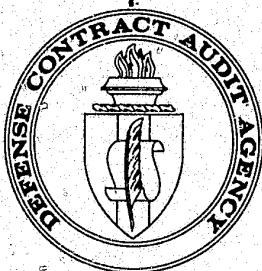


DCAAP 7641.55
March 1976



**IMPROPER TRANSACTIONS
WITH EMPHASIS ON
SALES AGENT'S FEES
AND COMMISSIONS**

68027

**DEPARTMENT OF DEFENSE
DEFENSE CONTRACT AUDIT AGENCY**

DCAAP 7641.55

NCJRS

March 1976

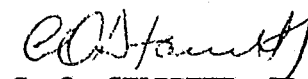
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ACQUISITIONS

FOREWORD

As a result of disclosures made during the Watergate investigation, DCAA has become heavily involved in audits of improper transactions and sales agent's fees. FAOs performing such reviews have provided sound and thorough coverage of the many areas involved, and much has been learned in accomplishing the audits. In light of the widespread occurrence of these costs and their sensitivity, it is important that this knowledge be disseminated throughout the Agency. It is the objective of this pamphlet to provide guidance in the audits of such costs based on the experience gained in past reviews and research of related laws and regulations.

This pamphlet does not include every type of improper transaction that has been disclosed or that may be uncovered in the future. Additional guidance is being developed for some of the other major categories of improper transactions, and pamphlets on consultants costs and entertainment expenses are expected to be issued in the near future.


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DISTRIBUTION
A, C, G, P

IMPROPER TRANSACTIONS
WITH EMPHASIS ON
SALES AGENT'S FEES AND COMMISSIONS

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IMPROPER TRANSACTIONS

WITH EMPHASIS ON

SALES AGENT'S FEES AND COMMISSIONS

BACKGROUND INFORMATION

In late 1972, the U.S. Senate Select Subcommittee investigated corporate contributions made during the 1972 presidential campaign. In doing so, it traced a number of checks drawn on a European bank by a representative of a U.S. corporation involved with DoD contracts to various presidential reelection committees. In 1974, the Watergate special prosecutor continued the investigation. As a result, charges for using corporate funds to make political contributions in violation of Section 610 and 611 of Title 18, U.S. Code were filed against the corporation and some of its officers. Guilty pleas were entered and fines were levied.

The Watergate special prosecutor encouraged other corporations to confess illegal political contributions by offering to have the penalties reduced. As a result, 20 companies declared illegal or improper payments. Nine of these companies had contracts with the Government, and we initiated special reviews on these nine.

We discovered that illegal and improper payments were made by a variety of methods. Slush funds were established by laundering monies through subsidiary companies, excessive bonuses were paid to trusted employees, blocks of airline tickets were sold without recording the receipts, and special employee funds were used to reimburse company executives for expenses at political functions. Sales agents and consultants were also paid excessive fees for influencing officials. Many of the funds went out of the United States and were circulated back for illegal political campaign contributions. Other monies were paid to political parties of foreign governments. Certain transactions were improperly recorded or not recorded at all, and some agreements and payments indicated other possible irregularities. Of course, these examples are by no means all inclusive, and the auditor may encounter new, more complex and varied situations.

LAWS AND REGULATIONS

There are specific laws which forbid many of the above types of payments; e.g., 18 U.S. Code, Section 610 and 611 (Campaign Contributions) and Public Law 86-695 (Kickbacks). The Securities Exchange Commission (SEC) also has specific regulations requiring full disclosure of significant transactions with management involvement to stockholders. In fact, SEC's disclosure requirements can help the auditor identify relationships that could lead to possible wrongdoing in the conduct of company business. (Parts of Form S-1 and Regulation 14A are in Appendix C.) Furthermore, the Internal Revenue Code prohibits the claiming of expenses for tax purposes that are contrary to public policy, such as bribes. However, laws or regulations (international or U.S.) prohibiting similar payments to foreign governments are not as numerous or effective. Nevertheless, where such costs are charged to Government contracts, we are obligated to report them to the appropriate authorities.

CONTRACT AUDIT MANUAL (CAM)

CAM 12-700 has audit responsibilities and procedures for some of the more common types of wrongdoing, such as:

- 12-701 - Fraud and other unlawful activity.
- 12-702 - Unsatisfactory conditions (possibly related to wrongdoing).
- 12-703 - Suspected violation of the anti-kickback statute.
- 12-704 - Suspected improper noncompetitive procurement practices.
- 12-707 - Contractor financial jeopardy (possibly related to wrongdoing).

CAM 11-030(g) (2) also provides the following guidance:

"Expenditures for influencing legislation are unallowable by Federal statute. Any identifiable portion of the costs of memberships in bona fide trade, business, technical and professional organizations, intended for use in connection with influencing legislation is likewise unallowable."

Procedures for evaluating selling expenses are in CAM 11-018, and CAM Chapter I has guidelines for cooperating with the various investigative agencies.

Field auditors should become thoroughly familiar with CAM guidelines and the audit procedures applicable to the situations discussed in this pamphlet.

GENERALLY ACCEPTED AUDITING STANDARDS

The American Institute of Certified Public Accountants' (AICPA) Statement on Auditing Standards (SAS No. 1) comments specifically on the independent auditor's responsibility for detecting fraud during the normal review of financial statements. (See Appendix B.) These guidelines also apply to the work of the contract auditor and may be extended to other types of wrongdoing as well. (General auditing standards and the standards for field audit work are in Sections 1 and 2 of CAM Chapter 2.)

The standards require the auditor to assure that a contractor has an adequate and effective accounting system and system of internal controls. Furthermore, they state the independent auditor becomes responsible for failure to detect fraud (or other similar wrongdoing) "only when such failure clearly results from failure to comply with generally accepted auditing standards." The standards encourage the auditor to use good judgment in the choice of tests and procedures and to do a good job in applying them.

All DCAA auditors should be thoroughly familiar with the generally accepted auditing standards of both the AICPA and the General Accounting Office. Field Audit Office (FAO) chiefs, and all supervisory personnel, should assure that the standards are adhered to in conducting contract audit field work.

DCAA RESPONSIBILITY

The DCAA charter document, DoDD 5105.36, dated 9 June 1965, states that we will "audit, examine, and/or review contractors' and subcontractors' accounts, records, documents, and other evidence; systems of internal controls; accounting, costing, and general business practices and procedures; to the extent and in whatever manner is considered necessary" in order for the auditor to properly provide advice and recommendations on the "Acceptability of incurred costs and estimates of costs to be incurred"

Basically, our audit procedures are designed to review contractors' claims or proposals to determine the acceptability of costs as to reasonableness, allocability, and allowability in accordance with specific cost principles in the Armed Services Procurement Regulations (ASPR), cost accounting standards, or generally accepted accounting principles. These procedures are not specially designed to detect fraud

or wrongdoing. Such an objective would require a minute examination of the transactions underlying the claimed cost, and this would be economically prohibitive. Further, fraudulent costs probably represent an infinitesimal percentage of total costs submitted. Therefore, auditors generally do not review contractors' claims and operations for the specific purpose of discovering fraud or other wrongdoing.

Although the detection of fraud and similar wrongdoing is not a primary function of contract audit, auditors should be very much aware of the possibility of fraud and assure that all applicable, generally accepted auditing standards are met. Furthermore, DCAA auditors will not ignore fraudulent or improper transactions that do not appear to directly affect Government contracts. For example, payments that appear to be illegal or improper may be charged directly to commercial work or simply not claimed by the contractor for reimbursement under Government contracts. However, when the auditor discovers such payments during normal reviews of Government contracts, he should request the contractor to trace the costs through the accounting records so it can be firmly established that the Government was not charged. This procedure should help identify any areas that may require additional testing.

The auditor will examine enough evidence to assure himself that the contractor's representations are accurate. If the contractor won't permit the auditor to examine the necessary data, the auditor will report the complete details of the situation through DCAA channels and to the contracting officer.

Where it is firmly established that the Government was not charged with the costs, the auditor will ordinarily have no further audit responsibility. However, if the contractor has violated a law, or at least a strong suspicion of wrongdoing exists, the auditor should report the circumstances to this Headquarters for consideration of referral to the appropriate authorities. (See CAM 12-701.4.)

DCAA ASSISTANCE TO INVESTIGATIVE ORGANIZATIONS

The Federal Government has many organizations with responsibilities for ferreting out, investigating, and taking action on wrongdoings of industrial and commercial concerns as well as employees of the Federal Government. The Department of Justice (FBI), SEC, and the Internal Revenue Service (IRS) are perhaps the most prominent. The Department of Justice is responsible for investigating violations of existing laws. SEC regulates selling of securities to the general public, and IRS administers the Internal Revenue Code, including investigations of noncompliance.

Within DoD, each military department has an office of special investigation as well as an inspector general. Congress, too, is responsible for investigating current business practices and evaluating the adequacy of current laws in view of those practices.

It is our policy to cooperate with these investigative agencies. When a situation requires investigation, the details will be turned over to one of the investigative organizations. Since we are familiar with the contractor's financial books and records, FAOs may be able to assist the investigators in a number of areas such as the following:

1. General background information on the contractor's operations.
2. Information on the contractor's financial management systems including budgeting, estimating, accounting, and internal control systems.
3. Management reports submitted to the Government on major weapons systems contracts.
4. Status of reimbursements to contractors on contracts in progress.
5. Significant deficiencies in the contractor's operation noted during earlier audits.
6. Copies of audit reports issued.
7. Details of the audit findings leading to a suspicion of wrongdoing.
8. FAO files or working papers.

Occasional instances may also arise where the investigator believes our auditors have a special expertise and knowledge of the contractor's business records and practices that would be very difficult, inefficient, expensive, and time consuming for its office to duplicate. When it is in the overall interest of the Government and within our Agency's field of expertise, we will respond to such requests for assistance, providing this does not conflict with our charter.

All arrangements for assisting investigative agencies should be referred initially to DCAA Headquarters. Each request will be reviewed with Counsel, and the assistance to be furnished will be determined on a case-by-case basis.

When the auditor is specifically requested to examine suspected illegal or improper payments, his responsibilities are expanded beyond those inherent in the normal audits of contract costs. In these instances,

the auditor will request access to the records needed and attempt to furnish the information requested. If the contractor refuses to cooperate and denies access to the data needed, the requestor will be advised of the circumstances. No further action on the request will be taken until the requestor arranges for access to the necessary data.

SUGGESTED AUDIT PROCEDURES - ILLEGAL AND IMPROPER TRANSACTIONS

Although it is clear from the preceding discussion that the normal audit is not expected to assure the discovery of wrongdoing, certain procedures are incorporated into annual plans and/or specific audit programs to help identify such wrongdoing. Many of these are standard procedures that have proven successful for the Agency and the accounting profession in the past. In view of the more recent types of improper transactions, other procedures may also warrant consideration. A few of the more important procedures to be considered in developing future plans and programs are summarized in the following paragraphs:

1. Perform the normal survey of the organization being audited, including its accounting system and internal controls as a part of our TACT approach to operations auditing. This procedure is essential for the auditor to understand all facets of a major contractor's business--its organization, responsible officers, internal controls, accounting system, and factors that might motivate management to initiate illegal or improper transactions within the company.

2. Examine information normally available within the FAO, such as permanent files, prior working papers, audit programs, and significant deficiencies discovered during other audits for evidence of potential wrongdoing and weaknesses in management controls.

3. Give special consideration to unusual transactions, especially occurring at yearend or at the close of other interim accounting periods. Journal entries and other special adjustments to the normal accounting books and records may provide leads for discovering improper transactions. Significant unusual transactions and adjustments with vague explanations are required to be investigated carefully. The auditor should determine whether the books and records reflect the true substance of a transaction.

4. Examine minutes of the Board of Directors' meetings for approvals of unusual transactions, especially when they are with company employees, officers, affiliated companies, and other related organizations. Lack of approval may indicate the Board is unaware of the transaction.

5. Obtain a current list of all important officers and members of the Board of Directors. This list should be made a part of the permanent file along with information on contractors' interests in other businesses.

At major contractors, special attention must be given members of the Board of Directors if their relationship with other firms cannot be considered "arm's length." Thus a closer review of any transactions involving these individuals is necessary.

6. Be alert for indications of concealed transactions, i.e., those that have not been recorded on the company's books or have been disguised to conceal the true nature of the transaction. Audit programs should be designed to test the adequacy of controls built into a contractor's management system to prevent such transactions.

7. Watch for factors that might encourage wrongdoing, such as:

(i) A poor profit history and lack of working capital either for the company or a particular organization within a company. These circumstances can lead to overstatements of claims for reimbursement, and/or the deliberate mischarging of costs to the more profitable segments of the business.

(ii) Overexpansion of the business or production lines. This can lead to the improper accounting for costs.

(iii) Unusual employee receivables and payables. These may indicate the existence of unauthorized or concealed transactions involving the misuse of assets.

(iv) Fragmented operations with independent accounting systems or key documents maintained at widely dispersed locations and not readily available to top management. These can enhance opportunities for improper activities.

(v) Company management dominated by one or a few individuals.

(vi) Poor internal controls and an inadequate or nonexistent internal audit staff.

8. Be especially alert for wrongdoing in sensitive areas including the "less than arm's length," and "related party" transactions, covered by "Statement on Auditing Standards" No. 6 of the AICPA. Some examples are:

(i) Dealings with suppliers that are owned or controlled by officers of the company under audit.

(ii) Dealings with subsidiary companies, especially in foreign locations.

(iii) The hiring of consultants, particularly on a retainer basis, without adequate documentation, explanation of the scope of work, or requirement for a final performance report.

(iv) Payment of large commissions especially on sales to foreign governments.

(v) Leasing arrangements or sales of real estate between affiliated or closely held businesses.

(vi) Sales of scrap and returns of materials.

(vii) Unusual bonuses and refunds from bonuses.

(viii) Unusual entertainment expenses, disclosed during normal reviews of contract costs. These may provide clues to illegal or improper transactions.

(ix) Significant transfers of cash between organizations of the business.

9. Review key financial figures and ratios at major contractors for unusual trends or deviations that would require investigation. Studies of the tax returns and published financial statements may also be useful.

10. Give special attention to instances where costs are charged totally to Government business, or credits and refunds are applied only to commercial business. There may be good reason for such treatment; however, contractors should be required to fully document the circumstances of significant transactions.

11. Management often requires declarations of financial interest from its officers and directors to identify conflicts of interest within the company. Obtain and review this documentation at major contractors.

12. Where there is reasonable doubt concerning a transaction that results in significant costs being charged against Government contracts, the amounts must be clearly stated in the audit report and also reported through DCAA channels.

When the contractor has made illegal or improper payments, request a listing of all Government contracts negotiated on the basis of cost data submitted by the company for consideration of adjustment due to defective pricing. In cases where contracts meet the exceptions of Public Law 87-653 (i.e., prices negotiated based on adequate price competition, established catalog or market prices of commercial items sold publicly, or prices set by law or regulation), it will not be necessary

to perform an in-depth review. Finally, if feasible, determine whether any additional administrative controls have been implemented or are needed to ensure that future occurrence of this type will be prevented.

FOREIGN MILITARY SALES (FMS) - DoD POLICY

The Foreign Military Sales Act of 1968 defines these sales as those of defense articles and services to foreign governments. Under DoD policy, foreign countries are encouraged to purchase defense articles directly from U.S. commercial sources rather than through established DoD channels for procurement and contract administration. If practicable, DoD assists in direct sales to foreign governments. However, the major portion of FMS actually passes through established DoD procurement and supply channels, since many kinds of defense transactions are not conducive to direct sales. These include transactions that require Government-to-Government arrangements, such as sales of (i) classified equipment, (ii) items produced in U.S. arsenals, (iii) major weapon systems, and (iv) situations where the U.S. Government wants to exercise special control. Additionally, foreign governments usually want the advantages of DoD's procurement expertise, including contract administration and audit.

The basic procurement policy for pricing FMS contracts is in ASPR 6-705.3, Pricing Procurements for FMS. Under this regulation, DoD assumes the responsibility for assuring that fair prices are paid. This policy states that the pricing for FMS contracts shall be on the same basis and using the same cost principles as for "normal DoD contracts." This does not mean, however, that prices of DoD contracts for the same or similar items are automatically applicable to FMS contracts for the same item. Prices of items in FMS contracts may differ from prices of identical items in DoD contracts in the United States because certain kinds of costs may reasonably and allocably arise in different amounts.

AGENT'S FEES

Business firms sometimes hire an independent organization or individual to conduct business on its behalf. Often this is done for remote or foreign locations where it would be too difficult and/or expensive to open and maintain a regular place of business. An organization or individual hired for this purpose is known as an "agent" of the employing firm. While he acts as an agent he is sometimes referred to as a "consultant." If he is hired to make sales for the firm, he is known as a sales agent and is usually paid a commission or fee calculated on some percentage of sales accredited to his efforts. Such arrangements should be supported by written agreements specifying the scope of service and the terms of reimbursement.

Agent's fees may be paid under either of two forms of foreign procurements. The foreign government may buy direct from a U.S. contractor with its own funds, or it may use DoD's procurement resources to buy items. In either case, agents may be involved in arranging the sales, and their fees should appear in contractors' proposals.

In a letter dated 5 May 1975 to the military departments, the Defense Security Assistance Agency established the following policy, effective immediately:

"The inclusion of such agent's fees must be identified during the process of obtaining price and availability information for a proposed sale. Such information may be made available to the contracting officer who will be responsible for contracting for the equipment or services involved."

DoD PROCUREMENT REGULATIONS - AGENT'S FEES AND COMMISSIONS

Agent's fees will usually be charged direct to contracts since, in most cases, independent agents are used and paid for individual sales transactions. However, where an agent is paid a retainer (see item 10, page 14), the fees may be charged indirect through the allocation of general and administrative expense. The following paragraphs discuss certain regulations applicable to the costs, regardless of the manner of charging.

ASPR 15-205.37 presents the cost principles relating to selling costs. Subparagraph (b) states that selling costs are allowable only if they are reasonable and are allocable to Government business. It further states, "Allocability of selling costs will be determined in the light of reasonable benefit to the Government arising from such activities as technical, consulting, demonstration, and other services which are for purposes such as application or adaptation of the contractor's products to Government use." However, ASPR 15-205.37(c) which applies to DoD domestic contracts states that "... salesmen's or agent's compensation, fees, commissions, percentages, or brokerage fees, which are contingent upon the award of contracts, are allowable only when paid to bona fide employees or bona fide established commercial or selling agencies maintained by the contractor for the purpose of securing business." DPC 75-1, Item IX, 30 July 1975, extends this guidance to FMS. It states that the contracting officer shall:

1. Require the contractor to submit a "Contractor's Statement of Contingent or Other Fees" Standard Form 119.

(See Appendix D.) This form requires a contractor to identify (i) any company or person employed or retained to solicit or secure a contract, or (ii) any company or person to whom the contractor paid or agreed to pay any fee, commission, percentage, or brokerage fee, contingent upon or resulting from the award of a contract.

2. Determine whether a "bona fide" agency relationship exists in accordance with ASPR 1-505. Agent's fees/commissions are allowable only when paid to bona fide employees or bona fide established commercial or selling agencies maintained by the contractor.

ESTABLISHING A BONA FIDE RELATIONSHIP

ASPR 1-505.3 defines a bona fide employee as an individual employed by a "concern" in good faith. The individual must devote his full time to this concern which has the right to supervise and control the individual's time, place, and manner of performing work. A concern, especially a small business organization, may employ an individual who represents other firms. Some of the considerations in determining an individual's bona fide relationship with a contractor are:

1. A person may be a bona fide employee whether his compensation is on a fixed-salary basis or, when customary in the trade, on a percentage, commission, or other contingent basis.
2. The hiring must contemplate some continuity and it may not be related only to the obtaining of one or more specific Government contracts.
3. An employee is not bona fide who seeks to obtain any Government contract or contracts for his employer through the use of improper influence.

Determining the bona fides of a commercial or selling agency maintained by a contractor is somewhat more involved and entails a number of factors. These factors cannot be measured or defined precisely, nor is it possible or desirable to prescribe the relative weight to be given each one. Some of these factors follow:

1. The fees should not be inequitable and exorbitant in relation to the services actually rendered. That is, the compensation should be commensurate with the nature and extent of the services and should not be excessive as compared with fees customarily allowed in the trade for

similar services related to commercial business. In evaluating the reasonableness of the fee, all the services of the agent, not just the actual solicitation, should be considered; for example, technical, consultant, or managerial services, and assistance in the procurement of essential personnel, facilities, equipment, etc.

2. The sales agency should have adequate knowledge of the products and the business of the concern represented, as well as other qualifications necessary to sell the products or services on their merits.

3. There should ordinarily be a continuity of relationship. The fact that the agency has represented the contractor over a considerable period of time is favorable. It is not intended, however, to disqualify newly established contractor-agent relationships.

4. It should be evident that the agency is an established concern. The agency may be one which has been in business for a considerable period of time or a new agency which is a presently going concern and appears likely to continue in business.

5. The selling agency should be employed to secure business generally--that is, to represent the concern in connection with sales to the Government as well as regular commercial sales to non-Government organizations. The fact that a selling agency confines its selling activities to the field of Government contracts does not, in and of itself, disqualify it. Arrangements confined, however, to obtaining Government contracts, particularly those involving a selling agency organized immediately before or during periods of expanded procurement resulting from conditions of national emergency, must be carefully scrutinized. However, no agency or agent is bona fide which seeks to obtain any Government contracts for its principals through improper influence, or which holds itself out as being able to obtain any Government contract or contracts through improper influence.

Subparagraph c of DPC 75-1 states:

"Even though a bona fide agency relationship is determined to exist, the agent's fees/commissions will only be allowed to the extent reasonable. The basic test of reasonableness is an assessment of the services provided compared to the amount of the fee. A comparison should be made of the proposed fee/commission with recent payment for comparable services under non-FMS, commercial sales of the same or similar items, or agent's fees/commissions

allowed on previous FMS sales of comparable scope and dollar amounts. Consideration should be given to whether the sale is the initial or follow-on sale because the effort for follow-on sales of additional quantities, spares and support equipment would not normally be as great as the effort for the initial sale. Agent's fees/ commissions are prohibited for follow-on spares provided under DoD Supply Support Arrangements."

SUGGESTED AUDIT PROCEDURES - SALES AGENT'S FEES

In the past, contracting officers have usually determined the acceptability of agent's fees in price proposals, without audit assistance. According to a proposed new ASPR paragraph 6-1304.4 (ASPR Case 73-88; see PROPOSED REGULATIONS), contracting officers will normally determine the acceptability of the contingent fees before the contractor submits its formal DD 633. Consequently, DCAA will probably not be involved in evaluating proposed agent's fees in the offer and acceptance phase unless the contracting officer specifically requests our services. However, in those instances where we receive a request, regardless of the phase of procurement, i.e., offer and acceptance, formal preaward submission or postaward, we will assist procurement representatives in determining the bona fides of an employee or agency and the reasonableness of their fees to the extent possible. Depending on the circumstances---phase of procurement, manner of charging (direct or indirect), etc.,--this may include but not be limited to the following:

1. Verify that the contractor has filed Standard Form 119, Contractor's Statement of the Contingent or Other Fees, etc., where the agent's fee is included in the initial proposal. The auditor should evaluate the adequacy and accuracy of the information submitted to the contracting officer according to DPC 75-1. Any other known documents or information bearing on the allowability and reasonableness of the agent's commissions or fees should also be requested from the contractor.
2. Examine formal agreements with agents and other "consultants" who perform comparable services for all pertinent terms (length of agreements, fees, the type of services to be rendered, types of sales, types of products, etc.).
3. Review the contractor's payroll, personnel, and other related records to ascertain the extent and period of employment of the agent or "consultant" and fee payment practices, i.e., fixed salary or percentage basis.
4. Examine correspondence with agents and "consultants" to ascertain the true nature of the activities and evidence of disputes over amounts of fees and commissions due.

5. Review past activities of the agent or agency as they relate to the contractor's products or services to determine the allocability of the agent's services.

6. In conjunction with 2 and 4 above, examine available documentation or evidence of the agent's qualifications or knowledge about the contractor's products. This may require technical assistance from the contracting officer.

7. Review previous payments of the agent's fees to determine the customary rate paid for comparable contracts (for the same or similar products or services, dollar amount, and scope of contracts, etc.). A comparison of fees paid for similar work on commercial contracts should be especially useful.

8. Verify that the terms of the agreement between the agent and the contractor apply to the attendant contract or proposed contract under review.

9. Determine whether a proposal evaluation is for an initial or follow-on sale. The work for follow-on sales of additional quantities, spares, and support equipment should not normally be as great as that for initial sales. Consequently, the fees should not usually be as large. Additionally, the agent's fees are not allowed for follow-on spares provided under DoD Supply Support Arrangements.

10. Where commissions can be identified with specific sales, they should be charged directly to those sales. Where fixed retainer fees are paid to agents representing the contractor in specific areas of the world, they should normally be allocated to all applicable sales in these areas. A task force to enhance effectiveness of DoD Safeguards against reimbursing defense contractors for improper expenditures, appointed by the Secretary of Defense, has recommended that the ASPR Committee revise the regulations to require contractors to demonstrate that services covered by retainer were necessary and customary, and the level of past services justifies the retainer. It also recommended that there should be a showing that the retainer is cost effective compared with the cost of maintaining an in-house capability.

11. It will usually be necessary to request technical assistance from the contracting officer in evaluating the reasonableness of the agent's commissions or fees. The request will state all facts available to the auditor which could bear on the technical review. If the requested technical assistance is not provided before the report is issued, the acceptability of these costs should be qualified in the report as in CAM 10-207.5(a).

12. If the auditor has information which (i) clearly shows that fees claimed are allowable and reasonable or (ii) significantly bears on the determination, the FAO can present its recommendations in the audit report without a formal request for technical assistance. However, audit recommendations should be informally coordinated with the contracting officer before the report is issued, and the report should clearly state the facts and rationale on which the audit recommendations are based.

13. Additional guidance is provided in DPC 75-1 (Item IX) concerning tests of reasonableness of the fees. Commissions and other items of cost such as taxes and miscellaneous fees, unique to each country, must be handled on an individual case-by-case basis in evaluating the overall reasonableness of the agent's fees. These costs should be brought to the contracting officer's attention through coordination and reporting.

14. When the auditor discovers that fees and commissions are paid for illegal or improper activities, he will notify Headquarters of the specifics so that the responsible investigating agency and appropriate DoD personnel can be contacted.

15. Auditors should review foreign agent's fees and costs to assure that fines or penalties for violating statutes and other unallowable costs are not included.

16. The auditor should ascertain that fees charged direct do not duplicate other sales effort, costs of which were included in overhead. The requirements of the existing cost accounting standards should ordinarily result in the identification of these situations.

17. Instances where the agent's fees are limited to specific portions of the contractor's business, e.g., Government sales only, should be reported to the contracting officer.

18. A contractor may elect to delete consultants fees from Government contracts rather than disclose the purpose of the payment. In such instances, we cannot insist that documentation be provided. However, auditors will fulfill their responsibilities as described earlier and report such action to the contracting officer.

19. Information regarding the agent's fees may be available in contractor filings with SEC. Copies of these documents may be obtained directly from the contractor. If not, arrangements may be made through DCAA Headquarters to secure the necessary information from SEC (CAM Appendix D26).

In brief, the audit report should include all significant, pertinent data that will help the contracting officer decide on the acceptability

of the fees. Often the contracting officer has data available on fees paid by other contractors in the same industry and possibly fees charged by the same agencies. Ordinarily, he will make the final decision on the fees, considering the auditor's findings in conjunction with all of the other data available at the procurement level.

For the above procedures to be effective in evaluating the reasonableness of fees, there should be a history of procurements related to the particular foreign country. Without this history, audits may produce little or no significant information on the reasonableness of the fees. Wherever feasible, the auditor should consider developing such a history from the contractor's data for both the contracting officer and for future audits.

PROPOSED REGULATIONS

As mentioned earlier, the ASPR Committee is studying agent's fees under Case 73-88. In this case, the committee is proposing to revise the previous regulations in Item IX, "Allowability of Agent's Fees and Commissions on FMS," of DPC 75-1 and Item X "Foreign Military Sales to Iran" of DPC 74-1. The proposed revision (informally issued in August 1975, by TWX to U.S. officials in various foreign countries) provides the following:

1. It includes a mandatory requirement for disclosing all sale commissions and contingent fees to be included in a contract to any foreign government before or in conjunction with the submission of the DoD Offer and Acceptance Form (submitted before the contractor's DD 633 submission). The procedures require DoD officials to state whether they consider the fee reasonable in part or whole, and their rationale. In the case of competitive contracts, it may not be possible to determine whether the price includes sales commissions or fees before offer and acceptance. If subsequent negotiations indicate their inclusion, the purchasing government will be notified as soon as possible, and DoD officials will determine their acceptability unless notified otherwise within 30 days.
2. Where a sales agent is determined not to be bona fide, as required by 1-503, for reasons other than reasonableness of fee, DoD will not submit an Offer and Acceptance Form until the prospective contractor withdraws the fee.
3. Special requests from foreign countries to deviate from the proposed policy to allow reasonable fees are to be considered. If the request is approved, contractors will be required to certify, for firm fixed-price contracts with escalation, that the proposed price does not include any sales commissions or fees. For all other types of contracts, commissions and fees will not be considered as allowable items of costs.

4. Contractors are required to identify the amount of any commission or fees in their pricing data. They will also have to submit a cost breakdown of the fee related to the sales representative's services. The contractor may also submit a comparative analysis with recent payments for comparable services.

5. The Chief of the Purchasing Activity will be required to approve any fees or commissions more than 5 percent of the contract price, or \$200,000, and the Head of the Procuring Activity must approve any fees or commissions more than \$1 million.

6. Where a fee or commission is accepted by the purchasing government, the contracting officer should consider treating the element of cost as a separate line item and pay the contractor only after the agent has been paid. Where it is treated as a separate element of cost, no recognition should be given to the sales effort under ASPR 3-808.6(b) in establishing a profit factor.

§ 610. Contributions or expenditures by national banks, corporations or labor organizations

It is unlawful for any national bank, or any corporation organized by authority of any law of Congress, to make a contribution or expenditure in connection with any election to any political office, or in connection with any primary election or political convention or caucus held to select candidates for any political office, or for any corporation whatever, or any labor organization to make a contribution or expenditure in connection with any election at which Presidential and Vice Presidential electors or a Senator or Representative in, or a Delegate or Resident Commissioner to Congress are to be voted for, or in connection with any primary election or political convention or caucus held to select candidates for any of the foregoing offices, or for any candidate, political committee, or other person to accept or receive any contribution prohibited by this section.

Every corporation or labor organization which makes any contribution or expenditure in violation of this section shall be fined not more than \$5,000; and every officer or director of any corporation, or officer of any labor organization, who consents to any contribution or expenditure by the corporation or labor organization, as the case may be, and any person who accepts or receives any contribution, in violation of this section, shall be fined not more than \$1,000 or imprisoned not more than one year, or both; and if the violation was willful, shall be fined not more than \$10,000 or imprisoned not more than two years, or both.

For the purposes of this section "labor organization" means any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and which exist for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work.

As amended May 21, 1949, c. 139, § 10, 63 Stat. 90; Oct 31, 1951, c. 655, § 20(c), 65 Stat. 718.

§ 611. Contributions by firms or individuals contracting with the United States

Whoever, entering into any contract with the United States or any department or agency thereof, either for the rendition of personal services or furnishing any material, supplies, or equipment to the United States or any department or agency thereof, or selling any land or building to the United States or any department or agency thereof, if payment for the performance of such contract or payment for such material, supplies, equipment, land, or building is to be made in whole or in part from funds appropriated by the Congress, during the period of negotiation for, or performance under such contract or furnishing of material, supplies, equipment, land, or buildings, directly or indirectly makes any contribution of money or any other thing of value, or promises expressly or impliedly to make any such contribution, to any political party, committee, or candidate for public office or to any person for any political purpose or use; or

Whoever knowingly solicits any such contribution from any such person or firm, for any such purpose during any such period--

Shall be fined not more than \$5,000 or imprisoned not more than five years, or both

EXCERPTS FROM THE AICPA STATEMENT ON AUDITING STANDARDS #1

110.05 In making the ordinary examination, the independent auditor is aware of the possibility that fraud may exist However, the ordinary examination directed to the expression of an opinion on financial statements is not primarily or specifically designed, and cannot be relief upon, to disclose defalcations and other similar irregularities, although their discovery may result. Similarly, although the discovery of deliberate misrepresentation by management is usually more closely associated with the objective of the ordinary examination, such examination cannot be relief upon to assure its discovery. The responsibility of the independent auditor for failure to detect fraud (which responsibility differs as to clients and others) arises only when such failure clearly results from failure to comply with generally accepted auditing standards.

110.06 Reliance for the prevention and detection of fraud should be placed principally upon an adequate accounting system with appropriate internal control. The well-established practice of the independent auditor of evaluating the adequacy and effectiveness of the system of internal control by testing the accounting records and related data and by relying on such evaluation for the selection and timing of his other auditing procedures has generally proved sufficient for making an adequate examination. If an objective of an independent auditor's examination were the discovery of all fraud, he would have to extend his work to a point where its cost would be prohibitive. Even then he could not give assurance that all types of fraud had been detected, or that none existed, because items such as unrecorded transactions, forgeries, and collusive fraud would not necessarily be uncovered. Accordingly, it is generally recognized that good internal control and fidelity bonds provide protection more economically and effectively

110.8 The subsequent discovery that fraud existed during the period covered by the independent auditor's examination does not of itself indicate negligence on his part. He is not an insurer or guarantor; if this examination was made with due professional skill and care in accordance with generally accepted auditing standards, he has fulfilled all of the obligations implicit in his undertaking.

EXCERPTS OF VARIOUS SEC DISCLOSURE REQUIREMENTS

Form S-1

Item 16. Directors and Executive Officers.

List the names of all directors and executive officers of the registrant and all persons chosen to become directors or executive officers. Indicate all positions and offices with the registrant held by each person named, and the principal occupation during the past five years of each executive officer and each person chosen to become an executive officer.

Item 17. Remuneration of Directors and Officers

(a) Furnish information in tabular form as to all direct remuneration paid by the registrant and its subsidiaries during the registrant's last fiscal year to the following persons for services in all capacities:

(1) Each director, and each of the three highest paid officers, of the registrant whose aggregate direct remuneration exceeded \$30,000, naming each such person.

(2) All directors and officers of the registrant as a group, without naming them.

(b) Furnish information, in tabular form, as to all pension or retirement benefits proposed to be paid under any existing plan in the event of retirement at normal retirement date, directly or indirectly, by the registrant or any of its subsidiaries to each director or officer named in answer to paragraph (a) (1) above.

(c) Describe briefly all remuneration payments (other than payments reported under paragraph (a) or (b) of this item) proposed to be made in the future, directly or indirectly, by the registrant or any of its subsidiaries pursuant to any existing plan or arrangement to (i) each director or officer named in answer to paragraph (a) (1), naming each such person, and (ii) all directors and officers of the registrant as a group, without naming them.

Item 18. (With respect to options to purchase options)

(c) Furnish separately the information called for by paragraph (b) above for all options held by (i) each director or officer named in answer to paragraph (a) (1) of Item 17 naming each such person, and (ii) all directors and officers as a group without naming them.

Item 19. Principal Holders of Securities.

Furnish the following information as of a specified date within 90 days prior to the date of filing in tabular form:

(a) As to the voting securities of the registrant owned of record or beneficially by each person who owns of records, or is known by the registrant to own beneficially, more than 10 percent of any class of such securities. Show whether the securities are owned both of record and beneficially, of record only, or beneficially only, and show the respective amounts and percentages owned in each such manner.

(b) As to each class of equity securities of the registrant or any of its parents or subsidiaries, other than directors' qualifying shares, beneficially owned directly or indirectly by all directors and officers of the registrant, as a group, without naming them.

Item 20. Interest of Management and Others in Certain Transactions.

Describe briefly, and where practicable state the approximate amount of any material interest, direct or indirect, of any of the following persons in any material transactions during the last three years, or in any material transactions during the last three years, or in any material proposed transactions, to which the registrant or any of its subsidiaries was, or is to be, a party:

(a) Any director or officer of the registrant;

(b) Any security holder named in answer to Item 19(a);

(c) Any associate of any of the foregoing persons.

Regulation 14A

Item 7. Remuneration and Other Transactions with Management and Others ((a), (b), and (c) substantially the same as in Item 17, Form S-1; (d) substantially the same as Item 18, Form S-1)

(e) State as to each of the following persons who are indebted to the issuer or its subsidiaries at any time since the beginning of the last fiscal year of the issuer, (i) the largest aggregate amount of indebtedness outstanding at any time during such period, (ii) the nature of the indebtedness and of the transaction in which it was incurred, (iii) the amount thereof outstanding as of the latest practicable date, and (iv) the rate of interest paid or charged thereon:

(1) Each director or officer of the issuer;

(2) Each nominee for election as a director; and,

(3) Each associate of any such director, officer or nominee.

(f) Describe briefly any transactions since the beginning of the issuer's last fiscal year or any presently proposed transactions, to which the issuer or any of its subsidiaries was or is to be a party, in which any of the following persons had or is to have a direct or indirect material interest, naming such person and stating his relationship to the issuer, the nature of his interest in the transaction and, where practicable, the amount of such interest:

(1) Any director or officer of the issuer;

(2) Any nominee for election as a director;

(3) Any security holder named in answer to Item 5(d); or

(4) Any relative or spouse of any of the foregoing persons, or any relative of such spouse, who has the same home as such person or who is a director or officer of any parent or subsidiary of the issuer.

STANDARD FORM 119¹
DECEMBER 1952
PRESCRIBED BY
GENERAL SERVICES ADMINISTRATION

CONTRACTOR'S STATEMENT OF CONTINGENT OR OTHER FEES²

FOR SOLICITING OR SECURING, OR RESULTING FROM AWARD OF, CONTRACT

INVITATION NO.

CONTRACT NO.

NAME OF GOVERNMENT PURCHASING OFFICE

The following information is furnished by the undersigned contractor² concerning any company or person employed or retained to solicit or secure the above identified contract, or concerning any company or person to whom the contractor has paid or agreed to pay any fee, commission, percentage or brokerage fee, contingent upon or resulting from the award of that contract.

1. STATE FULL NAME AND BUSINESS ADDRESS OF SUCH COMPANY OR PERSON (*if more than one, identify all*) AND INDICATE WHETHER CORPORATION, PARTNERSHIP, INDIVIDUAL, ETC.:

2A. DESCRIBE RELATIONSHIP TO CONTRACTOR OF THE COMPANY OR PERSON LISTED UNDER ITEM 1, THAT IS, WHETHER SUCH COMPANY OR PERSON IS A SALES AGENT OR REPRESENTATIVE, BROKER, EMPLOYEE, CORPORATE OFFICER OR PRINCIPAL, OR OTHER RELATIONSHIP:

B. IF THERE IS A WRITTEN CONTRACT OR AGREEMENT COVERING SUCH RELATIONSHIP, ATTACH A COPY. IF NOT IN WRITING, STATE *in detail* THE TERMS OF SUCH ARRANGEMENT. INCLUDE THE AMOUNT AND METHOD OF COMPUTATION OF COMPENSATION AND EXPENSES:

Appendix D
Page 1 of 2

CONTINUE ON OTHER SIDE

¹ This form is prescribed by General Services Administration for use as part of the procedure concerning the "Covenant Against Contingent Fees." See General Services Administration Regulations, 41 (CFR) 1-1.507, 101-45.313, and 101-47.315.

² As used throughout this form, the term "contractor" includes "bidder."

If additional space is required, attach separate sheet which must also be signed

3. IF SUCH PERSON IS AN EMPLOYEE:

A. SPECIFY THE DURATION (PERIOD) OF EMPLOYMENT:

B. IS SUCH PERSON ON THE CONTRACTOR'S PAYROLL FOR PURPOSES OF SOCIAL SECURITY AND FEDERAL INCOME TAX WITHHOLDING? ☐ YES ☐ NO

C. IS SUCH PERSON EMPLOYED BY OR DOES HE REPRESENT ANY OTHER CONCERN'S? ☐ YES ☐ NO
IF ANSWER IS "YES," STATE NAMES AND ADDRESSES OF SUCH CONCERNS AND IN WHAT CAPACITY:

4. DOES THE COMPANY OR PERSON LISTED UNDER ITEM 1 REPRESENT THE CONTRACTOR:

A. WITH RESPECT TO BOTH COMMERCIAL AND GOVERNMENT BUSINESS? ☐ YES ☐ NO

B. WITH RESPECT TO GOVERNMENT BUSINESS ONLY? ☐ YES ☐ NO

C. SOLELY WITH RESPECT TO THIS CONTRACT? ☐ YES ☐ NO

D. WITH RESPECT TO CONTRACTS OF PARTICULAR GOVERNMENT PROCUREMENT OFFICES? ☐ YES ☐ NO
IF ANSWER IS "YES," SPECIFY THE OFFICES:

5A. WITH RESPECT TO THIS CONTRACT, ARE THE DUTIES OF THE COMPANY OR PERSON LISTED UNDER ITEM 1 CONFINED TO SOLICITING, OBTAINING, OR ASSISTING IN OBTAINING THE CONTRACT? ☐ YES ☐ NO

B. IF THE DUTIES INCLUDE OTHER SERVICES SPECIFY SUCH SERVICES:

6. IS IT THE CONTRACTOR'S REGULAR PRACTICE TO HAVE AN ARRANGEMENT OF THE TYPE SPECIFIED HEREIN? ☐ YES ☐ NO

7. WITH RESPECT TO THE COMPANY OR PERSON SPECIFIED UNDER ITEM 1, STATE:

A. HOW LONG SUCH COMPANY OR PERSON HAS BEEN ENGAGED IN THIS TYPE OF WORK (i. e., sales representative, etc.):

B. HOW LONG SUCH COMPANY OR PERSON HAS PERFORMED THIS TYPE OF WORK FOR THE CONTRACTOR:

U. S. Code, Title 18 (Crimes and Criminal Procedure) Section 1001 makes it a criminal offense to make a willfully false statement or representation herein.

CONTRACTOR

BY (to be signed only by authorized principal, such as corporate officer, of contractor, i. e., may not be signed by sales agent, etc.)

TITLE

DATE

ADDRESS OF CONTRACTOR

Appendix D
Page 2 of 2

If additional space is required, attach separate sheet which must also be signed

GPO : 1965 O-771-061

END