Management and Budget; the Attorney General of the United States; the Administrator, Office of Federal Procurement Policy; the Secretaries of the Air Force, Army, and Navy; and the Raytheon Company.

In an enclosure we are providing a more detailed discussion of the facts summarized above.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "R. W. Gutmann".

R. W. Gutmann
Director

Enclosure

SUMMARY DETAILS OF THE GENERAL ACCOUNTING OFFICE
REVIEW OF SELECTED PURCHASE ORDERS BY THE
RAYTHEON COMPANY, MICROWAVE AND POWER TUBE DIVISION,
MICROWAVE TUBE OPERATION WALTHAM, MASSACHUSETTS

REFERRAL FROM U.S. ATTORNEY

Because of the Comptroller General's responsibility under the Anti-Kickback Act, the First Assistant U.S. Attorney, Boston, requested GAO's determination of the amount of kickbacks believed to have been paid to the former buyer of Raytheon while that company was holding Defense contracts with the Government.

THE ANTI-KICKBACK ACT

The Anti-Kickback Act prohibits paying any gift or gratuity by or on behalf of a subcontractor to an employee of a prime contractor holding a negotiated contract with the Government, either as an inducement for the award of the contract or as acknowledgement of a subcontract previously awarded. The act presumes that the cost of such gifts or gratuities (commonly called kickbacks) is ultimately borne by the Government. The act provides for recovering amounts paid as kickbacks from the subcontractor by withholding moneys owed a subcontractor under other contracts by the Government or by a prime contractor, or by civil court action against the subcontractor or the recipient of the kickback. The act does not provide for recovery from the prime contractor when action against the subcontractor or kickback recipient is not feasible. GAO is authorized to inspect the plants and to audit the books and records of any prime contractor or lower tier subcontractor engaged in a negotiated contract to determine whether kickbacks have been paid.

RAYTHEON'S MICROWAVE
TUBE OPERATION

The Microwave Tube Operation produces microwave tubes for Government radar installations and missile systems throughout the world and for commercial applications. In 1975, the Operation had sales of about \$42 million, about \$28 million, or 67 percent, of which were to the Government.

The Operation's purchasing department places large numbers of low dollar value purchase orders. About 75 percent of all purchase orders are under \$500. The purchasing department is headed by a procurement manager who is authorized to sign purchase orders of up to \$50,000. Two supervisory buyers have approval authority up to \$1,000 and six buyers have authority up to \$500. The 2 supervisors and 6 buyers each place 8 to 10 purchase orders a day. The person who pleaded guilty to accepting kickbacks from subcontractors was a supervisory buyer.

KICKBACKS AND PARTIAL RECOVERY FOR THE UNITED STATES

The kickback scheme

Three subcontractors admitted paying kickbacks to the Raytheon buyer from about 1962, 1970, and 1971, respectively, until April 1975. All three subcontractors had agreed to give the buyer kickbacks to receive work.

The three subcontractors estimated they had paid a total of about \$125,000 in kickbacks. However, as discussed later, all of this is probably not recoverable by the Government because of insufficient documentary evidence.

The kickbacks, always made in cash, amounted to 2-1/2 to 5 percent of the labor cost portion of the subcontracts. One subcontractor made weekly payments, one made monthly payments, and one paid when requested by the buyer. The subcontractors concealed the payments in their accounting records by drawing checks for cash or for additional salary payments and bonuses to officers.

In February 1974, Raytheon's buyer attempted to raise the kickback rate paid by one subcontractor from 4 to 5 percent. The subcontractor refused to pay and attempted to get other subcontractors to assist in stopping the kickbacks. About February 1975, two subcontractors disclosed the kickback scheme to Raytheon officials.

The criminal prosecution

Raytheon investigated the matter for about 1 month and gained the cooperation of the third subcontractor. In March 1975, Raytheon turned the matter over to the Federal Bureau of Investigation (FBI) in Boston.

The buyer was arrested by the FBI in April 1975 while accepting a \$750 kickback and was immediately dismissed by Raytheon. At that time, Raytheon held several Army, Navy, Air Force, and Defense Logistics Agency negotiated contracts. The subcontractors were furnishing articles and services required by Raytheon for the performance of the negotiated Government contracts.

In October 1975, a Federal grand jury in Boston returned a 16-count indictment charging the former Raytheon buyer with accepting kickbacks in connection with Government contracts. Three subcontractors admitted paying kickbacks to the former buyer and testified against him. Another six subcontractors denied giving kickbacks to the former buyer.

In February 1976, the former buyer pleaded guilty to the first four counts of the indictment and repaid \$2,447. The U.S. Attorney for the District of Massachusetts dismissed the remaining 12 counts which involved \$2,965 in kickbacks. This amount has not been recovered for the Government.

The former buyer received a prison sentence of 2 years, with 3 months actual confinement and 2 years probation. The three subcontractors who admitted paying the kickbacks were not prosecuted.

Amount of kickbacks to be
recovered for the United States

We found that about \$46,000 paid to the Raytheon buyer by the three subcontractors, in addition to the \$2,447 cited above, may be recoverable on behalf of the United States. This is the amount we were able to document as kickbacks paid from 1970 through April 1975 related to negotiated Government prime contracts.

All three subcontractors stated that they had paid kickbacks on all orders received from the Raytheon buyer during this 1970-75 period. Although the subcontractors estimated they paid about \$125,000 from about 1962 to 1975, we could not verify kickbacks paid prior to 1970 because much of the prime contractor and subcontractor documentation for that period had been destroyed by the time of our review in 1976. In addition, the total amount includes kickbacks not related to negotiated Government prime contracts.

In establishing the \$46,000 figure we were assisted by the three subcontractors and Raytheon officials. While the subcontractors would not specifically state that the amounts we calculated were the amounts they actually paid, they gave us the "kickback rate," identified the purchase orders involved, and disclosed the method of calculation.

Conclusion and recommendation

Three Raytheon subcontractors paid kickbacks far in excess of the amount which the convicted buyer repaid. Under the Anti-Kickback Act, it is conclusively presumed that any kickback paid by a subcontractor was included in the prime contract price and ultimately borne by the Government. We recommend that the Secretary of Defense initiate action to recover the \$46,000 in kickbacks we were able to document.

EVALUATION OF RAYTHEON PROCUREMENT SYSTEM

At the time of the buyer's arrest in April 1975, Raytheon's internal auditors were examining the Microwave Tube Operation purchasing department. This audit was terminated after the buyer's arrest, and a special audit of 100 purchase orders issued by the arrested buyer was initiated at the request of the Microwave and Power Tube Division general manager. The first audit concluded that financial and related operating controls and procedures generally were adequate and complied with company policy, but that certain problems existed. The second audit also disclosed problem situations. The results of both audits were released to management on June 30, 1975.

We evaluated the audit results and the problem situations identified. We also made some tests of our own to determine whether (1) weaknesses in the purchasing department had contributed to the 13-year kickback situation and (2) weaknesses disclosed by Raytheon's audits had been corrected. The results of our work follow.

Documenting subcontractor quotations

Although Raytheon's policies require that subcontractors confirm oral quotations in writing, the first Raytheon internal audit disclosed that 14 of 30 purchase orders, or 47 percent, were not supported by written quotations or other subcontractor documentation. Further, the second audit disclosed that 86 out of a sample of 100 purchase orders placed by the arrested buyer lacked the documentation required by company policy.

In responding to the second audit, the division general manager stated that obtaining written confirmation of oral quotations had long been a problem. He indicated that because the many small shops, which receive 75 percent of the division's business, have limited clerical help and do not confirm oral quotations in writing, particularly if they do not get the award. The official stated that, to correct the situation, a system would be established to followup on overdue written quotations and that vendors who continually failed to submit written quotations would be dropped as qualified suppliers.

To test the followup system, we reviewed a sample of 35 purchase orders placed by the Operation's buyers in 1976. Thirty-three purchase orders, or 94 percent, were adequately documented. However, we believe that the longstanding failure to obtain written quotations helped create the environment in which kickbacks thrived. Not requiring written quotations allows an unscrupulous buyer to (1) manipulate the oral quotations received to award subcontracts to a payer of kickbacks and (2) create spurious quotations to give the impression that competition exists.

Invoice payments

Both Raytheon's second internal audit and our review disclosed problems in the internal control over payments of subcontractors' invoices. Raytheon's internal control procedure is that a purchase order must be formally modified before payment when either

- the quantity of materials delivered exceeds those ordered by the lesser of \$100 or 10 percent of the purchase order value, or

--price increases exceed the lesser of \$25 or 5 percent of the total purchase order value.

The Raytheon audit of 100 purchase orders placed by the arrested buyer disclosed 8 violations of this procedure. The purchase orders for these eight instances were not formally modified.

We examined 100 purchase orders placed by the arrested buyer in 1974 and the first 3 months of 1975 to determine how widespread the problem may have been. We found 23 invoice payments which did not comply with the procedure requiring purchase order modifications for overdeliveries from subcontractors. We also found eight instances of non-compliance with the procedure requiring purchase order modification for price increases.

While the total number of purchase orders examined represents only a small percentage of the total placed by the Microwave Tube Operation, it indicated that overdeliveries, which were paid without formal purchase order modification, were common with this buyer prior to his arrest. This failure to assure adherence to Raytheon's internal control procedures probably contributed to the buyer's opportunity to demand and receive kickbacks without detection.

The Microwave and Power Tube Division acted on the internal audit report by instructing its personnel to adhere to company internal control procedures for changing purchase orders and by transferring one clerk to another department. The Operation also instituted additional controls to insure that similar problems do not happen again. We found that the controls were operating effectively at the time of our review.

Approving purchase orders

In our review of purchase orders, we noted that the buyer had signed purchase orders in excess of his \$1,000 approval level. Accordingly, we expanded our review to all available purchase orders placed by the buyer in 1974 and 1975 to determine whether approval authority had been exceeded. Of these 516 orders, 252 were for \$1,000 or more and should have been signed by a higher official. Our review showed that 56, or 22 percent, of the 252 purchase orders were signed by the buyer but not approved by higher authority.

At the time of our review, the Microwave Tube Operation had no procedures to assure that purchase orders had correct approval signatures and thus help prevent unauthorized procurements. This lack of procedures enabled the buyer to place orders arbitrarily with favored subcontractors without fear of detection. Raytheon officials told us that they were establishing a twice yearly review to ensure that purchase orders bear the correct signatures.

Government reviews of
Raytheon purchasing system

The Defense Contract Administration Services Region (DCASR) has administrative contracting responsibility for Raytheon Company. DCASR has never reviewed the Microwave Tube Operation's purchasing system because the system had not met the criteria for such reviews as set forth in section 23 of the Armed Services Procurement Regulation (ASPR). According to both the DCASR administrative contracting officer for Raytheon and a DCAS official from its Boston regional office, the annual sales to the Government of the Microwave Tube Operation have never met the ASPR criteria for such a review.

The administrative contracting officer stated that because no review had been made, the purchasing system was neither approved nor disapproved under section 23. He told us that he relied on Raytheon to insure that the purchasing system was operated in a businesslike manner. However, he stated that such a review should now be made.

NEED FOR CONTRACT CLAUSE PROHIBITING GIFTS
AND GRATUITIES (PREVIOUSLY RECOMMENDED)

The Armed Services Procurement Regulation (ASPR) does not require a specific clause in negotiated contracts calling attention to the prohibitions and penalties of the Anti-Kickback Act. In an earlier report to the Subcommittee on Priorities and Economy in Government, Joint Economic Committee, entitled, "Subcontracting by Department of Defense Prime Contractors: Integrity, Pricing, and Surveillance," (P 6-23, Nov. 19, 1975), we recommended that the Secretary of Defense amend the ASPR to require that each negotiated Government contract include a clause specifically prohibiting payments of gratuities by subcontractors to higher tier contractors. Our proposed clause would provide a remedy, contract termination,

for action against the contractor as an alternative to the setoff or civil court action against the subcontractor or civil court action against the kickback recipient as provided for in the act. The Secretary of Defense deferred any action on our recommendation when the Office of Federal Procurement Policy undertook a project to draft a model clause prohibiting subcontractor gratuities for all Government contracts. The model clause has been drafted and comments obtained from Government and industry sources.

In commenting on the Office of Federal Procurement Policy model clause we proposed an alternative to the remedy of contract termination when kickbacks are detected. This alternative involves the imposition of civil money penalties as another approach to securing compliance with statutory provisions or administrative regulations. The Administrative Conference of the United States--an independent Federal agency established to identify and analyze the causes of administrative inefficiency--adopted a recommendation in December 1972 sanctioning civil money penalties as a substitute or supplement to criminal penalties. Final action on the model clause is still under consideration within the Office of Federal Procurement Policy.

Conclusion and Recommendation

We are still convinced that an anti-kickback clause is needed as a means of fostering public policy against giving kickbacks, gifts, and gratuities. The Government has no legal authority to seek recovery from the prime contractor to protect the Government's interests as well as serve as a deterrent to kickback activities by prime contractor employees. Our suggestions for a contract clause would strengthen the deterrent factor by adding contract termination and/or civil money penalties as possible Government actions where gratuities were offered or accepted in the performance of Government subcontracts.

We recommend that the Secretary of Defense circulate this case to all Defense contract administration offices as an illustration of serious internal control and procurement problems.