

TIPS ON ESTABLISHING A SUCCESSFUL CONTRACTOR INTERNAL AUDIT PROGRAM

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With the publication of the new version of the property portion of FAR, an internal review or audit program is now a contractual requirement. The Government has the option of accepting this contractor self-assessment (CSA) report in lieu of their own required analysis.

FAR 52.245-1 (f) (3) states that “The Contractor shall establish and maintain procedures necessary to assess its property management system effectiveness and shall perform periodic internal reviews and audits. Significant findings and/or results of such reviews and audits pertaining to Government property shall be made available to the Property Administrator.”

FAR 52.245-1(f) (1) (vi) Reports – says that “The Contractor shall have a process to create and provide reports of discrepancies; ...audits and self-assessments; corrective actions; ...as directed by the Contracting Officer.”

Why would a contractor want the Government to use their audit in the place of the Government’s own analysis? The benefit to a contractor for establishing a successful internal audit (IA) or CSA program would be to assure a healthy Property Control System and would also bring with it the knowledge that there would be no surprise from a Government property analysis. Time spent with one audit versus two should also be considered a plus.

So how does a company make their CSA successful enough to fulfill the Government’s audit requirements? This might be found within the history of the contractor self-oversight (CSO) program which has been practiced within DCMC/DCMA since 1997.



History

CSO experiments were initiated to test the feasibility of having contractor representatives perform surveillance tasks in lieu of direct DCMC surveillance. They proved successful and in May of 1997 Major General Robert W. Drews published DCMC Information Memorandum 97-06 stating that the necessary revisions to DCMC policies were being developed to incorporate the CSO technique.

In October of 1997 Brigadier General Timothy P. Malishenko issued DCMC Policy Memorandum 98-05 to provide additional guidance on CSO. In the Memo he cautioned that CSO did not reduce any contractual obligations of the contractor.

As you can see, as far back as 1997 the Government was encouraging contractors to do CSA/IAs and encouraging the Gov-

ernment Property Administrators (PAs) to embrace that concept.

Background

My personal experience as a DCMA Government PA working successfully with a contractor under CSO for 8 years, has proved that this concept can work quite well. It takes open communication between both parties and a desire to work together to resolve audit performance issues. It also takes planning up front.

During the time we practiced CSO, we worked together under a Memorandum of Agreement (MOA) that was revised annually to incorporate our plans for the year. The contractor also wrote a procedure for their implementation methodology of CSO detailing how they would accomplish their audits so that we would have no future disagreements on how the process would work.

Since CSO (under that name) will no longer exist, I believe a detailed procedure describing how the contractor will perform the IA is still necessary for a successful audit program. This process should be incorporated into the contractor's Property Management System Procedures.

Our CSO procedure covered such things as the schedule, the audit planning, contractor and Government coordination, the review criteria, the sampling, the work papers, how the deficiencies and corrective actions would be handled, and the reporting process. While the contractor wrote the procedures, they were open to suggestions from me. From the very first, our intent was to work together to make this concept successful.

Another reason our process worked so well was the fact that the CSO auditors were from an independent compliance organization within the company. My vision for CSO was not for Property Management (PM) to do an oversight of itself. The CSO auditors did not work for the same vice president as PM. Even though the CSO auditors did the analysis for the Government, we still considered the CSO program a triad – CSO auditors, DCMA PA, and contractor's PM. We strongly valued PM's participation in the analysis even though they were not responsible for performing the audit. The entity responsible for performing the IA is another consideration that could weigh on a PA's decision whether or not to accept a contractor-performed audit.

Things to consider when writing a CSA/IA procedure:

The method of operation should be written into the procedure. Performing the analysis according to the guidance in the DoD Manual for the Performance of Contract Property Administration 4161.2 is really a must for an audit to be accepted by the Government. The review objectives and audit steps should be developed based on the criteria and techniques provided in the DoD manual the same as the Government PA would do.

For a contractor who has never done an audit IAW the DoD 4161.2-M, it might be a good idea to take one of the DAU courses on performing a Property Control System Analysis. Or you could ask your PA for some guidance or discuss with your PA the possibility of performing some joint process analyses.

To prevent duplication of efforts, it



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would always be a good idea for the contractor and the Government to discuss the development of an annual system analysis plan before the contractor performs its audit. It would be helpful for the contractor to know which functions or process the Government PA feels should be accomplished each year and the reason for that decision. The PA's input on this plan could be invaluable for an acceptable audit.

As always, the Property Management function would be retained by the Government PA, but since that analysis does cover contractor audits of Government property, it could be a step in the right direction to involve the PA to some extent in the IA. Detailing how the contractor and PA would interact on the IA activities is another consideration for incorporation into the procedures.

Under CSO the PA had to validate the work the contractor did, either by taking a sample of the work papers and performing a mini audit or by participating in the audit. While PA participation isn't a requirement under IA, as I said before, PA involvement at some level could be a good idea. The same suggestion applies to any required corrective actions. For example, it would be helpful to know if the PA feels the corrective action plan would be sufficient to correct the deficiencies found. Again, this isn't a requirement, but it could be just good business sense when trying to get a successful CSA off the ground.

Don't be surprised if the PA asks to look at your work papers or other documentation. Before taking someone's report at face value, most PAs would want to see what was done and how it was done. They would want to assure an adequate and unbiased selection of populations, samples and transactions were selected for the analysis. In fact, I wouldn't be surprised if there were some Government requirements forthcoming about what the PAs must do before accepting a contractor's IA as their own.

What does the Government need to see in the way of a report they could accept? It would be best to discuss that with your PA before you write the procedure or perform your first audit. An audit report of a small "mom and pop" shop would not need to be nearly as comprehensive or detailed as that of a large corporation. Most likely the PA would want to see something about the methodology used to perform the audit including the lot size, sample size, narrative on the criteria from the DoD Manual based on the applicable processes reviewed, documentation if any procedural, contractual, or systemic deficiencies were discovered and what was done to resolve those defects.

The handling of any corrective action requests as well as the issue of follow-up audits after the completion of a corrective action plan also needs to be addressed in the procedures.

The most helpful audit tool we found with CSO was that of the electronic work papers developed by my contractor. I was able to review the lot, sample, work papers, other documentation and report all on a CD updated throughout the year. And at the end of the fiscal year, the entire year's work was on one thin disc. Talk about progress toward a paperless society! My contractor is certainly the role model for that.

As always, it would still be the responsibility of the PA to determine the property control system rating ("adequate" or "inadequate" instead of the previous ratings of "satisfactory" or "unsatisfactory") and to verify there were prompt and adequate corrections of any system deficiencies.

This article wasn't written to be one of those "all you ever needed to know" about something articles. I wrote this article to give you some ideas to start with and to build on. I believe the most important single facet of a successful contractor audit program could be as simple as good communication between a contractor and their Government PA. □