Review of Consultant/Professional Services Cost Accounts

Table of Contents

Risk Assessment – Research and Planning

Entrance Conference

Preliminary Analytical Procedures

Results from Preliminary Analytical Procedures

Audit Team Brainstorming for Fraud Risk Assessment

Results from Audit Procedures

Expanded Audit Procedures and Results

Further Actions

General Comments/Lessons Learned

Fraud Indicators

Risk Assessment- Research and Planning

The auditor was assigned to review the consultant and professional services costs for contractor XYZ's incurred cost audit. The auditor first reviewed the permanent files, prior incurred cost audit reports and working papers, accounting system audit, and other relevant internal control audits. Based on the information gathered, the auditor identified the following relevant risk factors:

- Previous incurred cost audits questioned consultant and professional services costs charged to the General and Administrative (G&A) Pool because the contractor did not provide adequate documentation supporting that services procured were for allowable activities.
- Defense Contract Audit Agency (DCAA) also issued an accounting system deficiency report stating that XYZ had inadequate controls to reasonably preclude unallowable consultant and professional services costs from being charged or allocated to Government contracts. Deficiencies identified included incomplete files for purchased services, inadequate competition, vague service specifications/requirements, and invoices or trip reports that did not provide sufficient information about the work performed. The contractor disagreed with the report findings.

Entrance Conference

The auditor held an entrance conference with the contractor's representative to discuss the audit and the contractor's controls over consultant and professional services costs. The contractor's representative stated that controls over consultant costs were adequate despite the DCAA-reported deficiencies; and therefore, the contractor had not implemented the recommended corrective actions. The contractor's representative stated that its key management control was an independent review of the costs charged by individuals who prepared the incurred cost submission. The auditor then requested:

- a detailed listing of all consultants and professional services firms charged directly or indirectly to Government contracts that included the individual or firm name, cost account charged, amount paid, and a detailed description of services performed;
- a complete list of all Form 1099-MISC recipients with the total amounts paid; and
- any internal audit reports or similar products addressing or discussing professional or consultant or professional services or costs.

Entrance Conference (Cont'd)

In addition, the auditor asked the contractor's representative the following series of questions.

Auditor Question: "What fraud risks has XYZ identified pertaining to consultant and professional services contracts?"

Contractor Response: "We consider the risk of fraud for these costs to be low."

Auditor Question: "What is the basis for this assessment?"

Contractor Response: "The company has determined through its corporate fraud risk assessment process that this area is not particularly vulnerable to fraud. Thus, company management is willing to assume the risk as they think the probability of occurrence and the overall impact of any potential fraud would be low."

Auditor Question: "Are you aware of any allegations or investigations regarding XYZ's consultant or professional services charges?"

Contractor Response: "I am unaware of any allegations or investigations regarding consultants."

Auditor Question: "Has XYZ submitted, or is planning to submit, any contractor disclosures related to consultants or professional services costs?

Contractor Response: "XYZ has not submitted any contractor disclosures regarding consultant or professional services contracts. I am unaware of any planned submittal of a contractor disclosure for consultant costs."

Preliminary Analytical Procedures

The auditor performed the following preliminary analytical procedures:

- compared the costs charged to the consultant and professional services cost accounts in the overhead and G&A pools to the previous 3 years' actual costs,
- compared each year's actual charges to the corresponding amounts in the relevant year's budgeted amounts to determine and analyze the historical relationship between budgeted and actual costs,
- compared consultant and professional services costs charged to the Government to the amounts on the Form 1099-MISC recipients listing provided by the contractor, and
- reviewed the detailed listing of all consultants and professional services firms charged directly or indirectly to Government contracts to determine what services were provided and identify high-risk areas for further review.

Results from Preliminary Analytical Procedures

The auditor developed the following additional risk factors:

- Costs shown on the incurred cost submission for both consultant and professional services G&A costs increased substantially from the prior year's actual and budgeted costs. The same overhead costs increased only marginally over the past 3 years.
- The costs shown on the Form 1099-MISC recipient listing did not reconcile to the consultant and professional services costs claimed in the submission.
- Fifty percent of the consultants and professional services firms on the detailed listing were on a retainer fee basis; legal and sales/marketing were the most significant types of services performed.
- The auditor could not ascertain the nature or type of the services provided for about
  30 percent of the consultants on the listing because the descriptions listed for the services provided were too general.

Audit Team Brainstorming for Fraud Risk Assessment

The auditor met with the **supervisor**, **lead auditor for incurred cost audit**, and **incurred cost technical specialist** to brainstorm about the risk of fraud, based on the information and issues the auditor had obtained, reviewed, and identified to date. The audit team recognized that many of these factors represent fraud risk indicators; therefore, the overall risk increased that consultant and professional services costs in the submission could include unallowable costs.

Audit Team Brainstorming for Fraud Risk Assessment (Cont'd)

To address the indicators, the audit team decided that the following audit steps should be performed.

- A review of the contractor's reconciliation of the Form 1099-MISC costs to the costs on the submission to identify for further review any previously unidentified consultants or professional service providers.
- A 100 percent review of all consultants and professional services firms with identified high-risk factors on the detailed listing. The auditor should perform a more in-depth nomenclature review of the detailed listing of all consultants and professional services suppliers provided by the contractor and select any consultants/vendors for which a high-risk of unallowable cost could exist. This could include legal and/or accounting services for merger/acquisition activities and/or fraud investigations, marketing/sales services, and consultants with general or vague service descriptions. The 100 percent review should also include those consultants not used in previous years.
- A statistical sample of remaining consultants and professional services firms with a larger sample size since the auditor is expecting a high amount of questioned costs (high expected error rate) and is unwilling to accept the risk that the questioned cost will not be identified in the sample reviewed (low tolerable misstatement).

Audit Team Brainstorming for Fraud Risk Assessment (Cont'd)

For all selected consultants and professional services firms, the auditor should do the following.

- Obtain the procurement file and other available documentation to support that consultants and professional services firms' activities are allowable in accordance with the Federal Acquisition Regulation (FAR) and benefit the business as a whole. Items to be reviewed would include the agreement details; evidence of work performed such as trip reports, meeting minutes, and deliverables; and invoices with details of services rendered.
- Compare the rates paid to other consultants on the listing that performed similar or comparable services. In particular, review the justification for significant increases from previous years in rates paid to individual consultants or professional services firms.
- Obtain additional information to help determine what services might have been provided by the consultants or professional services firms for which the contractor did not provide sufficient detailed information. Information sources include the internet, financial reporting records, Board of Directors meeting minutes, and databases for lobbyist activities.

Results from Audit Procedures

The auditor determined the following based on the review of selected procurement files and supporting documents for selected consultants and professional services firms from both the statistical and non-statistical samples.

- About 40 percent of the consultants and professional services firms reviewed contained proper supporting documentation with detailed consultant/professional services agreements, invoices, and reports. The subjects covered were germane to the contractor's operations and provided appropriate recommendations to improve the efficiency of certain operations. The contractor implemented the majority of the recommendations.
- About 20 percent of the consultants and professional services firms reviewed were for legal services provided on a retainer basis.
  - Ten retainer agreements were with law firms the contractor had used extensively during each of the past 3 years for various legal matters considered allowable. The applicable agreements contained the necessary level of detail, and the fees were considered reasonable
  - Three retainer agreements were with law firms whose services were not previously used and for which the contractor did not have any supporting documentation other than the retainer agreement. The agreement stated only that the firm would be performing various legal services as determined necessary using the attached rate schedule.

Results from Audit Procedures (Cont'd)

- An additional 20 percent of the consultants and professional services firms reviewed were also for services provided on a retainer-fee basis that, as described in the agreements, appeared to be marketing. Invoices for specific services were reviewed in addition to those for the retainer fees. The auditor determined:
  - the invoices were vague in describing services rendered and only referred to the retainer agreement;
  - the expenses were for a lump sum with no breakdown of hours expended, hourly rate, travel expenses, or other expenses;
  - no trip reports or other summary reports were available;
  - the invoices showed a post office box as a mailing address; and
  - the telephone directory and the internet did not contain a listing for the firm.

Results from Audit Procedures (Cont'd)

- The individuals' resumes were also not available, and the retainer fees were higher for those firms than the law firms. The contractor's representative could not explain the higher fees or the specifics of what services were provided or were covered by the retainer agreement.
- A Form 1099-MISC recipient was not on the consultant listing, and those payments accounted for the previously identified differences between the consultant cost accounts on the submission and the amounts on the contractor-provided list of 1099-MISC recipients. The recurring monthly cost for this individual was charged to the G&A miscellaneous expense account. However, the contractor was unable to provide any agreements or evidence of work performed other than the monthly invoices with a vague description of "consultant services provided" and checks for amounts paid to the consultant. The auditor was unable to obtain any additional information through an independent review of the internet or other sources.

Expanded Audit Procedures and Results

The audit team discussed the results of the testing and decided to expand testing and perform additional procedures.

- The auditor discussed the testing results with the contractor's representative and again asked for any additional information and supporting documentation. However, the contractor's representative stated that all available records had been provided. The auditor requested that the contractor provide that statement in writing.
- The auditor determined that services rendered by one marketing consultant were for unallowable business acquisition activities; and therefore, the auditor identified and reviewed all invoices submitted by the consultant.
- The auditor requested data regarding any unallowable in-house costs, such as labor or travel, directly related to the unallowable activities the auditor identified. The contractor's representative provided the requested data and explained that these costs were just missed when the incurred cost submission was prepared.

Expanded Audit Procedures and Results (Cont'd)

- Overall the auditor was unable to substantiate the allowability of more than the half the consultant or professional services firms' transactions reviewed and, thus, questioned the cost. The questioned costs were all in the G&A Pool, represented 10 percent of the pool costs, and included:
  - all costs for the marketing consultant that provided unallowable business acquisition services;
  - directly related contractor labor and travel for the unallowable business acquisition activities; and
  - all costs for consultants and professional services providers that were not adequately supported.

The auditor also reclassified all costs for one marketing consultant from the G&A Pool to a firm-fixed-price contract because the costs directly related to only that contract.

Further Actions

The audit team again discussed the review results and decided to take the following actions:

- Contact the Administrative Contracting Officer (ACO) to determine what actions the ACO is taking to resolve the continuing accounting system deficiency.
- Discuss with the audit office manager and regional audit manager issuing a notice to the appropriate official to suspend reimbursement of the questioned cost to protect the Government's interests. DCAA generally issues a Form 1, Notice of Costs Suspended and/or Disapproved to the ACO.
- Contact a local DoD criminal investigator to informally discuss the audit results and issuance of a fraud referral, and
- Draft a written fraud referral, DCAA Form 2000, based on the identified patterns of inconsistent support and the expressly unallowable costs.

For an example of a Form 2000, see www.dodig.mil/resources/fraud/pdfs/DCAAF2000_5505.pdf.

General Comments/ Lessons Learned

As defined in the FAR, professional and consultant services are those services rendered by persons who are members of a particular profession or possess a special skill and who are not officers or employees of the contractor. Contractors hire consultants for a multitude of services (such as legal, economic, financial, or technical). These cost accounts are considered sensitive because of the increased risk that the services procured or the costs charged may be unallowable, unreasonable, or even illegal. The contractor may be hiding payments for illegal activities by charging them as "consultant fees" and maintaining no or only minimal supporting documentation. (See the scenarios for bribery and kickback schemes and for lobbying, earmarks, and political contributions.) The auditor needs to exercise professional skepticism in selecting and reviewing the transactions. The auditor should also be alert to certain documentation patterns. For example, certain transactions are fully supported, but others have minimal or no support to identify the nature of the services provided and their allowability. The contractor's possible objective in not maintaining adequate support is to encourage the auditor to question the cost rather than spend the time identifying the true nature of the payments. In contrast, when the contractor produces the required supporting documentation but with unreasonable delays, the auditor should consider whether the support could have been created just for the auditor.

Fraud Indicators

- No formal signed agreements or contracts; however, large sums paid for "services rendered" based on invoices with few specifics.
- Formal agreements or contracts exist but are vague as to services to be rendered, and no other documented support, such as detailed invoices, trip reports, or studies, exists to justify the expenses.
- Services paid for were used to improperly obtain, distribute, or use information or data protected by law or regulation.
- Services paid for were intended to improperly influence the content of a solicitation, the evaluation of a proposal or quotation, the selection of sources for contract award or the negotiation of a contract, modification, or claim. It does not matter whether the award is from the Government, a prime contractor, or any tier subcontractor.
- Services paid for were obtained or performed in some way that violated a statute or regulation prohibiting improper business practices or conflict of interest.
- Services paid for violated a Federal, state, or local statute or regulation.
- Services paid were recorded in unusual accounts or cost objectives.