

## Another Peek into the Fraud Files

Written by Nick Sanders  
Monday, 14 February 2011 00:00

---



As we write this, Hosni Mubarak has just resigned and regime change is in the air. From Tunisia to Egypt to ... DCAA? But enough about contract audit. Let's talk about fraud.

We talk about fraud so much, of course, because there is so much fraud in the public procurement process to talk about. Though we do not always agree with government oversight officials or "independent" gadfly organizations when they accuse government contractors of being war profiteers and/or crooks, the fact is that there are enough crooked contractors to taint them all. (And as we keep pointing out, there seem to be as many crooked government officials in the game, as well.) We write about fraud in the government contracting arena because we think contractors need to learn from the mistakes of others. We think contractors ought to invest in internal control systems, and employee training, and in robust "self-governance" mechanisms to assure themselves that their employees are toeing the straight-and-narrow line of compliant and ethical business practices.

The prevailing zeitgeist in today's government contracting environment seems to be that simply having a written ethics/business conduct policy, and pushing training videos to employees once or twice per quarter, is a sufficient investment. In these times of intense pressure to cut non value-added overhead spending, we are told, nobody has the budgets to stand-up anything more than a token internal audit department. Besides, we are told too often, companies' Sarbanes-Oxley certifications are sufficient to demonstrate both adequate controls and compliance therewith. So there's no budget—and no need—to establish the kind of internal control systems that both detect and prevent employee wrongdoing.

Yeah, we've heard that same refrain over the past 20 years, in good times and in bad. Nobody,

## Another Peek into the Fraud Files

Written by Nick Sanders

Monday, 14 February 2011 00:00

---

it seems, wants to spend sufficient money to provide robust assurance that employee wrongdoing is not taking place. We get it. No VP or other corporate executive ever earned a bonus for suggesting. “Hey, you know what? Let’s spend some more overhead.” Quite the opposite in fact—as executives routinely score big incentive comp checks for cutting overhead and “streamlining” back-office processes.

Yet when that first subpoena hits, or when that first DCIS phone call is received—and when that first of many checks to outside investigators and legal counsel gets written—somehow nobody ever thinks to point the fingers back at those company executives who vetoed putting preventive and detective controls in place. In 30 years of this business, we have never, ever, heard about Boards of Directors or Compensation Committees or Audit Committees ever reaching back two or three years and asking for the return of those old bonus checks because the executives’ “innovative out-of-the-box” idea to cut overhead by cutting back on non value-added personnel such as internal auditors and contract compliance personnel ended-up costing the company millions in dollars. (Not to mention the hits to the stock price and to the brand reputation.) We have never heard about companies holding those decision-makers—those that earn the big bucks—accountable for their decisions.

Moreover, what happens over and over is that people get awarded even bigger bonus checks for successfully managing the crisis—the same crisis that could have and should have been avoided in the first place. Instead of being held accountable for shorting the shareholders and the customers by cutting-back on controls, the executives are rewarded for seeing their crisis through to the end (which is typically a DOJ settlement involving a large payment and a deferred prosecution agreement).

And by the way, if our point of view has not been clearly communicated in previous blog articles, we feel very much the same about Federal government agencies as well as military commands, where everybody seems quite happy to spend millions of dollars on large multi-month investigations of suspected miscreants—but nobody wants to put effective controls into place that would prevent wrongdoing in the first place.

So, let’s jump off the soapbox and peek into the fraud files to see which entities failed to implement adequate internal controls.

Foreign Corrupt Practices

## Another Peek into the Fraud Files

Written by Nick Sanders

Monday, 14 February 2011 00:00

---

You are responsible for the actions of your foreign subsidiaries, as Maxwell Technologies, Inc. learned to its chagrin. According to the [Dept. of Justice](#), “Maxwell Technologies Inc., a publicly-traded manufacturer of energy-storage and power-delivery products based in San Diego, has agreed to pay an \$8 million criminal penalty to resolve charges related to the Foreign Corrupt Practices Act (FCPA) for bribing Chinese government officials to secure sales of Maxwell’s products to state-owned manufacturers of electric-utility infrastructure in several Chinese provinces.” According to the DOJ—

Maxwell’s wholly-owned Swiss subsidiary, Maxwell S.A., engaged a Chinese agent to sell Maxwell’s products in China. From at least July 2002 through May 2009, Maxwell S.A. paid more than \$2.5 million to its Chinese agent to secure contracts with Chinese customers, including contracts for the sale of Maxwell’s high-voltage capacitor products to state-owned manufacturers of electrical-utility infrastructure. The agent in turn used Maxwell S.A.’s money to bribe officials at the state-owned entities in connection with the sales contracts. Maxwell S.A. paid its Chinese agent approximately \$165,000 in 2002 and increased the payments to the agent to \$1.1 million in 2008. In its books and records, Maxwell mischaracterized the bribes as sales-commission expenses. According to court documents, Maxwell’s U.S. management discovered the bribery scheme in late 2002. ... Maxwell also reached a settlement of a related civil complaint filed by the SEC charging Maxwell with violating the FCPA’s anti-bribery, books and records, internal controls and disclosure provisions. As part of that settlement, Maxwell agreed to pay \$5.654 million in disgorgement of profits and nearly \$700,000 in prejudgment interest relating to those violations.

Let’s see, how many internal auditors could make how many trips to Maxwell’s foreign subsidiaries for how long for \$14 million dollars? We wonder if Maxwell’s shareholders are asking themselves that question.

### Corrupt Foreigners

Export controls are burdensome and we understand that the Obama Administration is moving to streamline them in order to facilitate exports (and create jobs). In the meantime, companies need to be careful to whom they sell sensitive items, as this [DOJ announcement](#) warns. According to the DOJ—

## Another Peek into the Fraud Files

Written by Nick Sanders

Monday, 14 February 2011 00:00

---

From about February 2004 through about August 2007 ... [Milad] Jafari engaged in a conspiracy to defraud the United States and to cause the export of goods to Iran in violation of the U.S. embargo and without the required U.S. government licenses for such exports. In carrying out the conspiracy, Jafari and his conspirators allegedly solicited orders from customers in Iran and purchased goods from U.S. companies on behalf of these Iranian customers. Jafari and others allegedly wired money to the U.S. companies as payment, concealed from the U.S. companies the end-use and end-users of the goods, and caused the goods to be shipped to Turkey and later to Iran.

For instance ... in July 2006, Sanam Industrial Group – an entity in Iran that is controlled by Iran's AIO and has been sanctioned by the United States and United Nations for involvement in nuclear and ballistic missile activities -- issued to Jafari's company, STEP, a request for quote for 660 pounds of a specialized steel welding wire with aerospace applications. In May 2007, Jafari allegedly caused an order to be placed for 660 pounds of this exact type of welding wire with a Nevada company. The following month, the Nevada firm received more than \$38,000 from Jafari's company, Macpar.

In another instance ... in August 2006, Heavy Metals Industries in Iran placed an order with Jafari's company, STEP, for 3,410 pounds of precipitation hardening steel made in the United States. The following year, Jafari caused Macpar to place an order with an Ohio company for 4,410 pounds of a high-grade, temperature resistant, stainless steel known to have aerospace applications. Jafari informed the Ohio firm that the steel would not be shipped to Iran. In August 2007, the stainless steel shipment was detained by the Department of Commerce's Office of Export Enforcement before it left the country.

### Corrupt Government Employees

Osama Esam Saleem Ayesh, 36, was a resident of Jordan hired by the Department of State as a shipping and customs supervisor at the embassy in Baghdad, who oversaw the shipments of personal property of embassy officials and personnel in Iraq. According to the DOJ's [press release](#)

---

Ayesh used his State Department computer to create a phony e-mail account in the name of a real Iraqi contractor and used that e-mail account to impersonate the contractor in communications with embassy procurement officials. He also established a bank account in

## Another Peek into the Fraud Files

Written by Nick Sanders

Monday, 14 February 2011 00:00

---

Jordan under his wife's name to further his criminal scheme and falsified wire transfer instructions that directed U.S. government electronic funds transfers to that account.

Court records and evidence at trial [where he was convicted] showed that Ayesh was personally involved in establishing and operating blanket purchase agreements for the provision of customs clearance and delivery services to the U.S. Embassy in Baghdad. From November 2008 to June 2010, Ayesh submitted false invoices in the name of an Iraqi contractor – which Ayesh fabricated on blank stationery he kept in his embassy apartment – and caused the U.S. Department of State to wire \$243,416 to his wife's account in Jordan.

### Corrupt Corporate Employees

After a three-week trial, the jury found Wen Chyu Liu, aka David W. Liou, 74, of Houston, guilty of one count of conspiracy to commit trade secret theft and one count of perjury. Liu/Liou was a former research scientist with the Dow Chemical Company, where he was employed from 1965 to 1992. According to the [DOJ](#) —

Liou conspired with at least four current and former employees of Dow's facilities in Plaquemine and Stade, Germany, who had worked in Tyrin CPE [chlorinated polyethylene] production, to misappropriate those trade secrets in an effort to develop and market CPE process design packages to various Chinese companies.

Liou traveled extensively throughout China to market the stolen information, and evidence introduced at trial showed that he paid current and former Dow employees for Dow's CPE-related material and information. In one instance, Liou bribed a then-employee at the Plaquemine facility with \$50,000 in cash to provide Dow's process manual and other CPE-related information.

So, basically, this former employee was helping to establish a new CPE factory in China, aided by current company employees. That new factory was going to compete with Dow, not only

## Another Peek into the Fraud Files

Written by Nick Sanders

Monday, 14 February 2011 00:00

---

impacting its ability to sell into China, but also to sell its goods globally. We're guessing his Dow retirement package was not to his liking.

### Conclusion

The DoJ doesn't provide much helpful information that tells us how this malefactors were caught. But we think these vignettes provide evidence that fraud is rampant, both at contractors and in the ranks of government employees. Even retirees seem to be getting into the act!

If you think your workforce is immune to wrongdoing, if you think your government customer is beyond reproach, if you think your foreign subsidiaries are all following your corporate guidance to the letter, well we hope you're right. But we think it would be a whole lot better, for both you and your shareholders, if you checked once in a while to make sure.