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Statement
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Office of the Inspector General of the
Department of Defense
to the
Senate Committee Governmental Affairs
on
"How to Save the Taxpayers Money When They Use
Government Credit Cards"

Department of Defense
Office of the Inspector General

Madam Chairman and Members of the Committee:

Thank you for the opportunity to appear before your Committee today and address your questions regarding the use of purchase cards in the Department of Defense. Although the Department has taken aggressive action to improve the program, the purchase card program still needs better implementation and oversight of management controls at the activity level. Every dollar that is not spent prudently through purchase cards is a dollar that is not being spent to support the global war on terrorism.

The Inspector General of the Department of Defense has an important statutory role in the Purchase Card program. The National Defense Authorization Act for fiscal year 2003 contains a provision at section 2784 (b)(8) of title 10, United States Code, that:

“the Inspector General of the Department of Defense . . . perform periodic audits to identify -

- (A) potentially fraudulent, improper, and abusive uses of purchase cards;
- (B) any patterns of improper cardholder transactions, such as purchases of prohibited items; and
- (C) categories of purchases that should be made by means other than purchase cards in order to better aggregate purchases and obtain lower prices.”

The Joint Purchase Card Program Management Office reports that the purchase card program within the Department of Defense accounted for 10.7 million purchase actions

valued at about \$7.2 billion in fiscal year 2003. Every working day DoD employees make about 41,000 purchases valued at \$27.6 million, which exemplifies the magnitude of this program. Nevertheless, the purchase card is only one of many acquisition instruments available to the Department. The purchase card accounts for 3 percent of the \$231 billion in acquisitions and 25 percent of the purchase actions made in the Department in fiscal year 2003.

Today, I want to present the results of three Office of the Inspector General, Department of Defense audit reports issued in fiscal years 2003 and 2004, which identified management control problems with the use of purchase cards. I will also discuss the actions our office is taking to promote data mining and to partner with program management offices so that we can more proactively identify and prevent potential fraud, waste, and mismanagement. These collective efforts will help improve the purchase card program. Further, I want to present information that show improvements in management of the purchase card program.

The three reports issued were “Summary Report on the Review of Selected DoD Purchase Card Transactions” June 27, 2003, (D-2003-109); “Selected Purchase Card Transactions at Washington Headquarters Services and Civilian Personnel Management Service” October 16, 2003, (D-2004-002); and “Purchase Card Use at the Space and Naval Warfare Systems Command, Information Technology Center, New Orleans, Louisiana,” November 14, 2003, (D-2004-016).

Summary Report

The Office of the Inspector General auditors and investigators led the Service and Defense agency audit organizations and the Military Criminal Investigative Organizations in performing an in-depth review of purchase card transactions for 1,357 purchase cardholders that had been identified by our data mining division using business rules and fraud indicators. The review involved calendar year 2001 purchase card transactions and was done from May 2002 through June 2003. This review determined that 182 cardholders used their purchase cards inappropriately or fraudulently and spent about \$5 million in scarce resources by doing so.

- The Office of the Inspector General and Defense agency personnel identified \$840,000 of inappropriate or fraudulent purchases. Nine cardholders made inappropriate purchases; five of whom were referred for criminal investigation. For example, a cardholder used the purchase card 52 times over an 8-week period to make a single purchase for \$551,000. The cardholder was circumventing the dollar value limit on the purchase cards.
- The Army auditors identified \$520,000 of inappropriate or fraudulent purchases. Eighty-eight cardholders made inappropriate purchases; four of whom were referred for criminal investigation. One cardholder purchased a Santa suit for \$232, one inappropriately rented a vehicle for \$910, and another accessed pornographic and sports-related Web sites.

- The Navy auditors identified \$3.2 million of inappropriate or fraudulent purchases. Forty-four cardholders made inappropriate purchases; eight of whom were referred for criminal investigation. One cardholder used the purchase card to make 59 fraudulent purchases totaling more than \$130,000. The purchases included two automobiles, one motorcycle, and cosmetic enhancements done through surgery.
- The Air Force auditors identified \$554,000 of inappropriate or fraudulent purchases made by 41 cardholders; 24 of whom were referred for criminal investigations. One cardholder made 29 inappropriate or unauthorized purchases of meals, gasoline, and recreational activities that totaled about \$6,000. Additionally, unauthorized individuals used stolen Air Force purchase card account numbers for 155 purchases totaling \$30,196. The transactions included charges to sexually explicit and gambling Web sites.

Washington Headquarters Services

Washington Headquarters Services management controls for the purchase card program did not ensure that purchases totaling about \$6 million, were mission related, properly safeguarded, and provided the best value for the Government. A lack of controls and management oversight resulted in about \$1.7 million of fraudulent purchases from May 1999 through August 2002 and at least \$201,000 in additional purchases that were abusive, improper, or unauthorized. Property costing at least \$50,000 purchased with the

Government purchase cards was not recorded on the inventory records and could not be located.

The audit examined 17 cardholders and 4,793 purchase card transactions that occurred from September 2000 through December 2001. The audit was ongoing from May 2002 through April 2003. This is a good example of the benefits of data mining because we originally identified 6 cardholders with 79 flagged transactions and expanded the audit after reviewing the initial flagged transactions.

The audit and investigative work resulted in three convictions:

- The civilian Director of the Graphics and Presentation Division, Real Estate and Facilities Division, Washington Headquarters Services was convicted of theft of Government property stemming from her use of the Government charge card to make about \$1.7 million of fictitious purchases from a fictitious firm. She was sentenced to 37 months imprisonment and \$1.7 million restitution.
- A vendor was convicted of theft of Government property stemming from his participation in a scheme with his sister, the Director of the Graphics and Presentation Division, Real Estate and Facilities Division. The vendor created a company solely to facilitate the scheme and was sentenced to 48 months imprisonment; 3 years supervised probation, and \$1.6 million restitution.
- The civilian Deputy Director of the Graphics and Presentation Division was convicted for theft of Government property totaling more than \$30,000 resulting from her misuse of the Government charge card. She used her Government

charge card to purchase items, which she then stole and converted to her own use. She was sentenced to 3 years of supervised probation, which included 6 months of home confinement with electronic monitoring, and ordered to make full restitution.

Ten cardholders in the Graphics and Presentation Division of the Washington Headquarters Service made at least 162 purchases, valued at \$173,509, that had no apparent Government need or were at an excessive cost. Items purchased that we considered abusive were 11 portable DVD players; 4 cameras costing between \$1,099 and \$19,369; and a variety of novelty items such as stainless steel cups, mugs, key chains, and tote bags, all costing \$57,000. Items purchased that we considered improper included furniture, unauthorized computer equipment, and a hand-held computer. Items purchased for personal use included computer games, a microwave oven with a 3-year warranty, 3 sets of magnetic toys, a digital mini-stereo system, two desk fans, and two under-the-counter kitchen CD radios.

The cardholders also circumvented required contracting procedures and did not receive the best value for \$511,000 of supplies and services. The cardholders split purchases into multiple transactions so they could stay below the \$2,500 micro-purchase threshold. This resulted in noncompetitive acquisitions and higher prices. For example, one vendor was paid \$36,000 for 9,000 American flag decals that could have been bought for \$3,000.

We recommended that a review be performed and appropriate actions be taken to hold the management officials and cardholders accountable for failure to perform their duties under the purchase card program; establishing separation of duties for key positions of oversight, implementing required purchase card controls, and performing required oversight reviews. We also recommended periodic reviews that place emphasis on stopping the use of split purchases and vendor preference. In response, the Director of Washington Headquarters Service initiated aggressive measures that included recovery of assets, continuing review and upgrade of program safeguards, and major changes in the management of the purchase card program.

Information Technology Center, New Orleans, Louisiana

Controls over the purchase cards that would have reduced the risk of fraud, waste, and abuse were not properly implemented and were ignored by senior management at the Information Technology Center. Controls were not effective because the senior managers displayed a lack of integrity and did not adopt internal control procedures. Approximately \$1.1 million of Information Technology Center purchases were questionable because there was no obvious mission need for the items purchased. Further, the Government had an unnecessary monthly financial risk because the monthly cycle limit was \$31 million more than needed. The Information Technology Center management also needed to improve controls over property accountability. At least \$1.7 million of property was not recorded in the property book, property was missing and went unreported, property was at individuals' homes without adequate property passes,

and pilferable property was inappropriately removed from the accountable record. The audit covered purchase card transactions from May 1999 through September 2002 and was performed from March 2002 through May 2003.

- Questionable items purchased included 10 pairs of binoculars totaling \$1,999 as a security measure to watch for terrorists on Lake Ponchartrain; 6 bicycles costing \$2,393 to be used by interns from New Orleans University in a non-existent intern program; 3 global positioning systems costing about \$1,720 for the Director to use because he routinely got lost when he went on travel; and luggage costing about \$700 that was purchased because the Director and his Deputy traveled a lot and needed to carry briefing papers.
- The purchase card was used to inappropriately acquire \$785,000 of computer equipment, 18 cell phones and monthly usage plans, and \$21,000 of office supplies. The cardholders failed to use Navy contracts, General Services Administration Advantage contracts, and DoD Enterprise Software Initiative Contracts. The cardholders were not getting the discounts and reduced prices available from the contracts.

We recommended the Commander, Space and Naval Warfare Systems Command perform a review and initiate appropriate actions against the managers and cardholders involved in making the purchases categorized as abusive. We also recommended implementing required management controls and reviews of purchase cards and requiring cardholders to order from required sources. The Chief of Staff/Policy for the Deputy

Assistant Secretary of the Navy for Acquisition Management and the Deputy Commander of the Space and Naval Warfare System Command both responded to the report and agreed to initiate the required corrective actions.

Data Mining

In January 2003, we established a Data Mining Division in the Office of the Inspector General. We took 12 personnel from other audit activities to pioneer the use of data mining techniques in the Department of Defense. Data mining is the process of analyzing data from different perspectives to identify previously unknown relationships among data, or finding correlations or patterns among data and summarizing it into useful information. As part of the process, the techniques developed are passed on to management to assist in their oversight of the programs reviewed. I want to assure the committee that concerns for personal privacy are foremost in any data mining efforts we perform. In addition, we protect any personal information we obtain and limit its access to personnel with the need to know.

The Office of the Inspector General has been the focal point in the Department of Defense for charge card audits, data mining, and investigations. The Office of the Inspector General has coordinated the efforts of the ongoing and planned audits and investigations on charge cards in the Department and provided a forum for management to identify issues that they would like the auditors to include in their reviews. This increase in communications between auditors and the Department of Defense Program Management Offices for the Purchase Card, Travel Card, Fleet Card, and Aviation Card,

and the Defense Finance and Accounting Service has resulted in a positive approach to improving the DoD Charge Card Program as well as enhanced management relations.

Outside of the Department of Defense, we provided assistance and lessons learned on data mining to the President's Council on Integrity and Efficiency, Inspection and Evaluation Committee; the Office of Federal Procurement Policy; the Fraud Detection Office, Department of Justice; the House Appropriations Committee surveys and investigations staff, the Government Printing Office, Federal Bureau of Prisons, and the Offices of the Inspector General for the:

Central Intelligence Agency,
Department of Commerce,
United States Postal Service,
Small Business Administration,
Department of Justice, and
Department of the Treasury.

The Office of the Inspector General, Department of Defense, Data Mining Division has mined data from purchase cards, travel cards, fleet cards, aviation cards, and transportation payments. Since March of 2003, the Division has been working with the Navy to develop the Navy Pilot Program for the purchase card. The Navy Pilot Program is a prototype system that is based on a set of business rules and potential fraud indicators. The system uses high-risk purchase card transactions identified by the Data Mining Division, and sends an e-mail to a management official requesting additional information for assessing the appropriateness of the purchase card transaction. The

approving official's response to questions populates the database, which can be used for reporting trends, identifying deficiencies, and better managing the purchase card program through risk analyses. The Department of Defense Program Management Office for purchase cards plans to implement some of the procedures and techniques used in the prototype Department-wide. A concept for a Continuous Monitoring System for the purchase card program is at Attachment 1.

Positive Trends on Improved Controls Over the Use of Purchase Cards

The Department of Defense is actively working to maintain a culture that promotes a positive and supportive attitude toward active management controls for purchase cards and accountability. In a June 21, 2002, Memorandum the Deputy Secretary of Defense set the tone when he stated:

“I am directing management at all levels to ensure the necessary oversight of Government charge cards and education to eliminate fraud, misuse, and abuse of these charge cards. We are the stewards of public funds and must not tolerate any use of charge cards that violates the public's trust. Therefore, we must take immediate action to ensure that: (1) further misuse of government charge cards does not occur and (2) appropriate remedies are taken with respect to those who engage in or tolerate such misuse. The key factor to success of these valuable programs is the direct involvement of senior military leaders and civilian managers for the Department of Defense.”

Defense managers have made a concerted effort to improve internal controls and publicize disciplinary actions to be taken when misuse or abuse of the charge card is identified. Positive trends in the management of the purchase card program include the reduction in the number of purchase cards from 214,000 in September 2002 to 114,000 in March 2003 (47 percent). Additionally, the average number of accounts that each billing or approving official is responsible for has decreased from 3.5 to 1 in fiscal year 2002 to 2.4 to 1 in the first half of fiscal year 2004. The Department has developed a web-based tutorial to train all new cardholders and billing officials. This is in addition to the training already available from the General Services Administration and the banks. The Deputy Under Secretary of Defense for Civilian Personnel Policy issued a Government Charge Card Disciplinary Guide for Civilian Employees on April 21, 2003, and the Under Secretary of Defense for Personnel and Readiness issued Disciplinary Guidelines for Misuse of Government Charge Cards by Military Personnel on June 10, 2003.

Other indicators of improvements in the Purchase Card Programs are cited in General Accounting Office Report Number GAO-04-156, "Purchase Cards – Steps Taken to Improve DoD Program Management, but Actions Needed to Address Misuse," December 2003. The report stated that:

“DoD and the military services have taken strong actions to improve the controls over the purchase card program. DoD has initiated actions to implement all of the requirements that were mandated in the fiscal year 2003 National Defense Authorization and DoD Appropriations acts. In addition, DoD and the military services have taken actions on

nearly all of the 109 recommendations that GAO made in its four reports on the purchase card program, and DoD has plans to have most of the recommendations implemented by June 2004.”

Achieving Savings on Purchase Card Buys

We support the conclusions in General Accounting Office Report Number GAO-04-430, “Agencies Could Achieve Significant Savings on Purchase Card Buys,” April 2004 and recommendations that identify opportunities to obtain more favorable prices on purchase card buys. We look forward to using data mining techniques and working with the Department of Defense acquisition community to creatively reduce costs related to prices on purchase card buys. We can do this by determining which vendors we are buying from, the volume of the purchases, and the types of purchases. Data mining will also tell us whom we need to negotiate contracts and point of sale discounts with. Further, with detail purchasing data we can determine if Federal buyers are purchasing from the appropriate or best source. However, this is an area where the Administrator of the General Services Administration should take the lead. I do not believe we want commercial vendors to have to negotiate point of sale discounts and other discount agreements on purchase cards from a multitude of Federal agencies. Further, this is an area where establishing a Center of Excellence for Charge Cards should be considered.

Investigations

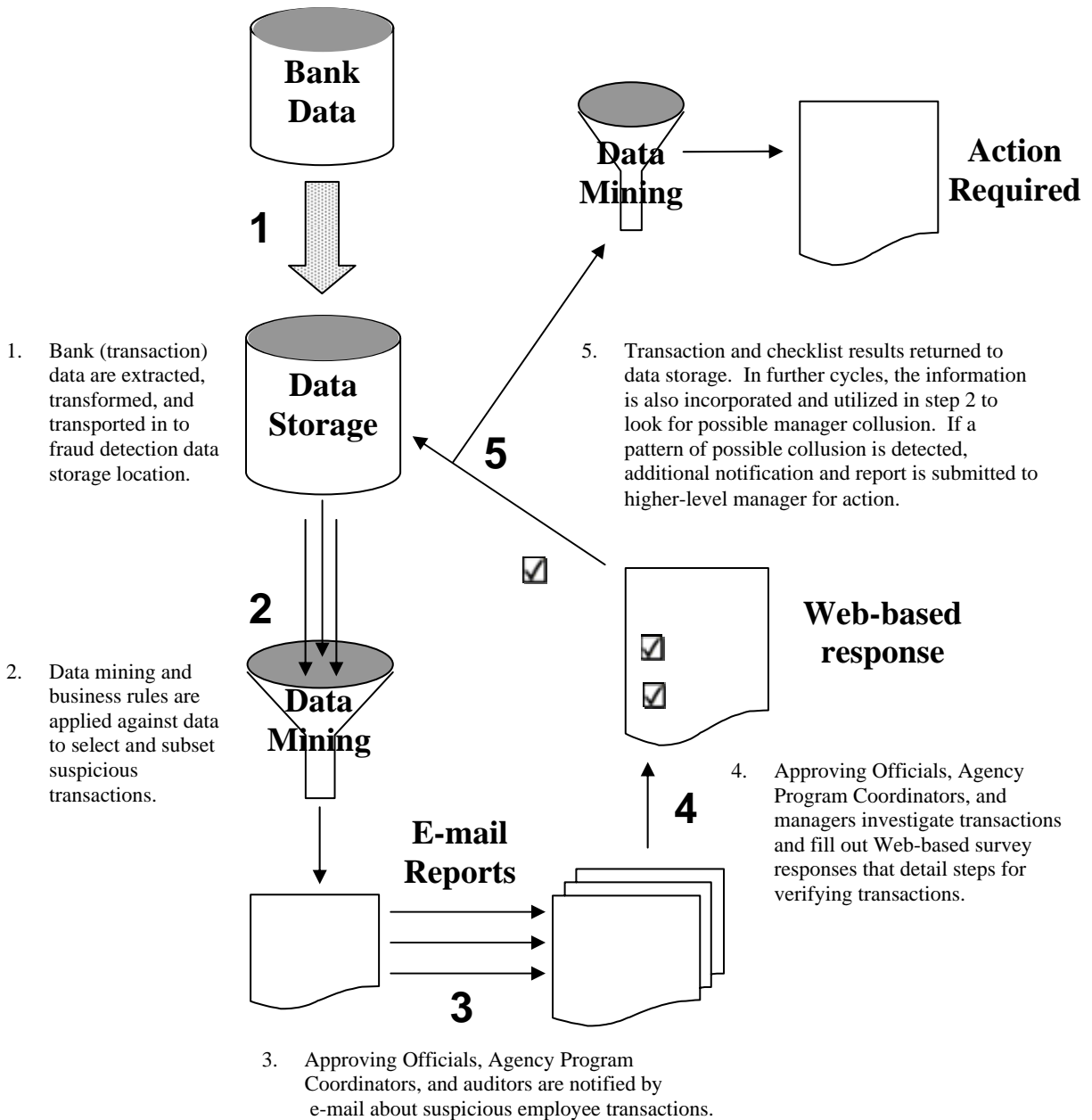
The Department has outstanding criminal investigative organizations that have worked hard on reducing purchase card fraud. The Office of the Inspector General Defense Criminal Investigative Service, the Army Criminal Investigative Division, Navy Criminal Investigative Service, and Air Force Office of Special Investigations have all worked diligently to eliminate purchase card fraud. Since reporting began in January 2003, 15 investigations have been completed and 57 criminal investigations are ongoing related to charge cards. Attachment 2 highlights some of the completed investigations.

Conclusion

The positive actions that have been presented in this testimony have occurred because of serious problems highlighted in 2002. Although the Department has made great strides in improving the program, there is still work to be done to ensure that all of the charge cards in the hands of Department employees are used prudently. We currently have three ongoing reviews on purchase cards in the Military Health System, at the Education Activity in Europe, and at the Corps of Engineers, Louisville District. We are also reviewing the use of purchase card convenience checks. We plan to issue reports on these reviews later in 2004.

Thank you for considering the views of the Department of Defense, Office of the Inspector General on these critical issues. This concludes our testimony

Continuous Monitoring System



Examples of Cases on Charge Card Fraud

Personal Use

- David M. White pled guilty to placing fraudulent charges against 13 Government credit cards. He was sentenced in U.S. District Court, Panama City, Florida, to 18-months incarceration, \$262,840 in restitution and other fees, and 36 months supervised release.
- Jerome D. Phillips pled guilty to conspiracy in a fraudulent scheme involving the misuse of a purchase card while assigned to the Joint Staff Supply Service. He was sentenced in U.S. District Court, Eastern District of Virginia, to serve a jail term of 12 months and one day, 24 months probation, and restitution and other fees of \$120,000.
- Sherry K. Pierre pled guilty of making \$130,000 worth of illegal purchases on her Government-issued charge card. Pierre's purchases included a car, motorcycle, breast-lift surgery, furniture and other household goods, and a down payment on another vehicle. Pierre was demoted from staff sergeant to lance corporal, fined \$30,000 and sentenced to 14-months of imprisonment.

Cardholder Conspiracy With Vendor

- Former Master Sergeant Bobby Gilchrist pled guilty to one count of money laundering, accepting bribes and conspiracy with office product vendors. He conspired with contractors to defraud the Department of Defense by requesting the submission of fake bills for goods and services that were never provided, and accepting cash payments (kickbacks) for making both legitimate and bogus purchases from them, using his and other employees' credit cards. He was sentenced in U.S. District Court, Eastern District of Virginia, to 41 months in prison, 3 years of supervised release, and \$400,300 in restitution and other fees.
- Jerome Phillips, a cardholder involved with the Gilchrist scheme was sentenced to one year and a day in prison.
- Dennis Carey, a cardholder with the U. S. Army Corp of Engineers, pled guilty to two counts of bribery. He was sentenced in the U. S. Court, Central District of California, to 30 months of imprisonment, a three-year period of supervised release, a restitution payment of over \$283,000 including a special assessment related to fraudulent billings on his Government purchase card. Mr. Carey and the vendor agreed to submit fraudulent invoices for goods and services to the U. S. Army Corp of Engineers that Mr. Carey would authorize for payment through his purchase card. Mr. Carey and the vendor split the proceeds of the fraudulent billing scheme, sharing an estimated total of more than \$267,000.

Vendor Fraud

- Tyrone X. Celey, Sr., owner of Pronto and Speedy, (two of the companies involved in the Gilchrist case) pled guilty to bribing DoD employees to make credit card purchases from his office supply company. He was sentenced in U.S. District Court, Eastern District of Virginia, to 27 months incarceration, 36 months of supervised release, and \$400,200 in restitution and other fees.
- Robin Noland, owner of Direct Office Products (one of the vendors involved in the Gilchrist case) pled guilty to conspiracy to defraud the United States and was sentenced to 2 years of probation and ordered to pay \$72,500 in restitution.