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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

October 31, 2000

The Honorable Thomas Bliley
Chairman
Committee on Commerce
House of Representatives

Subject: HCFA Extended Its Contract With Accounting Firm Implicated in Major Fraud

Dear Chairman Bliley:

This letter responds to your June 16, 2000, request that we investigate the Health Care Financing Administration's (HCFA) oversight of contractors in its Audit Quality Review Program. That program reviews the work of Medicare auditors. As such, it entails checking whether Medicare auditors have done their work appropriately to detect improper or fraudulent charges. In particular, you expressed concern with the circumstances surrounding KPMG's¹ performance of a national audit quality review contract, given difficulties the firm has encountered since the contract award in September 1997.

We conducted our investigation from June 2000 through mid-October 2000 in accordance with quality standards for investigations as set forth by the President's Council on Integrity and Efficiency. We interviewed officials and reviewed documents from HCFA, the Department of Health and Human Services, the Federal Bureau of Investigation, and the Department of Justice. We also spoke with attorneys representing KPMG.

In brief, during its performance of the HCFA audit quality review contract from September 1997 to September 2000, KPMG was implicated in a significant Medicare fraud case against its client, Columbia/HCA. Specifically, KPMG advised Columbia/HCA on preparing cost reports whose submission led to criminal and civil fraud charges against Columbia/HCA. Two Columbia/HCA executives were convicted of conspiracy and criminal fraud in July 1999. Columbia/HCA has also agreed to pay the government approximately \$750 million in partial settlement of the civil fraud claims. Senior HCFA officials and officials in the General Counsel's office of the Department of Health and Human Services were in a position to be generally aware of allegations that Columbia/HCA engaged in fraud and that KPMG contributed

¹ KPMG was formerly known as KPMG Peat Marwick.

to its client's improper actions.² Before September 1998, when HCFA exercised an option to extend KPMG's contract performance for another year, these officials either knew or should have known that civil and criminal actions were pending in the Columbia/HCA matter. Moreover, these same officials knew or should have known that, as an audit quality review contractor, KPMG would be responsible for reviewing transactions that were of the same type as transactions about which KPMG had advised Columbia/HCA. Finally, the HCFA contracting officer responsible for the contract with KPMG had actual knowledge of a separate civil suit against KPMG that also made serious and credible allegations of fraud related to KPMG's work for Columbia/HCA.³ The contracting officer did not advise her supervisor about this information and did not retain relevant documents in the contract file.

KPMG's contract with HCFA included annual options to extend performance that could be exercised or not at HCFA's sole discretion. The Federal Acquisition Regulation (FAR) does not require that a contracting agency take action to end a contract with a contractor accused of fraud; but as regards exercising the option to extend, HCFA had complete discretion as to what action to take in response to KPMG's situation. Although much information was available to HCFA staff at various levels, the information was not used to make reasoned contracting decisions. As a result, HCFA extended KPMG's contract in the fall of 1998 and again in September 1999 without considering the impact the fraud allegations would have on KPMG's ability to provide audit quality review services. In one instance, the lack of information resulted in HCFA issuing KPMG a task order to perform audits at a firm employing a key prosecution witness in the criminal trial of the Columbia/HCA executives.

Finally, senior HCFA officials should have used the information that was available to make an informed decision about KPMG's continued performance. If those officials had done so, HCFA might still have decided to extend KPMG's audit quality review contract and remained consistent with the FAR, which confers wide discretion on the contracting agency in these circumstances. However, the decision would have been reasoned and supported; and it would have minimized embarrassment over the decision. Furthermore, HCFA could have avoided the inappropriate situation concerning a task order for auditing the firm that employed a key witness against Columbia/HCA and KPMG, if HCFA officials had communicated information about the case to employees who needed to know in order to administer the contract.

Background

On September 15, 1997, HCFA awarded Indefinite Delivery/Indefinite Quantity (ID/IQ) contracts to KPMG and four other accounting firms to perform audit services under HCFA's Audit Quality Review Program. The contracts guaranteed each of the five contractors a minimum amount of business, with work delineated by means of task orders. The initial contracts covered 1 year; but each one permitted HCFA, at its

² Some particulars of Columbia/HCA's and KPMG's questioned accounting practices were reported in the news media as early as Dec. 1997. See Kurt Eichenwald, "Health Care's Giant: Artful Accounting - Hospital Chain Cheated U.S. On Expenses, Documents Show," *New York Times*, Dec. 18, 1997, p. A1.

³ This litigation is still pending.

sole discretion, to exercise an annual option to extend the effective period of the contract for 4 additional years.

At the time of the contract award in September 1997, HCFA determined that KPMG was responsible. In the judgment of the contracting officer, KPMG was found to possess the resources and integrity needed to perform the contract. In May 1998, after award but before the time to exercise the first option to extend the contract for an additional performance year, KPMG was implicated in a multimillion-dollar Medicare fraud case against its client, Columbia/HCA. By September 1999, the date for exercising the second option to extend contract performance, many details of KPMG's alleged part in the fraud had been publicly disclosed.

Responsibility Determinations and Contract Extension

Before awarding a government contract, the FAR requires the contracting officer to make an affirmative determination that the prospective contractor is responsible.⁴ Among other factors, a responsibility review includes an examination of the prospective contractor's integrity and business ethics.⁵ A contracting officer has considerable latitude to exercise judgment and discretion in finding a contractor to be responsible or not.⁶ Issues, such as serious and credible accusations that an audit firm had aided and abetted a client's fraud, could certainly reflect on a firm's responsibility to perform other audit contracts. Consistent with the FAR, a contracting officer would potentially be justified in declining to make a positive responsibility determination on that basis.⁷ On the other hand, because of the discretion vested in the contracting officer, similar circumstances would not necessarily preclude a finding of responsibility,⁸ provided that the firm had not been suspended or debarred.⁹

The FAR does not require the contracting officer to reexamine responsibility during the contract's performance.¹⁰ Neither does it require making a further determination of responsibility before extending performance by exercising an option to renew the contract for another year.¹¹ However, because the exercise of an option is at the sole discretion of the contracting agency, any relevant factors, including new information

⁴ 48 C.F.R. § 9.103 (2000).

⁵ 48 C.F.R. § 9.104-1 (2000).

⁶ See, e.g., *John C. Holland Enterprises*, B-216250, Sept. 24, 1984, 84-2 CPD ¶ 336. (A contracting officer's responsibility determination is not reviewable except for allegations of fraud or bad faith on the part of the contracting officer or in the event of a failure to apply a definitive responsibility criterion.)

⁷ See, e.g., *Standard Tank Cleaning Co.*, B-245364, Jan. 2, 1992, 92-1 CPD ¶ 3. (Violations and alleged violations of state environmental laws justified the contracting officer's finding that the firm was not responsible to clean out fuel storage tanks on surface ships.)

⁸ See, e.g., *ProServe Corp.*, B-247948, B-247948.3, Oct. 5, 1992, 92-2 CPD ¶ 225. (A firm's prior fraud in performing a government contract did not require a determination of nonresponsibility.)

⁹ *Sabreliner Corp.*, B-242023, B-242023.2, Mar. 25, 1991, 91-1 CPD ¶ 326. (Inclusion on an agency's "Alert List" of contractors with responsibility concerns does not require a finding of nonresponsibility, absent suspension or debarment.)

¹⁰ Even a contractor that is debarred while performing a contract may be permitted to continue performance. However, contracts may not be extended while debarment continues, absent compelling reasons. 48 C.F.R. 4 § 9.405-1 (2000).

¹¹ *E. Huttenbauer & Son, Inc.*, B-258028, B-258028.3, 95-1 CPD ¶ 148.

that might raise responsibility concerns if disclosed at the time of award, can be taken into account in making that decision.

In this case, HCFA found KPMG to be responsible prior to the award of the ID/IQ contract. That determination is not in question. At the time of the award, information regarding the Columbia/HCA fraud case was not available. HCFA did not reexamine responsibility when it exercised the options, but there was no requirement to address the issue again. However, the allegations that KPMG contributed to Columbia/HCA's fraudulent billing actions had been disclosed to HCFA in May 1998 and were public knowledge by the summer of 1999. In our view, HCFA could reasonably have declined to exercise the options because of the release of information that had a negative bearing on the contractor's integrity. Alternatively, it could just as reasonably have exercised the options based on the fact that KPMG employees had not been indicted and the firm had not been proven to be culpable in the Columbia/HCA case.¹² Nevertheless, HCFA did not make a reasoned decision to extend the performance, because those employees who actually made the decision either did not have or did not share all available and relevant information.

HCFA Should Have Considered Information About KPMG's Involvement in the Columbia/HCA Matter

At the criminal trial¹³ of four Columbia/HCA executives, two individuals from KPMG—a KPMG partner and a management employee—were publicly identified as unindicted co-conspirators in Columbia's fraudulent activity. Two Columbia/HCA executives were subsequently convicted of conspiracy and criminal fraud in July 1999.¹⁴ The proceedings in open court revealed a significant amount of supporting testimony and documentation concerning KPMG's alleged role in the fraud, and the information was reported widely in the press. Further, a senior HCFA official testified at the trial. This official had notified HCFA management in writing on at least three occasions that this fraud case was one of the top five fraud cases that HCFA should actively monitor. In addition, Columbia/HCA agreed to pay approximately \$750 million to the government as a partial settlement of civil fraud claims.

In addition, in May 1998, the Department of Justice mailed copies of a Qui Tam complaint¹⁵ to the Inspector General and the General Counsel of the Department of Health and Human Services. The Qui Tam complaint alleged that KPMG had assisted in preparing false cost reports for Columbia/HCA. The Inspector General received that document and logged it in, but the Office of the General Counsel claims never to have received its copy. However, in July or August 1998, a copy of the complaint was

¹² Other litigation against KPMG is still pending.

¹³ *United States v. Jay A. Jarrell, et al.*, S97-52-CR-FTM-24D (M.D. Fla.).

¹⁴ The jury was not able to reach a verdict for one defendant. That individual agreed to a pretrial diversion, meaning essentially that he accepted legal responsibility for criminal actions, provided the Department of Justice would not retry him. The fourth defendant was acquitted.

¹⁵ The False Claims Act (31 U.S.C. §§ 3729 – 33 (1994)) permits private individuals to bring alleged false claims to the government's attention and request the Department of Justice to prosecute. Such requests are called Qui Tam actions, and the private party is known as the relator. When a Qui Tam action concludes successfully, the statute awards a percentage of the government's recovery to the relator.

provided anonymously to the HCFA contracting officer responsible for the KPMG ID/IQ contract.¹⁶

KPMG, through its attorney, denied the allegations against the firm and stated that no KPMG employees were indicted or convicted in the Columbia/HCA case. He pointed out that KPMG still employs the two employees named as unindicted co-conspirators. The Qui Tam proceeding against KPMG is continuing, but additional information is not publicly available.

HCFA Failed to Use Available Information

All HCFA contracting staff that we interviewed agreed that the information about KPMG and its alleged part in the Columbia/HCA case was critically important to making reasoned and informed decisions about continued performance and the propriety of issuing specific task orders. None of these employees had the full benefit of information that was or should have been available within the agency.

The contracting officer who handled the first two contract extensions told us that in December 1997 she read a news account of Columbia/HCA's alleged fraud and questions about KPMG's role in preparing questionable cost claims.¹⁷ She said, however, that she had not taken it seriously. Later, in July or August 1998—before exercising the first option—she found a copy of the Qui Tam complaint against KPMG, which was still under court seal, on her desk. While she was not able to determine who had provided her this document, she recognized that it contained serious allegations and that it could affect KPMG's continued performance. She did not discuss this matter with her supervisor, but she was concerned enough to contact the KPMG officials responsible for the ID/IQ contract. These officials, although “embarrassed,” provided assurances that the unit performing the ID/IQ contract was not involved in any way in the alleged fraud.

When the contracting officer exercised the option, she apparently relied on those assurances and on an observation that KPMG's actual performance of the ID/IQ contract was fully satisfactory. However, she did not document the contract file to inform others of the information she had obtained. When the contracting officer left her position in February 2000, that information was effectively lost. The current contracting officer told us that she had not known about KPMG's possible involvement in the Columbia/HCA fraud prior to our interview with her.

HCFA's contracting officers told us that they rely on Project Officers, Government Task Leaders, and other HCFA employees from the program areas to provide information on potential contractors prior to making contract decisions. In this instance, neither the Project Officer nor the Government Task Leader provided any information to the contracting officers prior to the yearly contract extensions. Such dependence on receiving information from others contributed to KPMG's contract

¹⁶ We were not able to establish how the document came to be on HCFA's premises. The Inspector General stated that her office did not provide a copy to anyone in HCFA because the cover letter from the Department of Justice indicated that the General Counsel had also been mailed a copy.

¹⁷ Kurt Eichenwald, “Health Care's Giant: Artful Accounting - Hospital Chain Cheated U.S. On Expenses, Documents Show,” *New York Times*, Dec. 18, 1997, p. A1.

extensions. This allowed KPMG to continue to review some transactions that were of the same type as those that it had advised Columbia/HCA about and that had become involved in the criminal trial and civil suits against Columbia/HCA.

Meanwhile, the contracting officer who extended the contract did not share information she had about the Qui Tam proceeding with the contract administration personnel. As a result, the contract administration staff unknowingly issued a task order to KPMG to perform audit services at the same firm that employed the Qui Tam relator, who was a key witness against both Columbia/HCA and KPMG. When the Department of Justice requested that HCFA remove KPMG from that task order, HCFA complied. Apparently, no one from HCFA followed up with the Justice Department to learn the reason for that request, because information about the allegations against KPMG still was not disseminated to appropriate HCFA staff.

Later, in March 2000, a HCFA audit of Columbia/HCA disclosed the KPMG involvement with the Columbia/HCA case. HCFA officials maintain that this was the first notice that HCFA had of the apparent and actual conflict of interest in KPMG's continued performance of the audit service contract.

In September 2000, HCFA cited lack of funds to continue performance of any of the contracts under its Audit Quality Review Program. For this reason, the agency declined to exercise the option to extend the KPMG contract and took similar action on the other four contracts for the 2001 performance year.

As arranged with your office, unless you announce its contents earlier, we plan no further distribution of this letter until 30 days after the date of the letter. At that time, we will make copies of the letter available to interested congressional committees and agency officials and to others on request. If you have any questions about this investigation please call me at (202) 512-7455 or Assistant Director William Hamel at (202) 512-6722. Special Agent Andrew O'Connell was a key contributor to this investigation.

Sincerely yours,



Robert H. Hast
Managing Director
Office of Special Investigations

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