STATE OF ILLINOIS
DEPARTMENT OF TRANSPORTATION

IN THE MATTER OF:	)	
	)	
McDonough Associates, Inc.	)	**2012-S-001**
	)	
Respondents	)	

FINDINGS AND RECOMMENDATIONS TO THE CHIEF PROCUREMENT OFFICER

On January 12, 2012 Mr. Bill Grunloh, Chief Procurement Officer for the Illinois Department of Transportation, issued a Notice of Suspension and Interim Suspension to Respondent McDonough Associates, Inc. (hereinafter "MAI" or "Respondent"). The charges against MAI arise entirely out of the findings of an audit conducted by IDOT auditors of the financial records of MAI from 2000 – 2009. According to the introductory paragraph of the audit report, the purpose of the audit was "to assess the factual basis for MAI's overhead rates reflected in its financial submissions to the Department for work performed on projects during these periods, as well as to determine whether MAI is utilizing an appropriate system of accounting practices and controls." The audit included 15 "Findings" which allege MAI made errors in accounting for certain expenses related to various projects. The Notice of Interim Suspension and Action to Seek Suspension cites only Findings 1 through 5 as the basis for the charges against MAI in this matter, and the parties are in agreement that only those 5 findings will be considered for purposes of the suspension.

The issue at the core of this matter in its simplest form, is whether accounting errors—many of which MAI admits—constitute adequate evidence that MAI "*lacks integrity and honesty in the conduct of business or the performance of contracts."*

Pursuant to 44 Ill. Adm. Code 6.630, I was appointed as Hearing Officer for this matter. Section 6.680 (f) provides that "(t)he Hearing Officer shall make a report containing findings of fact and conclusions of law and shall transmit the entire record, including such findings and conclusions, to the CPO for review and final decision."

A hearing was held on April 25 and 26, 2012, at the IDOT Hanley Building in Springfield. Present were IDOT Deputy Chief Counsel Lance Jones representing the Department, Mr. William Sullivan and Ms. Laurie Martin Montplaisir, representing MAI, and witnesses Donald Kosta, Alan Swanson, and Feroz Nathani, as well as observers from IDOT, MAI and the United States Department of Transportation

LAW

The Illinois Procurement Code (30 ILCS 500/) gives the Chief Procurement Officer broad authority to promulgate rules governing its various provisions, including suspension of contractors:

> Sec. 50-65. Suspension. Any contractor or subcontractor may be suspended for violation of this Code or for failure to conform to specifications or terms of delivery. Suspension shall be for cause and may be for a period of up to 10 years at the discretion of the applicable chief procurement officer. Contractors or subcontractors may be debarred in accordance with rules promulgated by the chief procurement officer or as otherwise provided by law. (30 ILCS 500/50-65)

Pursuant to that authority, the Chief Procurement Officer has promulgated rules which appear in Title 44, Subtitle A, Part 6 of the Illinois Administrative Code. Among them are rules to govern suspension of contractors. Of particular note, Section 6.510 states:

> The CPO (Chief Procurement Officer) may suspend a contractor or subcontractor from participation on any contract or subcontract awarded by or requiring approval or concurrence of the Department upon a determination by the CPO based upon adequate evidence that the contractor or subcontractor has engaged in conduct proscribed by Section 6.520 of this Subpart. This determination may be predicated on evidence developed by means of an investigation conducted by the CPO and procurement compliance monitors and the record of any hearing requested and conducted pursuant to this Subpart; * * * * [44 Ill. Adm. Code 6.510]

The grounds for suspension or debarment are set forth in Section 6.520, and provide, in portions relevant to this proceeding:

> A contractor or subcontractor may be suspended or debarred from participation due to acts or omissions that indicate that the contractor or subcontractor lacks integrity and honesty in the conduct of business or the performance of contracts. Acts or omissions that indicate the lack of business integrity and honesty include but are not limited to:
>
> a) fraud, bribery, embezzlement, theft, collusion, conspiracy, anti-competitive activity or other misconduct and offenses prohibited by law whether or not any such misconduct or offense is in connection with a Department contract or subcontract or any contract or subcontract requiring Department approval;

* * * *

d) making a material false statement, representation, claim or report respecting the character, quality, quantity, or cost of any work performed or materials furnished in connection with a contract or subcontract administered or supervised by the Department; [44 Ill. Adm. Code 6.510]

The regulations set forth the burden of proof which must be met as "adequate evidence." Section 6.510 deals with the initial (i.e., pre-hearing) determination by the CPO. Section 6.690(a) sets forth the same standard to be applied following the hearing provided for by Section 6.620 (i.e., the hearing that is the subject of these recommendations):

> Based on the record as a whole and an *adequate evidence standard of proof*, the CPO will determine the suspension action to be taken. [44 Ill. Adm. Code 6.690(a)] (Emphasis added).

Section 6.690 of the regulations also provides guidance in considering the evidence:

> "In assessing adequate evidence, consideration will be given to how much credible information is available, its reasonableness in view of surrounding circumstances, corroboration or lack thereof as to important allegations, and inferences that may be drawn from the existence or absence of affirmative facts. This assessment will include an examination of basic documents such as contracts, inspection reports, and correspondence." 44 Ill. Adm. Code 6.690 (b).

DISCUSSION

The parties reached an agreement, prior to the hearing, to significantly simplify and expedite the hearing process. The Department's case was presented by introduction of the audit report but without oral testimony by the auditors, and by cross-examination of MAI witnesses. The Respondent's case involved examination of three witnesses—former MAI CFO Donald Kosik, MAI Senior Vice President Alan Swanson and MAI President Feroz Nathani. All of the Department's Exhibits – 1 through 9 – and all of the MAI Exhibits—1 through 24 – were admitted into evidence without objection.

The core allegation which forms the basis for the suspension issued is that MAI allocated expenses that were not allowable as "overhead" into various overhead accounts so as to inflate overhead and consequently receive a greater reimbursement from IDOT (and any other client who paid overhead expenses). Finding No. 5 is a mostly conclusory finding which summarizes and relies on Findings 1, 2, and 3. It is somewhat unclear, in reading Finding No. 5, whether the Department intends to rely on Finding No. 4 as part of it's case, but Finding No. 4 is cited in the

Notice of Interim Suspension and Action to Seek Suspension, and thus I consider it part of the Department's case and will address it.

Prior to examining the particular Findings upon which the Department bases it's case, it is essential to set forth some overriding principles which I believe should govern consideration of the case, and through which I will evaluate the factual situation.

First, it important to note that this proceeding is limited to determining whether there is adequate evidence to conclude that MAI *lacks integrity and honesty in the conduct of business or the performance of contracts* and is therefore subject to suspension or debarment. It is not the purpose or function of the hearing process to determine whether audit figures are correct, or to referee a dispute between MAI and Department auditors. Thus, any conclusion on the part of the Hearing Officer (or ultimately on the part of the CPO) should not be interpreted as a judgment on the validity of the audit findings and says nothing about the correctness of the audit finding. As I will note below, it is entirely possible that an audit finding may be 100% correct and valid, and yet not constitute grounds for suspension.

Second, the Department bears the burden of proof. It must present evidence to establish the charges against MAI—i.e., that MAI is guilty of *acts or omissions that indicate that it lacks integrity and honesty in the conduct of business or the performance of contracts.* [44 Ill. Adm. Code 6.520]

The regulations governing suspension of contractors identifies the burden of proof which must be met as "adequate evidence:"

> Based on the record as a whole and an adequate evidence standard of proof, the CPO will determine the suspension action to be taken. [44 Ill. Adm. Code 6.690(a)]

Many types of burdens of proof are well known and relatively well established: "beyond a reasonable doubt" and "preponderance of the evidence" are perhaps the two most widely used in the United States, and there are hundreds or perhaps thousands of cases which attempt to explain their meaning and application. Unfortunately, there is no definition of "adequate evidence" in the Illinois Procurement Code or in pertinent state regulations or case law. It is evident, however, from a review of federal law that Illinois has adopted its approach—and much of the language in its regulations--from the federal procurement structure. Thus, while there appears to be nothing in Illinois law that defines "adequate evidence," an examination of the federal provisions is helpful in interpreting the state regulations. The federal provisions define the term "adequate evidence" in a number of sections of the Code of Federal Regulations (CFR) governing procurement. "Adequate evidence" is defined in those sections as "information sufficient to support the reasonable belief that a particular act or omission has occurred."[1]

[1] See, for example: 13 CFR 124.305 (d) (1), 48 C.F.R. 2.101 (2), 41 C.F.R. § 105-68.900 and 48 C.F.R. 2.101 (2).

The federal regulations and related cases lead to the conclusion that the burden of showing "adequate evidence" is a low threshold. Thus, while the Department bears the burden of proof, it is by no means a heavy burden, and one which appears to be at least to some extent less than the more familiar "preponderance of the evidence" standard. In simpler terms, then, it appears that the Department's burden doesn't even rise to the level of "more likely than not."

Illinois regulations also, give helpful guidance to evaluation of "adequate evidence:"

> "In assessing adequate evidence, consideration will be given to how much credible information is available, its reasonableness in view of surrounding circumstances, corroboration or lack thereof as to important allegations, and inferences that may be drawn from the existence or absence of affirmative facts. This assessment will include an examination of basic documents such as contracts, inspection reports, and correspondence." 44 Ill. Adm. Code 6.690 (b).

Applying the two applicable concepts – i.e., that it is the Department that has the burden of proof, and that the burden of proof is less than "more likely than not" can be a complex proposition.

In my opinion a finding that a respondent "*lacks integrity and honesty in the conduct of business or the performance of contracts"* must require more than establishing that accounting errors were made. Put another way, an error in applying accounting principles does not—*in and of itself*—establish a lack of integrity and honesty. It may simply be an innocent mistake. To hold otherwise would be to establish that any accounting mistake made by a contractor automatically subjects a contractor to suspension. I do not believe such a harsh finding is intended, nor would such a holding, in my opinion, be in the best interests of the Department of Transportation or the State of Illinois.

Furthermore, while the adequate evidence standard requires no more than "information sufficient to support the reasonable belief that a particular act or omission has occurred," an appropriate consideration of the case requires an evaluation not only of the audit and supporting exhibits (which in this case constitutes the Department's complete case), but also the testimony and exhibits offered by MAI. Were it not intended that a contractor have a meaningful opportunity to present evidence to contradict or otherwise explain its position with respect to the audit findings, and to have that evidence considered, there would be no purpose for a hearing.

That is not to say that the audit itself cannot be sufficient to establish the Department's case, since the regulations (Section 6.690(b)) require that "(i)n assessing adequate evidence, consideration will be given to * * * inferences that may be drawn from the existence or absence of affirmative facts." Without more, however, a simple allegation that a contractor has made accounting errors does not establish the Department's case.

Thus, in analyzing the record in this case, my focus will be—taking into consideration the findings of the auditors, the testimony of witnesses and the Exhibits admitted into evidence—determining whether there is "adequate evidence" to show not only that Respondent incorrectly applied accounting principles, but whether it deliberately or knowingly disregarded or

misapplied accounting rules, resulting in increased charges to IDOT and additional compensation to MAI than it was otherwise entitled.

One additional principle is important. The auditors twice state that their conclusions are based "on the totality of the audit findings cited in this report." Such an approach may be appropriate from an audit approach. However, as an independent Hearing Officer charged with evaluation of the allegations charged I first must look at each individual audit finding in conjunction with the testimony and exhibits introduced at the hearing, and determine whether—standing alone—it provides adequate evidence of intent to defraud. Only after that step is it, in my judgment, appropriate to consider the "totality of the audit findings" for which the Department has met its burden of proof. Just as prosecution of one defendant for five burglaries requires evidence that the defendant is guilty of each separate offense, and proof of guilt for one or two offenses cannot be used to infer guilt of the others, a finding of "guilt" on some of the audit Findings will not automatically infer guilt on the remaining findings. While this is somewhat complicated by the auditor's reliance on all of its findings to reach it's ultimate conclusion, I believe any other approach would not afford Respondent the due process to which it is entitled. Therefore, I will first evaluate each of the allegations (findings) independently.

Finding No. 1: $46.5 million included by MAI as Bonuses in Overhead Computations Disallowed as Disguised Dividends.

The presentation of this issue—both in the Audit Report and in the testimony—is confusing, at best. At times it seems that the auditors and the Respondents are talking about two separate issues. At other times the discussion lumps two compensation plans together and addresses them as one issue.

Essentially, applicable accounting rules provide that payments made to owners of a company may be either (a) compensation for work performed, or (b) payment of profits from the company—such as dividends. Payments for compensation may—within certain parameters--be included in overhead, but payment of profits may not be included in overhead.

The evidence illustrates there are two types of bonus payments MAI made to owners. The Principals Bonus Plan is a plan which MAI admits is a distribution of profits. Mr. Kosik testified, and demonstrated with references to the SEFCs[2] over a number of years, that MAI deducted the amounts paid to MAI's owners under the Principals plan from the total Principals Payroll in arriving at the amount allocated to overhead. (See, for example, MAI Exhibit 2 (a), page 00692, account # 6110).

The "Incentive Compensation Bonus Plan" is a compensation method by which some employees of MAI—including non-owners as well as many with ownership interest—are paid a "bonus" above and beyond their normal salary.

[2] SEFC is an acronym for "Statement of Experience and Financial Condition," a set of documents which must be submitted by a contractor annually to be approved for prequalification. It includes significant financial detail.

In Finding No. 1, the Department appears to lump the two plans together and in doing so comes up with a total of $46.5[3] million which it alleges was improperly included by MAI in the overhead computation. The evidence, however, shows that the Department (via the audit) failed to make clear that of the $46.5 million that it claims should be disallowed (i.e, NOT included in overhead) MAI has already disallowed $31 million when it submitted its SEFCs. Thus, the statement of Finding No. 1 that "$46.5 million ***included by MAI as Bonuses in Overhead Computations*** Disallowed as Disguised Dividends" is inaccurate, since two-thirds of that amount was already deducted by MAI. Put another way, $31 million of the $46.5 million the Department seeks to exclude from the overhead computations was in fact never included in overhead computations. This is disturbing, since the SEFC's clearly show the deduction and, in fact, a preliminary draft of the Audit included documentation showing MAI's deduction. Counsel for the Department, in responding to the suggestion that the Department deliberately removed evidence that MAI had already disallowed the $31 million from its overhead computations, pointed to the Auditors Note on page 13 of the final Audit (Department Exhibit 1), which notes that "MAI did exclude a considerable portion of the dividends disguised as a bonus." However, it goes on to take issue with the exclusion, because it was based on "reasonableness" which the auditors claim is not a valid criterion for exclusion of costs. MAI *excluded* the amount from overhead—a result with which the Department would appear to agree, since it claims these are "disguised dividends"--and yet in the Auditors Note the auditors appear to object to exclusion of the amount because it is based on a theory unacceptable to the Department. It appears that the Auditors Note may have confused *exclusion* of the $31 million "Principals' Bonus" with MAI's *inclusion* of $15 million from the Incentive Bonus Plan. If the Department's position is that $31 million should have been disallowed (i.e. should not be included in overhead) and it in fact was not included in overhead, it seems that the matter of the $31 million is resolved.

As to the remaining $15 million, there is a great amount of testimony and exhibits that seek to address the question of whether the Incentive Plan bonuses are allowable inclusions in overhead. Certainly the introduction of MAI Exhibit #5 (the "Wolaver Memorandum") is significant evidence of lack of intent to defraud since MAIs treatment of the $15 million in payments to owners appear to be consistent with the approach suggested by the Chief of IDOT's Bureau of Design. We need not go into those arguments, however, as it would appear that the auditors have accepted (reluctantly, perhaps) the inclusion of the $15 million in the "Incentive Compensation Bonus Plan" paid to owners. On page 5 of the Audit Report (Department Exhibit I) the auditors state ". . . we are not at this time proposing to disallow payments under the Incentive Compensation Bonus Plan for purposes of the overhead rate determinations insofar as those payments appear to be for the benefit of the majority of the employees, irrespective of whether they own stock of the company." If the auditors are not willing or able to make a case that the inclusion of the Incentive Compensation Bonus Plan payments to owners is improper, it should not be used to infer knowledge or intent to defraud on the part of MAI.

In conclusion, the evidence indicates that of the $46.5 million claimed to be included in overhead fraudulently, $31 million was never claimed by MAI as overhead, and the Department's auditors have—at the very least—conceded that inclusion of the $15 million in Incentive Compensation Bonus payments to owners is arguably correct. I therefore recommend

[3] For simplicity, the amounts in question are rounded. The determination to be made by this Hearing Officer and recommended to the CPO does not rely on specific amounts.

that the Chief Procurement Officer find that Audit Finding No. 1 does not constitute adequate evidence that MAI lacks integrity and honesty in the conduct of business or the performance of contracts"

Finding No. 2: Need to Properly Code Time to Direct Labor.

Auditors discovered that in several cases expenses that should have been charged to "direct labor" were in fact charged to either the "office" or "precontract" accounts, both of which are overhead accounts. As a result, the overhead rate was inflated, and IDOT would then end up paying more than appropriate.

The testimony of MAI's CFO Kosik was straightforward and direct. He indicated that direct labor costs could be put into one of three accounts or "buckets." The expenses could be allocated to "Direct Labor," "Precontract," or "Office." He testified to the policy followed by MAI, and gave several examples. Direct labor would include time spent on an existing contract. Time spent on preparing for or attempting to obtain a particular project was allocated to "Precontract." It could not be properly allocated to the "direct labor" account, he explained, because it did not involve an existing contract. In any given case the cost may or may not result in obtaining a particular contract. The "office" account is used for time of employees who generally do office-related work, whether it be clerical support, accounting, the CFO or that of the President/CEO. The items that generally go into the office account are not identifiable to a particular contract or job.

However, Mr. Kosik also testified that it was the policy of MAI that other expenses were put into the "precontract" or "office" accounts. He noted, for example, that clients might ask to have certain work done that is not included in the contract, with the understanding or expectation that even though the work is outside the scope of the contract, MAI would do it with no additional billing to the client. In such cases, the charge would go to the "office" account.

In cross-examination, counsel for the Department brought out a number of examples that illustrate the Department's position with respect to improper coding of direct labor. Work was done by at least one MAI employee in developing a proposal relating to the city of Chicago's efforts to obtain the Olympics. Mr. Kozik explained that the work was billed to "precontract" because it was done with the hope that if Chicago were to obtain the Olympics, MAI would be given a consulting contract to develop transportation plan. Another example was work done by MAI employees on a project for the Forest Preserve District, which clearly was allocated to the precontract account, not the direct overhead account.

Two additional examples brought out by the Department showed that two MAI employees did a substantial amount of work on a specific Cook County Forest Preserve District project and charged their time to the "precontract" overhead account.

At the outset of cross-examination, Mr. Kosik admitted that he was familiar with the requirements of the Federal Acquisition Regulations (FARs) and AASHTO guidance and other applicable requirements, and that under those policies it is not allowable to charge a direct labor cost to an overhead account or to charge losses or cost overruns from one contract to another

contract. Yet, that is precisely what the MAI policy does. The prohibitions apply to direct or indirect charges, and allocation of a direct expense to an overhead account clearly constitutes an indirect charge to any clients who are required by their contract to pay a portion of overhead.

An exchange between Counsel for the Department and Mr. Kosik sums up the Department's position very well [See Transcript, page 138, et seq.]:
.

> Q. So essentially when someone asks you to do something, you decide to do it, because you couldn't bill that person, they've asked you to do it without compensation, because you couldn't bill it, you put it into the Office overhead account?
>
> A: Yes, because we wanted to, you know, make that client happy so they would consider us for future work.
>
> Q: Right. You didn't eat the expense; you made everybody else pay for that expense?
>
> A: You could look at it that way, yes.

The testimony and exhibits leave no doubt that MAI had a policy that violated the applicable accounting guidelines, that the policy resulted in significant inflation of overhead costs payable by the Department. Clearly the CFO was aware or the policy.

I therefore recommend that the Chief Procurement Officer find that Audit Finding No. 2 constitutes more-than-adequate evidence that MAI lacks integrity and honesty in the conduct of business or the performance of contracts.

Finding No. 3: Direct Costs Included in Transportation Expenses

The Department alleges that MAI improperly allocated costs that should have been allocated to specific projects to the transportation overhead account.

There are a number of sub-issues in this Finding. First, Mr. Kosik testified that it was MAI's standard procedure to post certain expenses to the overhead account, and later to reverse the entry to remove it and allocate it to the appropriate project. MAI argues that the practice is not objectionable since correcting entries removing those charges are later made when those costs can be reassigned to reimbursable accounts. The auditors admit to observing many reversals of prior charges to the Transportation account, they find it problematic that there "remains substantial risk of over-inclusion of charges. . . " It is noteworthy that the auditors state there is "substantial risk" rather than alleging actual over-inclusion of charges to the Transportation account. I interpret that statement as saying "there *could be* improper allocation" rather than "there *was* improper allocation." MAI produced documentation summarizing the

charges and credits to the account in question, which appear to show that over a period of 10 years, a net of less than $1400, or less than $140 per year that was placed into the account but not reversed. This would suggest that there was no intent to mislead or defraud. There was no response from the auditors to the specific argument of MAI that the great majority of improper charges to transportation were later reversed. If MAI is correct—and it's allegation is uncontested in the record—it is difficult to infer a fraudulent intent with respect to these particular charges to the transportation account.

The second issue in Finding No. 3 relates to the use of "post-it notes" found on expense reports of some employees. These are, understandably, of particular concern to the auditors. Auditors found 22 examples in Expense Report files of four different individuals. These Post-It Notes, according to the auditors, clearly indicated a direct project on which the employee in question was working, whereas the expense report to which the post-it note was attached indicated the project name as "Office." Follow-up by the auditors confirmed the specific projects on which the employees were working.

MAI's response and the testimony of Mr. Kosik (based in part on his conversations with the supervisor in question) indicate the rationale for the post-it notes was making sure clients who are not required to pay the direct transportation expenses are not billed for them. Counsel for the Department correctly points out that the effect of not charging this expense to the specific project to which it should have been charged effectively and improperly spreads the cost to other clients of MAI. This issue was addressed in Finding No. 2 above.

However, there are at least two significant differences in the facts in Finding No. 2 and the facts in this Finding. The amounts in question in this Finding are, at least in the examples attached to the Audit (which is the only evidence in the record on this issue), insignificant. Section 6.510 (d), in setting forth particular actions that indicate a lack of business integrity and honesty, "*making a material false statement, representation, claim or report. . . "*(emphasis added). [44 Ill. Adm. Code 6.510]. The actions cited do not, in my opinion, violate subsection (d) because they are not material. It is arguable that by effectively inflating the overhead, the action resulted in theft (for which there is no requirement of materiality), in violation of subsection (a) of Section 6.510. ("*Acts or omissions that indicate the lack of business integrity and honesty include but are not limited to. . . a) fraud, bribery, embezzlement, theft, collusion, conspiracy. . . .")* Coupled with the fact that auditors found the post-it notes on the expense reports of only four employees (according to MAI counsel, MAI has nearly 150 professional employees), and the four employees apparently report to the same "overzealous" supervisor, I do not believe it realistic to infer that the post-it notes constitute adequate evidence of an MAI policy enacted for the purpose of or with the result of inflating MAI's overhead. Finding No. 2 involved a clear policy of MAI. While the audit finding is undoubtedly correct, is it reasonable to charge the company with the actions of a few employees who were neither accountants nor held significant positions in the management of the company? That is not to say that the use of the post-it notes, or the reasons given for their use, are acceptable. Sometimes, however, misguided and sloppy recordkeeping is simply misguided and sloppy.

I recommend the Chief Procurement Officer find that Audit Finding No. 3 does not constitute adequate evidence that MAI lacks integrity and honesty in the conduct of business or the performance of contracts.

Finding No. 4: Direct Project Settlement Costs Included in Legal and Accounting Expenses.

The Department has established MAI included $490,000 in specific settlement costs which should have been attributed to two specific projects, to the "Legal and Accounting" overhead account. MAI explained its reasoning, citing to a DCAA Contract Auditing Manual. The Department countered with additional citations which appear to establish clearly that since the questioned settlement costs were identifiable to a specific contract, the entire award should be charged to that contract, and not to the indirect cost pool (i.e., overhead account).

I have noted in my initial discussion that an error in applying accounting principles does not—in and of itself—establish a lack of integrity and honesty. There must be an indication—either in the Exhibits or testimony, directly or by fair inference—that Respondent's actions were knowingly false or intended to deceive. Is there any such indication here?

44 Ill. Adm. Code 6.690 (b) of the governing regulations provides "(i)n assessing adequate evidence, consideration will be given to how much credible information is available, its reasonableness in view of surrounding circumstances, corroboration or lack thereof as to important allegations* * * *" MAI indicated in its response to the audit that it "believed our inclusion of these costs in the overhead was acceptable. . ." There is nothing in the statement or in the testimony of the witnesses that would indicate the statement lacks credibility, and in view of the complexity of the various provisions, MAI's treatment of the settlement expenses is not patently unreasonable. According to MAI CFO Kosik, MAI had put legal claims in overhead prior to the instances cited in this audit and IDOT never objected. More importantly, MAI also stated that ". . . the practice was endorsed by our outside accounting firm who reviewed our overhead submission."

Because MAI has presented a plausible (although incorrect) position to justify its allocation of the settlement costs to the overhead account, and predominantly in view of the position of MAI's outside accounting firm that the allocation was not objectionable, and in view of the fact that there is no evidence by which to determine or even infer a fraudulent intent, I recommend that the Chief Procurement Officer find that Audit Finding No. 4 does not constitute adequate evidence that MAI lacks integrity and honesty in the conduct of business or the performance of contracts"

Finding No. 5: "Post-it" Notes and False or Improper Charging or Recording of Costs indicate Material Weaknesses in MAI's Accounting Procedures and Controls and Raise Substantial Concerns Regarding Its Business Ethics"

Much of Finding No. 5 consists of a summary and restatement of Findings 1, 2 and 3. To the extent that Finding No. 5 is a summary of earlier issues, I will not re-address them.

There were two new issues in Finding No. 5. The first was the post-it notes found on the expense reports of one employee. The information on the post-it notes contradicted the information on the actual expense report. The second issue involves credit card receipts of Mr. James McDonough, which the auditors found had less information that necessary.

The auditors point out, and 3 IDOT Exhibits IY, IZ and IAA show, that the expense reports submitted by MAI employee Jim Easterly have attached thereto post-it notes which contradict the information which appears on the expense reports themselves. This is uncontradicted. Unfortunately, Mr. Easterly is deceased and therefore not able to explain his actions. CFO Kosik could not explain why the post-it notes were attached, nor why the information on the post-it notes contradicts the information on the expense reports.

Mr. Kosik did explain that Mr. Easterly was a former IDOT employee, who lived in Litchfield, Illinois. He did not have an MAI office, but worked from his home and typically met with clients in local restaurants. Mr. Kosik did an analysis of Mr. Easterly's expense account for 2008 and 2009 (Exhibit M19) The analysis shows the average cost of meals Mr. Easterly reported was in the range of $15 to $18 per person. The highest amount reflected on any of the expense reports was $44.

Since the facts regarding the Easterly expense reports are uncontradicted, the only question for determination is whether those facts constitute evidence that MAI lacks integrity and honesty in the conduct of business or the performance of contracts, as required by the regulations. Section 6.510 (d) of the regulations cite, as evidence that a contractor lacks integrity and honesty, "*making a material false statement, representation, claim or report . . . .*" [44 Ill. Adm. Code 6.510](Emphasis added). The figures in Exhibit M19 would indicate that the amounts involved in the Easterly expense reports are not "material." Thus, it cannot be said that the Easterly expense reports constitute a violation of Section 6.510(d) in terms of the dollars involved. However, if the Department's primary concern is with possible violation of ethics requirements for its employees, spending a very small amount could be considered "material." Was former IDOT employee Easterly misrepresenting the meal expenses to aid his former associates at IDOT to receive more "free lunches" than permitted by law? Whatever the motivation of Mr. Easterly, in view of the auditors statement that during the audit of fiscal years 2000 through 2007 they performed "an *extensive* review of MAI expenses associated with providing lunches, dinners, golf outings, Christmas luncheons, and professional baseball and basketball game excursions involving IDOT employees. . . (Audit, page 21) (Emphasis added) the types of violations that are apparent with the Easterly reports are obviously not part of a policy of MAI, and there is no evidence that the company management were aware of any falsification.

The other issue which first appears in Finding 5 relates to credit card slips of Mr. James McDonough. The audit states only that "MAI employee credit card billing statements now only indicated, for instance, that 'clients' were taken to Cubs games and food and beverage costs were incurred. Previously similar charges indicated the names, or at least the organization to which the clients worked." The audit does not allege, however, that there was any evidence of inaccurate, false or misleading information. While absence of additional information as to the exact nature

of the expense is important, the absence of any information at all cannot be said to be "adequate evidence" of wrongdoing.

I therefore recommend the Chief Procurement Officer find that Audit Finding No. 5 (apart from the portions repeated from Finding No. 2) does not constitute adequate evidence that MAI lacks integrity and honesty in the conduct of business or the performance of contracts"

PENALTY

I have recommended a finding of guilt based on the evidence produced with respect to Finding No. 2. Under the terms of the Procurement Code [30 ILCS 500/50-65] and regulations [44 Ill. Adm. Code 6.550] a contractor may be suspended for up to 10 years for such violation . Neither the Notice of Suspension nor the Department in the process of the hearing specified a recommended length for the suspension. The length of suspension is completely at the discretion of the Chief Procurement Officer, subject only to the admonition in Section 6.650 that it be commensurate with the seriousness of the cause or causes for the suspension. Additional guidance is found, however, in Section 6.500:

> In order to protect the public interest in the solicitation, execution and performance of contracts or subcontracts administered by the Department, it is the policy of the Department to conduct business only with contractors or subcontractors of responsible business integrity and honesty. Suspension is a discretionary action imposed in accordance with this Part to serve the public interest and to implement this policy. It may be imposed only for the causes and in accordance with the procedures set forth in this Subpart. [44 Ill. Adm. Code 6.500]

According to the regulation, suspension is (a) *discretionary*, (b) *to serve the public interest*, and (3) *to implement the policy to conduct business only with contractors of responsible business integrity and honesty*.

While there can be no doubt that the violation of which I have recommended MAI be found guilty is a serious matter, and must be penalized to "implement the policy to conduct business only with contractors of responsible business integrity and honesty" the penalty imposed should also "serve the public interest."

At the hearing, MAI produced Exhibit M 23, in which it sets forth its estimate of the impact of the Interim Suspension on MAI. According to the exhibit, the interim suspension has resulted in a loss of revenue of between $54.5 million and $58.5 million. In addition, at the hearing MAI President Feroz Nathani testified that the company was nearing bankrupty, and would likely go bankrupt in a matter of weeks if the suspension isn't lifted soon.

Taking the MAI exhibit and testimony at face value—and the Department has not suggested any disagreement with the MAI position—a lengthy suspension is tantamount to a

death sentence for McDonough Association, Inc. A death sentence for MAI will result in a number of results that would not, in my view, serve the public interest as required by Section 6.50 of the regulations. First, it would destroy a company that has a long history—and until the present an apparently unblemished history--of providing consulting services to IDOT and other state and local agencies in Illinois and beyond. That would result in less competition, which could adversely affect IDOT and other users of consulting services. It would also eliminate the jobs of over 150 employees—the vast majority of which had nothing to do with the actions that result in the penalty--in a job market in which it is obviously distressed. That would in turn affect the families of the displaced workers, and constitute a drag on the local economies of the cities and towns of the employees. Another serious result flowing from MAI's bankruptcy would be an adverse effect on the ability of IDOT and other state and local clients who have employed MAI to recoup improper payments made as a result of the inflated overhead charges. I do not believe imposition of a death sentence on MAI serves the public interest.

While Mr. Nathani has suggested that MAI could survive only for a very short time if the suspension is not lifted, I would suggest that a suspension with an end in the near future will permit MAI to adjust its business operations in such a way as to survive pending the lifting of a reasonable suspension.

In view of the need to enforce the Department's policy to conduct only with contractors of responsible business honesty and integrity, and to also serve the public interest, I recommend that MAI be suspended for a total of six months, beginning on the date of the original interim suspension.

CONCLUSION

After a thorough review of the testimony, exhibits and arguments of counsel, it is my recommendation that the Chief Procurement Officer find as follows:

1. McDonough Associates, Inc. (MAI) is a contractor which provides consulting services to the Illinois Department of Transportation, and as such is required to adhere to requirements found in the Illinois Procurement Code (30 ILCS 500/), the Illinois Administrative Code (44 Ill. Adm. Code 6.10 et seq.), Federal Acquisition Regulations, and other guidelines and pronouncements of the IDOT and governing accounting pronouncements.

2. IDOT auditors conducted an audit of the books and records of MAI for the period of 2000-2009, the results of which are set forth in Audit Report No. 11-22-001, dated July 22, 2011.

3. The audit makes a number of findings with regard to improper accounting entries and procedures, of which Findings No. 1 through 5 form the basis of the Notice of Interim Suspension and Action to Seek Suspension issued by IDOT Chief Procurement Bill Grunloh on January 12, 2012.

4. Pursuant to the request of MAI, a hearing was conducted by a duly appointed Hearing Officer on April 25 and April 26, 2012 to take testimony with regard to the charges alleged in the Notice of Interim Suspension and Action to Seek Suspension.

5. The allegations contained in Finding No. 2 of the IDOT audit, that MAI improperly allocated time to overhead accounts which should have been allocated to direct costs, have been established by adequate evidence.

6. As a result of the improper allocation of time to overhead, the amount of overhead was overstated, thus resulting in IDOT paying MAI more than it was required to pay under the applicable law and its contracts with MAI.

7. The actions of MAI as aforesaid constitute theft in violation of 44 Ill. Adm. Code 6.520 (a), and pursuant to 44 Ill. Adm. Code 6.520 indicate that MAI lacks integrity and honesty in the conduct of business or the performance of contracts.

8. The actions of MAI in submitting the inaccurate overhead amounts constitute making a material false statement, representation, claim or report, in violation of Section 6.520(d), and pursuant to 44 Ill. Adm. Code 6.520 indicate that MAI lacks integrity and honesty in the conduct of business or the performance of contracts.

9. The allegations contained in Findings No. 1, 3, 4 and 5 of the IDOT audit, while cause for concern. have not been established by adequate evidence.

10. The findings that MAI lacks integrity and honesty in the conduct of business or the performance of contracts, as set forth in paragraphs 7 and 8 subject MAI to suspension of up to ten years.

11. Suspension is a discretionary action imposed with the dual purpose to serve the public interest and to implement the Department policy to conduct business only with contractors or subcontractors of responsible business integrity and honesty.

12. As a result of the Interim Suspension imposed on January 12, 2012, MAI has lost roughly $50 million in revenues from contracts and projects from which is was disqualified because of the Interim Suspension, which is a significant penalty in and of itself.

13. While a significant suspension of MAI is appropriate in view of the seriousness of the violation for which I find it responsible, a suspension beyond 6 months in length is likely to result in the bankruptcy and dissolution of MAI.

14. The bankruptcy and dissolution of MAI would have serious adverse consequences not only on the owners of MAI, but more importantly on the employees of MAI, their families, as well as on the economies of the state and local communities in which they live, and possibly on the Department of Transportation and other governmental agencies which have used the services of MAI for many years.

15. It is not in the public interest to risk the adverse consequences which would likely flow from the dissolution of MAI by imposing a suspension that would force the company to go out of business.

16. In view of the seriousness of the charges for which I find MAI guilty, and keeping in mind the overriding regulatory policy set forth in 44 Ill. Adm. Code 6.500 to serve the public interest, I impose a suspension of six months, beginning on the date of the Interim Suspension.

As I assume it is not your intent to view the entire record in this matter, in accordance with the Illinois Administrative Procedure Act I am forwarding these recommendations to the parties advising them they have until Wednesday, May 23, 2012 to submit exceptions to my report. The parties requested a very short turn-around time for filing exceptions, and I will advise them to contact you directly if they desire additional time.

If I can be of any further assistance, please let me know.

Respectfully submitted.

Thomas R. Wetzler
Hearing Officer

May 18, 2012