

REMARKS OF DEPARTMENT OF TRANSPORTATION
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HIGHWAY CONSTRUCTION AND SURFACE TRANSPORTATION
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Before I begin my formal remarks, I'd like to open with a moment of silence for President Reagan and for those like him who have suffered from Alzheimers's.

Pause.

Thanks to all of you for coming to Seattle for our third National Fraud Awareness Conference. Our goals for this conference are threefold: to sharpen awareness of fraud schemes; to share best practices; and strengthen our all-important working relationships.

My remarks today center on (i) the current landscape in terms of surface transportation funding and activity; (ii) where we have been and progress achieved in our fraud prevention efforts; and (iii) areas that need greater emphasis and improvement.

This Conference is not just about criminal investigations, and prosecutions, but rather encompasses the entire continuum—oversight; stewardship; preventing fraud, waste and abuse in the first place; detecting it; then investigating and prosecuting it.

We have over 215 registrants representing some 40 states at the Conference this week. Conference participants are professionals from a whole variety of disciplines working at the Federal, state, and local levels: auditors, accountants, engineers, analysts, attorneys, and investigators.

Today, fraud in highway and transit programs is increasingly sophisticated and crosses geographic boundaries, which is precisely why effective prevention, detection, and prosecution is achievable only through a well-coordinated, multi-disciplined, and intergovernmental approach.

Before getting to the heart of my comments, I'd like to extend our appreciation to the State of Washington and our co-sponsors, the Federal Highway Administration, the Federal Transit Administration, the American Association of State Highway and Transportation Officials, and the American Public Transit Administration. We're also pleased to have the support and participation of the FBI and the Justice and Labor Departments.

Our Conference agenda includes a host of important topics and case studies presented by an impressive list of speakers. We thank them, appreciate your attendance, and look forward to participating with you in discussions this week.

The Current Landscape - Transportation Funding and Activity:

Let me now briefly discuss the current landscape in terms of surface transportation funding and activity.

The TEA-21 reauthorization process has made clear that there is an overwhelming demand for transportation dollars, and an equally substantial concern that revenues to the Highway Trust Fund and funding levels will fall too short of what's required to meet those demands.

Let me give you a frame of reference. The Administration's bill, called SAFETEA, proposes a six-year funding level of \$256 billion—that's \$45 billion, or 21% increase, over TEA-21's record funding levels.

But the House originally proposed a \$375 billion funding level and has since revised its proposal to \$275 billion as a result of drawing a Presidential veto threat. The Senate is proposing, for its part, a \$318 billion funding level. Hopefully, the Conference will take place soon. Stay tuned.

On the Trust Fund revenue side, Congress has recognized that Motor Fuel Tax Evasion represents a significant drain on Highway Trust Fund revenues. Some estimates put it at as much as \$1 billion a year, and is proposing reforms and funding to combat motor fuel tax evasion, which we will discuss this week.

Add to this backdrop and landscape the following:

In 2000, the Department's Mega Projects Task Force identified just 16 FHWA and FTA projects in the mega projects category, i.e., those with estimated costs greater than \$1 billion or high Congressional significance.

Today, there are currently 41 active mega-projects (15 highway and 26 transit), with a combined total cost estimate of \$56 billion.

There are another 34 proposed projects with a combined cost estimate of \$57 billion.

This week, you will probably hear the following statistic several times—1 percent. I'd like you to carry this statistic and this message back to your states, localities, and division offices.

Whether funds are lost to cost overruns, schedule delays, or fraud, the result is the same: Fewer resources available for important transportation projects. If the efficiency with which the \$700 billion invested by the Federal Government and states over the last six years in highway projects had been improved by only 1%, an additional \$7 billion would have been made available. That's enough to fund 8 of the 15 active major highway projects. That's just with the yield of 1%.

That is the challenge. Now let me address where we have been, the progress achieved, and areas needing greater emphasis and improvement.

Where We've Been & Progress Achieved:

1. We collectively have a stronger and more effective national focus on a broad continuum of oversight, stewardship, fraud prevention and detection.

Prior to our initial Conference in 2000 in Atlanta, there really wasn't a national focus—by all of us stakeholders—on oversight and prevention of fraud in the highway and transit program. I think all of us were going our separate ways. What we have today is a better national focus, and significantly closer collaboration at all levels as a result.

Moreover, through our collective efforts, I think we have been able to prevent the highway and transit program from getting labeled as a scandal-ridden program. We saw such a label the last time the program had such an infusion of money when the interstate system was under construction in the 1950s and 1960s. Today, I hope that we have been able to get ahead of the curve and establish a range of strategies for confronting fraud before it reaches scandal proportions. But I am not sure of this yet.

I know the FHWA, FTA, and states have made progress towards enhancing oversight, though a great deal more needs to be done. FTA is further along than FHWA.

FHWA, though, is in the early phase of watching projects more closely for signs of trouble. This is being done through emphasis on cost estimates, finance plans, project management plans, and risk assessments.

The ship is turning to embrace a commitment to oversight and stewardship, as opposed a more “cash and carry” mode of operation. I believe you will see a gradually greater willingness at the federal level to impose administrative sanctions and withholding of funds, as distinguished from relying almost exclusively on criminal prosecution.

We have seen some noteworthy progress by the states. You'll be hearing some success stories and best practice accounts this week, but here are a few brief examples:

The Connecticut DOT has a good model for Federal-state cooperation. Its engineering division makes timely referrals of irregularities to internal audit, whose probes have become the cornerstone for a successful Federal prosecution.

Illinois DOT's mechanisms to improve project oversight, which includes an independent oversight entity.

Florida DOT's Dispute Resolution Process, which is designed to promptly resolve contractor disputes to reduce cost overruns and claims.

Oklahoma DOT has a dedicated investigative unit that is aggressively investigating fraud in partnership with us and other Federal law enforcement agencies.

Maryland and Virginia have taken a proactive approach to oversight of the Wilson Bridge project on a number of fronts, including periodic audits to ensure invoice changes are valid and reasonable.

The Washington State DOT's Cost Estimating Validation Process is drawing favorable attention in a number of quarters.

The cost recovery program of Boston's Central Artery Project has drawn some negative attention, but I think they have turned it around.

Congress and the Administration have recognized efforts to heighten oversight over transportation programs.

A second very encouraging sign of progress—on multiple fronts—is the pending SAFETEA legislation, which includes key, unprecedented oversight provisions. Now, if they would only pass it into law, we'd have something to work with. Some of these provisions include:

Allowing for the states to share in financial recoveries from Federal fraud investigations. Sharing of monetary recoveries is a landmark provision, in that the law currently provides that monies recovered in Federal prosecutions, with rare exception, go only to the Federal Government. It doesn't even go to the FHWA. It goes into the General Fund of the Treasury. This provision is intended to help states restore their programs damaged by fraud, and to serve as an incentive for states to beef up their audit and investigative capabilities.

Strengthened debarment procedures. The Senate bill and the Administration's bill would make debarment mandatory when a firm or its principals are convicted of fraud on a highway or transit project. FHWA also has authority to take administrative debarment and suspension action even in the absence of criminal sanctions. In addition, there are

unscrupulous elements in the industry that treat criminal and civil fines and restitution as simply a cost of doing business. For such outfits, what would really make a difference is knowing that they'll be debarred from future employment by the Government if convicted of fraud. We've got to make the commission of fraud more than just a cost of doing business.

Minimum cost estimating standards.

An expanded requirement for finance plans on projects costing \$100 million or more.

3. Together, we have a strong record of prosecutions.

Since our initial Fraud Awareness Conference in Atlanta in 2000, we've experienced a sharp increase in the number of highway and transit construction fraud investigations, as well as the number of states referring cases for investigation or working them jointly with us.

For example, in the beginning of FY2000, we had a total of 26 highway and transit cases nationwide. By the end of FY2000 and into the next year, our caseload nearly tripled, with an associated increase in case referrals from the states, FHWA and FTA.

Fast forward to the present, we now have 145 pending investigations of highway and transit construction fraud in 41 states (including Puerto Rico, the Virgin Islands, and Washington, DC). Highway and transit fraud investigations now represent fully 75% of our total contract and grant fraud caseload.

Since the first conference in 2000, we've had 131 indictments, 96 convictions to date, and over \$73 million in fines, restitution and other recoveries. These figures would not have been attainable without the increase in referrals from the States, and cases jointly worked, which we attribute to productive working relationships that have been cultivated through these conferences, as well as our outreach initiative—to date we've spoken with over 11,000 state and local government employees and industry representatives.

Cases we work vary from those that are relatively small-scale, i.e., involving small firms and few culpable individuals, to major criminal enterprises and conspiracies—sometimes involving organized crime—with tens of millions of dollars in fraud.

We're seeing a wide variety of schemes, ranging from bribery of road and bridge inspectors; to false claims for work that was never performed; to product substitution— asphalt, steel; to bid-rigging; to kickbacks between contractors; to companies cheating employees out of prevailing wages required on highway projects; to motor fuel tax evasion; and—every time we turn over a rock—fraud in the DBE program.

I'd like to highlight some of our cases for you.

Fraud involving engineering consultants

A Connecticut consulting firm was prosecuted for submitting false invoices for work not performed and inflated overhead rates. The firm was ordered to pay almost \$9 million in penalties and damages, almost \$3 million will go back to the four northeastern states that were victims. Great work on this case by the Connecticut DOT in exposing the fraud and following-through with a timely, quality referral.

Bid-rigging on specialty bridge projects

Four construction contractors are paying more than \$5 million in civil and criminal penalties for bid-rigging on bridge cabling projects in five different states - California, Georgia, Massachusetts, Kentucky and Ohio. This is a good example of how fraud in transportation projects migrates across state lines.

Fraudulent DBE certifications

A California highway construction company and its secretary-treasurer falsified DBE certifications. A felony conviction and \$1.5 million in fines in that case. An electrical supply company and its president were convicted of a similar scheme in Virginia. Fraud in the DBE program is national in scope. We are seeing scores of these cases, and I think the very integrity of the program is at stake.

We and the Department are focusing on DBE fraud, which, for example, involves prime contractors who conspire with sham "false front" DBEs in order to obtain contracts and meet required DBE participation criteria. Sometimes this is little more than a laundering operation. The false front DBE does little or no work at all. This type of crime defrauds the very integrity of the DBE program and harms legitimate DBEs who abide by the law. The Department has undertaken an important initiative in this area to enhance oversight by DOT Operating Administrations and strengthen the regulations. We currently have 40 DBE fraud schemes in 19 states under investigation.

Bribery of government inspectors

Several road paving contractors in Washington, DC, were caught bribing DC Public Works employees. One of the contractors paid a fine of almost \$1 million. Nine inspectors were prosecuted. However, I think both the Department and D.C. could, and should, have come down harder on this one in terms of debarment.

Bid-rigging on highway projects

Two Wisconsin road construction companies and four of its executives were indicted for conspiring to rig bids on highway projects worth over \$100 million. The Wisconsin DOT and FHWA have taken action to suspend the firms pending prosecution. This case is one of the largest in the history of Wisconsin.

Motor fuel tax evasion

The owner of a New York fuel company was put in jail for 5 years, along with a fine. He evaded motor fuel excise taxes by claiming he sold tax-exempt fuel to a railroad when he really sold the fuel to gas stations and pocketed the \$600,000 in fuel taxes paid by the gas stations. That's \$600,000 that never made it into the Trust Fund.

Bribery of state highway/bridge inspectors

In Ohio, 2 bridge construction company officers and 5 Ohio State DOT inspectors pled guilty in connection with a bribery scheme. This investigation is ongoing and additional prosecutions are likely.

Public corruption and fraud on FTA grant project

You may have heard that in 2003, the former Mayor of Bridgeport, CT, was sentenced to 9 years in federal prison for racketeering. One of his kickback schemes involved a \$1/2 million contract change order for a parking garage funded with a \$5 million FTA grant.

And speaking of change orders, we're finding these to be particularly conducive to fraud, waste and abuse. On Puerto Rico's \$2 billion Tren Urbano light rail project there have been over 750 change orders exceeding nearly \$500 million. FTA's Project Management Oversight Contractor alerted us to some 200 change orders—totaling over \$100 million—that were processed without required fair cost estimates. FTA is withholding over \$100 million until these change orders are investigated and resolved.

Areas Needing Greater Emphasis and Improvement:

While we have made progress—no doubt about it, I want to underscore that—there is more that can be done. The following are 6 areas that, in my view, require considerably greater emphasis and improvement. I think it is important that an action agenda be developed during this Conference and that we commit to carry it out over the next two years, thus we can measure our progress for our next conference in 2006.

Inactive Obligations: Did you know that we recently identified nearly \$300 million in unneeded obligations on highway and related transportation projects in 10 states. These are obligations that were no longer needed because they were associated with projects that had been canceled, reduced in scope, or already completed. But the money was just sitting there, some times for nearly a decade.

We just scratched the surface with our audit. We looked at only those projects with outstanding balances of \$1 million or more, at only a handful of states, **even excluded any earmarked projects**, and still found nearly \$300 million sitting idle! What's worse is that this is our third report since 1999 where we found the same thing. Meanwhile as the cry for more transportation dollars gets louder and louder, both DOT and the states need to be

paying attention to hundreds of millions of available dollars just sitting around idle. These funds need to be de-obligated and moved to projects where they are needed.

Cost Recovery: You may have heard about new cost recovery efforts underway at the Central Artery in Boston. We hope they are successful but until this current effort, cost recovery at the Central Artery was best described as anemic. The project is currently estimated to cost \$14.6 billion. Yet last year we found that 8 years of cost recovery efforts had yielded only \$30,000 in recoveries from a single consultant. We did find that 76 cost recovery items involving more than \$53 million in change orders had been resolved up to that point, but we also found a backlog of 295 unresolved items valued at \$188 million—and of these 76 were between 2 and 7 years old.

A 2001 industry study found that design errors and/or omissions were the most frequently cited causes of delays and cost overruns. On 150 projects reviewed in the report, errors and/or omissions accounted for an average time delay of 272 days on all projects and an average cost growth of 2.1 %.

The states need to aggressively pursue cost recovery as a standard, fundamental means of providing accountability for the taxpayer dollar. Remember that 1% statistic?

Compensation and Overhead Costs Claimed by Engineer and Design Firms: I mentioned earlier the case in Connecticut involving the prosecution of an engineering and design firm. But even absent criminal fraud, we have heard concerns from a number of states about this issue. In particular are concerns about the adequacy of the annual audits of the rates charged by engineering and design firms. We plan carry out an audit on this issue and will report our results to you. The real question is whether, through loose oversight, are we paying some large highway contractors and design firms much greater overhead and executive compensation than occurs with defense contractors?

Suspension and Debarment: the Department is taking steps to strengthen our internal processes. We found that in many cases it was taking more than 6 months to take debarment actions even after a conviction. FHWA has been stepping up its efforts in this area.

Risk Assessments: FHWA deserves credit for its initiative on risk assessments carried out by its division offices. We will be issuing a report soon and will be making recommendations on how FHWA might improve their risk assessments. These recommendations will center on identifying critical areas for the risk assessments to target and applying consistent methods, approaches and measurements. I'd like to highlight several key findings from our review:

One state's financial management practices were not evaluated even though Federal and state audits had disclosed a history of financial management deficiencies.

Another state's bridge program was determined to have no risk, although 30 percent of the state's bridges were structurally deficient or functionally obsolete, and its bridge replacement and rehabilitation practices had not been evaluated.

A state's work zone safety program was rated satisfactory even though the state was responsible for 14 percent of the nation's work zone fatalities in 2000 and 2001. Yet other state programs with less than one percent of work zone fatalities nationwide were rated as medium risk.

In two other states, bid-rigging was rated as low risk, although investigations disclosed that one state had \$500 million in suspicious contracts. Although these states had purchased bid-rigging software, they had never used the software to detect bid-rigging.

Motor Fuel Tax Evasion: We need help from the Treasury Department and IRS on this. Historically, we've always worked these cases, along with the states, as part of IRS-led task forces because, under current law, we do not have independent access to tax returns. We are not advocating this at all. From IRS' point of view, the incidence of losses to fuel evasion in recent years generally hasn't justified the expenditure of investigative resources. Without the IRS, there won't be an investigation. SAFETEA is proposing increased funding for IRS to bolster this area, but it is important that this funding be effectively spent. Administrator Peters recently met with IRS Commissioner Everson to seek a commitment from IRS to help tackle this problem. We'll also need your help on the state level to secure IRS' commitment to ramp-up enforcement efforts in this area.

Strengthening DOT's DBE Program: As mentioned earlier, we identified the DBE program as a one of the top management challenges facing the Department. We've really got to get a handle on that.

Information Sharing: There are several critical issues concerning information sharing that need to be addressed:

Establishing a central repository of criminal and civil fraud cases. An outstanding issue from our last conference and, quite frankly, one where I am disappointed in the lack of progress, is the establishment of a central repository of criminal and civil fraud cases. We post the results of our audits and investigations on our website but there are other audits and investigations at the state and local level or even carried out by other federal agencies that we all need to be aware of. You can expect better leadership from our organization on this issue.

Identifying criminal enterprises in the highway and transit construction industry. We have several ongoing investigations where the same contractor is operating in more than one state. If a contractor is under investigation for fraud in one state, we need to be able to alert any other states where the contractor is doing business. In order to do that, we need

to share our information about contractors under investigation. This is not unlike the hard lesson learned by our intelligence agencies after 9/11.

Sharing best practices. In many respects this conference is all about sharing best practices. But we need to do a better job. Florida's efforts on dispute resolution is a good example of the type of best practice we need to know about. AASHTO and APTA can be especially helpful here.

Oversight Resources: We have heard anecdotal and episodic accounts that resources committed to oversight, audit and fraud prevention activities are woefully inadequate, or may even have been pared back in recent years. I don't know that for sure. We know we are never going to have enough resources but, more fundamentally, we do not have a good sense of what resources are being committed at the state and local level. We want to shine a spotlight on this issue as an action item we can take away from this Conference and would like your ideas in developing this.

Conclusion:

In conclusion, let me again thank you for your participation at this year's conference. Your continuing efforts to ensure that highway and infrastructure projects are delivered to the taxpayers and traveling public approximately on budget, on schedule, and free from fraud are critically important.

As a closing thought, I'd like to ask you keep that 1% statistic in mind and carry it back to your home states. Truly, you are worth your weight in gold—the ratio between yield in fraud recoveries to resources applied is enormous, somewhere around 5-10 to 1.

Thank you for your participation with us. I would be pleased to answer any questions you may have.

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