
Financing Inventory-Material Transfers

The Scenario

During a progress payment review, the auditor noted that the total material costs claimed on the progress payment had decreased from the material costs claimed on the prior request. The auditor also noticed that the decrease was caused by an adjusting journal entry. The auditor expanded the scope of their review and requested supporting documentation for all adjusting journal entries made within the past three months. The auditor's review disclosed that the contractor had transferred material costs from an ongoing Government contract to a newly awarded commercial contract. Interviews with the comptroller, program manager and material requisitioning manager disclosed that contracting personnel knew about the impending award of a commercial contract when they ordered the material for the Government contract and that the commercial and Government product lines were similar.

The contractor's policy was to combine orders whenever possible to maximize savings. The contractor's inventory consisted of small general use materials. The contractor charged work orders for material when received, not when used. Since the contractor ordered all materials on one purchase order, the contractor charged all the materials to the one existing open work order. The contractor billed material costs, in turn, to the Government through progress payments or public vouchers. The Government also paid for the carrying and finance costs for the commercial job.

General Comments / Lessons Learned.

The auditor should be alert to material cost transfers between accounts. Repeated cost transfers can be an indication of suspect accounting transactions and/or improperly charged costs. Further, when the auditor discovers problems with the contractor's accounting system, its billing system should also be reviewed to ensure that the Government is not charged and/or paying costs to support non-Government contracts.

FRAUD INDICATORS

- **Material cost transfers from Government to commercial contracts.**
- **Transfers between Government and commercial contracts with similar product lines.**
- **Materials ordered and charged in excess of contract requirements.**
- **Initial billings for actual material costs exceed the negotiated amounts.**
- **Government charged for carrying and/or finance costs for non-Government contracts.**