Falsification of Documents

Next Slide

Table of Contents

Risk Assessment-Research and Planning

The supervisor assigned a team of auditors to audit a contractor's $600 million proposal to definitize a letter contract.[1] The high priority requirement was for the design and build of an accounting system by customizing off-the-shelf commercial software. DCAA started the audit several months ago, but canceled it, after consultation with the Procuring Contracting Officer (PCO). The contractor could not provide timely support and withdrew its proposal. Now that the contractor had resubmitted the final proposal, the PCO was eager to get it audited, negotiated and definitized because negotiations were three months behind schedule.

[1] A letter contract is a written preliminary contractual instrument that authorizes the contractor to begin immediately manufacturing supplies or performing services. Contracting officers issue a letter contract when the Government needs the work to start immediately and it cannot negotiate a definitive contract in time to meet the requirement. A letter contract should contain a definitization schedule that includes dates for submission of final proposal, date for start of negotiations and target date for contract definitization and signing.

Risk Assessment-Research and Planning (Continued)

The letter contract specified that the contractor should submit the final definitization proposal three months after letter contract award, and the PCO would begin negotiations of the definitized or final contract six months after the letter contract was issued. The PCO and contractor signed the letter contract nine months ago.

An auditor had already determined that the final proposal was adequate using the standard proposal adequacy checklist. The auditors divided up the initial work of performing the risk assessment and preliminary audit procedures.

Risk Assessment-
Review of Permanent File

One auditor reviewed the permanent file to document an understanding of the contractor and DCAA's audit experience with the contractor.

- Contractor's primary business involved providing a wide variety of information technology services to multiple Government customers.
- Contractor had $1.5 billion in annual sales in the last fiscal year, all with the Government.
- Contract mix was 60 percent cost reimbursable, 25 percent time and material (T&M), and 15 percent fixed price.
- An estimating system audit had been in process for three months.
- The contractor did not have any reported non-compliances with Cost Accounting Standards.
- The most recently completed incurred cost audit questioned significant indirect costs including pension costs, consulting costs, and business organization/merger costs. The report recommended penalties for the claimed expressly unallowable costs. The audit did not question any direct costs.

Risk Assessment- Initial Review of Proposal Documents

Another auditor performed an initial review of the request for proposal (RFP), the contractor's final proposal, the related audit request, and the letter contract. The auditor documented the following information in the audit working papers.

- The letter contract was issued and funded for a not to exceed amount of $200 million. The contractor could bill up to 85 percent of this amount prior to contract definitization.[2]

[2] Profit or fee associated with costs billed under a letter contract is not paid until the letter contract is finalized.

Risk Assessment- Initial Review of Proposal Documents (Continued)

- Proposal was for a $600 million sole source contract with a 5-year performance period. As illustrated in the following table, it was comprised of three contract line item numbers (CLINS) and broken out into costs incurred during the letter contract and those estimated for remainder of the contract.

CLINs	Type of CLIN	Incurred Costs and Profit for Letter Contract (a) (millions)	Estimated Costs and Profit (a) (millions)	Total Proposed Amount (a) (millions)
Labor and Materials	T&M	$115	$225	$340
Travel, Training, and Subcontracts	Cost Reimbursable	55	85	140
Facility Costs	FFP	40	80	120
Total		**$210**	**$390**	**$600**
(a) Profit is included in the CLIN amount				

Previous Slide

Next Slide

Risk Assessment- Initial Review of Proposal Documents

- The contractor used the labor and indirect rates from its current forward pricing rate agreement (FPRA) for the proposal.
- RFP required the contractor to certify that cost or pricing data submitted for the proposal was current, accurate and complete as of the date of price agreement.

Risk Assessment-Discussion with Requester

- The audit team held a teleconference with the PCO to discuss the audit request and any requester sensitivities or concerns about the proposal. The PCO confirmed that the final performance work statement (PWS) deleted some requirements that were in the PWS used to issue the letter contract. The Defense Contract Management Agency (DCMA) would be providing a technical evaluation of the proposed labor hours, material quantities and travel requirements.
- The PCO also was concerned about the costs incurred during the letter contract period. The letter contract required the contractor to submit invoices, including a cumulative listing of all costs incurred, for payment approval to PCO. Although the contractor had not billed more than $170 million ($200 million X 0.85), the contractor's incurred costs during the letter contract period exceeded $200 million.

Preliminary Analytical Procedures

The auditor responsible for the auditing the firm-fixed price CLIN for facility costs reviewed the proposal and noted that the incurred facility costs from the letter contract period were used to project the costs forward to the remainder of the contract periods. The proposal included copies of accounting records and invoices to support the incurred facility costs. The auditor performed the following analytical procedure using the proposal data and documented the results.

Preliminary Analytical Procedures (Continued)

Analytical Procedures: Using data from the incurred cost section of the current proposal, computed the percentage of each facility cost element (rent, utilities, supplies, etc.) to the total incurred facility CLIN costs.

Result: Facility rental costs represented more than 70 percent of the total facility costs incurred during the letter contract period. The facility rental costs were recorded in the accounting records via monthly journal entries supported by invoices from the leasing management company.

Entrance Conference

The lead auditor contacted the finance director and arranged for an entrance conference which would include the proposal manager. On the day of the meeting, the proposal manager was unavailable. The finance director provided a walk-through of the proposal discussing the basis for each cost element in both the incurred cost and forward priced sections and the related supporting documentation. The finance director also associated how the cost elements were proposed with the contractor's estimating policies and procedures. During the meeting, the auditors asked the following questions about the proposal, letter contract, and potential risks of fraud.

Entrance Conference (Continued)

Auditor Question: "Why did it take nine months to submit the final proposal when the definitization schedule in the letter contract stated that it would be submitted three months after award?"

Contractor Response: "DoD kept changing the scope requirements in the work statement. We finally agreed on the scope about a month ago and then we finalized the proposal."

Auditor Question: "What were the scope changes?"

Contractor Response: "DoD decided to de-scope some the original build requirements and compete them under separate solicitations. So once the design of the system is completed and approved by DoD, we will presumably be working with other contractors on building the system and putting it into operation."

Entrance Conference (Continued)

Auditor Question: ”What impact did these changes have on the proposed cost?”

Contractor Response: “It decreased our proposed costs by about 45 percent.”

Auditor (supervisor) Question: ”The DCAA auditor who audited the previous version of the proposal documented issues with obtaining timely, adequate support for the proposed costs. Are there any issues that will impact supporting this proposal audit?

Contractor Response: “We are fully prepared to provide timely support for any requests for information or records. Our ability to support the DCAA requests for supporting information on the previous version was negatively impacted by all the changes the Navy wanted.”

Entrance Conference (Continued)

Auditor Question: ”Why was the facility rental costs recorded in the accounting records using journal entries? Our audit experience with your system processes has been that costs generated from invoices are directly booked as account payable transactions when incurred?”

> *Contractor Response: “Ordinarily that might be the case, but in this instance it was easier when processing the interim billings to collect the rental cost from the accounts payable ledger and book them via the quarterly journal entries.”*

Entrance Conference (Continued)

Auditor Follow-up Question: "Why was it easier?"

Contractor Follow-up Response: "It will be faster to just show you. I will be happy to do so. Just contact me to schedule it at your convenience."

Auditor Follow-up Response: "Okay. But we would prefer that the person responsible for these transactions provided the walk-through of how the journal entry process worked."

Entrance Conference (Continued)

Auditor Response: ”Did the company submit interim billings during the letter contract period?”

> *Contractor Response: “Yes, we submitted four vouchers during that period for cost incurred up to 85% of the not to exceed amount in the letter contract.”*

Entrance Conference (Continued)

Auditor Question: ”What does management consider are the biggest risks of fraud for proposals and the estimating system?”

Contractor Response: “I can’t specifically address this question right now. Our internal audit department goes through an annual fraud risk assessment process that covers all our major operations including the estimating system processes, policies and procedures. The assessment is then discussed with the executive management to determine what, if any, changes need to be made to the internal control structures. I will provide you the results of the most recent assessment.”

Entrance Conference (Continued)

Auditor Question: ”Is the company aware of or investigating any allegations of fraud or suspected fraud made by employees, regulators or others related to this proposal or issues affecting this proposal?”

Contractor Response: “Not to my knowledge but our legal department handles these matters so I will contact them for a more definitive answer to your question.”

Entrance Conference (Continued)

Auditor Question: "What potential fraud or suspected fraud related to this program, or the cost charged or to be charged on this contract is the company aware of?"

Contractor Response: "I thought I just responded to that question. In any case as part of management, I am unaware of any such issues with this contract. However, as I said before, I will check with our legal department."

Auditor Follow-up Question: "It would probably be faster if you just provided us the point of contact and we will arrange a meeting with them. That way we can ask any follow-up questions that we have."

Contractor Follow-up Response: "Our process is that I obtain any additional information and give it to you. It facilitates the tracking process to make sure that you are getting everything that you need."

Audit Team Brainstorming for Fraud Risk Assessment

The audit team met to discuss the results of the risk assessment to date and to brainstorm about the risk of fraud or error that could materially affect the proposal. The supervisor first briefed the team on the internal audit fraud risk assessment summary provided by the finance director. The contractor's internal auditors concluded that the limited risk of fraud in the proposal preparation process was mostly associated with cost estimating outside the company's control such as subcontract costs. The contractor's management concurred with the assessment and agreed that current internal controls were sufficient to address the limited risk. The audit team then considered other fraud risk factors.

Audit Team Brainstorming for Fraud Risk Assessment (Continued)

- Proposal costs could be overstated to compensate for the significant, unanticipated de-scoping of the contract requirements.
- Incurred cost during the letter contract period could be overstated since, in many cases, they were the basis for the projected costs section of the proposal.
- Unexpected cost overruns of the not to exceed amount during the letter contract period could be unallowable costs that should be excluded from the proposal.
- Letter contract could be overbilled to date if incurred costs are overstated.
- FPRA rates used in the proposal may not have been adjusted for unallowable costs identified in the last incurred cost.

Audit Team Brainstorming for Fraud Risk Assessment (Continued)

With respect to the firm-fixed price CLIN for facility costs, the audit team determined that the following audit steps should be performed.

- Verify that the facility rental costs incurred during the letter contract period comply with the existing lease agreement.
- Trace all the facility rental invoice amounts for rental cost incurred to payments made in the accounts payable system.
- Determine whether the current lease agreement covers the projected cost period and if any pending lease renewals could impact the proposal costs.
- Develop a non-statistical sample of transactions for cost incurred during the letter contract period for the remaining facility cost categories, and verify that the incurred costs are allowable, allocable, and reasonable and were paid.

Results from Audit Procedures

The auditor submitted a written request for the data required to perform the planned audit steps including the existing lease agreement, any pending lease renewal or changes, and accounts payable payment records for incurred rental payments. The finance director emailed the auditor that the requested information would be provided within two weeks. When the auditor contacted the finance director after the two weeks had passed, the contractor stated that it was taking longer than anticipated to get the data together and needed an additional week. The contractor still had not provided the requested facility cost data after three weeks.

Previous Slide

Next Slide

Results from Audit Procedures (Continued)

When contacted to arrange the walk-through of the journal entries, the finance director stated that the individual was too busy at that time but would be available in a week or two. The auditor was given the same answer regarding the requested meeting with the company's legal counsel.

Expanded Audit Procedures and Results

The auditor discussed the situation with the lead auditor and supervisor. The auditor was concerned because the requested data should have been readily available. The auditor also noted that the contractor did not provide similar lease and payment data requested during the earlier proposal audit that was canceled.

Since the proposal audit due date was close, the auditor suggested contacting the leasing management company listed on the invoice to obtain, at least, the lease information. All parties agreed on this approach. The lead auditor also agreed to contact the Chief Financial Officer (CFO) about the information request delays. Additionally, the lead auditor notified the PCO of the delays in obtaining the requested supporting data and the alternative approach they were taking.

Expanded Audit Procedures and Results (Continued)

The auditor called the number for the leasing management company listed on the rental cost invoices and asked for the listed leasing agent. The employee who answered the phone stated that the leasing agent was on vacation but that they could address any questions. The auditor explained that DCAA was verifying the rental cost payments charged to a Government contract and needed a copy of the current lease agreement for the rental property. During their conversation, the auditor faxed over a copy of the rental invoices included with the proposal. The leasing agent pulled the lease files and confirmed that all rental payments were current on the lease. However, they commented that the rental cost on the faxed invoice was almost twice as much as the lease amount and the payments recorded in the leasing management company's accounting system. In addition, the faxed invoices had a little different format from the paid invoices in their files.

Expanded Audit Procedures and Results (Continued)

The leasing agent also stated that a lease amendment was in process to increase the rent to the amount listed on the faxed invoices. The proposed rental increase was not supported by a valid change such as increased rental space and the current 10-year lease was not due for renewal since it had only been issued a little over a year ago. The leasing agent agreed to give the auditor a copy of the current lease agreement, in-process lease amendment, and copies of the paid invoices.

A couple of days after the auditor talked to the leasing agent, the finance director gave the auditor a copy of the lease agreement to support the incurred and projected facility rental costs. The auditor noted that it did not match the signed lease agreement provided by the leasing agent. Instead it was a copy of the in-process lease amendment with the increased rent. The signature page looked to be from the current lease.

Further Actions

The auditor discussed the results of the audit of the facility cost CLIN with the rest of the audit team and the supervisor. The auditor stated that based on the signed lease agreement and paid invoices received from the leasing management company, the proposed rent was overstated by $6 million including $900,000 in overpayments billed during the letter contract period. The auditor suggested that the invoices submitted with the proposal were potential false documents that were recorded in the accounting records using the journal entries.

In addition, the auditor noted that:

- the finance director had approved the journal entry transactions;
- the finance director had still not provided any of the requested data for the other facility cost transactions selected for audit; and
- the finance director had also not arranged the requested meetings with the individual responsible for the journal entries and the company's legal counsel.

Previous Slide

Next Slide

Further Actions (Continued)

Based on this briefing the audit team decided on the following actions regarding the fraud indicators identified in the review of facility costs.

- Contact a local DoD Criminal Investigator to discuss the forthcoming fraud referral, whether the failure to provide the requested data both during the canceled and current audit could constitute an obstruction of audit charge, and whether the audit results could be discussed with the PCO.
- Submit a DCAA Form 2000 fraud referral for the irregular rental cost transactions charged to the Government and the related overpayments received by the contractor during the letter contract period.
- Calculate questioned rental costs as the difference between the proposed rental costs and actual payments made and to be made under the valid lease agreement.

Further Actions (Continued)

- Report the proposed other facility costs under the firm-fixed price CLIN as unsupported due to contractor failure to provide requesting supporting data. The audit report notes would include the details with the dates information was requested, the dates of the follow-ups to the requests, and the contractor's responses.
- If the investigator concurs, brief the Administrative Contracting Officer (ACO) and PCO on the results of the facility cost audit and discuss the status of the proposal audit.
- Discuss the results of the audit of facility costs with the auditor currently performing the estimating system audit. and
- Draft an audit lead for future proposal and incurred cost audits to verify that rental costs are supported by a valid lease agreement, and that invoices for costs incurred are supported by actual payments.

General Comments and Lessons Learned

The majority of contractor data and records are now generated and maintained electronically. Sophisticated software tools are available to alter documents so that they appear authentic. Auditors may, therefore, have more difficulty identifying false documents and transactions. Auditors need to be alert to instances where the transactions or supporting documents do not seem reasonable or conflict with documents obtained from outside sources or other departments within the company.

General Comments and Lessons Learned (Continued)

The auditor should also periodically test the integrity of the accounting and operating system data before relying on it to determine the level of transaction testing needed for the audit. This can be done by doing transactional and compliance testing on a selected basis. It could involve requesting original documentation from the contractor or obtaining third party confirmations from outside the company. The audit step(s) verifying data integrity might be done during a system review or as part of another substantive audit such as a proposal or incurred cost audit. The auditor must still be alert to changes in how a system works after the system has been reviewed and accepted.

Fraud Indicators

- **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.**

Fraud Indicators (Continued)

- 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.