

Fraud is Everywhere

Written by Administrator
Tuesday, 12 January 2010 00:00

We've discussed the potentially misplaced emphasis on contractor fraud and corruption [before](#) , and asserted that the majority of contractor fraud also involves corruption on the part of Government officials. On January 7, 2010, the Department of Justice [reported](#) that a former Army and Air Force Exchange Service (AAFES) official "was sentenced to three years in prison "for his role in a bribery conspiracy involving a multi-million dollar telecommunications contract" and for income tax evasion. "In addition to the prison term ... Henry Lee Holloway [was ordered] to pay a \$5,000 fine and to forfeit \$70,000 as the proceeds of [his] involvement in the conspiracy."

The DOJ press release notes that the AAFES provides billions of dollars of goods and services each year to service men and women by operating base and post exchanges. Holloway was a general store manager at the Central Exchange in the Republic of Korea (RoK) from 2003 through 2007. During his tenure, he accepted "at least \$70,000 worth of stock, entertainment, travel expenses, cash and other things of value" from the

Fraud is Everywhere

Written by Administrator

Tuesday, 12 January 2010 00:00

CEO of Samsung Rental Company (SSRT) in return for maintaining “SSRT’s \$206 million contract with AAFES to provide telecommunications services to U.S. Armed Forces installations” in the RoK

, “despite Holloway’s knowledge and belief that SSRT was underperforming and violating the terms of its contract with AAFES.” (The SSRT CEO was sentenced to five years in prison and a \$50,000 fine.)

But fraud and corruption are not confined to the aerospace/defense industry. On December 24, 2009 reports emerged that Koss Corporation fired its long-time VP of Finance and Corporate Secretary, for allegedly embezzling millions from the company. The individual in question (Ms. Sujata “Sue” Sachdeva), was “suspended” on December 21st

“for financial improprieties,” and was fired on December 24th

for embezzling as much as \$31 million over the past 18 years. Two members of the Koss accounting staff who reported to Ms.

Sachdeva

were also put on unpaid administrative

leave. According to the

Wall Street Journal

, “The government alleges she embezzled company funds to pay off her personal American Express credit-card charges for the purchases of furs, jewelry, apparel and home decor.”

Importantly, Ms. Sachdeva, as VP of Finance, was responsible for many “management representations” provided to its external auditors, Grant Thornton. Because those representations can no longer be relied upon, Koss’ financial statements must be reaudited, and will likely need to be restated. Koss is a publicly traded company, so the

SEC

and

PCAOB

will also be involved in the resolution. But Grant Thornton won’t be involved in that resolution, because that audit entity was

dismissed

after the fraud was uncovered.

Fraud is Everywhere

Written by Administrator

Tuesday, 12 January 2010 00:00

It's not clear why Grant Thornton was dismissed (and replaced by a smaller audit firm). News reports indicate that the dismissal was based on a "recommendation" from Koss' audit committee. One might think that Grant Thornton was being blamed for failing to uncover the multi-million dollar embezzlement scheme during its audits. (One article notes that it was American Express who brought the fraud to the company's attention--and not the external auditors, nor the internal auditors.) However, Grant Thornton states that "The fraud was apparently conducted by a longtime, trusted senior financial executive who was hired and supervised by senior management. The company (Koss) did not engage Grant Thornton LLP to conduct an audit or evaluation of internal controls over financial reporting. Establishing and maintaining effective internal control is management's and the board's responsibility."

Those in Government contracting hear a lot about internal control systems and contractor "business systems". As far as we can tell, current DCAA audit guidance tells auditors to expect perfection from DOD contractors, with the slightest mistake potentially imperiling the adequacy determination of an entire internal control system. Based on DCAA testimony before the Commission on Wartime Contracting, more than two-thirds of the largest contractors have at least one inadequate control system. But as this story shows, very few systems of internal controls can prevent 100% of fraud and corruption, especially when it is a trusted member of the senior leadership team who is engaging in it.