



## Comprehensive List of Fraud Indicators

This document provides links to our contract audit resources. The scenarios are grouped by audit type, but the issues presented could be applicable to other audits as well. The table below lists the various scenarios available on our website (<http://www.dodig.mil/fraud-resources/contractaudit>). The 'Cost Type' column identifies the major cost element related to the listed scenario.

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### **General Fraud Indicators**

- Management override of key controls.
- Inadequate or weak internal controls.
- No written policies and procedures.
- Overly complex organizational structure.
- Key employee never taking leave or vacation.
- High turnover rate, reassignment, firing of key personnel.
- Missing electronic or hard copy documents that materialize later in the review.
- Lost or destroyed electronic or hard copy records.
- Photocopied documents instead of originals. Copies are poor quality or illegible.
- “Unofficial” electronic files or records instead of “archived” or “official” files or records.
- Revisions to electronic or hard copy documents with no explanation or support.
- Use of means of alteration to data files.
- Computer-generated dates for modifications to electronic files that do not fit the appropriate time line for when they were created.
- Missing signatures of approval or discrepancies in signature/handwriting.
- Computer report totals that are not supported by source documentation.
- Lengthy unexplained delays in producing requested documentation.

### **Management Related Fraud Indicators**

- Failure to display and communicate an appropriate attitude regarding the importance of internal control, including a lack of internal control policies and procedures; ethics program; codes of conduct; self-governance activities; and oversight of significant controls.
- Displaying through words or actions that senior management is subject to less stringent rules, regulations, or internal controls than other employees.
- Significant portion of compensation being incentive-driven based on accomplishment of aggressive target goals linked to budgetary or program accomplishments or stock prices.
- High turnover of senior executives or managers.
- Hostile relationship between management and internal and/or external auditors. This would include domineering behavior towards the auditor, failure to provide information, and limiting access to employees of the organization.
- Failure to establish procedures to ensure compliance with laws and regulations and prevention of illegal acts.
- Indications that key personnel are not competent in the performance of their assigned responsibilities.
- Adverse publicity concerning an organization's activities or those of senior executives.
- Lack of, or failure to adhere to, policies and procedures requiring thorough background checks before hiring key management, accounting, or operating personnel.
- Inadequate resources to assist personnel in performing their duties, including personal computers, access to information, and temporary personnel.
- Failure to effectively follow-up on recommendations resulting from external reviews or questions about financial results.
- Nondisclosure to the appropriate Government officials of known noncompliances with laws, regulations, or significant contract or grant provisions.
- Directing subordinates to perform tasks that override management or internal controls.
- Undue interest or micromanagement of issues or projects that most knowledgeable individuals would identify with a substantially lower level manager.
- A manager that claims disinterest or having no knowledge about a sensitive or high profile issue in which you would expect management involvement.
- Constant over usage or inappropriate use of cautionary markings on management or organizational documents such as "Attorney Client Privilege/Attorney Work Product," "For Official Use Only," or other markings indicating an item is business sensitive or has a higher security classification than is appropriate.

### **Review of Consultant/Professional Services Cost Accounts**

- 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.

### **Subcontractor/Vendor Kickbacks**

- None or few contractor policies on ethical business practices including lack of anti-kickback training required for both employees and subcontractor employees.
- Poor enforcement of existing contractor policies on conflicts of interest or acceptance of gratuities.
- Poor contractor internal controls over key functional areas, such as purchasing, receiving, and storing.
- Lack of separation of duties between purchasing and receiving.
- Lack of separation of duties in the purchasing department. Buyers should be rotated to prevent familiarity with specific vendors.
- Indications of poor or no established contractor procedures for competition of subcontracts such as:
  - lack of competitive awards;
  - poor documentation supporting award of subcontracts, particularly sole-source awards;
  - lack of or inadequate cost/price analysis for subcontract awards; and
  - non award of subcontract to lowest bidder.
- Instances of buyers or other employees circumventing established contractor procedures for competition of subcontracts.
- Purchasing employees maintaining a standard of living obviously exceeding their income.
- A one-time payment for services or materials usually bought from another vendor(s). The kickback recipient could be using the company to obtain his payoff.
- Supporting documents for transactions that indicate potential payments of commissions, entertainment, travel, expensive gifts or un-repaid loans to prime contractor personnel or government officials.
- Indications of patterns or relationship between potential irregular payment transactions and contracting/subcontracting actions such as awards, change orders, modifications, or other favorable contracting actions.
- Equipment charged to contract that cannot be located.
- Services charged to contract that cannot be substantiated as performed.

### **Adjusting Journal Entries-Labor Transfers**

- Transfers from fixed-price Government or commercial contracts.
- Transfers from or to cost-type Government contracts.
- Transfers from or to indirect accounts.
- Transfers from contracts to Bid and Proposal (B&P) and Independent Research and Development (IR&D) accounts.
- Transfers to any type of holding or suspense account.
- Transfers from one contract line item or work order to another line item or work order on the same contract but with different appropriations.

## Direct and Indirect Labor

- Distinctive potential mischarging patterns:
  - Sudden, significant shifts in charging.
  - Decrease in charges to projects/contracts in overrun position or near ceilings.
  - A disproportionate percentage of employees charging indirect when compared to the contractor's normal or historical charging practices.
- Large number of employees reclassified from direct to indirect or vice versa.
- Same employees constantly reclassified from direct to indirect or vice versa.
- Weak internal controls over labor charging:
  - Employee time cards completed in advance.
  - Employee time cards completed by the supervisor.
  - Adjustments to time cards without adequate explanation and/or authorization by employee.
  - Inadequate processes for work authorization and assignment of charge codes.
- Actual hours and dollars consistently at or near budgeted amounts.
- Use of adjusting journal entries to shift costs between contracts, Independent Research and Development (IR&D), Bid and Proposal (B&P), commercial work, particularly when made a considerable time after when the costs were originally incurred.
- Significant increases or decreases in charging to sensitive accounts.
- Differences between what employees are actually working on or observed to be working on and recorded timesheet charges.
- Differences between employee timesheet charges and labor accounting records.
- Employee's time charged differently than associated travel costs.
- Employee's time charged differently than statements in contract status report deliverables submitted to the Government.

### **Expressly Unallowable Costs**

- Claiming expressly unallowable costs.
- Claiming costs determined to be unallowable/non-reimbursable prior to the certification of the incurred cost submission.
- Claiming mutually agreed to unallowable costs, including directly associated costs, in a certified incurred cost submission.
- Claiming costs that were verbally agreed to or conceded to as unallowable in a certified incurred cost submission when:
  - the agreement occurred prior to the submission in question;
  - the process involved bidding rates, billing rates or a prior year's final indirect rates; and
  - the contractor changed the account that the costs were charged to in an apparent attempt to hide or conceal the costs.
- Repeated failure to correct reported accounting system deficiencies involving charging or claiming of unallowable costs.
- Billing expressly unallowable costs, costs determined unallowable, or mutually agreed to be unallowable.



### **Improper Billing of Costs on Progress Payments**

- Slow in paying suppliers or non-payments to suppliers, employees or government entities.
- Billing costs that were not incurred on the contract.
- Lack of support for calculations of key figures, such as estimate to complete (ETCs) or cost of undelivered work.
- ETCs that are not developed within 6 months of the progress payment date and/or do not reflect current contract delivery schedule or work performance.
- ETCs used for billing or contract performance reports that differ from other internal financial projections without reasonable explanation.
- Little or no physical progress even though significant costs have been billed and the contract delivery schedule indicates that significant physical progress should have occurred.
- Continued work performance, delivery or rework issues identified by Government official.
- Supporting documents missing or unavailable for review.
- Unreasonable time period for contractor to produce records that should be readily available.

### **Material Transfers and Material Management and Accounting System (MMAS)**

- Transfers from ongoing jobs to open work orders for items previously delivered.
- Transfers from ongoing jobs to open work orders for items scheduled for delivery in the distant future.
- Transfers from Government contracts (projects) to commercial projects.
- Transfers from cost-type job orders to fixed-price job orders.
- Transfers at costs substantially different (higher or lower) than actual costs.
- Mass transfers from one job order to various other job orders. No physical inventory is left on the original job order, but it still has costs charged to it.
- Patterns of material transfers that are not compliant with established policies and procedures.

### **Forward Pricing Proposal – Labor Categories**

- Significant differences between proposed and actual labor rates or number of hours with no corresponding changes in work scope or job requirements.
- Task-by-task billings consistently at the ceiling level established in the contract. An exception would be if the contract/work order specifies how many hours to bill.
- Individuals proposed as "key employees" not working on the contract.
- Proposed labor not based on existing work force. Massive new hires needed. New hire labor rates significantly lower than proposed.
- Employees' skills do not match the skill requirements as specified for their labor category or the contract requirements.
- Employees typically charged indirect by the company being charged direct to the contract.
- Partners', officers', supervisors' and other high level employees' time being charged in noncompliance with the contract terms or with the company's established accounting policies and procedures.
- Changes in the company's labor charging policies and procedures depending on the type of contract [fixed-price, cost-type, time and material (T&M) or commercial)].
- Repeated noncompliance with Cost Accounting Standards 402, "Consistency in Allocating Cost Incurred for the Same Purpose, "for labor. An example involving labor would be repeatedly charging administrative labor direct sometimes and indirect other times when the employees are essentially performing the same function under like circumstances.

### **Falsification of Documents**

- Information on the supporting document provided does not match information obtained from third party sources, such as confirmation letters to vendors, subcontractors, or assist audits.
- Information on the supporting document conflicts with other available contractor information or related source documents.
- Unreasonable delays in providing supporting documentation that should be readily available.
- Unreasonable or unexplained delays in providing agreed-to briefings/walk-throughs or access to employees with pertinent knowledge to the subject matter being audited.
- Differing supporting documents provided for the same costs in separate audits.
- Original documentation consistently unavailable for the auditor's review.
- Consistently poor, illegible copies of supporting documentation.
- Different supporting documents provided for the same item with unit prices varying widely for the same part, for no obvious reason.
- Changes to the original documentation that do not appear to be authentic, such as different print or incorrect spacing.

### **Material Pricing Deficiencies**

- A significant variance between proposed and negotiated vendor/ subcontract quantities or prices.
- Use of different vendors or subcontractors than proposed.
- Contractor using higher budgetary/planning quotes to support proposal or negotiations knowing that lower firm quotes have been or will be submitted on request.
- Contractor using higher courtesy bids to support proposal or negotiations knowing that lower bids are or will be available. Courtesy bids also increase the lowest bid.
- Failure to disclose the existence of a decrement factor, purchase discount or historical negotiation experience with vendors.
- Specific knowledge that is not disclosed regarding significant cost issues that will reduce the proposed cost.
- Consistent failure to update submitted cost or pricing data prior to agreement on price.
- Repeated defective pricing involving similar patterns or conditions.
- Continued failure to make complete disclosure to the Government of data known to responsible personnel.
- Denial by responsible contractor employees of the existence of historical or other records that are later found.
- Continued failure to correct known business system deficiencies that impact or allow for submission of proposal data that is not accurate, complete or current.

### **Repetitive Bidding of Duplicative Material Costs**

- Repetitive noncompliance with the contractor's disclosed bidding/estimating practices.
- Repetitive, significant noncompliances with CAS and/or the contractor's CAS Disclosure Statement.
- Inconsistencies between the proposal bill of material and the engineering and/or manufacturing bill of material.
- Proposed material requirements that cannot be verified to engineering drawings or other production documents.
- Nomenclature similarities between proposed direct material items and items normally bid indirect as part of an overhead rate or as part of a material cost estimating factor.
- Vague terms used to bid materials based solely on management's judgments or rough estimates.

### **Defective Pricing Selective Disclosure**

- Failure to correct known system deficiencies, especially those that the contractor agreed to correct.
- Failure to consider all relevant historical data in developing proposed costs.
- Specific knowledge that is not disclosed regarding significant cost issues that would reduce the proposed cost.
- Repeated denial by responsible contractor employees of the existence of historical records that are subsequently found.
- Refusing to provide requested data.
- Inconsistencies between contractor statements and records reviewed.
- Multiple instances of defective pricing involving similar patterns or conditions.

### **Subcontract Pricing Deficiencies**

- A significant variance between proposed and negotiated vendor/subcontract quantities or prices.
- Use of different subcontractors or vendors than proposed.
- High percentage of sole source (noncompetitive) subcontract awards with poor explanations/documentation.
- Non-competitive subcontract award when the contractor's files state that award was based on adequate competition.
- Failure to disclose decreases in subcontract pricings even though parts of the subcontracts are still under negotiation.
- Pattern of subcontractor employees buying contractor employees lunches, dinners and/or other items. Individual items could be of low value, but the aggregate value of all items could be material.
- Indicators of personal or family associations between contractor and subcontractor employees involved in the awarding and negotiating of subcontracts.
- Continued failure to correct known business system deficiencies that impact or allow for subcontract pricing deficiencies.



### **Uncompensated Overtime**

- Professional salaried/exempt staff required to work a significant amount of unpaid overtime on a variety of projects, both direct and indirect.
- Salaried/exempt employees only charging the first 8 hours worked during any day for an extended period.
- A pattern of management-directed unpaid overtime being worked with employee bonuses based on the extra hours worked.
- Cost-type Government contracts worked during the first 8 hours and fixed price or commercial contract work performed only during the unpaid hours.
- Overrun contracts/projects worked on only during unpaid hours.
- Encouraging employees to work significant unpaid overtime but to not record the hours in direct conflict with company policy.
- Contractors consistently working significant uncompensated overtime when no uncompensated overtime was identified in the proposal and proposed labor rates were not adjusted for any uncompensated overtime.

### **Excess/Residual Inventory in a Proposal Audit**

- No reporting of residual/excess materials.
- Transfers from prior lot work orders to current or forecasted work orders.
- Transfers from cost-type to fixed-price work orders.
- Transfers from cost-type to commercial work orders.
- Mass transfers to scrap accounts.
- Mass transfers to an inventory write-off account.
- Transfers to or via a suspense or any type of holding account.
- Lengthy time periods between when material is received and charged to the contract.
- Poor internal controls over physical inventories.
- Disproportionate increase in the proposed scrap factor.
- Disproportionate increase in the inventory write-off account.
- Large quantity of or significant costs for "found" parts.
- Proposed material costs on follow-on contracts are based solely on historical costs without consideration of actual costs incurred on the original contract.
- Management non-disclosure or vague explanations of significant events that may have an effect on inventory levels to the Government.

### **Make or Buy Decisions in a Proposal Audit**

- Pattern of switching from make to buy or vice versa without proper notification to the Government.
- Misrepresentation of the monetary effect of switching from make to buy or vice versa.
- Documented lower vendor price and still proposing as a make item.
- Indications of altered supporting document(s).
- Inadequate internal controls over make or buy decisions and/or continued failure to correct known system deficiencies.