

Filling the Pool Teaching Notes

What Are the Relevant Facts?

1. Bob's company is heavily dependent on cost-reimbursable government contracts.
2. Bob has no previous experience on auditing government contracts.
3. Bob has discovered what he believes are questionable G&A costs.
4. Jan, Bob's supervisor, has experience on auditing government contracts and in the past has discovered items similar to those found by Bob; however, she deleted the items from the sample based on materiality.
5. The government reimburses the company for a share of G&A pool costs.
6. Government auditors have evidently relied on the work of internal auditors in the past to substantiate G&A pool charges.
7. The individual items and costs may or may not be material; however, in the aggregate, they evidently affect the G&A allocation rate.
8. If the items were discovered by government auditors, they might be disallowed from the pool, which would reduce the company's reimbursement.

What Are the Ethical Issues?

1. What obligation does Bob have as an internal auditor to determine the materiality of the charges based on his own professional judgment?
2. What should Bob do to determine whether the items and costs sampled are reasonable charges for allocation to government contracts?
3. Does the company have an obligation to establish a clear policy for charging costs to a G&A pool which will be allocated to government contracts? For resolving questionable items?
4. What should Bob do about Jan's suggestions concerning the items and the documentation of his sample in the workpapers (i.e., to "forget about them")?

Who Are the Primary Stakeholders?

- Bob
- Jan

- Other internal auditors and employees of the company
- Company management and stockholders
- Government auditors
- Federal government and commercial customers
- Other government contractors
- U.S. citizens as taxpayers.

What Are the Possible Alternatives?

1. Accept Jan's suggestion and delete the items from the sample.
2. Document the audit results as they occurred, i.e., leave the items and costs in the workpapers.
3. Document the audit results as they occurred and also document the discussion with the supervisor in the workpapers.
4. Request a conference with Jan and the Director of Internal Audit.
5. Take some other actions (e.g., call a federal government investigative agency).

What Are the Ethics of the Alternatives?

- From a "utilitarian" (costs and benefits) perspective:
 1. Which possible alternative would provide the greatest benefit to the greatest number of stakeholders?
 2. What are the potential costs of examining the G&A pools in detail for current and prior years? What are the potential costs of not examining the pools? (Seek both monetary and nonmonetary costs.)
 3. Should the possibility that prior-year contracts may be reexamined be considered?
- From a "rights" perspective:
 1. What does each stakeholder have the right to expect (i.e., in terms of the identification, allocation, and reimbursement of reasonable G&A costs; the nature and extent of supporting evidence in terms of what is documented versus what is known)?
- From a "justice" perspective:

1. Which stakeholders are the most burdened, and what burdens do they carry if Bob does nothing, i.e., accepts Jan's suggestion?

What Are the Practical Constraints?

1. As a staff internal auditor in a business heavily dependent on government contracts, Bob must consider the possibility that the corporate culture fosters an aggressive approach to allocating costs to government contracts.
2. Bob must also consider the implication of documenting a disagreement with his supervisor in workpapers that will be examined both by Jan and probably by outside auditors.
3. Bob should recognize that this pooling practice of covering unrelated items may violate the law.

What Actions Should Be Taken?

1. What action(s) should Bob take?

2. What alternative would you choose if you were Bob, and why?
3. What ethical theories or approaches make the most sense in this situation? Compare and contrast the perspective of an internal auditor with that of an outside auditor in this situation.

Background Material

1. *Government Contract Cost Accounting*, available from any office of the Defense Contract Audit Agency. This guide provides explanations of reasonable and allocable costs for defense contracts.
2. United States General Accounting Office "Federally Sponsored Research," *Testimony before the Subcommittee on Oversight and Investigation Committee on Energy and Commerce, House of Representatives*, GAO/T-RCED-91-18, March 13, 1991. This testimony recounts the charging of indirect costs to research contracts by major universities and is the foundation for this minicase.