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United States General Accounting Office
Washington, DC 20548

May 26, 2004

The Honorable Ernest J. Istook, Jr.
Chairman

The Honorable John W. Olver
Ranking Minority Member

Subcommittee on Transportation, Treasury, and Independent Agencies
Committee on Appropriations
House of Representatives

Subject: *GSA Actions Leading to Proposed Debarment of WorldCom*

On June 25, 2002, WorldCom, Inc.,¹ announced its intention to restate its financial statements for 2001 and the first quarter of 2002, reducing previously reported earnings by nearly \$4 billion. WorldCom's announcement sparked a series of investigations by the Securities and Exchange Commission (SEC), the Department of Justice, and WorldCom's Board of Directors, among others, and eventually resulted in criminal charges against six of its corporate officials. WorldCom filed for bankruptcy protection in July 2002, and, over the next several months, announced restatements for additional periods.²

On July 31, 2003—over a year after WorldCom first announced its intention to restate its earnings—the General Services Administration (GSA) formally proposed the company for debarment, making the company ineligible for future government contracts. When WorldCom consented to a 3-year administrative agreement allowing GSA to continue monitoring the company's conduct, GSA terminated the debarment proceedings on January 7, 2004.

House Report 108-243, which accompanied the Transportation, Treasury, and Independent Agencies Appropriations Act, 2004, required us to review the actions GSA took between WorldCom's June 2002 announcement and GSA's July 2003 decision to propose the company for debarment. As discussed with your staff, we

¹ WorldCom, which now does business under the MCI brand name, is a global communications provider of voice, network, and data services to over 20 million residential, business, and government customers.

² In March 2004, WorldCom filed its restatements for 2000 and 2001 with the SEC. According to a WorldCom news release, the portion of the restatements attributable to the accounting irregularities that prompted the investigations totaled \$8.8 billion for those 2 years. The restatements also included \$5.8 billion in reductions to previously reported earnings for the value of acquired assets, and \$59.8 billion in reductions to the value of numerous companies WorldCom had previously acquired, for a total restatement of \$74.4 billion.

agreed to (1) identify the GSA offices involved and the actions they took and (2) describe the sources of information on which GSA relied in considering WorldCom for debarment. To do so, we interviewed or obtained information from cognizant GSA officials as well as officials from Justice and the SEC who were responsible for conducting the criminal and civil investigations resulting from WorldCom's financial restatements. We also reviewed relevant provisions from the Federal Acquisition Regulation (FAR) and the General Services Acquisition Regulation. We did not evaluate the merits of GSA's decision to propose WorldCom for debarment, or its subsequent decision to terminate debarment proceedings. More information on our scope and methodology may be found on page 7.

GSA provided comments on a draft of this report by electronic mail, and characterized the report as fair and even-handed. GSA also provided technical comments and additional information, which we incorporated as appropriate.

We conducted our review from November 2003 to May 2004 in accordance with generally accepted government auditing standards.

Summary

Two GSA offices gathered information related to the WorldCom case at different times during the year leading up to the July 31, 2003, decision to propose debarment. The Office of General Counsel monitored events related to WorldCom's financial irregularities for nearly a year, but General Counsel officials did not believe they had sufficient information to make a recommendation to GSA's suspension and debarment official. In May 2003, after WorldCom and the SEC proposed to settle the civil suit the SEC had filed concerning the company's financial irregularities, GSA's Office of Inspector General began an independent review. In June, the Inspector General recommended that the company be made ineligible to receive federal contracts. GSA's suspension and debarment official subsequently determined, based on additional information he received from WorldCom executives, external auditors, and a court-appointed official, that the company was not a responsible contractor as defined by the FAR.³ On July 31, 2003, he proposed WorldCom for debarment.

GSA's General Counsel and Inspector General offices obtained publicly available information about WorldCom. GSA obtained limited access to nonpublic information collected by Justice and the SEC. GSA's access to information collected by Justice was limited due to constraints associated with an ongoing criminal investigation. GSA obtained limited information from the SEC, such as the extent to which WorldCom was cooperating with the SEC's investigation.

Background

To protect the government's interests in contracting for goods and services from the private sector, the FAR requires agencies to do business only with responsible

³ Federal Acquisition Regulation, at § 9.104-1 (January 2004) [hereinafter FAR].

contractors.⁴ In cases where contractors demonstrate a lack of responsibility—such as by a history of failure to perform in accordance with the terms of a contract, or by conviction or civil judgment for fraud or other criminal activity—the government can suspend or debar such contractors from receiving future government contracts.⁵ The FAR identifies specific causes that agencies can use to determine whether to debar a contractor, as well as broad discretion to debar contractors for “any other cause of so serious or compelling a nature that it affects the present responsibility” of the contractor. However, the FAR notes that the existence of a cause for debarment does not necessarily require the contractor to be debarred. Rather, the agency official responsible for suspension and debarment decisions is to consider the seriousness of the contractor’s acts or omissions and any measures it has taken to remedy the problem or mitigating factors, such as the contractor’s cooperation with investigating government agencies.

The FAR does not give any agency the specific responsibility for debarring contractors. Any federal agency may suspend or debar a contractor if the situation warrants, and its determination is effective governmentwide.⁶ When more than one agency has an interest in reviewing a particular contractor, the FAR calls for the agencies to consider designating a lead agency to coordinate the effort.

As required by the FAR, GSA has issued regulations describing GSA’s suspension and debarment processes. Under these regulations, contract-related improprieties or performance deficiencies on GSA-awarded contracts may be referred directly to the GSA suspension and debarment official. The Inspector General may also refer cases to the suspension and debarment official based on possible criminal or fraudulent activity that office discovers during audits and investigations. However, GSA regulations do not expressly address proposed debarments based on “any other cause of so serious or compelling a nature that it affects the present responsibility” of the contractor.⁷

After receiving a recommendation, the suspension and debarment official in turn provides notice to the contractor and an opportunity to respond, and may refer the

⁴ To be considered responsible, a contractor must have, among other things, the financial resources, organization, and ability to perform the requirements of a contract, and a satisfactory record of integrity and business ethics. FAR, supra note 3, at § 9.104-1, (a), (b), (d), and (e).

⁵ Suspension has the same effect as debarment, in that a suspended contractor is ineligible to receive contracts from any federal agency unless that agency head determines a compelling reason exists. Suspension requires only a showing of adequate evidence, or an indictment, and provides a means to protect the government’s interests while an investigation takes place; debarment requires a preponderance of the evidence, or a conviction or civil judgment, and is a longer-term decision, normally up to 3 years. FAR, supra note 3, at §§ 9.406 - 9.407.

⁶ Once suspended or debarred, the contractor is placed on the List of Parties Excluded from Federal Procurement and Nonprocurement Programs, a list maintained by GSA. As of March 31, 2004, more than 33,000 individuals and companies were included on the list.

⁷ In May 2004, GSA officials told us that in the future the Inspector General will be responsible for suspension and debarment reviews in this type of case.

case to a fact-finding official in cases where a material fact is in dispute. Before making a decision to suspend or debar a contractor, the suspension and debarment official must obtain legal review from the Office of General Counsel.

Two GSA Offices Independently Gathered Information

Two GSA offices gathered information related to the WorldCom case to assess whether the company's actions should make it ineligible to receive federal contracts. These two offices, the Office of General Counsel and the Office of Inspector General, acted at different times during the year leading up to the decision to propose debarment for WorldCom.

Shortly after WorldCom's June 2002 announcement, the Office of General Counsel began monitoring the WorldCom case. In the absence of GSA regulations addressing proposed debarments in cases of miscellaneous serious or compelling deficiencies, the General Counsel initiated a review based on their past experience in another case related to a company's accounting irregularities. Earlier in 2002, the General Counsel led the agency's review of whether to initiate suspension or debarment proceedings against Arthur Andersen, L.L.P., and Enron Corporation, following disclosure of Enron's accounting irregularities.⁸ Based on that precedent, the General Counsel took initial responsibility for the WorldCom case.

According to General Counsel officials, their review was intended to enable them to advise GSA's Federal Technology Service, which held a large telecommunications contract with WorldCom, as well as to determine if the company's actions warranted consideration for possible suspension or debarment. As part of this effort, the General Counsel recommended two former WorldCom officials for suspension in November 2002 following Justice's filing of criminal charges against the officials in August and September 2002.⁹ General Counsel officials indicated they did not recommend the company for suspension or debarment at that time because they did not believe the information they had collected provided sufficient evidence to do so.¹⁰

⁸ In that case, in January 2002, the Director of the Office of Management and Budget wrote a letter to the Administrator of General Services, calling for GSA to consider whether to initiate suspension or debarment proceedings against the two companies. In turn, the Administrator of General Services referred the matter to the General Counsel. In March 2002, the General Counsel recommended Enron, corporate entities related to Enron, seven Enron officials, and one Arthur Andersen official for suspension.

⁹ GSA's suspension and debarment official suspended those two officials following the recommendation. Three other former WorldCom employees also pled guilty to criminal charges, but General Counsel officials told us they focused their efforts on the company's more senior personnel who gave direction in carrying out the accounting irregularities.

¹⁰ Both the General Counsel and the suspension and debarment official noted that having the General Counsel's office develop information and make recommendations on whether to debar a contractor could raise questions regarding the appearance of a potential lack of independence should the General Counsel be asked to provide legal advice on recommendations it initiated. On the WorldCom case, General Counsel representatives told us they mitigated this risk by assigning different attorneys to handle the suspension and debarment cases and to provide legal advice to the Federal Technology

They noted, however, that they continued to monitor events related to WorldCom after that point, particularly seeking copies of detailed reviews of the company that ultimately were publicly released in June 2003.

In May 2003, the Inspector General independently began a review of the WorldCom case. Inspector General officials told us they made this decision once they learned that WorldCom and the SEC had agreed to settle SEC's civil suit; the settlement was made public on May 19, 2003. On June 2, 2003, the Inspector General recommended that the company be suspended.¹¹ General Counsel officials ended their efforts after the Inspector General's recommendation, believing that any further evaluation was unnecessary.

After receiving the Inspector General's recommendation, GSA's suspension and debarment official conducted a series of meetings and discussions in June and July 2003, with WorldCom executives, external auditors, and a court-appointed official reviewing the company's corporate governance. These discussions led the suspension and debarment official to conclude that WorldCom's problems had not been resolved and that the company's efforts to address these issues were still a "work in progress." The official told us that the finding by external auditors of 10 material internal control weaknesses and the fact that the company had only just begun implementing an ethics program led the official to conclude that WorldCom was not presently responsible. Consequently, on July 31, 2003, the official proposed WorldCom for debarment under the FAR provision related to miscellaneous serious and compelling deficiencies.¹²

GSA Offices Generally Relied on Public Information

Both the Offices of General Counsel and Inspector General obtained and used publicly available information as the basis for their suspension and debarment recommendations. They obtained limited access to nonpublic information collected by Justice and the SEC.

General Counsel representatives told us that after WorldCom's June 2002 announcement, they monitored sources such as newspapers, WorldCom news conferences, and information related to the case posted on various Web sites. For example, the General Counsel's November 2002 recommendation to suspend two

Service. They also noted that the suspension and debarment official had access to an attorney assigned to counsel GSA's Office of Acquisition Policy, the office in which the suspension and debarment official is located, and that this attorney did not participate in the General Counsel's efforts to research and develop a recommendation.

¹¹ In addition, the Inspector General also recommended suspending MCI WorldCom Communications, Inc., a subsidiary, as well as the three accounting employees the General Counsel had previously declined to refer. On July 25, 2003, the Inspector General revised its recommendation, calling for the company to be debarred rather than suspended.

¹² FAR, supra note 3, at § 9.406-2(c).

WorldCom officials was based on publicly disclosed criminal charges brought against the individuals earlier that year. General Counsel officials told us they also made continuing efforts to obtain a draft version of an internal WorldCom report—the Report of Investigation by the Special Investigative Committee of the Board of Directors of WorldCom, Inc. (commonly known as the McLucas Report)—and to find out when it would become public. General Counsel officials noted they discussed the current conditions at the company and the status of its remedial actions with the court-appointed official reviewing the company’s corporate governance. Similarly, in its June 2, 2003, recommendation, the Inspector General mainly provided copies of publicly available criminal charges against WorldCom officers and employees, as well as general information on WorldCom as a company. In its subsequent referrals, the Inspector General included copies of investigative reports, including the McLucas Report, which was made public in June.

GSA officials obtained limited nonpublic information from the Department of Justice and the SEC, the agencies conducting criminal and civil investigations into WorldCom’s actions. GSA officials indicated that they made inquiries to Justice regarding their investigation, but obtained information only on the status of that investigation. According to a Justice official, Justice provided what information they could lawfully disclose, but they were restricted from providing certain information by grand jury secrecy rules and the need to avoid either jeopardizing Justice’s ongoing criminal investigation or tainting civil and administrative proceedings with grand jury information. GSA officials contacted the SEC to request information, but an SEC official indicated he understood GSA to be seeking advance notice of any potential future developments, such as a decision to liquidate the company, which could have affected WorldCom’s ability to perform its contracts.¹³ GSA officials obtained limited information from the SEC, such as the extent to which WorldCom was cooperating with the SEC’s investigation, and current contact information for former WorldCom officials.

Conclusion

The WorldCom case illustrates the number of participants and the range of information that can play a role in determining whether a contractor’s noncontract-related deficiencies should make it ineligible to receive government contracts. It also shows how legal and procedural considerations can limit the sharing of information among the participants. It is not clear, however, whether these constraints affected GSA’s decision, or its timing, on whether to debar WorldCom. As part of a broader review of suspension and debarment policies and procedures, we plan to examine whether these constraints could have governmentwide implications.

¹³ The SEC provided us an electronic mail message in which GSA stated that the agency was “continuing to monitor WorldCom’s present responsibility in performing government contracts,” and that “any information you can share with us in the future is helpful.”

Agency Comments and Our Evaluation

GSA provided comments on a draft of this report by electronic mail, and characterized the report as fair and even-handed. GSA also provided technical comments and additional information, which we incorporated as appropriate.

Scope and Methodology

To identify the GSA offices involved and the actions they took to review WorldCom's eligibility for government contracts, we interviewed officials in GSA's Offices of Acquisition Policy, General Counsel, and Inspector General, as well as the Federal Technology Service. We reviewed applicable provisions of the FAR and of the General Services Acquisition Regulation, and examined applicable court cases that discuss the evidentiary standards applicable to the actions GSA took. To describe the sources of information on which GSA relied in making its decision, we reviewed correspondence, memoranda, briefing materials provided by GSA or issued by WorldCom, and public statements, such as news releases issued by GSA, WorldCom, and the SEC. We also interviewed officials at the SEC that were responsible for the civil cases filed against WorldCom and its officers, reviewed electronic mail documenting contacts with GSA officials, and reviewed SEC's regulations governing access to information obtained by the SEC. We obtained written responses to questions submitted to Justice.

We focused our efforts on GSA's actions between WorldCom's June 2002 announcement and GSA's July 2003 decision proposing debarment. We did not evaluate the merits of GSA's decision to propose WorldCom for debarment, or its subsequent decision to terminate debarment proceedings.

We are sending copies of this report to the Administrator of General Services; the Attorney General; the Chairman, Securities and Exchange Commission; and other interested congressional committees. This report is also available on GAO's home page at <http://www.gao.gov>.

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