



NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

MBA PROFESSIONAL PROJECT

AN ANALYSIS OF THE TAIWAN NAVY MINEHUNTER PROCUREMENT FRAUD CASE

June 2019

By: Hui-Fen Huang

Advisor: Rene G. Rendon
Co-Advisor: Juanita M. Rendon

Approved for public release. Distribution is unlimited.

THIS PAGE INTENTIONALLY LEFT BLANK

REPORT DOCUMENTATION PAGE			<i>Form Approved OMB No. 0704-0188</i>	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington, DC 20503.				
1. AGENCY USE ONLY (Leave blank)		2. REPORT DATE June 2019	3. REPORT TYPE AND DATES COVERED MBA Professional Project	
4. TITLE AND SUBTITLE AN ANALYSIS OF THE TAIWAN NAVY MINEHUNTER PROCUREMENT FRAUD CASE			5. FUNDING NUMBERS	
6. AUTHOR(S) Hui-Fen Huang				
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Naval Postgraduate School Monterey, CA 93943-5000			8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING / MONITORING AGENCY NAME(S) AND ADDRESS(ES) N/A			10. SPONSORING / MONITORING AGENCY REPORT NUMBER	
11. SUPPLEMENTARY NOTES The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.				
12a. DISTRIBUTION / AVAILABILITY STATEMENT Approved for public release. Distribution is unlimited.			12b. DISTRIBUTION CODE A	
13. ABSTRACT (maximum 200 words) This thesis analyzes the alleged fraud and non-fraud incidents related to the Taiwan Navy (ROCN) minehunter procurement fraud case through the lens of auditability theory. In 2014, the Ching-Fu Shipbuilding Company was awarded a US \$1.85 billion contract from the Taiwan Navy to build six minehunters; but, due to Ching-Fu's loan syndication scandal and contract breach, the Taiwan Navy terminated the contract. This procurement failure hindered Taiwan's indigenous defense shipbuilding goal and damaged the national interest. In this thesis, a three-part matrix was created to describe the alleged incidents of Taiwan Ministry of National Defense (MND), First Bank, and Ching-Fu's fraudulent loan activities. The alleged incidents detailed in the investigation report and publicly available resources are aligned with contract management processes, internal control components, and procurement fraud schemes to identify the vulnerable areas. The research findings indicate that the source selection and contract administration phases were the most vulnerable areas. In addition, the control activities component was found to be the most vulnerable internal control component. Furthermore, the four procurement fraud schemes found in this case included a fraudulent financial capital increase, a shell company creation, fraudulent representation, and money laundering. Based on these findings, recommendations are provided to improve the Taiwan military procurement process going forward.				
14. SUBJECT TERMS Taiwan Navy minehunter procurement fraud case, shell company, money laundering, contract processes, contract management, internal control, syndicated loan			15. NUMBER OF PAGES 97	
			16. PRICE CODE	
17. SECURITY CLASSIFICATION OF REPORT Unclassified	18. SECURITY CLASSIFICATION OF THIS PAGE Unclassified	19. SECURITY CLASSIFICATION OF ABSTRACT Unclassified	20. LIMITATION OF ABSTRACT UU	

THIS PAGE INTENTIONALLY LEFT BLANK

Approved for public release. Distribution is unlimited.

**AN ANALYSIS OF THE TAIWAN NAVY MINEHUNTER PROCUREMENT
FRAUD CASE**

Hui-Fen Huang, Lieutenant, Taiwan Republic of China Navy

Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION

from the

**NAVAL POSTGRADUATE SCHOOL
June 2019**

Approved by: Rene G. Rendon
Advisor

Juanita M. Rendon
Co-Advisor

Rene G. Rendon
Academic Associate, Graduate School of Business and Public Policy

THIS PAGE INTENTIONALLY LEFT BLANK

AN ANALYSIS OF THE TAIWAN NAVY MINEHUNTER PROCUREMENT FRAUD CASE

ABSTRACT

This thesis analyzes the alleged fraud and non-fraud incidents related to the Taiwan Navy (ROCN) minehunter procurement fraud case through the lens of auditability theory. In 2014, the Ching-Fu Shipbuilding Company was awarded a US \$1.85 billion contract from the Taiwan Navy to build six minehunters; but, due to Ching-Fu's loan syndication scandal and contract breach, the Taiwan Navy terminated the contract. This procurement failure hindered Taiwan's indigenous defense shipbuilding goal and damaged the national interest. In this thesis, a three-part matrix was created to describe the alleged incidents of Taiwan Ministry of National Defense (MND), First Bank, and Ching-Fu's fraudulent loan activities. The alleged incidents detailed in the investigation report and publicly available resources are aligned with contract management processes, internal control components, and procurement fraud schemes to identify the vulnerable areas. The research findings indicate that the source selection and contract administration phases were the most vulnerable areas. In addition, the control activities component was found to be the most vulnerable internal control component. Furthermore, the four procurement fraud schemes found in this case included a fraudulent financial capital increase, a shell company creation, fraudulent representation, and money laundering. Based on these findings, recommendations are provided to improve the Taiwan military procurement process going forward.

THIS PAGE INTENTIONALLY LEFT BLANK

TABLE OF CONTENTS

I.	INTRODUCTION.....	1
A.	BACKGROUND	1
B.	PURPOSE OF RESEARCH	1
C.	RESEARCH QUESTIONS	2
D.	METHODOLOGY	2
E.	IMPORTANCE OF THIS RESEARCH	2
F.	LIMITATIONS OF RESEARCH	3
G.	ORGANIZATION OF THE REPORT.....	4
H.	SUMMARY	4
II.	LITERATURE REVIEW	5
A.	INTRODUCTION.....	5
B.	AUDITABILITY THEORY	5
	1. Competent Personnel.....	6
	2. Capable Processes	7
	3. Effective Internal Controls	7
C.	CONTRACT MANAGEMENT FRAMEWORK	8
	1. Procurement Planning.....	9
	2. Solicitation Planning	9
	3. Solicitation	10
	4. Source Selection	11
	5. Contract Administration	11
	6. Contract Closeout and Termination	12
D.	INTERNAL CONTROL INTEGRATED FRAMEWORK	13
	1. Control Environment.....	14
	2. Risk Assessment	14
	3. Control Activities	14
	4. Information and Communication	15
	5. Monitoring Activities	15
	6. COSO Principles.....	15
E.	PROCUREMENT FRAUD SCHEMES	16
	1. Collusion.....	16
	2. Conflict of Interest	17
	3. Bid Rigging.....	17
	4. Billing, Cost, and Pricing Schemes.....	17
	5. Fraudulent Purchases.....	18
	6. Fraudulent Representations	18

F.	SUMMARY.....	19
III.	TAIWAN NAVY MINEHUNTER PROCUREMENT CASE HISTORY	21
A.	INTRODUCTION.....	21
B.	PRE-AWARD PHASE	21
1.	Procurement Planning.....	21
2.	Solicitation Planning.....	22
3.	Solicitation	22
C.	AWARD PHASE.....	23
D.	POST-AWARD PHASE.....	23
1.	Contract Administration	23
2.	Contract Termination.....	25
E.	SUMMARY	28
IV.	METHODOLOGY	29
A.	INTRODUCTION.....	29
B.	DEVELOPMENT OF THE TAIWAN NAVY PROCUREMENT FRAUD MATRIX.....	29
1.	Sources	30
2.	Search Terms.....	30
3.	Alignment to Frameworks and Fraud Schemes.....	31
C.	SUMMARY	31
V.	FINDINGS, ANALYSIS, AND RECOMMENDATIONS	33
A.	INTRODUCTION.....	33
B.	FINDINGS AND ANALYSIS	33
1.	Contract Management Processes.....	34
2.	Internal Controls	42
C.	IMPLICATIONS OF FINDINGS	51
1.	Contract Management Processes.....	51
2.	Internal Control Components.....	52
3.	Procurement Fraud Schemes.....	54
D.	RECOMMENDATIONS BASED ON RESEARCH FINDINGS.....	54
1.	Build the Taiwan Military Procurement Source Selection Procedures	55
2.	Build the Capability to Audit Offerors' and Contractors' Finances and Accounting Systems.....	55
3.	Improve and Enhance Control Activities	55
4.	Establish the Joint Supervision Mechanism between MND and Banks.....	56

5.	Establish Military Contracting Personnel Training.....	56
E.	SUMMARY	57
VI.	SUMMARY, CONCLUSIONS, AND AREAS FOR FURTHER RESEARCH	59
A.	SUMMARY	59
B.	CONCLUSIONS	60
C.	AREAS FOR FURTHER RESEARCH.....	61
APPENDIX A. ALLEGED FRAUD AND NON-FRAUD INCIDENTS ASSOCIATED WITH MND IN THE MINEHUNTER PROCUREMENT CASE		63
APPENDIX B. ALLEGED INCIDENTS ASSOCIATED WITH FIRST BANK IN THE MINEHUNTER PROCUREMENT CASE		67
APPENDIX C. PROCUREMENT FRAUD SCHEMES ASSOCIATED WITH CHING-FU		71
LIST OF REFERENCES		73
INITIAL DISTRIBUTION LIST		77

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF FIGURES

Figure 1.	Auditability Triangle. Source: Rendon and Rendon (2015).	6
Figure 2.	Contract Management Process. Source: Garrett (2007).	9
Figure 3.	Relationship of Objectives and Components. Source: COSO (2013).	13
Figure 4.	COSO's 17 Fundamental Principles. Adapted from COSO (2013).	16
Figure 5.	Procurement Fraud Matrix. Source: Rendon and Rendon (2015)	19
Figure 6.	Alleged Incidents Percentage in the Contract Management Process.....	52
Figure 7.	Alleged Incidents by Percentage in Internal Control Components.....	53

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF TABLES

Table 1.	Ching-Fu Money Laundering through Overseas Bank Accounts. Adapted from Taiwan Executive Yuan (2017).....	41
Table 2.	Number of Alleged Incidents and Responsible Entity by Contract Management Phases.....	52
Table 3.	Number of Alleged Incidents and Responsible Entity by Internal Control Component.....	53
Table 4.	Relevant Procurement Fraud Schemes and Their Descriptions.....	54

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF ACRONYMS AND ABBREVIATIONS

AT&L	Acquisition, Technology and Logistics
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CSBC	China Shipbuilding Corporation
DoD	U.S. Department of Defense
DoD IG	Department of Defense Inspector General
FAR	Federal Acquisition Regulation
FMS	Foreign Military Sales
FSC	Financial Supervisory Commission
GAO	Government Accountability Office
GSA OIG	General Services Administration Office of Inspector General
HTRO	Highest Technically Rated Offeror
IFB	Invitation for Bids
IFN	Invitation for Negotiation
ITB	Invitation to Bid
LPTA	Lowest Price Technically Acceptable
MND	Ministry of National Defense (Taiwan)
NCMA	National Contract Management Association
OGE	Office of Government Ethics
PCC	Public Construction Commission
PRC	People's Republic of China
RFP	Request for Proposal
RFQ	Request for Quote
RFT	Request for Tenders
SSA	Source Selection Authority
SSAC	Source Selection Advisory Council
SSEB	Source Selection Evaluation Board
SSP	Source Selection Procedures
USAID	U.S. Agency for International Development

THIS PAGE INTENTIONALLY LEFT BLANK

ACKNOWLEDGMENTS

First, I would like to thank my advisors, Dr. Rene G. Rendon and Dr. Juanita M. Rendon, for their guidance, patience, and support. They make the impossible possible. Next, I would like to thank the Republic of China (Taiwan) Navy, for this priceless opportunity to pursue an MBA degree at the Naval Postgraduate School. Finally, I appreciate all the prayers from my fiancé and my church brothers and sisters.

THIS PAGE INTENTIONALLY LEFT BLANK

I. INTRODUCTION

A. BACKGROUND

The Republic of China (Taiwan) has procured defensive weapons from the United States for many years (Kan, 2014) to build domestic defense industry capabilities and to reach national defense self-sufficiency. Following domestic shipbuilding policy, the Taiwan Ministry of National Defense (MND) sought to build six minehunters, which are the naval vessels that detect, identify, and destroy individual naval mines (Global Security, 2019). In 2014, Ching-Fu Shipbuilding Company was awarded the US\$1.185 billion contract from the Taiwan Navy to build six minehunters as part of Taiwan's indigenous shipbuilding and upgrade program (Minnick, 2016). Due to Ching-Fu's loan syndication scandal and contract breach, however, the Taiwan Navy eventually terminated the contract with Ching-Fu on December 13, 2017. This procurement failure has not only hindered the ambition of Taiwan's indigenous defense shipbuilding goal but also damages the national interest (Taipei AFP, 2018). The Taiwan Executive Yuan, which is the executive branch of the Taiwan government, established a task force to investigate the Taiwan Navy minehunter procurement process, credit check problems from the loan syndication banks, fraudulent loan applications, and illegal money transfers by Ching-Fu (Huang & Peng, 2017). The investigation report identifies 25 alleged fraud and non-fraud incidents relating to the MND in the procurement process and the fraudulent loan applications to multiple banks (Taiwan Executive Yuan, 2017). This research study reviews the Taiwan Navy minehunter procurement case by using auditability theory, as a model allowing Taiwan to identify problems in the areas of contract management, personnel competency, and internal controls.

B. PURPOSE OF RESEARCH

The purpose of this research is to analyze the Taiwan Navy minehunter procurement case by using auditability theory, to align the alleged incidents listed in the investigation report of the Executive Yuan on the Taiwan Navy minehunter procurement case to the contract management framework, internal control components, and fraud

schemes. The findings of this research provide recommendations for improving the contract workforce, processes, and internal control capabilities in Taiwan procurement operations.

C. RESEARCH QUESTIONS

This research addresses the following research questions:

1. In which contracting processes did the alleged fraud and non-fraud incidents occur in the Taiwan Navy minehunter procurement case?
2. What internal controls were deficient that allowed the alleged fraud and non-fraud incidents to occur in the Taiwan Navy minehunter procurement case?
3. What were the alleged procurement fraud schemes that happened in the Taiwan Navy minehunter procurement case?

D. METHODOLOGY

This research study analyzes the Taiwan Navy minehunter procurement case by using the auditability theory, contract management process, internal control frameworks, and procurement fraud schemes. First, this research examines alleged fraud and non-fraud incidents to identify in which contract management phase the alleged incidents appeared. Second, the analysis examines which internal control component(s) had vulnerabilities enabling the alleged incidents to occur. Finally, this research classifies the alleged incidents according to the related procurement fraud schemes. This methodology creates a matrix from a database based on the investigation report of the Executive Yuan on the Taiwan Navy minehunter procurement case, news released by government institutes and the media, court documents, and publicly available criminal indictments related to the minehunter procurement case.

E. IMPORTANCE OF THIS RESEARCH

The Taiwan Navy minehunter procurement case is an important procurement case relevant to developing indigenous defense industry capabilities and enhancing national

defense self-sufficiency. As the research highlights, the failure of this case hurts public confidence in the Taiwan Navy's administration capability in indigenous shipbuilding. Because this analysis is based on a real contract fraud case, it provides findings that reveal the issues related to current contracting personnel, contract processes, and internal controls in the Taiwan Navy. Thus, this research study is meaningful for Taiwan MND to recognize the vulnerabilities and seek solutions based on auditability theory and suggests improvement methods for Taiwan Navy leadership to adopt not only to help prevent fraud, but also to enhance the future procurement operation capability.

F. LIMITATIONS OF RESEARCH

There are a few limitations in this research study. One of the limitations is the lack of publicly available documents related to this particular procurement case for analysis. The investigation report of the Executive Yuan on the Taiwan Navy minehunter procurement case was the primary document available publicly. One other limitation has to do with the subjectivity of the alignment of each alleged fraud and non-fraud incident to a contract management phase and to an internal control component. The allegations of fraud criminal indictments and court documents related to the Taiwan Navy minehunter procurement case were found on the Taiwan Ministry of Justice website, as of April 30, 2019. Both administrative and criminal investigations are now finished. Although this case is a significant procurement case with a high contract price, according to the criminal investigation results, the alleged incidents of the MND and the syndication loan management bank (First Bank) are not under the criminal domain. As of the date of this report, only five members of Ching-Fu Company have been indicted, and the trials are currently ongoing (Hsieh & Chin, 2019).

Another limitation is that the Taiwan Navy minehunter procurement processes, which are summarized from the Investigation Report of the Executive Yuan on the case, and the court documents, are different from the U.S. procurement processes and regulations. This research focuses on the analysis of the alleged incidents documented in the Executive Yuan's investigation report, rather than on the Taiwan procurement processes and regulations per se.

G. ORGANIZATION OF THE REPORT

This report includes six chapters, starting with this introduction chapter. Chapter II is the literature review, which provides a foundational knowledge to analyze the Taiwan Navy minehunter procurement case. The relevant literature review topics are auditability theory, the contract management process, internal controls, and the fraud schemes. Chapter III provides the history of the Taiwan Navy performing the minehunter procurement operations and the process by which Ching-Fu Company increased its financial capital and received syndicated loans received. Chapter IV reviews the methodology for this research study. Chapter V provides the findings of this research, analysis, and the implications of the findings and recommendations based on the results. Chapter VI presents a research summary, conclusions, and areas for further research.

H. SUMMARY

This chapter provided a brief introduction to the Taiwan Navy minehunter procurement case. It covered the purpose of analyzing the minehunter procurement case to provide recommendations that might improve the auditability of the Taiwan Navy's procurement contracting processes. Next, the research questions that are the focus of this study were outlined. The methodology, importance, and limitations of the research were also addressed. The last part of this chapter discussed the organization of the report. The next chapter is the literature review, which covers the background for the Taiwan Navy minehunter procurement case, including the alleged incidents that occurred and caused the termination of the contract and the loss of money from bank loan syndication. Chapter II also offers an overview of auditability theory, contract management processes, internal control components, and fraud schemes.

II. LITERATURE REVIEW

A. INTRODUCTION

This chapter first reviews auditability theory that includes the competency of personnel, capable contract processes, and internal controls. Next, the chapter expands on the six phases of the contract management framework. A discussion about the internal control integrated framework, originally introduced by Committee of Sponsoring Organizations of the Treadway Commission (COSO) and then adopted by the U.S. Federal Government, including the five components of an internal control system, is provided. The last section covers procurement fraud schemes and the most common contract frauds.

B. AUDITABILITY THEORY

Nowadays, both public and private organizations are getting more attention for their efforts to strengthen their procedures and performance. Organizations focus in particular on auditability to deal with this situation in business operations. Auditability is more focused on “making things auditable” than on the actual performance of an audit or examination (Power, 1996, p. 289). To make things auditable, entities need to create a systematic management control method to support their efforts on the procedures and performance of the organization. The process to achieve auditability is about organizations creating auditable records and having proper documentation (Power, 2007). Rendon and Rendon (2015) state that for an organization to be auditable, it needs to have competent personnel, capable processes, and efficient internal controls. The relationship between these components is depicted in Figure 1.

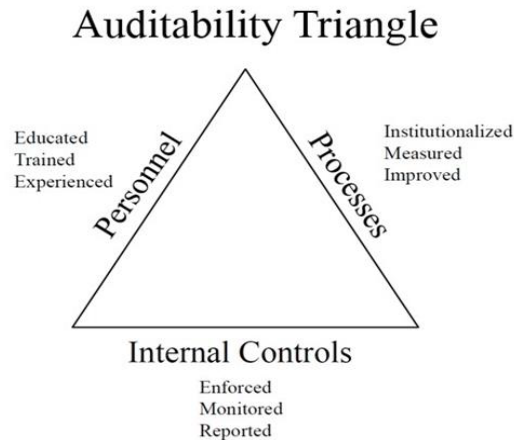


Figure 1. Auditability Triangle. Source: Rendon and Rendon (2015).

Different entities can apply the auditability theory to their organizations. Regarding an organization's contract administration control structure, Rendon and Rendon (2016) state that an organization can utilize the auditability theory. As organizations increase outsourcing to obtain the required supplies and services, they also need proficient processes, higher quality personnel, and effective internal controls. There is more and more research that supports the impact of entities' incorporation of a governance structure and how the structure influences contract success.

1. Competent Personnel

Competent personnel is one of the three components of the auditability triangle. Rendon and Rendon (2015) define competent personnel as those people that have the education, training, and experience requirements for different operational fields. Among those personnel, according to Rendon and Rendon (2015), contracting officials play an essential role in the procurement process. They are the first line of defense to identify and report fraudulent activities. To effectively prevent procurement fraud, contract personnel must understand contract procedures and internal controls. Based on the experience of the U.S. Department of Defense (DoD) contract actions, Rendon and Rendon (2015) report that personnel capabilities have a significant impact on the execution of procurement contracts.

Both the Government Accountability Office (GAO) and the DoD Inspector General (DoDIG) have reported problems in procurement. GAO has identified some issues in DoD contract management, particularly insufficient well-trained contract personnel and the inappropriate methods of contract management (GAO, 2013). Further, the DoDIG has identified many issues in the contract management process and weaknesses in contract management internal controls within the Department's procurement process (DoDIG, 2009; DoDIG, 2014). Insufficient well-trained personnel, less capable processes, and ineffective internal controls have led the DoD to be vulnerable to procurement fraud (Rendon & Rendon, 2015).

2. Capable Processes

Capable processes is the second component of the auditability triangle. Rendon and Rendon (2016) note that the capable process component includes the contract management processes and contract actions conducted by the contract personnel. Competent personnel need appropriate regulations and processes to follow to achieve the organization's procurement goals. The Federal Acquisition Regulations (FAR) 2.101 states, "Acquisition planning means the process by which the efforts of all personnel responsible for an acquisition are coordinated and integrated through a comprehensive plan for fulfilling the agency need in a timely manner and at a reasonable cost" (Definition of Words and Terms, 2016).

The process of DoD contract management and activities performed by the contracting workforce are within the auditability process component. Contracting process has three phases, such as contract life cycle, pre-award, award, and post-award (Rendon & Snider, 2008). The capability of the contract management process is evaluated by the quality of systematic processes, integration ability with other organization processes, and constant improvement (Rendon, 2008).

3. Effective Internal Controls

An effective internal control system is the third component of the auditability triangle. Rendon and Rendon (2016) state that internal controls are established using the internal control components set up by the Internal Control Integrated Framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2013). The U.S. federal

government has implemented the COSO internal control components (GAO, 2014). Implementing appropriate internal controls is a crucial factor to support the organization's mission and program objectives. Adequate internal controls also facilitate management's ability to respond to the constantly changing environments, requirements, and priorities. Organizations improve business processes and implement new technology developments according to corresponding plan changes. Management must continually assess the outcome of internal controls to ensure that these activities remain active and continuously updated (GAO, 1999; GAO, 2014). The following section discusses the contract management framework.

C. CONTRACT MANAGEMENT FRAMEWORK

The Contract Management Body of Knowledge describes contract management as the actions performed by a contract manager in the contract life cycle, which is comprised of three phases: pre-award, award, and post-award (NCMA, 2017). The contract life cycle phase begins with procurement planning followed by solicitation planning, solicitation, source selection, contract administration, and contract closeout. Figure 2 outlines the six phases of the contract management process (Garrett, 2007). Rendon and Snider (2008) state that government organizations can use these phases to acquire services and goods, acting fairly and with transparency. In addition, these processes also help government organizations plan and execute procurement strategically, as well as maintain the prescribed budget and meet the user's requirement while ensuring the contractors are acting in compliance with contract terms (Rendon & Snider, 2008).



Figure 2. Contract Management Process. Source: Garrett (2007).

1. Procurement Planning

Procurement planning involves determining the requirements of a contract for external goods and services (Garrett, 2007). It includes “deciding whether to purchase, how to purchase, what to buy, how much to purchase, and when to purchase” (p. 81). Garrett states organizations use tools and techniques that include outsourcing analysis, expert judgment, contract type selection, risk management process, and contract terms and conditions to make decisions to create a procurement plan (Garrett, 2007). Procurement planning is comprised of scope statement, product description, procurement resource, market conditions, other planning output, constraints, and assumptions. After procurement planning, the results will be incorporated into different plans such as the procurement management plan and the statement of work (Garrett, 2007).

2. Solicitation Planning

Solicitation planning is the step in which procurement personnel apply the procurement management plan or statements of work. The standard forms and expert judgment are utilized to build procurement documents, evaluation criteria, and updated statements of work. The output of solicitation planning are the procurement documents such as the request for proposals (RFP), request for quotations (RFQ), request for tenders (RFT), invitation to bid (ITB), invitation for bids (IFB), and an invitation for negotiation (IFN) (Garrett, 2007).

3. Solicitation

Solicitation involves seeking proposals from the industry to meet its requirements. The government can solicit in several ways depending on the tendering procedures (NCMA, 2017).

The RFP is for the solicitation under negotiated procedures. By contrast, the IFB is for sealed-bid procedures. Solicitations consist of a draft contract and provisions for offerors to prepare and submit offers (NCMA, 2017). Based on the estimated amount of the solicitation, it can be advertised verbally, physically, or electronically on websites. While many solicitations are posted, it is important that government buyers publish good quality solicitation documents to make sure the procurement process will be accomplished. Garrett (2007) points out, “Better solicitations from the buyer generally result in having better bids, quotes, proposals, or tenders submitted by the seller in a timely manner. Poorly communicated solicitations often result in delays, confusion, fewer bids or proposals, and lower-quality responses” (p. 24).

Solicitation documents such as open tendering or tendering information can be posted on the Internet electronically. Promoting procurement opportunities electronically on relevant government websites is beneficial for the government as well as potential contractors. The potential supplier gains more access to government opportunities when they are posted electronically. This method of advertisement also increases open competition, which can result in lower contract prices and better quality responses from vendors. In the limited competition process, only one or limited suppliers are exempted from open competition. Further, to improve the responses of potential offerors, some government organizations may release a draft solicitation document in public for potential offerors to preview and convene a pre-proposal conference to clarify the solicitation process before releasing the final solicitation document. The pre-proposal conferences focus on explaining the complex requirements of procurement objectives to prospective offerors, seeking new sources for some limited competition cases, answering any questions or issues of the supplier, or publishing some changes in the conference before the final solicitation documents are released (Rendon & Snider, 2008).

4. Source Selection

Source selection is the process of analyzing the submitted offers based on the solicitation criteria and procurement method to decide on the source with the highest added value and mitigate the buyer's risk by selecting the offeror who is most likely to perform the contract satisfactorily (NCMA, 2017). The concept of the Federal Acquisition System is to provide customers with the most valuable products or services as scheduled, to make sure the public trust is maintained, and to ensure that the policy objectives are achieved (Statement of Guiding Principles for the Federal Acquisition System, 2017). There are several contract award methods available for an organization to obtain the best value such as lowest price technically acceptable (LPTA), the highest technically rated offeror (HTRO), or most economically advantageous offer (tradeoff). FAR 15.101-1 further states that when an organization's best value is to obtain the technically acceptable proposal with the lowest price, LPTA is the award method used (Tradeoff Process, 2017). The tradeoff process is the award method used for an organization to seek the best interest between the lowest priced offeror and the highest technically rated offeror.

The source selection is performed by the source selection organization, which is made up of the Source Selection Authority (SSA), Source Selection Evaluation Board (SSEB), Source Selection Advisory Council (SSAC), and other advisors (Under Secretary of Defense (AT&L), 2011). The SSA is the person who makes the best value decision or makes the decision on who gets the contract. The SSA also ensures that the entire selection process adheres to all evaluation regulations. The SSEB consists of a chairperson and several technical evaluators who are responsible for reviewing and evaluating proposals based on the different categories of evaluation criteria outlined in the RFP. The SSAC's function is to do a competitive analysis based on evaluation results from the SSEB and provide advice to the SSA (NCMA, 2017).

5. Contract Administration

Contract administration is the process by which the organization oversees and makes sure that both buyers and sellers act under contract requirements. Contract administration can be adjusted based on the complexity of the contract and the organization

scale. The contract manager should understand the contract terms and conditions to facilitate the communication between the buyer and seller. The seven essential tasks for post-award contract administration include stakeholder communication, contract kick-off meeting, status review meeting, status report, monitoring of contract performance, contract document, feedback, and issue resolution (NCMA, 2017).

Similarly, Garrett (2007) argues that the critical contract administration actions are monitoring of compliance with terms and conditions, applying useful communication and control, managing contract changes, invoicing and payment, and settling claims and disputes. The principle objectives for contract administration are the same for the buyer and the seller (Garrett, 2007).

6. Contract Closeout and Termination

Contract closeout is the last phase of the contract management process. A contract is considered closed out when all contract performance has been accomplished and final payment has been paid and reconciled (NCMA, 2017). The contract closeout procedure depends on the magnitude and complexity of the contract. Normally it will be a direct process for a simple and low dollar value contract, but for a large and complicated contract, the process to close out the contract properly is much more complex; so the contracting officer needs to make sure that all required steps in this process are completed. Contract closeout starts when the contract administration office receives substantial verification for the performance completion of a contract (Garrett, 2009).

Contract termination is an action taken by federal government contracting officers to end all or part of the work. It can be a “termination for convenience,” or a “termination for default.” In a termination for convenience in federal government contracting, the government always has the unilateral right to terminate a contract for convenience, when the contractor no longer serves the best interests of the government. Termination for default is when the contractor has defaulted on the requirement of the contract or when the contractor is not meeting cost, schedule, and performance requirements. When the contractor is not performing in accordance with the contract, the government can terminate

the contractor for default (NCMA, 2017). The following section discusses the internal control integrated framework.

D. INTERNAL CONTROL INTEGRATED FRAMEWORK

The Committee of Sponsoring Organizations released the guidance for internal control and outlines the purpose not only for the management level, but for all levels of an organization. COSO states that an internal control system is a process that is created and implemented by the board of directors, management level, and other personnel to ensure that the related operations, reporting, and compliance are capable to achieve the organization’s objectives (Committee of Sponsoring Organizations of the Treadway Commission [COSO], 2013). To respond to the changing environment, the government incorporated COSO’s framework as a standard and published the GAO Green Book “Standards for Internal Control in the Federal Government” (GAO 2014).

The five components of an internal control system include the control environment, risk assessment, control activities, information and communication, and monitoring activities. The five components are depicted in Figure 3. These components will be further detailed in the next section.

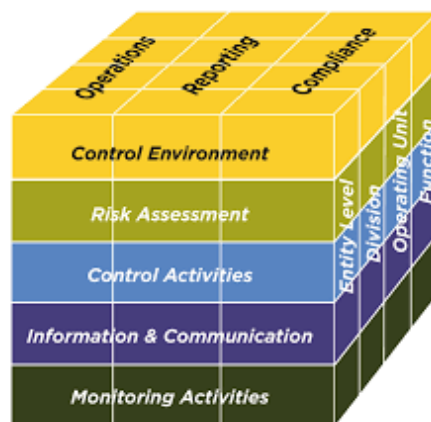


Figure 3. Relationship of Objectives and Components.
Source: COSO (2013).

1. Control Environment

The control environment is the first component of the COSO internal control framework. (COSO, 2013) The executive level sets the culture and tone that value internal controls. The control environment has many aspects including ethics, values, and capability of the personnel of the organization. In addition, the control environment addresses the leadership philosophy and style of the management of the organization.

2. Risk Assessment

The risk assessment is the second component of the COSO internal control framework (COSO, 2013). Organizations must understand the risks they are facing and try to deal with the identified risks. Each organization will face multiple risks both internally and externally, so management should decide the risk level they are willing to take and conduct risk management to keep the risks under a certain level of control (COSO, 2013). The GAO report summarized a proper response to risk as acceptance, avoidance, reduction, and sharing (GAO 2014). Rendon and Rendon (2015) state “weak internal controls, poor leadership, poor accountability, and lack of transparency nurture the opportunity for fraud in an organization” (p. 717). To enhance the organization’s operational capability, an organization should conduct a risk assessment throughout the organization and establish the mechanism to identify and analyze any related risks (COSO, 2013).

3. Control Activities

Control activities is the third component of the COSO internal control framework (COSO, 2013). Organizations must create and implement principles and procedures to make sure that their objectives are met, and actions must be taken to identify and address risks. For any identified risks, the control activities are mandatory regulations that require the employees to perform and implement specified policies and procedures. GAO (2014) observes that when a higher level is performing control activities on operational processes consistently, the effective control activities will support organizations to prevent or detect fraud events.

Moreover, Gramling, Hermanson, Hermanson, and Ye (2010) state separation of duties is one of the basic elements of useful internal controls. A work process is divided into

different stages and assigned to several people. Therefore, no one can use the situation to seek personal benefit or to conduct the improper behaviors.

4. Information and Communication

The information and communication system is the fourth component of the COSO internal control framework (COSO, 2013). The information and communication system includes the control activities that help employees in an entity communicate as needed in the organization (COSO, 2013). Organizations need to use effective communications properly to disseminate the pertinent information to the appropriate receivers on time, so they can successfully perform their duties and responsibilities. Information and communication also includes the entities' accounting systems (GAO, 2001).

5. Monitoring Activities

The monitoring activities is the fifth component of the COSO internal control framework (COSO, 2013). Monitoring includes activities that track the continuous change of procedure to ensure the internal controls are working properly. Continuous monitoring procedures should be integrated into an organization's daily operations to see if the internal control system is effective (COSO, 2013). GAO (2001) encourages an organization to meet with employees to show the outcome of internal controls. An independent evaluation would be advantageous to avoid bias or conspiracy. Independent assessments should be made when the company has an organizational change of top management and inspections.

6. COSO Principles

COSO expects a broad range of industries and legal entities to apply internal controls. Effective internal controls require five major components, as well as the 17 corresponding principles. Those principles should be considered and implemented at the same time. In addition, the risk management of anti-fraud will be strengthened (COSO, 2013). Figure 4 shows the five components, along with the 17 principles (COSO, 2013, p. 3).

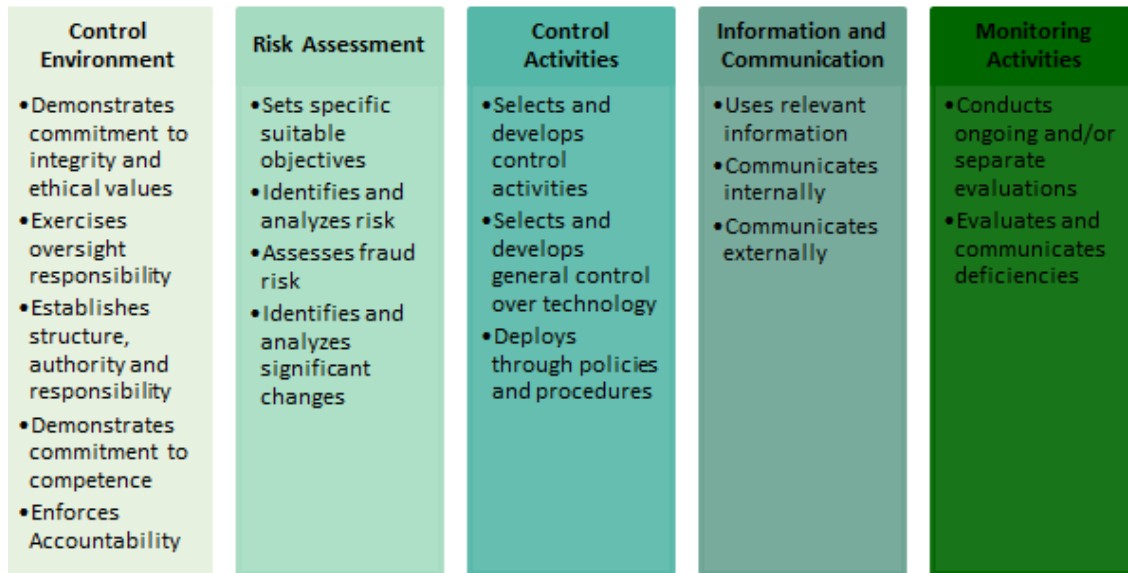


Figure 4. COSO's 17 Fundamental Principles.
Adapted from COSO (2013).

E. PROCUREMENT FRAUD SCHEMES

Black's Law Dictionary (1979) defines fraud as a variety of means designed by human beings with clever intelligence, using wrong advice or covering up the truth to gain an advantage. Fraud includes all unfair ways to cheat, such as surprises, tricks, blackmail, or fabrication. Wells (2001) recounts how Cressey interviewed over 200 imprisoned fraudsters, and recognized that pressure, opportunity, and rationalization comprised the three major characteristics for fraudsters. Cressey concluded that when the three characteristics are presented at the same time, the affected organization is predisposed to fraud by a person with these characteristics (Wells, 2001). Rendon and Rendon (2015) state that fraud within government procurement can be categorized into six types including "collusion, conflict of interest, bid rigging, billing, cost, and pricing schemes, fraudulent purchases, and fraudulent representations" (p. 9).

1. Collusion

Black's Law Dictionary (2004) defines collusion as "an agreement to defraud another or to do or obtain something forbidden by law" (p. 281). Wells (2005) defines collusion as employees collectively conspiring and breaching internal control systems to gain their private

benefits in an organization. Collusion includes distorting hours worked, receiving kickbacks, and setting up shell companies, which are fake companies. When a superior colludes with staff to forge hourly pay for a kickback, this behavior is called forgery of hours (Wells, 2005).

2. Conflict of Interest

According to *Black's Law Dictionary* (2004) conflict of interest is “a real or seeming incompatibility between one’s private interests and one’s public or fiduciary duties” (p. 319). Wells (2005) describes conflict of interest as when all levels of employees and their associates who perform their duties in the organization, directly or indirectly, obtain private benefits because of their actions or omissions. In procurement, if a member of the source selection team has a conflict of interest and the conflict is not resolved before the process begins, such conflicts, whether actual or potential, may affect the judgment of government officials in the source evaluation and selection process (U.S. Office of Government Ethics [OGE], 2007).

3. Bid Rigging

Bid rigging is an event that bypasses the government standard bidding process that legally represents government requirements and requests tenders from bidders. Bid rigging is the most vulnerable area in the procurement process because any member involved in the procurement case can violate the process (Vona, 2011). Wells (2005) describes bid rigging as a plot in which a tender obtains leverage over the potential rival in getting awarded a contract. The four types of bid rigging include bid suppression, complementary bidding, bid rotation, and subcontracting. In bid suppression, all contractors make an agreement not to join the bid and choose only one contractor to win a bid. After winning the contract, other conspirers will receive a kickback or a sub-contract job as a benefit return. Complementary bidding is where all bidders, except the chosen one, overbid or present unacceptable terms. This type of conspiracy gives the impression of the presence of competition but increases the price of award (Haberbush, 2000).

4. Billing, Cost, and Pricing Schemes

Wells (2014) discusses the billing plot in which the staff illegally uses fake documents such as fraudulent invoices, purchase orders, and bills for the company owner to apply for

payment. This type of billing plot may include the use of fictitious companies or fake documents to submit fraudulent invoices that create the false impression that service was performed (Wells, 2014). According to the General Services Administration Office of the Inspector General (GSAOIG), another scheme that has been observed during contract processes is that payment is made without receiving goods or services (GSAOIG, 2012). Defective pricing is when a contractor submits cost or pricing data that is imprecise, imperfect, or out of date. There are three elements that will be changed by hiding of information, which are cost price, distortion of supporting data, or failure to update data. Change order abuse means contractors inflate the price on a contract intentionally. This occurs when an offeror conspires with a government employee and then submits a lower bid price to win the contract. After the contract award, the offeror will share the benefit from high dollar value change orders (Silverstone, 2005).

5. Fraudulent Purchases

Wells (2005) defines fraudulent purchases as using company funds to buy or purchase items for personal use. Castillo and Flanigan (2014) define fraudulent purchases as “those in which a buyer acquires materials without having a specific government requirement but rather for personal use” (p. 26). Fraudulent purchases involve buying items that have higher specifications than government expectations. This can involve an employee buying items using public funds but keeping them for personal use or selling them for their own benefit (Vona, 2011). Several GAO reports indicate that service units were exposed to fraudulent purchases due to ineffective internal controls (GAO, 2002).

6. Fraudulent Representations

Wells (2005) defines fraudulent representation as when suppliers charge buyers a higher price than what the real goods and services are worth. The profit is illegally increased because contractors provide inferior quality of goods and services. Grennan and McCrory (2016) use “bait and switch” to explain fraudulent representations such as when a contractor provides the buyer with lower quality products than the stated contract requirements. The U.S. Agency for International Development pointed out some examples such as “a contractor uses

one coat of paint instead of two; uses watered loads of concrete; installs inferior memory chips in computers; or uses inferior automobile replacement parts” (USAID, n.d., p. 12).

All the types of fraud schemes discussed in this section are shown in Figure 5. The matrix shows that fraud can exist anywhere in this process. Therefore, these internal control components are potentially exposed to fraudulent actions (Rendon & Rendon, 2015).

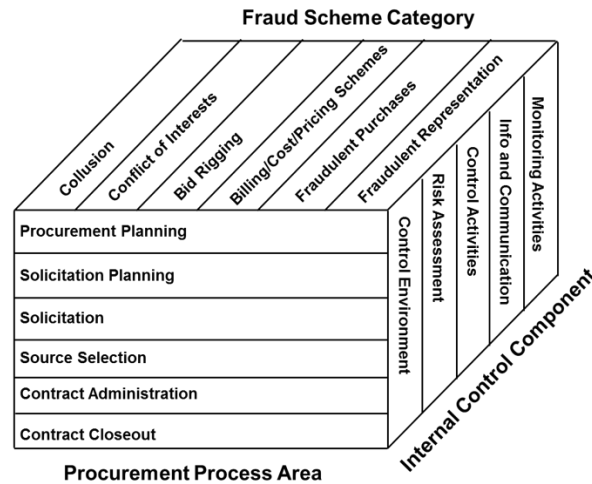


Figure 5. Procurement Fraud Matrix.
Source: Rendon and Rendon (2015)

F. SUMMARY

This chapter first provided the background on the three components of auditability theory, including competent personnel, capable processes, and effective internal controls. Next, the six phases of the contract management framework, consisting of procurement planning, solicitation planning, solicitation, source selection, contract administration, contract closeout and termination, were discussed. The five components of internal control including control environment, risk assessment, control activities, information and communication, and monitoring activities were also discussed. Lastly, procurement fraud schemes including collusion, conflict of interest, bid rigging, billing, cost and pricing schemes, fraudulent purchases and fraudulent representations were discussed. The next chapter presents the history of the Taiwan Navy minehunter procurement case.

THIS PAGE INTENTIONALLY LEFT BLANK

III. TAIWAN NAVY MINEHUNTER PROCUREMENT CASE HISTORY

A. INTRODUCTION

This chapter describes the entire procurement process of the Taiwan Navy minehunter procurement case. The first section of this chapter examines the contracting actions that the Taiwan MND executed in the pre-award phase. The second section of this chapter discusses the award phase related to the Ching-Fu Company, which was awarded the contract. The third section of this chapter discusses the post-award phase related to Ching Fu. An overview of Ching-Fu's application for the syndicated loan from public banks is also provided.

B. PRE-AWARD PHASE

This section discusses the Taiwan Navy procurement planning, solicitation planning, and solicitation in the contract management pre-award phase.

1. Procurement Planning

To enhance the Taiwan Navy's mine-countermeasure capability, Taiwan planned to acquire eight minehunters. After procuring two Osprey class minehunters via a foreign military sale (FMS) from the U.S. Navy in 2010, the Taiwan Navy adopted the national indigenous shipbuilding policy to build six minehunters domestically. This indigenous shipbuilding policy has two purposes: to meet the urgent mission requirement for national security and to support the defense shipbuilding industries in Taiwan. The Taiwan Navy incorporated the indigenous shipbuilding policy and created the Taiwan Navy minehunter procurement plan in 2011 (Global Security, 2019). According to the procurement plan, the minehunter shipbuilding budget was US\$1.17 billion, allocated from fiscal years 2013–2024 for 12 years. The Taiwan Navy planned to award the contract and to start the contract performance before the end of 2013. Further, the Taiwan Navy planned to launch the first minehunter in 2016 and to finish the sea trials in 2018. In 2019, the Taiwan Navy planned to build the follow-up five minehunters. The entire contract was planned to be

completed by building a total of six minehunters and then closeout in 2024 (Taiwan Executive Yuan, 2017).

2. Solicitation Planning

The Taiwan Navy held 14 industry days to explain the procurement requirements and the most advantageous award bidding method to representatives from industry from January 2008 to April 2013. According to the Regulations for Evaluation of the Most Advantageous Tender, the Taiwan Navy selected the evaluation factors relevant to minehunter shipbuilding, including past performance, project management, facility, quality, function, overall logistics and maintenance, and prices. Those factors were put in the evaluation criteria matrix that would be used by the source selection committee to evaluate the most advantageous tenders. In June 2013, the Taiwan MND approved the source selection plan with open competition and the most advantageous award method under the Taiwan Government Procurement Act. This procurement budget was US\$1.1 billion, and according to Standards for Qualifications of Tenderers and Determination of Special or Large Procurement, this case was defined as a large procurement. According to the Regulations Governing the Organization of Procurement Evaluation Committee, a large procurement shall select 13 source evaluation members. The first meeting of the evaluating members was convened on June 27, 2013, and the present evaluating members recommended each other and elected the convener and the deputy convener (Taiwan Executive Yuan, 2017).

3. Solicitation

The Taiwan MND approved the procurement plan on December 2, 2014, and then publicized the request for proposal and conducted the “Q&A” to offerors. The Taiwan MND had publicized the RFP three times and continued to clarify the questions from potential offerors by holding clarification conferences. After the fourth round of publicizing the opportunity, the Taiwan MND received two responsive offers and entered the source selection process (Taiwan Executive Yuan, 2017). The following section discusses the process of source selection and award in the contract management award phase.

C. AWARD PHASE

On September 30, 2014, the Taiwan Navy convened the first source selection meeting. The two responsive offerors were China Shipbuilding Corporation (CSBC) and Ching-Fu. Both companies provided qualified documents for contract performance capability, specific qualification, and bid proposals. The second source selection meeting was convened on October 21, 2014, where five of 13 evaluating members were absent, including the original convener, the deputy convener, and other three members. The eight members who were present during the meeting elected a new convener. From the scoring results, CSBC and Ching-Fu both got above the 700 score source selection criteria. Of the eight members, four voted for CSBC, four voted for Ching-Fu as the awardee, resulting in a tie. In order to break the tie, they drew straws, and Ching-Fu won the contract (Taiwan Executive Yuan, 2017).

On October 23, 2014, Ching-Fu was awarded the contract. The contract was signed on November 3, 2014. The contract price was US\$1.16 billion. On December 3, 2014, CSBC did not accept the bid outcome and filed a protest with the Taiwan Public Construction Commission, Executive Yuan. The Public Construction Commission repealed the protest and decided that the procurement process in this case did not violate any regulations (Taiwan Executive Yuan, 2017). The following section discusses the post-award phase in the contract management process.

D. POST-AWARD PHASE

This section discusses the activities in the post-award phase such as contract performance progress, contract performance management, payment, and performance delay penalty.

1. Contract Administration

The Taiwan Navy minehunter procurement contract was awarded by the most advantageous award method. Ching-Fu proposed to build the first minehunter ship body by cooperating with Intermarine, a shipbuilder in Italy serving as Ching-Fu's subcontractor. Ching-Fu planned to transport the ship body back to a new shipyard that would be built

for minehunter shipbuilding in Shin-Da Harbor, Kaohsiung, to conduct the combat system installation. Ching-Fu was awarded the contract, and according to the contract schedule, the first minehunter construction started in Italy on April 1, 2016. In the beginning, the contract progress went smoothly as scheduled. The schedule to launch the first minehunter was March 2018. The Taiwan Navy informed Ching-Fu by official letter on August 3, 2017 that the Taiwan Navy would not pay the contract payment until Ching-Fu completed the shipyard construction for shipbuilding in Shin-Da harbor, Kaohsiung. The main reason for the decision was that the contract progress of building the shipyard for the minehunter shipbuilding was behind schedule (Taiwan Executive Yuan, 2017).

After the contract was signed, from November 2014 to September 2017, the Taiwan Navy conducted 35 monthly project progress reviews and supervised the shipbuilding progress management and risk assessment. The Taiwan Navy sent letters to ask Ching-Fu to arrange their financial system and capital utilization prudently and follow the budget control mechanism to spend the specific budget for the specified purpose only as stated in the contract.

On January 5, 2015, the Taiwan Navy sent a contractor surveillance team to the Ching-Fu shipyard to perform a contract surveillance job. In March 2016, a surveillance team was sent to Italy for surveillance of the first minehunter construction. Due to Ching-Fu's financial issue, the Taiwan Navy had an official meeting with the Public Construction Commission (PCC), Financial Supervisory Commission (FSC), National Audit Office and Investigation Bureau, Ministry of Justice. In addition, the Taiwan Navy sent official letters to request the Investigation Bureau, First Bank, and Mega Bank to assist in the investigation and inspection (Taiwan Executive Yuan, 2017).

The Taiwan Navy paid a total of US\$242,108,978 for three contract progress payments. To ensure that Ching-Fu Company fulfilled its contractual obligations, Ching-Fu paid the contract performance bond of US\$58.2 million and the repayment bond of advance payment US\$242.1 million, which totaled US\$ 300.3 million payment to the Taiwan MND (Taiwan Executive Yuan, 2017).

Subsequently, Ching-Fu was fined for contract delay. The penalty totaled US\$75,333. The Taiwan Navy also informed Ching-Fu that no further payment would be made to them until they built the required shipyard for shipbuilding (Taiwan Executive Yuan, 2017).

2. Contract Termination

This section discusses the negative issues related to the Ching-Fu Company, including the loan fraud, the negative activities reported by the press, and the reasons that caused the shipbuilding contract to be terminated by the Taiwan MND. In addition, this section addresses the process of Ching-Fu obtaining a loan from the banks by fraudulent documents in the post-award phase (Taipei Times, 2017).

During the contract performance, Ching-Fu successfully used fraudulent documents to increase company financial capital and obtain funds from the banks. Consequently, the Taiwan Navy terminated the contract with Ching-Fu due to the delay of the procurement project as well as the suspected loan fraud (Taipei Times, 2017). The Kaohsiung District Prosecutor's Office of Taiwan concluded its investigation and indicted Ching-Fu for suspected fraudulent loans and money laundering on February 12, 2018 (Strait Times, 2018). Moreover, the Taiwan Navy minehunter procurement project represented a failure (Hsieh & Chin, 2019). From April 14, 2017, the media began to release the negative activities that Ching-Fu, the naval minehunter contractor, had carried out in violation of the contract terms, including the procurement of the sonar system from the People's Republic of China (PRC). Those negative issues associated with Ching-Fu's performance caused the public to have concerns and doubts about the execution of the minehunter procurement. Although the problems were related to Ching-Fu's internal business operations and had no direct relationship with the minehunter procurement case, the Taiwan Navy not only sent the official letter to request Ching-Fu to explain and improve its performance but also sought related entities such as the Investigation Bureau, First Bank, and Mega Bank to assist in the investigation and inspection (CNA, 2017). On August 9, 2017, Ching-Fu was researched and questioned by the prosecutor and the

Investigation Bureau. On December 13, 2017, the Taiwan MND terminated the contract with Ching-Fu (Taipei Times, 2017).

As previously noted, on October 23, 2014, Ching-Fu was awarded the Taiwan MND minehunter contract to build six minehunters. Ching-Fu signed the contract with MND (Taiwan Navy Headquarters was the agent) on November 3, 2014. According to the contract, Ching-Fu should have built six minehunters for the Taiwan Navy domestically. Yet, Ching-Fu was planning to cooperate with Intermarine, the Italian shipbuilding company that was to build the ship body. Furthermore, the combat system was procured from the U.S. firm Lockheed Martin. The first minehunter prototype would be built in Italy then shipped back to Taiwan, where the combat system would be installed. Five minehunters would be constructed domestically. To raise funds for shipbuilding and avoid working capital constraints, Ching-Fu started to increase its company's financial capital and seek banks to grant credit to them to get a syndicated loan after signing the contract. After winning the contract, from November 2014 to February 2016, Ching-Fu increased its capital three times, from US\$17.6 million to \$133.3 million, by using a loan from the Ching-Fu Company itself. In addition to using Ching-Fu Company's credit, the owner of Ching-Fu and the shareholders' personal credit were used to obtain loans (Taiwan Kaohsiung District Prosecutor's Office, 2017).

On February 4, 2016, Ching-Fu signed a loan syndication contract with First Bank, which was the loan syndication management bank, for a US\$683 million loan. A total of nine banks participated in the syndication loan, including the Taiwan Cooperative Bank, Hua Nan Commercial Bank, Taiwan Business Bank, Land Bank of Taiwan, Chang Hwa Bank, Agricultural Bank of Taiwan, The Export-Import Bank of the Republic of China, Bank of Taiwan, and First Bank. The financial capital of Ching-Fu was only US\$17.6 million at the time it was awarded the contract. After Ching-Fu was awarded the contract, it had to repay the bond of advance payment for the first construction progress and a large fee for export permit documents from technical assistance vendors. Although Ching-Fu's financial capital was US\$17.6 million, it also had investments in the PRC. After the contract was awarded, Ching-Fu was short on funds, and it was difficult for Ching-Fu to apply for loan syndication from banks in the beginning. To get a loan syndication contract,

in addition to increasing the company's financial capital by fraudulent activities, Ching-Fu also created foreign shell companies, which are fictitious companies, which Ching-Fu used to create fake contracts and invoices. Ching-Fu forged the contract with a fake title that shows transactions with shell companies that never took place. Those fraudulent contracts claimed that Ching-Fu procured equipment from the shell companies, but the contents of the contracts were extracted from the original Navy contract. Ching-Fu used the fraudulent contracts to apply for the syndicated loan from banks. After creating the false contract with the shell companies, Ching-Fu also produced fake business invoices and payment application forms in accordance with the real contract contents related to payment conditions and schedule (Taiwan Kaohsiung District Prosecutor's Office, 2017).

Ching-Fu used the fake invoices and payment application forms to apply for interim financing and loan disbursement. The loan syndication management bank approved the loan application and disbursed the funds. After loan disbursement, to cover up the crime and the illegal money from loan syndication banks, Ching-Fu wired the money to foreign bank accounts, which is money laundering, to avoid investigation. On August 9, 2016, Ching-Fu was investigated and interviewed by the prosecuting attorney for using the fraudulent contract to get the syndicated loan from public banks. The MND terminated the contract for several reasons. First, the loan syndication banks filed seven court cases to attach liens against Ching-Fu, totaling up to US\$212 million. The office building of Ching-Fu was sealed up by Taiwan Kaohsiung District Court. Second, Ching-Fu's company stopped work since January 2017, and failed to pay the subcontractor up to US\$36 million, severely affecting the subsequent combat system integration work. Third, Ching-Fu was unable to meet the contract progress terms even after the Taiwan MND confiscated the US\$80 million repayment bonds that Ching-Fu paid. Fourth, Ching-Fu was suspected of fraudulent loans and illegal financial capital increases. The judicial authorities investigated the case. Fifth, Ching-Fu did not finish the detailed ship specification plan for ship construction, which indicated the construction progress was delayed, and Ching-Fu had not begun to build the shipyard that was planned to be completed in May 2017 (Taipei Times, 2017). On February 12, 2018, Kaohsiung District Court finished the investigation and indicted the owner of Ching-Fu on suspicion of the fake financial capital increase,

fraudulent loans, and money laundering (Taiwan Kaohsiung District Prosecutor's Office, 2017).

E. SUMMARY

This chapter detailed the review of the Taiwan Navy minehunter procurement case, including the synopsis of the contract actions that the Taiwan Navy had taken in the contract management phases and the processes of Ching-Fu loan syndication after Ching-Fu was awarded the contract. The next chapter discusses the methodology for conducting this research.

IV. METHODOLOGY

A. INTRODUCTION

This chapter discusses the methodology utilized in this research. The literature review provides a foundation for this research. This chapter explains the development of the matrix which shows the alleged fraud and non-fraud incidents identified in the Investigation Report of the Executive Yuan on the Taiwan minehunter procurement case. Appendix A represents the alleged fraud and non-fraud incidents associated with MND in the minehunter procurement case. Appendix B represents the alleged incidents associated with First Bank in the minehunter procurement case. Appendix C represents the procurement fraud schemes associated with Ching-Fu. Those alleged fraud and non-fraud incidents include the procurement actions conducted by the Taiwan MND, the negligence of the First Bank in approving the syndicated loan, and the fraudulent loan activities that Ching-Fu conducted to apply for the loan. In addition, this chapter explains how the alleged incidents and fraudulent loan activities will be aligned to the contract management phases, the internal control components, and to their classification according to the six most common procurement fraud schemes.

B. DEVELOPMENT OF THE TAIWAN NAVY PROCUREMENT FRAUD MATRIX

The main data that was used in this research study included the official investigation report issued by Taiwan's Executive Yuan. The contents of the report recorded the alleged incidents of the procurement process of the MND and the alleged incidents of First Bank in approving the loan process. The content of the indictments provided by the Ministry of Justice showed that Ching-Fu used fake documents to obtain the syndicated loan from banks. After reviewing the official public document, the author developed the matrix to support this research. Every alleged fraud and non-fraud incident attributed to MND, First Bank, and Ching-Fu, are classified in the matrix.

1. Sources

The Taiwan minehunter procurement fraud case was investigated by Taiwan's Executive Yuan for an administrative investigation on the MND and First Bank. The Investigation Report of the Executive Yuan on the Taiwan Navy minehunter procurement case was released when the investigation was completed. Then, the Taiwan Executive Yuan handed over the case to the Ministry of Justice for a criminal investigation. The indictment documents were released after the criminal investigation was completed, and the defendant was sentenced by Taiwan Kaohsiung District Prosecutor's Office.

The Investigation Report of the Executive Yuan on the Taiwan Navy minehunter procurement case was retrieved from the Taiwan Executive Yuan website. The indictment documents were downloaded from the Taiwan Kaohsiung District Prosecutor's Office website (<http://www.ksc.moj.gov.tw/mp115.html>). The Lawsnote website (<https://www.lawsnote.com>) was also used to download Ministry of Justice and court documents. The Lawsnote website is open to the public and free for the latest cases. When people need to further search a case, it requires a membership account to search and download which is free for the first month after registration. All of the documents used in this research study were publicly available.

2. Search Terms

Search terms were used to look for the websites listed in the prior sections. These terms include the names of all government and civil units involved in the case and the people indicted by the courts. The terms are "Taiwan Navy minehunter procurement case syndication loan scandal," "the alleged fraudulent loan executives of Ching-Fu," "Ching-Fu Shipbuilding Loan Scandal," "the Taiwan Navy minehunter procurement scandal," "Taiwan Navy minehunter procurement," and "Ching-Fu Shipbuilding Company." The next section discusses the classification of alleged incidents of the Taiwan MND, First Bank, and the fraudulent loan activities by the Ching-Fu Shipbuilding Company.

3. Alignment to Frameworks and Fraud Schemes

The matrix was created by describing the alleged incidents of Taiwan MND, First Bank, and Ching-Fu's fraudulent loan activities. The matrix displays the alignments of the alleged incidents and fraudulent loan activities to the contract management process, internal control components, and the procurement fraud schemes. The alleged incidents and Ching-Fu's fraudulent loan activities are aligned with an internal control component more subjectively than the alignments of fraud schemes in the contract management phases. The alleged incidents and Ching-Fu's fraudulent loan activities may have been allowed due to weaknesses in one or more internal control components, but the matrix includes the internal control component that has the most significant impact on the alleged incidents. In addition, when most of the alleged incidents and Ching-Fu's fraudulent loan activities are located in one or more of the contract management phases, that particular contract phase would be the most vulnerable to allow the alleged incidents or fraudulent loan activities to happen.

Furthermore, the fraudulent loan activities by Ching-Fu are aligned to the classification of fraud schemes, which are the six most common fraud schemes in procurement fraud cases. The next section discusses the results of collected data of this case matrix.

C. SUMMARY

This chapter discussed the methodology utilized in this research, as well as the sources of the data and the development of the matrix. This chapter also discussed the alignments of the alleged incidents and fraudulent loan activities to the contract management phases, internal control components, and procurement fraud schemes. The explanation of the matrix development was also discussed. The next chapter analyzes the research findings, discusses research implications, and provides recommendations based on the findings.

THIS PAGE INTENTIONALLY LEFT BLANK

V. FINDINGS, ANALYSIS, AND RECOMMENDATIONS

A. INTRODUCTION

This chapter first provides the findings from the analysis of the matrix developed based on the alleged fraud and non-fraud incidents (hereafter referred to as alleged incidents) from the Investigation Report of the Executive Yuan on the Taiwan Navy minehunter procurement case and the court documents related to Ching-Fu's fraudulent loan activities. The findings include in which contract management phases the alleged incidents occurred most frequently, the lack of internal control components leading to the occurrence of these alleged incidents and Ching-Fu's fraudulent loan activities, and the specific procurement fraud schemes that Ching-Fu perpetrated in the Taiwan Navy minehunter procurement case. Second, the chapter discusses the analysis of these findings. Finally, it presents the recommendations generated from the research findings.

B. FINDINGS AND ANALYSIS

The matrix of the Taiwan Navy minehunter procurement case was developed by reviewing the alleged incidents from the publicly available Investigation Report of the Executive Yuan on the Taiwan Navy minehunter procurement case and the court documents related to Ching-Fu's fraudulent loan activities. The matrix represents the 11 alleged incidents that the Taiwan MND was responsible for in the minehunter procurement process (Appendix A). Moreover, 12 alleged incidents attributed to First Bank in the Ching-Fu loan application are discussed (Appendix B). Finally, there are four fraudulent loan activities Ching-Fu conducted in the loan application process (Appendix C).

This section discusses the interpretation of findings and implications regarding the alleged incidents from MND and First Bank. All of the alleged incidents previously described are first lined up with the theory of the contract management phases and then applied to the theory of internal control components. Lastly, this chapter discusses Ching-Fu's fraudulent loan activities and lines them up with the procurement fraud schemes.

1. Contract Management Processes

There are six phases of contract management process. In this case, almost all of the alleged incidents (20 out of total 23 alleged incidents) from the MND, First Bank, and the fraudulent loan activities occurred in the “source selection” and “contract administration” phases, indicating that these two phases are the most vulnerable areas for this procurement case. The details related to each phase are discussed next.

a. Procurement Planning

No alleged incidents occurred in this phase.

b. Solicitation Planning

1. In the source selection score sheet, the factor “Financial Management system is sound and effective,” only accounts for 15 out of 1,000 points. “The vendor has considerable financial resources” was not included as a criterion. (Refer to Appendix A/ MND 1).
2. The factor “the shipbuilding performance within five years” under “past performance” item in the evaluation sheet only accounts for 15 out of 1,000 points. (Refer to Appendix A/ MND 2).

The solicitation planning phase includes procurement requirements, awarding methods, contract types, and the development of solicitation documents. If not established well in this phase, there would be many problems in subsequent implementation according to the plan, and the companies that are not qualified according to the requirements cannot be recruited. The MND incorporated the “Financial Management System is sound and effective” and “past performance” to be the evaluation factors, but the weight ratios were too low and did not perform the critical role to screen out the unqualified contractors. It is essential to build general requirements that fit the objectives for the procurement case so subsequent activities will comply with and obtain the objectives.

c. Solicitation

The MND drastically reduced the financial qualifications of offerors, from one-tenth (US\$117.6 million) to one two-hundredths (US\$5.8 million) of the budget amount. (Refer to Appendix A/ MND 3).

Small capital companies have a considerable degree of difficulty performing in large procurement contracts. Beside capital amount, future funds operations and loan applications should be considered in solicitation planning. It is imperative to comply with the source selection criteria that were developed in solicitation planning to seek the proper contractors. In order to increase the number of offerors, the financial qualification could be reduced. However, reducing the financial qualifications of the offerors would increase the risks that contractors do not have the financial capability to fulfill the contract.

In the decision-making process of the MND and the Taiwan Navy reviewing the threshold for reducing the bidding capital of the offerors, it was not considered carefully that the case involves a significant amount of money. If the offerors with low capital do not have enough financial resources to support the procurement case for up to 12 years and if the capital is not carefully evaluated, they will have difficulties to fulfill the contract requirements. Nevertheless, the MND did not assess whether the low capital contractors have considerable experience, performance, workforce, financial resources, and equipment to complete the contract. To increase the number of offerors, MND reduced the threshold for the offeror's capital from one-tenth to one two-hundredths, and it underestimated the financial risks of low capital offerors.

d. Source Selection

1. The MND allowed Ching-Fu not to provide the latest financial report when submitting the bid document for source selection. (Refer to Appendix A/ MND 4).
2. Ching-Fu did not have an existing shipyard to build minehunters. Ching-Fu promised to build a new shipyard. Yet, it did not offer any document to

prove that it had obtained the relevant land rights. (Refer to Appendix A/ MND 5).

3. In the second source selection meeting, the selection committee also questioned that Ching-Fu had no plant and facilities, and it could not guarantee that the shipyard construction could be completed within 30 months. (Refer to Appendix A/ MND 6).
4. The original convener and the deputy convener were absent from the second source selection meeting. MND did not dismiss the original convener and deputy convener. Instead, the MND allowed the present members to elect the new convener and deputy convener. (Refer to Appendix A/ MND 7).
5. Some source selection committee members were absent to avoid a conflict of interests. The MND did not clarify the reasons for the absence of each member. (Refer to Appendix A/ MND 8).
6. In the second selection meeting, the two offerors tied twice. The MND did not follow the bidding regulations to negotiate the “price” with offerors first but awarded the contract by drawing straws. (Refer to Appendix A/ MND 9).
7. The quotation of the CBSC was US\$1.1 million lower than that of Ching-Fu. The MND knew that negotiation is one of the factors for source selection evaluation, but it still determined the awardee by drawing straws. (Refer to Appendix A/ MND 10).
8. The MND did not clarify and deal with the abnormality of the factor “to build the first minehunter domestically.” (Refer to Appendix A/ MND 11).

This phase uses the source selection evaluation criteria to select the awardee, or to negotiate with the offerors or to implement the awarding method to choose the awardee (Rendon, 2008). Most of the alleged incidents attributed to the MND occurred in the source

selection process. Those deficiencies caused Ching-Fu to win the bid, conduct the fraudulent loan activities, and fail in the end.

The MND has several alleged incidents in this phase that made it possible for Ching-Fu to win the bid. These mistakes include allowing Ching-Fu not to provide the latest financial report at the time of bidding. Ching-Fu does not have an existing shipyard, but the Taiwan Navy accepted a promise that the company would complete one in the future. In the source selection meeting, the convener and deputy convener were absent because of conflicts of interest, which the Taiwan Navy should have known of and dissolved before the source selection meeting. Yet, they proceeded to directly elect a new convener and deputy convener during the session. The two offerors had the same scores twice, but MND did not negotiate the price before choosing the awardee by drawing straws. These alleged incidents in this phase indicate that MND has many areas for improvement that need to be reviewed in the source selection phase to avoid similar problems.

e. Contract Administration

The primary contract administration actions are monitoring of compliance with terms and conditions, applying useful communication and control, managing contract changes, invoicing and payment, and settling claims and disputes (Garret, 2007).

(1) MND

There were no alleged incidents committed by MND in the contract administration phase according to the Investigation Report of the Executive Yuan on the Taiwan minehunter procurement case. Although MND executed the contract actions under the contract in the supervision of performance, the problems were caused by the fraudulent loan activities by Ching-Fu after the contract was awarded. Those alleged incidents are related to First Bank approving Ching-Fu's loan application and disbursement. Those alleged incidents reveal that besides the Taiwan Navy's shipbuilding performance surveillance, all the loan activities were conducted between Ching-Fu and the bank. The Taiwan Navy did not participate in the shipbuilding funds surveillance strictly by reviewing the financial status of the contractor in the source selection phase. It was also absent from the supervision of the contractor's finances in this phase. The negligence of

such review and monitoring created the loopholes in the bank loans and disbursements. The alleged incidents of First Bank caused loss of money and project failure, but the MND must also take primary responsibility.

(2) First Bank

1. The contract price of the minehunter procurement case was US\$1.1 billion; First Bank approved the loan amount of US\$683.3 million (for which the verification ratio is 58.7%). (Refer to Appendix B/ FB 1).
2. First Bank did not analyze Ching-Fu's 2015 to 2025 cash flow forecast and did not check its cash resources. (Refer to Appendix B/ FB 2).
3. First Bank did not require Ching-Fu to provide a financial capital increase plan to determine whether Ching-Fu could complete the capital increase as scheduled. After that, some of the capital increase funds came from Ching-Fu's new loan to itself (US\$35 million). (Refer to Appendix B/ FB 3).
4. Ching-Fu's first financial capital increase of US\$ 25 million in the first quarter and the second financial capital increase of US\$10 million in the third quarter in 2016 were obtained from the new loan of Ching Yan Investment Company, which is Ching-Fu's major shareholder. (Refer to Appendix B/ FB 4).
5. Mega Bank had a concern about shipbuilding uncertainty, so it refused the loan application. First Bank did not pay attention to Mega Bank's consideration. (Refer to Appendix B/ FB 5).
6. According to the syndicated loan contract, the shipyard should be completed within three years after the first use of the loan. First Bank did not track the progress after disbursement. (Refer to Appendix B/ FB 6).

7. Regarding the progress of the shipbuilding and shipyards, as well as the progress prepayment deposited into First Bank's account, First Bank did not track them. (Refer to Appendix B/ FB 7).
8. First Bank did not confirm the supplier list or contract with MND to ensure that the procurement supplier matched to the supplier list of the military procurement contract. (Refer to Appendix B/ FB 8).
9. First Bank did not require Ching-Fu to present a purchase contract with the equipment supplier to ensure that the procurement suppliers and products met the requirements of the military procurement contract. (Refer to Appendix B/ FB 9).
10. The business address of the three companies was in Hong Kong. But Hong Kong was not the location of the ship or weapon system export area specified in the contract. (Refer to Appendix B/ FB 10).
11. On Ching-Fu's invoices for the loan, the signatures of the responsible persons of the two companies are suspected to be the same person. The background information of the two companies was not identified to verify transaction authenticity before disbursement. (Refer to Appendix B/ FB 11).
12. The account for the remittance of Ching-Fu's purchase transaction is different from the country where the seller is located (Hong Kong). First Bank did not verify whether the fund's flow to Singapore and Macau was correct for purchasing the minehunter equipment. (Refer to Appendix B/ FB 12).

After Ching-Fu was awarded the contract, it started to apply for a syndicated and working capital loan. The management of First Bank in this phase improperly allowed Ching-Fu to achieve the fake financial capital increases, the establishment of the shell companies to forge a contract and invoices, and money laundering. First Bank had alleged incidents related to credit checks, credit granting, and post-loan management. First Bank

approved a US\$638 million syndicated loan without analyzing Ching-Fu's cash flow and checking the fund resources for capital increases. First Bank also failed to evaluate Ching-Fu's shipbuilding capability for contract performance and did not pay attention to why Mega Bank refused the syndicated loan when Ching-Fu halted the shipyard investment promotion. First Bank did not track the mortgage of the shipyard and shipbuilding construction progress. Furthermore, First Bank did not ask MND to get the minehunter contract to identify the contract contents about suppliers and products, and it failed to check the authenticity of the contract and invoices before disbursing funds to the designated bank accounts of Ching-Fu.

(3) Ching-Fu Fraud Scheme

a. Fraudulent representation

After the contract was awarded, in order to apply for a syndicated loan, Ching-Fu increased its financial capital from US\$17.6 million to US\$100 million by saying in the capital registration application paper that it had grown without actually having done so. (Refer to Appendix C/ CF 1).

Ching-Fu created fake contracts and invoices using shell companies. Ching-Fu forged a contract with a fake title that showed transactions with its shell companies, though the transactions had never taken place. (Refer to Appendix C/ CF 2).

b. Collusion

To obtain a working capital loan, Ching-Fu established several overseas shell companies, such as Harbour Stand Limited, L3 Capital Limited, and Ocean Kirin Limited. The son of Ching-Fu's executive is the head of the shell companies. (Refer to Appendix C/ CF 3).

Ching-Fu conducted money laundering to overseas bank accounts. After receiving funds from banks, to hide the illegally gained money, Ching-Fu transferred money to the overseas accounts to escape tracing (Refer to Appendix C/ CF 1). Table 1 represents Ching-Fu money laundering to overseas bank accounts.

Table 1. Ching-Fu Money Laundering through Overseas Bank Accounts.
Adapted from Taiwan Executive Yuan (2017).

Remittee	Location
Antai Zun Capital	Macau
HARBOUR STAND	Macau
OCEAN KIRIN	Macau
L3 Capital	Singapore
Antai Zun Capital	Hong Kong
Qing Yu	Hong Kong

The Taiwan Navy minehunter procurement case is the largest domestic shipbuilding project for two decades. Undoubtedly, public banks think they should support policy related to national security and national interest. And, in the Taiwan Navy minehunter procurement case, banks also likely believed the contract was awarded to the most advantageous bidder, and the financial condition and shipbuilding performance had been evaluated by MND. Also, the buyer in this case is the government, which has no credit risk. There is no regulation to ask MND to offer the banks the information related to contract contents. This lack of regulation allowed Ching-Fu to increase its financial capital five times, from US\$17.6 million to US\$166.6 million by collecting the loan from its major shareholder Ching Yang Investment Company, borrowing money from shareholders, getting registration documents, then transferring money back to shareholders, and filling the capital registration application paper without actually increasing its financial capital. To obtain a working capital loan, Ching-Fu established several overseas shell companies, forged a contract to pretend it had purchased equipment from the shell companies, and then created fake invoices to apply for working capital. To hide the illegally gained money, after receiving funds from banks, Ching-Fu conducted money laundering by transferring money to the overseas shell companies' accounts to escape tracing.

c. Contract Closeout Phase

There are no alleged incidents in this phase. The Taiwan Navy terminated the contract with Ching-Fu due to the delay of the procurement project and suspected fraudulent loan activities.

2. Internal Controls

Each alleged incident and Ching-Fu's fraudulent loan activities are aligned with the internal control component of the COSO Integrated Internal Control Framework (COSO, 2013). Each alleged incident and Ching-Fu's fraudulent loan activities are associated with specific insufficiencies in the main internal control components.

a. Control Environment

In this case, no alleged incidents or fraudulent loan activities occurred due to the lack of a control environment component.

b. Risk Assessment

There are three alleged incidents associated with MND (Refer to Appendix A/ MND 3, MND 5, MND 6) and two alleged incidents with First Bank (Refer to Appendix B/ FB 1, FB 4) caused by risk assessment failures.

(1) MND

1. The MND drastically reduced the financial qualifications of offerors, from one-tenth (US\$117.6 million) to one two-hundredths (US\$5.8 million) of the budget amount. (Refer to Appendix A/ MND 3).
2. Ching-Fu did not have an existing shipyard to build minehunters. Ching-Fu promised to build a new shipyard, but it did not offer any documents to prove that it had obtained the relevant land rights. (Refer to Appendix A/ MND 5).
3. In the second source selection meeting, the selection committee also questioned that Ching-Fu had no plant and facilities, and it could not

guarantee that the shipyard construction could be completed within 30 months. (Refer to Appendix A/ MND 6).

The Taiwan Navy did not identify and assess the risk of significantly reducing the financial qualifications of the offerors, thus allowing Ching-Fu to enter the source selection phase. Moreover, the Taiwan Navy accepted that Ching-Fu had no evidence to prove that it had obtained land for the proposed shipyard and that Ching-Fu replaced the physical shipyard with a promise and got the bid qualifications. The MND did not analyze whether the manufacturer had sufficient financial resources and the ability to undertake the procurement case, as it did not meet the original capital threshold, even if there were adequate facilities to perform the contract in the future, and did not consider the potential risk of fraud. To obtain enough funds, Ching-Fu, which had insufficient capital, chose to increase the amount of capital and obtain the syndicated loan by fraudulent activities.

(2) First Bank

1. The contract price of the minehunter procurement case was US\$1.1 billion; First Bank approved the loan amount for US\$683.3 million (the verification ratio of which is 58.7%). (Refer to Appendix B/ FB 1).
2. Ching-Fu's first financial capital increase of US\$ 25 million in the first quarter and second financial capital increase of US\$10 million in the third quarter in 2016 were obtained by the new loan from Ching Yan Investment Company, which is Ching-Fu's major shareholder. (Refer to Appendix B/ FB 4).

When Ching-Fu began to apply for a syndicated loan, First Bank had the requirement that Ching-Fu would increase its financial capital to be qualified for the syndicated loan. First Bank already knew that Ching-Fu had a gap in funds and did not analyze the potential risk of fraud. The cash source for Ching-Fu to increase the financial capital was from its subsidiary's loan from First Bank. First Bank did not set a risk-related target for Ching-Fu's future repayment ability and identified the financial capital increase from the loan, then approved a high-value syndicated loan of US\$683.3 million.

c. Control Activities

There are six alleged incidents attributed to MND and six to First Bank caused by control activities failures.

(1) MND

1. In the source selection score sheet, the factor “Financial Management system is sound and effective,” only accounts for 15 out of 1,000 points. “The vendor has considerable financial resources” was not included as a factor. (Refer to Appendix A/ MND 1).
2. The factor “shipbuilding performance within five years” under the “past performance” item in the evaluation sheet only accounts for 15 out of 1,000 points. (Refer to Appendix A/ MND 2).
3. The MND allowed Ching-Fu not to provide its latest financial report when submitting the bid document for source selection. (Refer to Appendix A/ MND 4).
4. The original convener and the deputy convener were absent from the second source selection meeting. Yet, MND did not dismiss the original convener and deputy convener. Instead, MND allowed the members present at the second meeting to elect a new convener and deputy convener. (Refer to Appendix A/ MND 7).
5. In the second source selection meeting, the two offerors tied twice. Yet, MND did not follow the bidding regulations to negotiate the “price” with offerors first. Instead, MND awarded the contract by drawing straws. (Refer to Appendix A/ MND 9).
6. (The quote of the CBSC was US\$1.1 million lower than that of Ching-Fu. Although MND knows negotiation is one of the factors for source selection evaluation, it still determined the awardee by drawing straws. (Refer to Appendix A/ MND 10).

MND allowed offerors not to provide the latest financial reports, which indicates that the control activities were not strictly enforced. The financial status of the offerors can refer to future contract execution. Without accurate financial status, it is difficult to screen out offerors that will have insufficient financial resources in the future. During contract performance, the contractor would face financial difficulties and be unable to perform effectively to fulfill the contract. Besides, the control component of the evaluation sheet is used to ensure that the most suitable candidate will be awarded the contract. MND did not emphasize the importance of the criteria such as “financial management is sound and effective” and “the offeror has considerable financial resources;” as these two factors only had 15 points each (out of 1,000). It is difficult to carry out further screening for low-scoring offerors or to achieve the goal of not allowing low-scoring offerors to leave the source selection process when the evaluation sheet is not well designed. In the end, Ching-Fu met the requirements to join the drawing of straws although it was not a suitable candidate.

In the second source selection meeting, the reason for the absence of the original convener and deputy convener was not ascertained. Nevertheless, Taiwan MND did not conduct the required dismissal procedure. Instead, the committee elected a new convener and a deputy convener by a temporary motion. The two offerors tied twice, even though the price quote of the CSBC was US\$1.1 million less than that of Ching-Fu. In such a case, price negotiation was one of the options for re-evaluation of the offers, according to the MND’s contract RFP document (Taiwan Executive Yuan, 2017). However, the committee did not follow this document’s procedure. It decided to follow an option presented in the Taiwan Government Procurement Act that allows a contract to be awarded by drawing straws when evaluation scores are the same (Taiwan Government Procurement Act, 2011). Skipping the negotiation process and determining the awardee by drawing straws obviously ignored these control activities.

Higher leadership of the Taiwanese Navy were censured due to the lack of surveillance in the control activity component. Although the Taiwan Navy higher leadership was not associated with any alleged incidents related to this component directly, the retired admirals were censured by the Control Yuan. Due to the procurement failure, the many years and efforts on this project were in vain. Beside the public confidence in the Taiwan Navy’s

administrative ability being hurt, the banks that participated in the loan syndication also lost US\$66.3 million (Pan, 2019).

(2) Bank

1. First Bank did not analyze the cash flow forecast from 2015 to 2025, which was submitted by Ching-Fu, and did not check the company's cash resources. (Refer to Appendix B/ FB 2).
2. (First Bank did not require Ching-Fu to provide a financial capital increase plan to determine whether Ching-Fu could complete the financial capital increase as scheduled. After that, some of the financial capital increase funds (US\$35 million) came from Ching-Fu's new loan itself. (Refer to Appendix B/ FB 3).
3. Mega Bank had a concern about the uncertainty of shipbuilding, so it refused the loan application. Yet, First Bank did not pay attention to Mega Bank's concern. (Refer to Appendix B/ FB 5).
4. According to the syndicated loan contract, the shipyard should be completed within three years after Ching-Fu's first use of the loan. First Bank did not track the progress on the project after the disbursement. (Refer to Appendix B/ FB 6).
5. Regarding the progress of the shipbuilding and shipyards as well as the progress of the prepayment deposit into the First Bank account, First Bank did not track those areas. (Refer to Appendix B/ FB 7).
6. On Ching-Fu's invoices for the loan, the signatures of the responsible persons of two companies are suspected to be the same person. The background information of the two companies was not identified to verify transaction authenticity before disbursement. (Refer to Appendix B/ FB 11).

First Bank also has six alleged incidents related to inadequate control activities, resulting in approval of a syndicated loan up to US\$638.3 million, which not only caused the

bank to lose US\$66.6 million but also 54 bank personnel were punished. First Bank did not ask Ching-Fu to provide a financial capital increase plan to determine whether Ching-Fu could complete the capital increase as scheduled. This resulted in some of the capital increase to be from the new loan made by First Bank itself. Ching-Fu only completed the first two capital increases, and First Bank did not enforce the requirement in the loan syndication contract to increase capital in 2017. Nevertheless, First Bank approved the loan. Even before it had approached First Bank, Ching-Fu had contacted Mega Bank and three other banks to request a syndicated loan. Mega Bank refused the loan request because it found that Ching-Fu halted the shipyard investment promotion in Shin Da harbor and had doubts about Ching-Fu's shipbuilding capability. By contrast, First Bank ignored Mega Bank's loan refusal, did not implement any credit check activities, and decided to approve the syndicated loan. According to the loan syndication contract, after the loan was disbursed, the shipyard construction would need to be completed within three years, and the shipyard would secure the first-order mortgage right to the loan syndication management bank—First Bank.

First Bank did not take any follow-up control measures, and Ching-Fu's advance payment bond was deposited into First Bank; it did not do any monitoring actions. On the invoices provided by Ching-Fu, the signatures of the persons in charge of the two companies were from the same person. Before disbursement approval, the authenticity of the transaction was not ascertained by First Bank. These alleged incidents caused by inadequate banking operation and control activities were not under the provisions of the loan syndication contract or the bank regulations. That way Ching-Fu successfully used the shell company to create fake contracts and invoices to obtain money and remit money to foreign accounts for money laundering.

(3) Ching-Fu's Fraudulent Financial Capital Increase

After the contract was awarded, to apply for a syndicated loan, Ching-Fu had to increase its financial capital from US\$17.6 million to US\$100 million, which it claimed it did on the capital registration application paper without actually increasing its capital. After First Bank approved the syndicated loan, according to the loan contract, Ching-Fu had to achieve three more capital increases to get the disbursement. Ching-Fu only finished two capital

increases through its subsidiary's loan of US\$35 million from First Bank and stakeholders' money.

There were three methods for Ching-Fu to increase financial capital. One was to increase its capital by collecting the loan from its major shareholder Ching Yang Investment Company. The second method was to borrow money from shareholders, after getting registration documents and then transferring the money back to its shareholders. The third was to fill out the capital registration application paper without increasing capital. Ching-Fu had increased its capital from US\$17.6 million to US\$166.6 million by fraudulent activities five times and successfully got registration to meet the syndication loan application requirement and disbursement (Hsieh & Chin, 2019).

d. Information and Communication

In this component, there are two alleged incidents associated with the Ministry of Defense from the communication with the source selection committee. There are four alleged incidents of First Bank caused by the lack of information and communication with MND. The lack of information and communication created a loophole for Ching-Fu to get the loan from First Bank. This loophole enabled Ching-Fu to create shell companies and forge contracts and invoices, which Ching-Fu sought to cover up through money laundering. The Taiwan Navy did not contact First Bank and offer any contract information actively, which created the loophole for Ching-Fu to apply for a syndicated loan and get disbursement through fraudulent loan activities. Because First Bank failed to have proper information from and communication with the Taiwan Navy, the bank suffered significant money loss and the procurement project ended in failure.

(1) MND

1. Some source selection committee members were absent from the second source selection meeting to avoid a conflict of interest. Yet, MND did not clarify the reasons for the absence of each member. (Refer to Appendix A/ MND 8).

2. MND did not clarify and deal with the abnormality of the factor “to build the first minehunter domestically.” (Refer to Appendix A/ MND 11).

The two alleged incidents associated with MND occurred from the lack of communication with the source selection committee. During the source selection period, the reason for the absence of the committee members was to avoid conflicts of interest. The Taiwan Navy should have obtained the background information of the members before the bid opening, and it should have conducted the dismissal of source selection committee members who were involved in the potential conflicts of interest or received the information early so that the committee would not have held the second selection meeting. If MND had dealt with the matter first, it would have avoided the situation where the members did not attend or had to postpone the review meeting. Furthermore, before the first selection meeting, the committee should have been informed about the scoring method for the first ship to be built in Taiwan. As part of that instruction, the Taiwan Navy should have informed the members of the location of the construction site, unified the score standards, fully informed the selection committee, and reached a consensus to avoid controversy during the source selection meeting.

(2) First Bank

1. First Bank did not confirm the supplier list or contract with MND to ensure that the procurement supplier matched the supplier list of the military procurement contract. (Refer to Appendix B/ FB 8).
2. First Bank did not require Ching-Fu to present a purchase contract with the equipment supplier to ensure that the procurement suppliers and products met the requirements of the military procurement contract. (Refer to Appendix B/ FB 9).
3. The business address of the three companies was in Hong Kong. But Hong Kong was not the location of the ship or weapon system export area in the contract. (Refer to Appendix B/ FB 10).

4. The account for the remittance of the Ching-Fu purchasing transaction was different from the country where the seller was located (Hong Kong). First Bank does not verify whether the funds' flow to Singapore and Macau was correct for purchasing the minehunter equipment. (Refer to Appendix B/ FB 12).

First Bank had no information regarding the list of relevant suppliers or contract contents from MND, and it was difficult for First Bank to ensure that Ching-Fu's suppliers were the original suppliers in the contract between Ching-Fu and MND. The lack of information and communication led to the loan disbursement from First Bank, which was enabled by Ching-Fu's false contract with shell companies. After First Bank accepted the fake invoice, it could not identify from the invoices the actual person in charge of the company, the business facts, and the companies' ability to provide the minehunter equipment as the suppliers in the original MND contract. First Bank wired the funds to Ching-Fu's designated accounts in Hong Kong, Singapore, and Macau without verifying whether the suppliers' addresses were the same as the ones listed in the original contract.

(3) Ching-Fu's Fraudulent Loan Activities

To obtain a working capital loan, Ching-Fu established several overseas shell companies, such as Harbour Stand Limited, L3 Capital Limited, and Ocean Kirin Limited. The son of Ching-Fu's executive was the head of the shell companies, and then Ching-Fu created the fake contracts and business invoices, representing that Ching-Fu was procuring minehunter equipment from those companies. Ching-Fu got a working capital loan by submitting fraudulent contracts and invoices to the bank. Ching-Fu established the shell companies to create fake contracts and invoices. Ching-Fu forged a contract with a false title that showed false transactions and stated it had a purchasing contract with the shell companies that never took place; then Ching-Fu added the real contract content that stated the products and schedule. This information was extracted from the original naval contract, from which Ching-Fu created fake invoices to apply for a working capital loan and get disbursement. To hide the illegally gained money, after receiving funds from banks, Ching-Fu transferred the money to overseas accounts to escape tracing.

e. Monitoring Activities

There is no alleged incident related to a lack of monitoring activities. When all alleged incidents are located in other components, but not control monitoring activities, it cannot be concluded that the control environment factor has met the practical requirements because all internal control components rely on and are influenced by each other (COSO, 2013).

C. IMPLICATIONS OF FINDINGS

This section discusses the implications of those findings, related to contract management processes, internal control components, and procurement fraud schemes.

1. Contract Management Processes

There are six phases in the contract management process (Procurement Planning, Solicitation Planning, Solicitation, Source Selection, Contract Administration, Contract Closeout and Termination). In this case, the 23 total alleged incidents attributed to MND (11 alleged incidents) and First Bank (12 alleged incidents) are summarized. All of the alleged incidents correspond to one of the six contract management phases, which is the most vulnerable area that caused the failure of the procurement project. As far as MND, there are two alleged incidents found in the solicitation planning phase, one alleged incident in the solicitation phase, and eight alleged incidents in the source selection phase. For First Bank, there are 12 alleged incidents all in the contract administration phase. Table 2 represents the number of alleged incidents and responsible entity in the contract management phases. Figure 6 represents the alleged incidents by percentage in the contract management process.

Table 2. Number of Alleged Incidents and Responsible Entity by Contract Management Phases

Contract Management Phases	Procurement Planning	Solicitation Planning	Solicitation	Source Selection	Contract Administration	Contract Closeout and Termination
Number. of alleged incidents	0	2	1	8	12	0
Responsible entity	N/A	MND	MND	MND	First Bank	N/A
Percentage	0%	9%	4%	35%	52%	0%

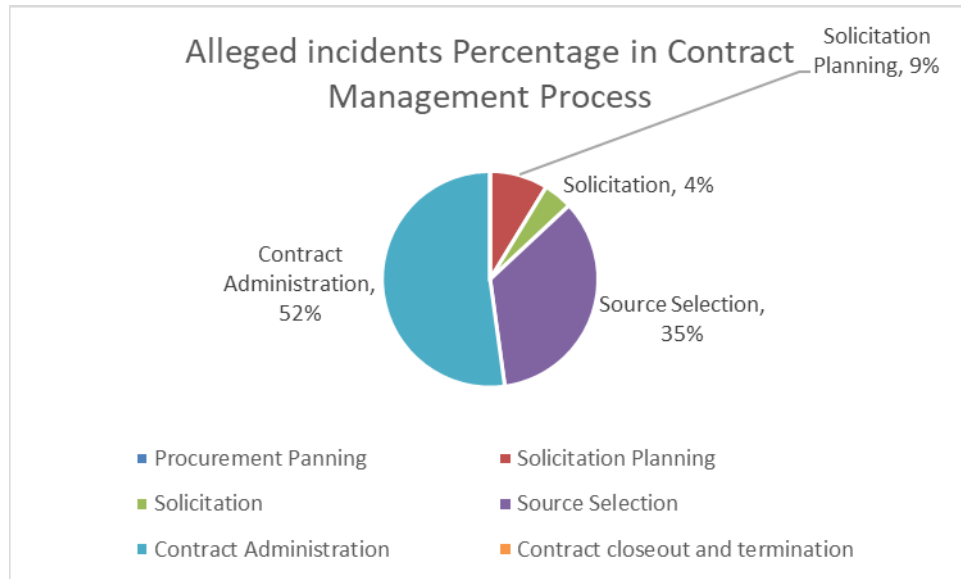


Figure 6. Alleged Incidents Percentage in the Contract Management Process

2. Internal Control Components

Every alleged incident attributed to MND and First Bank, as well as Ching-Fu's fraudulent loan activities, was lined up with an internal control component of the COSO Integrated Internal Control Framework (COSO, 2013). Every alleged incident attributed to MND and First Bank was also lined up to the deficient component that allowed the incidents to happen and cause the procurement project's failure.

There are five Internal Control Components (Control environment, Control activities, Risk assessment, Information communication, Monitoring activities). In this case, the same 23 total alleged incidents associated with MND and First Bank discussed earlier are aligned to each internal control component. In control activities, both MND and First Bank have six alleged incidents. In risk assessment, MND and First Bank have three and two alleged incidents, respectively, and in information communication, MND has two alleged incidents and First Bank has four alleged incidents. Table 3 represents the number of alleged incidents and responsible entity in internal control component. Figure 7 represents the alleged incidents by percentage in internal control components.

Table 3. Number of Alleged Incidents and Responsible Entity by Internal Control Component

Internal Control Components	Control Environment	Control Activities	Risk Assessment	Information Communication	Monitoring Activities
Number of alleged incidents	0	12	5	6	0
Responsible entity	N/A	MND (6) First Bank (6)	MND (3) First Bank (2)	MND (2) First Bank (4)	N/A
Percentage	0%	52%	22%	26%	0%

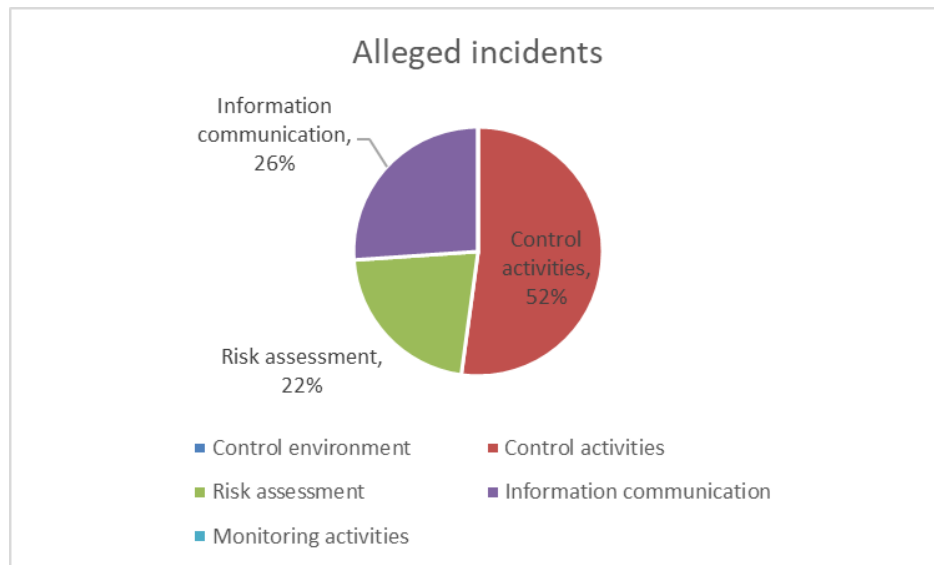


Figure 7. Alleged Incidents by Percentage in Internal Control Components

3. Procurement Fraud Schemes

There are four procurement fraud schemes found in this case, executed by Ching-Fu Company against First Bank. They include fraudulent financial capital increases, shell companies, fraudulent representations, and money laundering. Table 4 sums up the procurement fraud schemes involved in this case and their descriptions. This section described the procurement fraud schemes. The next section discusses the recommendations based on the research findings.

Table 4. Relevant Procurement Fraud Schemes and Their Descriptions

Item	Procurement Fraud Schemes	Activities	Description (Reference Appendix C)	Related to alleged incidents from First Bank (Reference from Appendix B)
1	fraudulent representation	fraudulent financial capital increase	CF 1	FB 2, FB 3, FB 4
2	fraudulent representation	fake invoices and contracts	CF 2	FB 8, FB 9
3	collusion	shell company	CF 3	FB 8, FB 9, FB 10, FB 11, FB 12
4	collusion	money laundering	CF 4	FB 10, FB 11, FB 12

D. RECOMMENDATIONS BASED ON RESEARCH FINDINGS

These recommendations are generated from the research findings and focus on building more effective source selection procedures, increasing capability to audit offeror's finance system, improving control activities, improving the joint supervision mechanism between MND and banks, and improving military contracting personnel training. If employed, these recommendations will increase the capability of Taiwan MND to successfully execute future procurement actions.

1. Build the Taiwan Military Procurement Source Selection Procedures

The Taiwan MND is associated with eight out of 11 alleged incidents that occurred in the source selection phase. This finding reveals the weakness in competent procedures for contract personnel to perform during source selection activities. To build the Taiwan military procurement source selection procedures, MND should refer to U.S. Department of Defense Source Selection Procedures (SSP) as a basis to create comprehensive operating procedures for Taiwan MND contract personnel in conducting source selection operations. The U.S. DoD SSP outlines a set of common principles and procedures for tradeoff and LPTA procurement in accordance with applicable principles and regulations. The U.S. DoD SSP could support the Taiwan MND to have the basic structure to make sure that the department's business selection process provides taxpayers with quality, timely products and services that are of the highest value for the country and the warrior.

2. Build the Capability to Audit Offerors' and Contractors' Finances and Accounting Systems

There are three alleged incidents in the solicitation planning and solicitations phases. The research findings expose the vulnerability in pre-planning the financial capital requirements for source selection. To build the capability for the military to audit an offeror's finances and accounting system, the MND should establish a competent process and properly train the relevant personnel. It is necessary to establish the financial review ability of military procurement offerors to identify their financial resources, or further procurement contracts, such as "fixed price" and cost type of contracts, to check the fair and reasonable price for contract payments.

3. Improve and Enhance Control Activities

Both MND and First Bank are associated with six alleged incidents in the control activities component. Some control activities were not emphasized during the planning phase. For example, examination of the offeror's past performance should be strengthened during the planning phase. Most of the control activities on the implementation side were not strictly enforced. For example, bank credit checks and fake invoices should be investigated but were not executed. It is important to ensure that the control activities are

enforced to achieve the entity's objectives, by making personnel understand and comply with regulations. It also is useful to have external control activities such as inspection teams to verify that MND and banks have abided by the control activities. To enforce a large military procurement inspection requirement, the Taiwan MND should establish an inspection team to scrutinize whether the Taiwan Navy and other services that perform the large procurement activities have complied with regulations. The Financial Supervisory Commission in Taiwan should strengthen the inspection of loan syndication operations such as credit checking, credit granting, and post-loan management to ensure that banks enforce the loan syndication regulations and money laundering prevention regulations.

4. Establish the Joint Supervision Mechanism between MND and Banks

First Bank is associated with four alleged incidents caused by the lack of information and communication platforms with the Taiwan Navy. These alleged incidents allowed Ching-Fu to get loans through fraudulent activities. First Bank should build an information and communication exchange mechanism to work with credit checking businesses and peer banks to do cross-validation to ensure the authenticity of transactions.

For the loan syndication contract of a military procurement case, it is sensible to establish a three-party (MND, banks, and contractors) contract mechanism to reduce the risks of procurement and regulate loan activities in the contract. This mechanism is to keep the banks from taking the great risk of granting credit due to the scarcity of procurement contract information.

5. Establish Military Contracting Personnel Training

According to the Investigation Report of the Executive Yuan on the Taiwan Navy minehunter procurement case (2017), the Taiwan MND should strengthen the training of contracting personnel to ensure that personnel understand the regulations and implement procurement operations according to regulations. It is recommended that Taiwan MND reference the U.S. Defense Acquisition University courses, depending on Taiwan's current procurement needs, to establish courses and training pipelines for Taiwan military acquisition personnel to meet the execution requirements of the procurement case.

E. SUMMARY

This chapter discussed the research findings and gave a detailed analysis of their implications when alleged incidents are aligned with contract management phases, internal control components, and procurement fraud schemes. Recommendations were also presented based on the findings and analysis to improve the capabilities of Taiwan military procurement operations. The next chapter discusses the research summary, conclusions, and further research areas.

THIS PAGE INTENTIONALLY LEFT BLANK

VI. SUMMARY, CONCLUSIONS, AND AREAS FOR FURTHER RESEARCH

A. SUMMARY

To enhance defense self-reliance at sea, the Taiwan Navy worked on the minehunter procurement project for more than ten years. After all the hardships, the contract was finally awarded to Ching-Fu Shipbuilding Company in 2014. At the time of the award, however, Ching-Fu's financial capital was low, the company had other investments, and it was unable to afford the large amount of performance bonds. Consequently, Ching-Fu conducted several fraudulent loan activities such as false capital increases, creation of shell companies, submission of falsified purchase contracts, and money laundering. When Ching-Fu was questioned and investigated, the loan scandal was revealed, the Taiwan Navy had to terminate the contract, and the minehunter procurement project failed in the end. As a result, the public has questioned the capability of the Taiwan Navy to conduct procurement actions, which has caused the Taiwan Navy's efforts for the past ten years to be in vain. All the money that Ching-Fu gained illegally has been attributed to the banks that participated in the loan syndication. The resulting total bank loss is as high as US\$436.6 million. This procurement failure has also jeopardized the national financial system and economic order. Ultimately, the head of Ching-Fu was charged with heavy penalties and fines.

The purpose of this research has been to analyze the Taiwan Navy minehunter procurement case by using auditability theory. The alleged fraud and non-fraud incidents listed in the Investigation Report of the Executive Yuan on the Taiwan Navy minehunter procurement case were aligned to the contract management framework, internal control components, and fraud schemes. The results of this research generated the recommendations provided in the preceding chapter for improving contract workforce, contract processes, and internal control capabilities in Taiwan procurement operations.

This study has examined all alleged fraud and non-fraud incidents to identify the contract management phases in which the incidents appeared, and which internal control component has the vulnerability to let these incidents occur. This methodology included a

matrix created from a database that consists of information from the Investigation Report of the Executive Yuan on the Taiwan Navy minehunter procurement case and publicly available criminal indictments related to the minehunter procurement case.

This research study is important for the Taiwan MND to acknowledge the vulnerabilities and seek solutions to them from auditability theory as the improvement methods for the Taiwan Navy leadership to adopt not only to prevent fraud but also to enhance future procurement operation capability.

B. CONCLUSIONS

This research has three focused questions. The answers to these questions come from the research findings and are discussed next.

1. In which contracting processes did the alleged fraud and non-fraud incidents occur in the Taiwan Navy minehunter procurement case?

In this case, almost all the alleged incidents (20 out of 23 total alleged incidents) attributed to the MND and First Bank and Ching-Fu's fraudulent loan activities occurred in the "source selection" and "contract administration" phases. Thus, these two phases were the most vulnerable areas for this procurement case.

2. What internal controls were deficient that allowed the alleged fraud and non-fraud incidents to occur in the Taiwan Navy minehunter procurement case?

In this case, the control activities component is the most vulnerable component that allowed both MND and First Bank to conduct control activities without following principles and regulations. In control activities, both MND and First Bank were associated with six alleged incidents; in risk assessment, MND and First Bank were associated with three and two alleged incidents, respectively; and in information and communication, MND had two alleged incidents and First Bank had four.

3. What were the alleged procurement fraud schemes that happened in the Taiwan Navy minehunter procurement case?

There are four procurement fraud schemes found in this case, executed by Ching-Fu Company against First Bank. They are fraudulent financial capital increase, shell company creation, fraudulent representation, and money laundering.

C. AREAS FOR FURTHER RESEARCH

There are two suggestions for further research. One research area is to use auditability theory to analyze the contract processes of prior Taiwan MND procurement cases. The research could include trying to find the vulnerable areas in contract processes, internal control, and personnel capability and to identify ways to strengthen contract regulations, internal controls, and the capability of the contracting workforce.

Another research area is to analyze the Taiwan Navy minehunter procurement case by conducting a comparison analysis between the U.S. DoD procurement processes and regulations and the Taiwan MND procurement processes and regulations. The research could include trying to find the insufficient procurement process and regulations that Taiwan MND needs to improve for future procurement efforts.

**APPENDIX A. ALLEGED FRAUD AND NON-FRAUD INCIDENTS
ASSOCIATED WITH MND IN THE MINEHUNTER
PROCUREMENT CASE**

No	Alleged Incidents and Fraudulent Loan Activities	Contract Management Phases (number/total)	Internal Control Components (number/total)	Reference Remark
1	The Ministry of National Defense had no proper supporting measures to strictly inspect the actual financial conditions of the bidding firm, including the item of “the financial management system is sound and effective” in the score sheet, for it was just 15 out of 1,000 (full score) and the proportion was very low. Moreover, the item of “whether the firm has sufficient financial resources” was not used for scoring.	solicitation planning (1/2)	control activities (1/6)	MND 1
2	This case was about building important equipment related to national defense and was critical to implementing the policy of building national ships indigenously. Hence, it was very important that the selected firm had the capabilities to complete the contract. However, in the score sheet, the item of “description on contract fulfillment of the shipyard in shipbuilding operations in recent 5 years” under “past contract fulfillment record” was just 15 out of 1,000 (full score); in other words, “the capabilities to fulfill the contract” in the scoring criteria was not fully valued.	solicitation planning (2/2)	control activities (2/6)	MND 2
3	The Ministry of National Defense dramatically loosened the financial requirements of bidding firms from 1/10 of the bidding target budget (NT\$ 3,529,318,200/ U.S. \$117.6 million) to 1/200 (NT\$ 176,465,910/ U.S. \$5.8 million). The capital of Ching-Fu was only over NT\$ 530 million when bidding, which was a seven-fold difference with 1/10 of the bidding target budget. Such a firm might not have sufficient financial resources to conduct the	solicitation (1/1)	risk assessment (1/3)	MND 3

	procurement case up to NT\$ 35 billion (US \$1.1 billion).			
4	Ching-Fu was permitted not to provide its latest financial reports when bidding, which formed multiple risks for financial evaluation on this procurement case. The Ministry of National Defense excessively loosened the financial eligibilities for the firm without any strict control and failed to ensure that Ching-Fu had sufficient financial resources to undertake this procurement case, which was improper.	source selection (1/8)	control activities (3/6)	MND 4
5	According to the data provided by Ching-Fu when bidding, Ching-Fu did not have any existing shipyard to build minehunters. Ching-Fu promised to build a new shipyard at Kaohsiung Singda Harbor, but no document in the bidding documents could certify that relevant land use rights had been acquired. In other words, whether Ching-Fu was able to build the shipyard smoothly as scheduled was highly uncertain.	source selection (2/8)	risk assessment (2/3)	MND 5
6	In the second meeting of the evaluating members, some members also questioned the plant and the equipment being empty, and Ching-Fu was unable to guarantee completion of the plant's building within 30 months. In fact, Ching-Fu had not completed the plant during the period from the date of winning the bid to present. Obviously, the risks associated with high uncertainty were not considered when the Ministry of National Defense allowed Ching-Fu to replace the real shipyard with a "promise" so as to obtain the bidding qualification, which was improper.	source selection (3/8)	risk assessment (3/3)	MND 6
7	When the original convener and the original deputy convener were absent from the second meeting of the evaluating members, in principle, another date should have been separately set for the meeting. Yet, the Ministry of National Defense neither dealt with the problem accordingly nor did it conduct the procedures to dismiss the original convener and the original deputy convener. Instead, it directly proposed a	source selection (4/8)	control activities (4/6)	MND 7

	temporary meeting at the beginning of the second meeting and let the members present elect the new convener and the new deputy convener by recommending each other. The procedure was obviously improper.			
8	According to the explanation made by the Ministry of National Defense, some of the members were absent from the meeting to avoid a conflict of interest. They should be ascertained by laws and dismissed. Furthermore, whether other suitable members should be employed additionally should be considered. Nonetheless, the Ministry of National Defense did not verify the reasons for all the members' absence and did not deal with the situation properly. There were flaws in the procedure.	source selection (5/8)	information communication (1/2)	MND 8
9	According to the scoring results of the second meeting of the evaluating members, two firms played to a draw twice. But based on the bidding documents, the Ministry of National Defense should firstly negotiate the "price" to avoid determining the firm with the most advantageous bid by lottery.	source selection (6/8)	control activities (5/6)	MND 9
10	This case was about procurement of major national defense weapons, but the quoted price of CSBC was NT\$33 million (US\$1.1 million) cheaper than that of Ching-Fu. In order to save public funds, price negotiations should have been conducted according to the specifications in the bidding firm selection notice. The Ministry of National Defense knew that negotiation was one of the conditions of re-evaluation but still determined the firm with the most advantageous bid by lottery, which was also improper.	source selection (7/8)	control activities (6/6)	MND 10
11	The Ministry of National Defense failed to clarify and to deal with the unreasonable abnormalities in the scores made by all the members in the second meeting of the evaluating members, which was an obvious flaw: In this case, the scoring results of a part of the items (such as "the first ship built in Taiwan") made by different members had	source selection (8/8)	information communication (2/2)	MND 11

	<p>obvious unreasonable differences, whereby some members scored 0 (the full score is 50) for this item because Ching-Fu just started to build ships in Taiwan from the second one. For this part, other members still scored 35 to 44 for Ching-Fu and had significant differences in recognizing whether the first ship of Ching-Fu was built in Taiwan. Some members' scoring order might have been affected by this. The Ministry of National Defense decided to make its choice by lottery without immediate clarification. The procedure was less complete.</p>			
--	---	--	--	--

Source: Taiwan Executive Yuan (2017).

APPENDIX B. ALLEGED INCIDENTS ASSOCIATED WITH FIRST BANK IN THE MINEHUNTER PROCUREMENT CASE

<p>1. The syndicated loan limit was NT\$20.5 billion (US\$683.3 million), including NT\$12.5 billion (US\$ 416.6 million) as the repayment bond of advance payment and NT\$8 billion (US\$266.6 million) as the revolving fund (including the issuing charge)</p> <p>2. As of October 24, 2017, the credit balance and the repayment bond of advance payment were NT\$7.263 billion (US\$242.1 million), the revolving fund of material purchase was NT\$7.466 billion (US\$248.8 million). The total amount including interest was NT\$14.729 billion (US\$490.9 million) and the total balance was NT\$15.411 billion (US\$513.7 million).</p> <p>3. The maximum probable loss of all Taiwanese banks was NT\$20.1 billion (US\$670 million), including NT\$12.5 billion (US\$416.6 million) as the maximum probable loss of the bank vaults participating in the minehunter loan syndication case.</p>				
No	Alleged Incidents and Fraudulent Loan Activities	Contract Management Phases (number/total)	Internal Control Components (number/total)	Reference Remark
1	The procurement amount of this item was NT\$34.933 billion (US\$1.2 million), and First Bank verified that the loan was NT\$20.5 billion (US\$683.3 million) (verification ratio 58.7%). In the loan syndication conditions, Ching-Fu was required to increase its capital, which indicated that, through loan verification, a financing gap had been foreseen at that time.	contract administration (1/12)	risk assessment (1/2)	FB 1
2	First Bank did not really analyze whether the company's cash flow forecast during the period from 2015 to 2025 provided by Ching-Fu was reasonable and did not really investigate the cash resources.	contract administration (2/12)	control activities (1/6)	FB 2
3	According to the loan syndication contract, Ching-Fu should have completed the capital increase of NT\$4 billion (US\$133.3 million) three times—in the first quarter of 2016, the third quarter of 2016, and in 2017. Ching-Fu did not complete the capital increase within the time limit, and after that, only completed the first two capital increases of NT\$2 billion (US\$66.6 million) in total. Moreover, NT\$2 billion (US\$66.6 million) should have been increased in 2017, which has not been completed yet.	contract administration (3/12)	control activities (2/6)	FB 3

4	As for Ching-Fu, the capital increase of NT\$750 million (US\$25 million) in the first quarter and the capital increase of NT\$300 million (US\$10 million) in the third quarter were acquired from the loan issued by First Bank to Qingyang Investment Company, which was Ching-Fu's major shareholder. Further, the NT\$300 million (US\$10 million) was guaranteed by shares of Ching-Fu and all the fishing boats of affiliate enterprises, but these fishing boats have reached the age of 13. Old fishing boats would cause hard disposal, which affected guarantee of debt rights.	contract administration (4/12)	risk assessment (2/2)	FB 4
5	Ching-Fu had negotiated with Bank of Taiwan, Mega Bank, Taiwan Business Bank, and Taiwan Cooperative Bank to prepare and organize the loan syndication. It was found that Singda Harbor made investment unattractive, which caused doubt about shipbuilding, so Mega Bank refused to lend money. Apparently, First Bank did not attach importance to Mega Bank's doubts.	contract administration (5/12)	control activities (3/6)	FB 5
6	According to the loan syndication contract, after the capital was employed the first time, the shipbuilding infrastructures of the shipyard were to be built and completed at Kaohsiung Singda Harbor within three years. After completion, the shipyard should establish the first mortgage to the loan syndication management bank. Yet, there was no monitoring after First Bank issued the loan.	contract administration (6/12)	control activities (4/6)	FB 6
7	First Bank also did not track the shipbuilding, schedule of the shipyard, and transfer of the project advance payment into First Bank's account.	contract administration (7/12)	control activities (5/6)	FB 7
8	First Bank did not confirm the supplier list or the contract details with the Ministry of National Defense, to ensure that the allegedly purchased objects complied with the military product procurement contract.	contract administration (8/12)	information communication (1/4)	FB 8
9	First Bank did not require Ching-Fu to propose the procurement contract which was signed with the equipment suppliers, to	contract administration (9/12)	information communication (2/4)	FB 9

	ensure that the objects and products being purchased complied with the military product procurement contract.			
10	Ching-Fu had three suppliers (Harbour Stand Limited, L3 Capital Limited, Ocean Kirin Limited) with business addresses in Hong Kong, and Hong Kong was not the place where the ships or weapons and equipment mentioned in the contract were supplied. First Bank failed to investigate the actual principals and business facts of these suppliers and providers of equipment related to minehunter, so as to evaluate whether the contract was complied with and whether the transactions were true.	contract administration (10/12)	information communication (3/4)	FB 10
11	The suppliers' invoices provided for the loan request by Ching-Fu showed that the signatures of two companies' principals (Harbour Stand Limited and L3 Capital Limited) were suspected to be the same. First Bank did not ascertain the background information of the two companies before allocating funds, so as to determine the truth of the transactions.	contract administration (11/12)	control activities (6/6)	FB 11
12	As for the fact that the account to which the remitted amount of Ching-Fu's procurement transactions was transferred was different with that of the country of the seller (Hong Kong), First Bank did not really investigate whether the funds which flowed to Singapore and Macau were consistent with the purpose of purchasing the equipment for the minehunter.	contract administration (12/12)	information communication (4/4)	FB 12

Source: Taiwan Executive Yuan (2017).

THIS PAGE INTENTIONALLY LEFT BLANK

APPENDIX C. PROCUREMENT FRAUD SCHEMES ASSOCIATED WITH CHING-FU

Item	Procurement Fraud Schemes	Description	Reference Remark
1	Fraudulent Representation (fraudulent capital increase)	There are three methods by which Ching-Fu increased capital. One was to increase its capital by collecting the loan from its major shareholder Ching Yang Investment company. The second method was to borrow money from shareholders, after getting registration documents and then transferring the money back to shareholders. The third was to fill the capital registration application paper without increasing capital. Ching-Fu increased its capital from US\$17.6 million to US\$166.6 million by fraudulent activities five times and successfully got registration to meet the syndicated loan application requirement and disbursement. After the contract was awarded, to apply for a syndicated loan, Ching-Fu had to increase its capital from US\$17.6 million to US\$100 million, which it claimed it did on the capital registration application paper without actually increasing its capital. After First Bank approved the loan syndication, according to the loan contract, Ching-Fu had to do three more capital increases to get the disbursement. Ching-Fu only finished two capital increases by its subsidiary's loan of US\$35 million from First Bank and shareholder's money.	CF 1
2	Fraudulent Representation (fake invoices and contracts)	To obtain a working capital loan, Ching-Fu established several overseas shell companies, such as Harbour Stand Limited, L3 Capital Limited, and Ocean Kirin Limited. The son of Ching-Fu's executive is the head of the shell companies. Ching-Fu created fake contracts and business invoices representing that Ching-Fu was procuring minehunter equipment form the shell companies. Ching-Fu got a working capital loan by using fake contracts and invoices.	CF 2
3	Collusion (shell company)	Ching-Fu established the shell companies to create fake contracts and invoices. Ching-Fu forged the contract with a false title, which states a purchasing deal with shell companies, and then it added the real contract content listing products and schedule extracted from the original naval contract. Then Ching-Fu created fake invoices to apply for a working capital loan and get disbursement.	CF 3
4	Collusion (money laundering)	To hide the illegally gained money, after receiving funds from banks, Ching-Fu transferred the money to overseas accounts to escape the tracing.	CF 4

Source: Kaohsiung District Prosecutor's Office (2017).

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF REFERENCES

- Black's law dictionary* (8th ed.). (2004). St. Paul, MN: Thomson/West.
- Boss, S. R., Kisch, L. J., Andermeier, I., Shingler, R. A., & Boss, R. W. (2009, April). If someone is watching, I'll do what I'm asked: Mandatoriness, control and information security. *European Journal of Information System*, 18(1), 151–164.
- Castillo, J. C., & Flanigan, E. M. (2014). *Procurement fraud: A knowledge-level analysis of contracting personnel* (Master's thesis). Retrieved from Calhoun <http://hdl.handle.net/10945/44533>
- Chen, W. (2017, November 3). Banks face NT\$20bn loss in Ching-Fu loan blunder. *The Taipei Times*. Retrieved from <http://www.taipeitimes.com/News/front/archives/2017/11/03/2003681553>
- Committee of Sponsoring Organizations of the Treadway Commission. (2013). Internal control—Integrated framework, executive summary. Retrieved from http://na.thesis.org/standards-uidance/topics/Documents/Executive_Summary.pdf
- Crawford, L.H., and Helm, J. (2009), Government and governance: the value of project management in the public sector. *Project Management Journal*, 40(1), 73–87.
- Definitions of Words and Terms, FAR 2.101. (2019). Retrieved from <http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/02.htm>
- Department of Defense Inspector General. (2009). *Summary of DoD Office of Inspector General audits of acquisition and contract administration* (DoD IG Report No. D-2009-071). Washington, DC: Author.
- Department of Defense Inspector General. (2014). *DoD needs to improve processes for issuing and managing cost-reimbursement contracts* (DoD IG Report No. D-2015-029). Washington, DC: Author.
- Frame, D. L. (1999). *Project management competence: Building key skills for individuals, teams, and organizations*. San Francisco, CA: Jossey-Bass.
- Fulcoon, M. (2018, April 24). Will a loan scandal sink Taiwan's warship-building ambition? *Taiwan Business Topics*. Retrieved from <https://topics.amcham.com.tw/2018/04/will-a-loan-scandal-sink-taiwans-warship-building-ambitions/>
- Garrett, G. A. (2007). *World class contracting* (4th ed.). Chicago, IL: CCH.
- Garrett, G. A. (2009). *Contract administration: Tools, techniques, and best practices*. Chicago, IL: CCH.

- Global Security. (2019, April 30) Navy modernization. Retrieved from <https://www.globalsecurity.org/military/world/taiwan/navy-mod.htm>
- Government Accountability Office. (1999). *Standards for internal control in the federal government*. Washington, DC: Author. Retrieved from <http://www.gao.gov/special.pubs/ai00021p.pdf>
- Government Accountability Office. (2001, August). *Internal control management and evaluation tool* (GAO-01-1008G). Washington, DC: Author. Retrieved from <https://www.gao.gov/new.items/d011008g.pdf>
- Government Accountability Office. (2002, September). *Purchase cards: Navy is vulnerable to fraud and abuse but is taking action to resolve control weaknesses* (GAO-02-1041). Retrieved from <http://www.gao.gov/new.items/d021041.pdf>
- Government Accountability Office. (2012). *DoD initiative to address audit backlog shows promise, but additional management attention needed to close aging contracts* (GAO-13-131). Washington, DC: Author. Retrieved from <http://www.gao.gov/products/GAO-13-131>
- Government Accountability Office. (2013, February). *High risk series: An update* (GAO-13-283). Washington, DC: Author.
- Government Accountability Office. (2014). *Standards for internal control in the federal government* (GAO-14-704G). Retrieved from <http://www.gao.gov/assets/670/665712.pdf>
- Government of Taiwan (2019). *Taiwan government procurement act*. Retrieved from <https://www.pcc.gov.tw/cp.aspx?n=2BE68E5656E06EFA>
- Gramling, A. A., Hermanson, D. R., Hermanson, H. M., & Ye, Z. (2010, July). Addressing problems with the segregation of duties in smaller companies. *CPA Journal*, 30–34. Retrieved from <http://web.a.ebscohost.com.libproxy.nps.edu/ehost/>
- Grennan, J. A., & McCrory, M. A. (2016). *Auditability in the U.S. Navy: Knowledge assessment of the contracting workforce* (Master's thesis). Retrieved from <https://calhoun.nps.edu/handle/10945/5170>
- Haberbush, K. L. (2000). Limiting the government's exposure to bid rigging schemes: A critical look at the sealed bidding regime. *Public Contract Law Journal*, 30, 97–122.
- Hsieh, C., & Chin, J. (2019, February 22). Agencies censured over minesweeper scandal. *Taipei Times*. Retrieved from <http://www.taipeitimes.com/News/taiwan/archives/2019/02/22/2003710205>

- Huang, C. & Peng, W. (2017, November 5). Two teams established to investigate Ching-Fu case. *Taipei Times*. Retrieved from <http://www.taipeitimes.com/News/taiwan/archives/2017/11/05/2003681700>
- Kan, S. A. (2014, August 29). Taiwan: Major U.S. arms sales since 1990. Retrieved from <https://fas.org/sgp/crs/weapons/RL30957.pdf>
- Lu, H., L., Tien, Y., & Kao, E. (2017 November 21). Military defends contract payment to Ching-Fu Shipbuilding Co. *Focus Taiwan News Channel*. Retrieved from <http://focustaiwan.tw/news/aip1/201711210024.aspx>
- Minnick, W. (2016, June 23). Taiwan moves on \$14.7B indigenous shipbuilding, upgrade projects. *Defense News*. Retrieved from <https://www.defensenews.com/naval/2016/06/23/taiwan-moves-on-14-7b-indigenous-shipbuilding-upgrade-projects/>
- National Contract Management Association. (2017). *Contract management body of knowledge* (5th ed.). Ashburn, VA: Author.
- Pan, J. (2019, February 2). Retired admirals impeached over scandal. *Taipei Times*. Retrieved from <http://www.taipeitimes.com/News/front/archives/2019/02/02/2003709094>
- Power, M. (1996). Making things auditable. *Accounting, Organizations and Society*, (21)2, 289–315.
- Power, M. (2007), *Organizations and auditability: A theory*, vol. 9. UK: Lancaster University.
- Rendon, J. M., & Rendon, R. G. (2015, March 22). *Defense procurement: An analysis of contract management, internal controls* (NPS-CM-15-003). Monterey, CA: Naval Postgraduate School.
- Rendon, J. M., & Rendon, R. G. (2016). Procurement fraud in the U.S. Department of Defense: Implications for contracting processes and internal controls. *Managerial Auditing Journal*, 31(7), 748–767. Retrieved from <https://doi.org/10.1108/MAJ-11-2015-1267>
- Rendon, R. G. (2008). Contract management. In R. G. Rendon & K. F. Snider (Eds.), *Management of defense acquisitions*. Monterey, CA: American Institute of Aeronautics and Astronautics.
- Rendon, R. G., & Rendon, J. M. (2015). Auditability in public procurement: An analysis of internal controls and fraud vulnerability. *International Journal of Procurement Management*, 8(6), 710–730. Rollins, S.C., & Lanza, R.B. (2005). *Essential project investment governance and reporting: Preventing project fraud and ensuring Sarbanes-Oxley compliance*. Fort Lauderdale, FL: J. Ross Publishing.

- Silverstone, H., & Davia, H.R. (2005). *Fraud 101: Techniques and strategies for detection* (2nd ed.). Hoboken, NJ: Wiley.
- Statement of Guiding Principles for the Federal Acquisition System. FAR 1.102. (2017), Retrieved from http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/01.htm#P9_1033
- Straits Times*. (2018, February 13). Chairman of Taiwan navy contract ship firm charged with fraud. Retrieved from <https://www.straitstimes.com/asia/east-asia/chairman-of-taiwan-navy-contract-ship-firm-charged-with-fraud>
- Taipei Times*. (2017, December 14). Ministry terminates Ching-Fu deal for six minesweepers. Retrieved from <http://www.taipeitimes.com/News/front/archives/2017/12/14/2003683938>
- Taiwan Executive Yuan (2017) *The Investigation Report of the Executive Yuan on the Taiwan Navy minehunter procurement case*, Department of Information Services, Executive Yuan Retrieved from <https://www.ey.gov.tw/Page/9277F759E41CCD91/2cf6077a-3cb4-45c8-8090-920c5f9c636e>
- Taiwan Kaohsiung District Prosecutor's Office (2017), *Indictment of Ching-Fu Company's fake financial capital increase, fraudulent loans, and money laundering on the Taiwan Navy minehunter procurement case*, Department of Information Services, Kaohsiung District Prosecutor's Office, Retrieved from <http://www.ksc.moj.gov.tw/ct.asp?xItem=502359&ctNode=44787&mp=021>
- Tradeoff Process. FAR 15.101-1. (2017). Under Secretary of Defense (AT&L). (2011, March 4). *Department of defense source selection procedures*. Washington, DC: Author. Retrieved from <https://www.acq.osd.mil/dpap/policy/policyvault/USA004370-14-DPAP.pdf>
- U.S. Office of Government Ethics (OGE). (2007, July). *Ethics & procurement integrity handbook*. Washington, DC: Author. Retrieved from http://www.oge.gov/uploadedFiles/Education/Education_Resources_for_Ethics_Officials/Resources/bkprocurementintegrity_07.pdf
- Vona, L. W. (2011). *The fraud audit*. Hoboken, NJ: Wiley.
- Wells, J. T. (2001, February 1). Why employees commit fraud. *Journal of Accountancy*, 191(2), 89–91. Retrieved from <http://www.journalofaccountancy.com/issues/2001/feb/whyemployeescommitfraud.html>
- Wells, J. T. (2005). *Principles of fraud examination* (1st ed.). Hoboken, NJ: John Wiley and Sons.
- Wells, J. T. (2014). *Principles of fraud examination* (4th ed.). Hoboken, NJ: John Wiley and Sons.

INITIAL DISTRIBUTION LIST

1. Defense Technical Information Center
Ft. Belvoir, Virginia
2. Dudley Knox Library
Naval Postgraduate School
Monterey, California