



Office of the Washington State Auditor
Pat McCarthy

Special Investigation Report

Washington Apple Commission

For the Investigation Period August 3, 2011 through May 3, 2017

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October 26, 2017

Washington Apple Commission
Wenatchee, Washington

Report on Special Investigation

Attached is the official report on our investigation at the Washington Apple Commission. On April 28, 2017, the Commission notified the State Auditor's Office of a potential loss of public funds. This notification was submitted to us under the provisions of state law (RCW 43.09.185).

This report contains the results of our investigation of invoices billed to the Commission by an overseas contractor from August 3, 2011 through May 3, 2017. The purpose of our investigation was to determine if a misappropriation had occurred.

Our investigation was performed under the authority of state law (RCW 43.09.290) and included procedures we considered necessary under the circumstances.

If you are a member of the media and have questions about this report, please contact Assistant Director for Communications Kathleen Cooper at (360) 902-0470. Otherwise, please contact Fraud Manager Sarah Walker at (509) 454-3621.

Pat McCarthy

State Auditor

Olympia, WA

cc: Ms. Robin Mooney, Vice President/Treasurer

INVESTIGATION REPORT

Investigation Summary

On April 28, 2017, the Board President of the Washington Apple Commission notified our Office regarding a potential loss of public funds, as required by state law.

We determined there was a significant discrepancy with two subcontractor-invoicing records, sent to the Commission by an overseas Contractor, totaling approximately \$573,182 between December 2011 and March 2017. We identified potential overbilling by year as follows:

| Total potential overbilling by year USD exchange | |
|---|------------------|
| 2011-2013 | \$59,025 |
| 2014 | \$135,274 |
| 2015 | \$182,619 |
| 2016 | \$95,382 |
| 2017 | \$100,882 |
| Total | \$573,182 |

Every invoice the Contractor submitted to the Commission on behalf of the two subcontractors contained discrepancies when compared with the subcontractors' original invoices. Rather than submit those original invoices to the Commission, the Contractor submitted a second set of invoices, using the subcontractors' names, which charged for services not provided or contained incorrect information including formatting, letterheads, billing number, amounts and signature approvals.

As of August 2017, the Commission has withheld payment to the Contractor in the amount of \$505,138 for invoices submitted from May 2017 to June 2017.

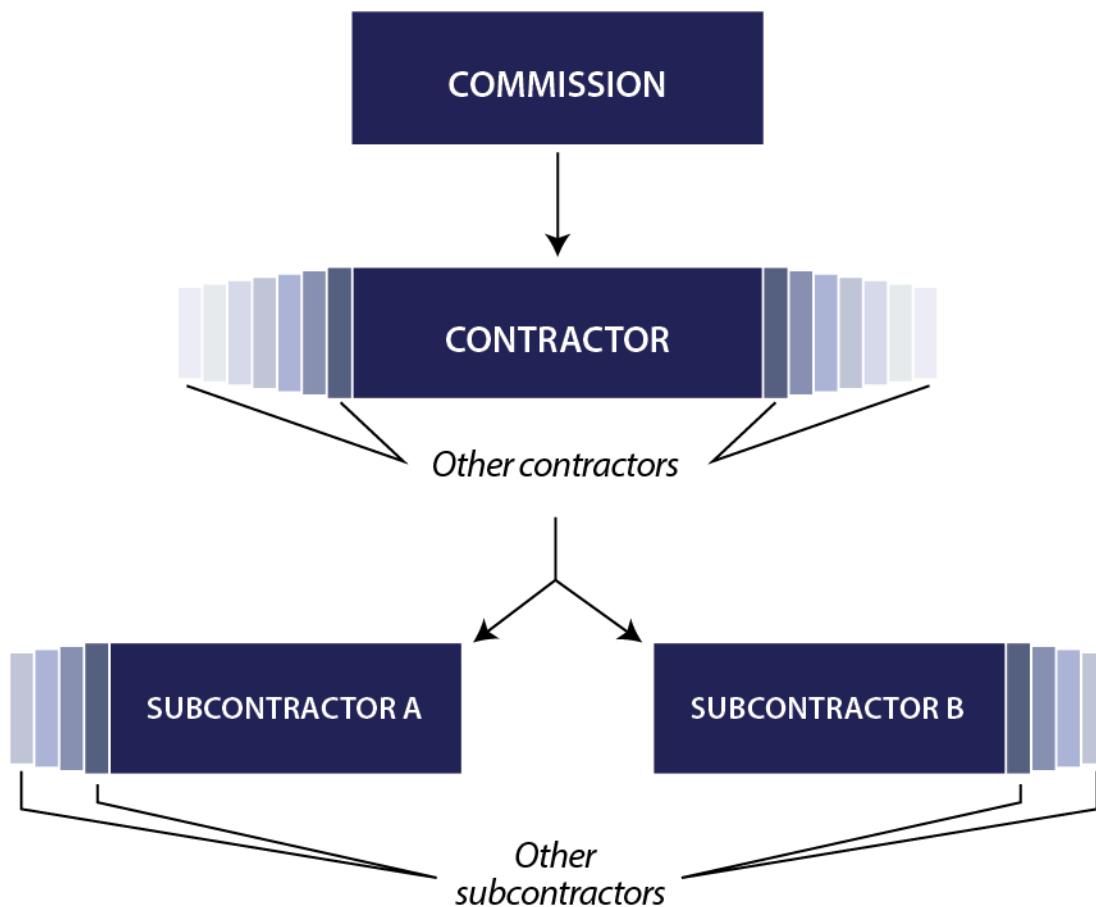
The Commission has notified its federal granting agency, the United States Department of Agriculture, which plans to refer the case to the Office of Inspector General for further review.

Background

The Commission, located in Chelan County, is set up to advertise and promote Washington apples. This includes administering and disbursing funds for apple promotions in 30 foreign markets under the federal Market Access Program (MAP). A 14-member Board of Commissioners approves the budget and sets direction for the Commission's operations. Six full-time and three part-time

employees work for the Commission, including a Board President, to oversee daily operations. The Commission has contracts with 11 international businesses to market and sell Washington apples in foreign countries.

Exhibit 1 below explains the relationship between the Commission, the Contractor, subcontractors and sub-subcontractors mentioned during the report.



Note: The Washington Apple Commission has 11 international contractors whose job is to promote Washington apples in foreign markets. These contractors often hire subcontractors for the work. This report deals with one contractor and two of its subcontractors.

In March 2017, the Commission became aware of invoice discrepancies with its Contractor based in India.

The Commission quickly hired an outside accounting firm to conduct an independent review. The accounting firm compared invoices the Contractor submitted to the Commission with one subcontractor's original invoice records from July 1, 2015, to June 30, 2016.

The accounting firm concluded that there were many discrepancies, including formatting, letterheads, references to non-existent India service tax numbers, bill numbers and amounts. The firm found:

- 118 invoices totaling \$77,885 were submitted to the Commission for promotional events that the Subcontractor did not perform
- 46 invoices totaling \$249,767 in documented mismatches of information compared with Subcontractor invoice details, resulting in overbilling of the Commission by \$26,216.

The Commission gave the accounting firm's conclusions to its federal granting agency. The granting agency requested the Commission expand the review of invoices to the past five years to assess the risk of additional MAP grant fund losses. The Commission asked us to conduct this expanded investigation.

Investigation Results

We focused our investigation on invoices paid by the Commission to the Contractor from August 3, 2011 to May 3, 2017. During this period, the Contractor sent 1,336 invoices to the Commission. These invoices were from various subcontractors and totaled \$5,051,471. About \$4,443,667 of this was paid using MAP grant funds. Our review found the following:

Contract agreement

Each year, the Commission signs a contract with the Contractor based in India. The contract clearly describes scope of work, billing procedures, the payment process and records maintenance. The relevant portion of the contract states:

- Original invoices are required
- The contracted business "shall maintain books, records, documents, data and other evidence relating to this contract and performance of services, including but not limited to accounting procedures and practices which sufficiently and properly reflect all direct and indirect costs of any nature expended in performance of this contract."

Invoice comparison

- We analyzed the amount paid to subcontractors and chose two of those subcontractors (A and B) who billed at high levels. We worked directly with the two selected subcontractors to obtain copies of their original invoice records.

- We completed a detailed invoice-to-invoice comparison of Subcontractor A's and B's original records to Commission records. The table below shows a summary of the potential overbilling discrepancy.

| Invoice comparison by Subcontractor | Total billed to Commission by contracted business | Potential overbilled amounts |
|---|--|-------------------------------------|
| Subcontractor A (December 2011 to March 2017) | \$974,367 | \$486,587 |
| Subcontractor B (January 2017 to February 2017) | \$91,426 | \$86,595 |
| Total | \$1,065,793 | \$573,182 |

Subcontractor A summary

- A total of 650 invoices were sent to the Commission under Subcontractor A's name by the Contractor. None of the invoices submitted to the Commission were original invoices from Subcontractor A.
- We identified significant discrepancies in the following areas:
 - 180 invoices totaling \$615,820, billed to the Commission, contained different information than what was originally billed to the Contractor. The mismatched information always included increased dollar amounts, which totaled \$155,779 in potential overbillings.
 - 470 invoices totaling \$358,547 were billed for services not provided, according to confirmation from Subcontractor A.
 - We also identified \$27,738 in Subcontractor A invoices that were billed to the Contractor that do not appear to have been sent to the Commission at all. For these invoices, we gave the Contractor credit and reduced this amount from the calculated potential overbilling.

Subcontractor B summary

- A total of 21 invoices were billed to the Commission under Subcontractor B's name by the Contractor. None of the invoices submitted to the Commission were original invoices.
- We identified a significant potential overbilling totaling \$86,595 submitted to the Commission by the Contractor. This difference was related to one invoice paid by the Commission. The other 20 invoices were withheld from payment.

Interviews

In July and August 2017, we spoke by phone to the owners of the Contractor and the Subcontractors to discuss the discrepancies, invoicing records, billing process and payment procedures.

The Contractor shared the following:

- It was easier to submit a single summary invoice to the Commission. The original subcontractor invoices involved too much detail that was not required and that they felt nobody wanted to go through. The Contractor shared that fundamentally, they have agreed with the Commission to a certain program at a certain overall cost.
- It is a challenge to tie out every individual invoice billed and that our Office should instead focus on the overall picture rather than the details. The information that is being tracked does not necessarily correlate to which individual invoice is being paid but instead the total amounts in float.
- Off-the-books cash payments are about 25 percent of business operations and a partial reason for the significant discrepancies. Records for these cash payments are not retained and therefore cannot be traced back to invoices billed to the Commission. However, the Contractor explained in reality there is no difference in what they have invoiced and what they have paid. It is just how the payments are being processed that makes matching billed invoice information difficult.
- Sometimes he would pay sub-subcontractors directly, on behalf of the sub-contractor. Those payments are included in the invoices submitted to the Commission under the sub-contractor's name and not the sub-subcontractor's name.

Subcontractor A shared the following:

- The company prepares one set of invoices for billing, and did not create nor prepare the summary invoices that the Contractor submitted to the Commission under its name.
- They have not received off-the-books cash payments from the Contractor.
- The Contractor has never paid a sub-subcontractor on its behalf.

Subcontractor B shared the following:

- The company has two sets of invoices. One set of invoices reflects what the company billed the Contractor and what the company was paid directly. The second set of invoices includes some off-the-books cash payments to them and sub-subcontractors paid directly on the company's behalf. However, our review indicates only the second set of invoices were sent

to the Commission, which creates doubt about the company's stated reason for the different sets of invoices.

Off-the-books cash payment assessment

Because the Contractor indicated a reason for the significant discrepancies related to off-the-books cash payment activity, we requested for the year 2015 that the Contractor clearly identify which off-the-books cash payments match the individual invoices billed to the Commission. The Contractor explained that the two are unrelated activities and withdrawals from the company for the off-books pool of cash are more a function of liquidity in their company. Documentation provided by the Contractor to support this understanding was limited to spreadsheet information and did not include any original bank statement records to prove cash withdrawal listings.

It was unfeasible to trace off-the-books cash payments to invoices sent to the Commission. This made tying invoices sent to the Commission back to original subcontractor records impossible.

Control Weaknesses

The Commission relied on the Contractor to submit original invoice records to the Commission for payment as clearly stated in the contract agreement. During the investigation, we identified that the Contractor never submitted an original invoice for at least Subcontractor A or Subcontractor B to the Commission. This made it very difficult for the Commission to have known that original invoice records were not being submitted; therefore, we did not identify a key control weakness in the Commission's processes.

Recommendations

We recommend the Commission further improve its internal controls over general disbursements involving international invoicing documentation to ensure adequate oversight and monitoring to safeguard public resources and compliance with Commission policies. Considerations for the Commission include:

- Obtain supporting payment documentation to compare with invoice records received to ensure original invoice records are submitted by contracted international businesses.
- Complete periodic confirmations with subcontractors used by the contracted international businesses to validate invoice information and billed amounts for services provided.
- Research and train staff on the various overseas countries where invoices are received from to help them become familiar with the accounting, invoicing and reporting standards specific to that country.

We also recommend the Commission seek recovery of the identified discrepancy discussed above, as appropriate and related investigation costs of \$25,611 from the former overseas Contractor business located in India and/or its insurance bonding company, as appropriate. Any compromise

or settlement of this claim by the Commission must be approved in writing by the Attorney General and State Auditor as directed by state law (RCW 43.09.330). Assistant Attorney General Matt Kernutt is the contact person for the Attorney General's Office and can be reached at (360) 586-0740 or mattk1@atg.wa.gov. The contact for the State Auditor's Office is Sadie Armijo, Assistant Director of Local Audit, who can be reached at (360) 902-0362 or Sadie.Armijo@sao.wa.gov.

Commission's Response

Upon notification by the State Auditors of potential fraudulent invoicing practices by our India Rep, we immediately suspended all activities and ceased payment. This led to non-payment of \$505,138 in submitted invoices.

In consideration of the ongoing investigation, we did not renew our contract with the representative, which elapsed on June 30, 2017. Instead, we executed a RFQQ (Request for Qualifications and Quotations) for new representation in India.

In addition, WAC developed new Compliance protocols to strengthen our current policies and procedures required for WAC representatives.

WAC presented the new compliance program to all contracted representatives and had them sign an Acknowledgment form stating that they have read and will comply with the new policies detailed in our updated Rep Manual.

Some of the more significant changes WAC has made to the compliance program include the following:

- Additional staff dedicated to review Rep invoices and all support documentation required to process the claim.*
- Proof of payment is now required for all expenses which may include copies of checks, or wires issued to vendors; copies of Rep bank statement listing payment for activity; or signed receipt from vendor that invoice has been paid in full.*
- For reference purposes, the Rep Manual lists in detail all required support documentation needed to support proof that the activity took place.*
- For every vendor that the Rep uses to conduct WAC activities, proof of payment, a copy of a contract, agreement or other document signed by both parties listing the scope of work, deliverables, period of performance and compensation is required to be submitted along with the invoices to WAC.*
- WAC has increased direct payments to 3rd party vendors.*

- *WAC will periodically request invoices directly from the vendors to ensure that Rep is submitting original invoices for reimbursement.*
- *Added a detailed deliverable list of requirements that must be completed by Rep before paying their monthly contract fee.*
- *Reps are required to complete and sign a Claim Form with every batch of invoices submitted to WAC for payment. This form contains a Certification Statement that they have personally examined all submitted documents and to the best of their knowledge they are complete, accurate, true and available for inspection.*
- *All Claims must now be submitted for reimbursement no later than 60 days after the activity has ended.*
- *All Rep contracts will continue to be bid out every 3-4 years.*

State Auditor's Office Remarks

We thank Commission officials and personnel for their assistance and cooperation during the investigation.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments as well as [fraud](#), state [whistleblower](#) and [citizen hotline](#) investigations.

The results of our work are widely distributed through a variety of reports, which are available on our [website](#) and through our free, electronic [subscription](#) service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

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