

September 18, 2002



# Audit Followup

The Army Contract Audit Followup  
Process  
(D-2002-6-009)

Office of the Inspector General  
of the Department of Defense

*Quality*

*Integrity*

*Accountability*

## Report Documentation Page

<b>Report Date</b> 18 Sep 2002	<b>Report Type</b> N/A	<b>Dates Covered (from... to)</b> -
<b>Title and Subtitle</b> Audit Followup: The Army Contract Audit Followup Process	<b>Contract Number</b>	
	<b>Grant Number</b>	
	<b>Program Element Number</b>	
<b>Author(s)</b>	<b>Project Number</b>	
	<b>Task Number</b>	
	<b>Work Unit Number</b>	
<b>Performing Organization Name(s) and Address(es)</b> OAIG-AUD (ATTN: AFTS Audit Suggestions) Inspector General, Department of Defense 400 Army Navy Drive (Room 801) Arlington, VA 22202-2884	<b>Performing Organization Report Number</b> D-2002-06-009	
	<b>Sponsoring/Monitoring Agency Name(s) and Address(es)</b>	
		<b>Sponsor/Monitor's Acronym(s)</b>
		<b>Sponsor/Monitor's Report Number(s)</b>
<b>Distribution/Availability Statement</b> Approved for public release, distribution unlimited		
<b>Supplementary Notes</b>		
<b>Abstract</b>		
<b>Subject Terms</b>		
<b>Report Classification</b> unclassified	<b>Classification of this page</b> unclassified	
<b>Classification of Abstract</b> unclassified	<b>Limitation of Abstract</b> UU	
<b>Number of Pages</b> 26		

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### **Acronyms**

AMCOM	Aviation and Missile Command
CAFU	Contract Audit Followup
DCAA	Defense Contract Audit Agency
FAR	Federal Acquisition Regulation
IMA	Information Management and Assessment
OIG DoD	Office of the Inspector General of the Department of Defense
OSC	Operations Support Command
PARC	Principal Assistant Responsible for Contracting
TACOM-ARDEC	Tank-Automotive and Armaments Command-Armament Research Development and Engineering Center



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September 18, 2002

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY  
(ACQUISITION, LOGISTICS, AND  
TECHNOLOGY)  
ASSISTANT SECRETARY OF THE ARMY  
(FINANCIAL MANAGEMENT AND  
COMPTROLLER)  
AUDITOR GENERAL, DEPARTMENT OF THE  
ARMY

SUBJECT: Report on the Army Contract Audit Followup Process  
(Report No. D-2002-6-009)

We are providing this report for information and use. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions should be directed to Mr. Wayne C. Berry at (703) 604-8789 (DSN 664-8789) (wberry@dodig.osd.mil) or Ms. Madelaine E. Fusfield at (703) 604-8739 (DSN 664-8739) (mfusfield@dodig.osd.mil). See Appendix B for the report distribution. Team members are listed inside the back cover.

  
Patricia A. Brannin  
Deputy Assistant Inspector General for  
Audit Policy and Oversight

# Office of the Inspector General of the Department of Defense

Report No. D-2002-6-009  
(Project No. D-2001CG-0139)

September 18, 2002

## The Army Contract Audit Followup Process

### Executive Summary

**Who Should Read This Report and Why?** Civilian and military acquisition officials responsible for any aspect of ensuring proper and timely settlement of contract audit issues should read this report. The report explains how to improve the contract audit followup process and therefore maximize the potential savings from more effective disposition of audit findings.

**Background.** This report addresses the Army contract audit followup process for ensuring the proper, timely resolution and disposition of contract audit issues. It discusses the Army's ability to accurately monitor contract audit reports, effectively settle audit findings, and submit the status of all Army contract audit reports semiannually to the Office of the Inspector General of the Department of Defense. The Army's two semiannual reports covering the 12-month period ending March 31, 2001, included 209 audit reports with total questioned costs of \$362 million.

**Results.** Although the Army generally complied with DoD contract audit followup procedures, the Army needs to improve the reliability of its contract audit followup databases and to correctly and timely pursue repayments, including interest. One settlement we reviewed resulted in a potential Antideficiency Act violation. The Army should create a process for the accurate and complete preparation of Army semiannual reports to improve their reliability. The Army should also include the contract audit followup function as an area of special interest in its FY 2003 Procurement Management Review Program. Increased awareness of debt collection guidance and improved documentation on the status of reportable audits will assist contracting officers to improve their efficiency at dispositioning audit findings. Finally, the Army must conduct a preliminary review to determine whether a potential Antideficiency Act occurred when a contracting officer settled an audit report and did not send the interest payment to the U.S. Treasury.

**Management Comments.** The Army concurred with the recommendations and is in the process of adopting a web-based contract audit followup system, is investigating the potential Antideficiency Act violation, and will make contract audit followup an area of special interest in the FY 2003 Procurement Management Review Program. Previously, the Army took action to update semiannual report information based on our initial results.

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## Background

**Contract Audit Followup.** The Office of Management and Budget Circular No. A-50 (OMB Circular A-50), “Audit Followup,” September 29, 1982, prescribes policies and procedures for Executive agencies to establish followup systems to assure prompt and proper resolution and implementation of audit recommendations. OMB Circular A-50 requires agencies to maintain accurate records of the status of audit reports or recommendations through the entire process of resolution and corrective action. The DoD Directive 7640.2, “Policy for Followup on Contract Audit Reports,” February 12, 1988, as amended August 16, 1995, implements OMB Circular A-50 and establishes DoD policies, responsibilities, reporting requirements, and followup procedures for contract audit reports. Secretaries of the Military Departments and Directors of the Defense agencies are required by DoD Directive 7640.2 to maintain adequate followup systems for the proper, timely resolution and disposition of contract audit reports.

DoD Directive 7640.2 also requires all DoD Components to submit reports on the status of reportable contract audits semiannually to the Inspector General of the Department of Defense within 30 calendar days of the 6-month periods ending March 31 and September 30 and specifies the information to be reported and the format to be used.

**Army Implementation.** The Army has established policies and procedures that implement the DoD Directive 7640.2 requirements to establish certain responsibilities, reporting requirements, and followup procedures for contract audit reports. The Army contract audit followup policy and procedures are contained in the Army Federal Acquisition Regulation Supplement Subpart 5142.1-90, “Follow-up on Contract Audit Reports.”

## Objectives

The overall objective was to evaluate the Army Contract Audit Followup (CAFU) process. Specifically, we evaluated the accuracy of the Army’s contract audit followup data and actions taken by contracting officials to ensure proper and timely settlement of contract audit issues. We also reviewed the management control program as it related to the stated objectives. See Appendix A for a discussion of the audit scope and methodology, the review of the management control program, and prior coverage related to the audit objectives.

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## A. Accuracy of Contract Audit Followup Information

The Army's semiannual reports to the Office of the Inspector General of the Department of Defense (OIG DoD) for the periods ending September 30, 2000, and March 31, 2001, contained incomplete and inaccurate contract audit followup information. The semiannual reports did not include 42 reports (with total questioned costs of \$35.1 million) out of the 94 reports issued by the Defense Contract Audit Agency (DCAA) to the Army during those periods. Inadequate management control procedures and the use of an obsolete data gathering process contributed to the omissions. Examples of inaccuracies included unusual delays in updating the semiannual report information and the deletion of information from the reports without explanations. As a result, Army procurement officials may not have reliable data to effectively determine whether audit findings are resolved and dispositioned in accordance with DoD guidelines.

### Accuracy of Information in Army Semiannual Reports

The DoD Directive 7640.2, paragraph 6.3, "Reporting Requirements," requires DoD acquisition and contract administration organizations to maintain timely and complete information regarding the status of reportable contract audit reports from the time the report is received through final disposition.

**Incomplete Reporting.** The DCAA provided a record each month to Army Headquarters listing all audit reports that the DCAA had issued during the month and that required resolution and disposition by the Army. We compared the DCAA information provided in the reports for April 2000 through March 2001 to the information in the two Army semiannual reports covering the 12-month period to determine whether the Army had included all DCAA issued audit reports. The two Army semiannual reports omitted 54 of the 94 audit reports included in the DCAA monthly records to the Army. With Army and DCAA assistance, we determined the reasons 12 of the 54 were omitted. DCAA accounted for 6 of the errors and the Corps of Engineers had not forwarded 6 audit reports to the correct office. However, Army management could not explain why the remaining 42 reportable audits were not included in the semiannual reports.

**Processing of Semiannual Report Information.** The Army CAFU semiannual reporting process is initiated at the lowest level, which is the contracting activities that receive the audit reports from the DCAA. The contracting activities could not verify whether they had received all reports issued to them because Army Headquarters did not always provide the monthly records received from the DCAA to the commands. The CAFU program manager at Army Headquarters did not reconcile the semiannual report information received from the commands against the DCAA records. He collected information received from the

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commands, consolidated it, and submitted a semiannual report to the OIG DoD. The program manager believed the Principal Assistant Responsible for Contracting (PARC) at the command level was responsible for the accuracy and completeness of the CAFU data.

**Inaccuracies in Army Semiannual Reports.** Examples of inaccuracies included unusual delays in updating the semiannual report information and the deletion of information from the reports without explanations. Three audits that were issued in 1995 and 1996 appeared in the March 31, 2001, report though the reports were not listed in the earlier September 30, 2000, report. Fifteen audits that were listed as opened in the September 30, 2000, report were not carried over to the March 31, 2001, report as either opened or closed cases. Those 18 reports represented \$14.5 million of questioned costs. Other examples of inaccuracies in the two reports included the predating of records and input errors that could have been corrected if edit checks had been performed. As a result of these and other errors, we were unable to fully reconcile the number of audits opened and closed in the two semiannual reports.

## **Army Contract Audit Followup Policies and Procedures**

**Army CAFU Policies and Practices.** The Assistant Secretary of the Army (Acquisition, Logistics, and Technology) is responsible for Information Management and Assessment (IMA). Army Federal Acquisition Regulation Supplement Subpart 5142.1-90-1, "Responsibilities," states that the Director for IMA is the Army's contract audit followup official but is silent on what the responsibilities are for that office. In contrast, the duties of the PARC are clear. Among other duties, the PARCs must ensure the effective and timely resolution and disposition of audit findings and recommendations and maintain close surveillance of all contract audit reports. The duties of the Director for IMA should include the establishment of procedures to ensure accuracy of semiannual report information and consistency of reporting.

**Automated Procedures.** The Army did not have a Service-wide system and had no current plan or funding to improve its current inadequate process. Each component used its own procedures to accumulate information at the procurement activity level for dissemination to the commands and to headquarters. The point of contact at one field office explained that the software program used to collect CAFU data forwarded from the commands has limited capabilities and is not compatible with the hardware used by some offices. A procurement analyst at the Corps of Engineers explained that data comparison is difficult because of software limitations. The Operations Support Command (OSC) had recently implemented a state-of-the-art system to manage its CAFU process. Another command had developed, but had not implemented, a similar system.

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The Defense Contract Management Agency is developing a DoD-wide CAFU system to be used by all Military Departments and DoD agencies with CAFU responsibilities. The new system, once implemented, should enhance the accuracy, completeness, and sharing of information.

## **Army Actions for Improvement of Data Integrity**

The Director for IMA acknowledged the need for improved information processing, and took immediate action based on our initial findings. He instructed the CAFU program manager to work closely with the PARC offices to improve data integrity. He also notified the heads of contracting activities and PARCs about the new DoD-wide CAFU system being developed by the Defense Contract Management Agency and indicated to them that he will promote field participation in testing the new system. In addition, on December 21, 2001, he issued a memorandum to the heads of contracting activities and PARCs informing them of our initial audit results and requiring them to update and resubmit their semiannual reports to his office no later than January 31, 2002. Lastly, if data integrity remains an issue by the end of FY 2002, the Director will recommend to the Deputy Assistant Secretary of the Army (Procurement) that the CAFU function be included as an area of special interest in its FY 2003 Procurement Management Review Program.

As of May 21, 2002, 8 of 21 Army commands had responded to the December 21, 2001, memorandum from the Director for IMA.

## **DCAA Audits Provided to the Army**

We determined that 6 of the 54 audits omitted from the two semiannual reporting periods included 5 reports that should not have been included in the DCAA monthly records to the Army. The five reports covered two assist audits, two limited scope reviews, including one forward pricing review, and one report that should have been addressed to a civilian, reimbursable group. Those reviews are not reportable under DoD Directive 7640.2. DCAA had addressed the sixth report to the incorrect Army command.

## **Recommendations, Management Comments, and Audit Response**

**A. We recommend that the Assistant Secretary of the Army (Acquisition, Logistics, and Technology):**

**1. Establish a process for the accurate and complete reporting of the contract audit followup semiannual information to the Office of the Inspector General of the Department of Defense.**

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**Management Comments.** The Army concurred with the finding and it is in the process of adopting a web-based contract audit followup system being developed by the Defense Contract Management Agency. However, until the new system is operational, the Army will continue to cross-reference Army generated reports with DCAA audit reports to ensure all reporting is as accurate and timely as possible.

**2. Include the contract audit followup area as an area of special interest in its FY 2003 Procurement Management Review Program.**

**Management Comments.** The Army concurred and is recommending that the Deputy Assistant Secretary for Procurement and Policy add contract audit followup as an area of special interest in the FY 2003 Procurement Management Review Program.

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## **B. Army Resolution and Disposition of Reportable Audits**

The Army generally complied with the DoD Directive 7640.2 procedures for the resolution and disposition of audit findings in the 96 open and closed reports that we reviewed. However, the Army did not issue timely letters of demand for repayment with interest in five of nine defective pricing cases and did not document any justification for substantial periods of inactivity for six audits we reviewed. The Army improperly settled two of the five defective pricing settlements in addition to the lack of a demand letter. The Army also did not notify the DCAA of the disposition of 14 of 53 closed audits. Deficiencies occurred because CAFU personnel were either not aware of relevant debt collection guidance or did not follow standard settlement procedures. As a result, monies owed to the Government may not have been fully collected with interest due, and the Army may not always have effectively resolved or dispositioned DCAA audit recommendations. In one case, the deficiencies resulted in a potential Antideficiency Act violation.

### **Bilateral Contract Modifications Without Demand Letters**

**Demand for Payment of Overpayments.** If the Government makes overpayments for defectively priced supplies or services, Federal Acquisition Regulation (FAR) Subpart 32.610, “Demand for Payment of Contract Debt,” requires that a demand for payment be issued to the contractor as soon as the Government has computed the amount of refund due. FAR Subpart 32.610(b) prescribes the required elements of a demand letter. A demand letter provides the contractor with instructions on how, when, and where to repay a contract debt and informs Government comptroller officials to establish an account receivable to record and follow up on the contract debt and any applicable interest. It is critical that the contracting officer also send a copy of each demand letter to the payment office designated in the contract and request an acknowledgment of receipt.

**DoD Policy for Contract Debt Collections.** The Director for Defense Procurement issued a policy memorandum, “Contract Debt Collection,” January 13, 1995. The memorandum, Part I, section B, states that:

1. Demands for payment shall be issued as business letters; they shall not be incorporated into contract modifications.
2. Even though a debt will be the subject of a bilateral modification, the contracting officer must still issue a demand for payment. The best practice is to send the demand letter with the bilateral modification to the contractor for signature.

A settlement agreement or a bilateral price-reduction modification without a letter demanding repayment does not provide sufficient notice of debt disposition. The FAR, Subpart 32.6, "Contract Debts," prescribes policies and procedures for Government actions in ascertaining and collecting contract debts.

**Demands for Payments.** We reviewed 13 closed defective pricing reports. The contracting officer did not sustain any questioned costs in 4 of the 13 reports. The remaining nine reports were dispositioned with monies owed to the Government. Army contracting officers settled five of the nine audits using bilateral contract modifications without having issued demand letters as required by FAR and DoD policy guidance. Details of the five audit reports are shown in Table 1.

<u>Command</u>	<u>Audit Report Number</u>	<u>Principal*</u>	<u>Interest*</u>	<u>Total Owed</u>
AMCOM	2801-1996X42000001-S1	\$159,736	\$ 14,376	\$ 174,112
AMCOM	2801-1998X42000005	393,854	115,202	509,056
AMCOM	1461-1994A42098007	115,510	103,888	219,398
OSC	1271-1997W42098111	75,000	27,917	102,917
TACOM-ARDEC	3541-1997N42000001	<u>102,198</u>	<u>33,846</u>	<u>136,044</u>
<b>Total</b>		<b>\$846,298</b>	<b>\$295,229</b>	<b>\$1,141,527</b>

\* Amounts recorded in Army files as settlement amounts and have not been validated.

CAFU officials at OSC and Aviation and Missile Command (AMCOM) were unaware of the specific guidance in the DoD policy memorandum. In addition, AMCOM written procedures for dispositioning defective pricing audits using bilateral contract modifications specifically instructed that the repayment demand appear in the text of the modification with the overpayment and interest amounts separately identified.

We discussed the need to disseminate available guidance with management in the Office of the Director for Defense Procurement. On March 27, 2002, Defense Procurement posted the memorandum to their web site at <http://www.acq.osd.mil/dp/> to increase awareness of proper debt collection procedures throughout the DoD acquisition community. The document is also accessible through the Defense Acquisition Deskbook website under updated documents/OSD at <http://deskbooktransition.dau.mil>. DoD Regulation 7000.14-R, "Financial Management Regulation," volume 10, chapter 18, "Contractor Debt Collection," contains additional policy and procedures for the collection and recovery of debts owed by contractors.

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## Settlement Actions Needing Correction

**Contract Price Adjustments for Defective Pricing.** The Truth in Negotiations Act requires a downward adjustment to the contract price, including profit or fee, if the price was increased because the contractor submitted defective cost or pricing data and the Government relied on the defective data when negotiating the contract price. In addition, the Truth in Negotiations Act requires contractors to pay interest on overpayments because of defective cost or pricing data.

**DoD Policy.** The January 13, 1995, DoD policy memorandum, Part I, section C states that:

The payment office will refund interest and penalty amounts to the U.S. Treasury, while principal amounts will be credited to the original appropriation or to Miscellaneous Receipts.

The Army improperly settled two of the five defective pricing settlements in addition to the lack of a demand letter. In one case, the contracting officer did not include a statement releasing the government from future responsibility for significant charges asserted by the contractor and included as part of the settlement. In the other case, the contracting officer reduced the amount owed on the contract by the interest amount. The interest should have gone to the Department of Treasury.

- Audit report number 1271-1997W42098111 contained a recommended price adjustment of \$728,278 against contract number DAAA09-94-C-0282. The contractor maintained that no defective pricing had occurred and concurrently anticipated charging the government \$230,000 to settle separate issues on contract number DAAA09-95-C-0036. The contracting officer settled both issues together in part by reducing the contract price for contract number DAAA09-95-C-0036 by \$75,000. In this case, the settlement of defective pricing issues involving two contracts was acceptable. However, the contracting officer did not include in the settlement modification a statement specifically releasing the government from the \$230,000 in anticipated charges against contract number DAAA09-95-C-0036. Since these potential charges were part of the final negotiated settlement, a specific release statement should have been part of the settlement modification to prevent the contractor from asserting those charges again at a later date.
- In dispositioning audit report number 3541-1997N42000001, a contracting officer at Tank-Automotive and Armaments Command-Armament Research Development and Engineering Center (TACOM-ARDEC) negotiated a total settlement of \$136,044, including \$102,198 for principal and \$33,846 for interest. To expedite the closeout, the contracting officer reduced the amount owed the contractor under an unrelated modification to the same contract by the entire \$136,044. The interest of \$33,846 should have gone to the U.S. Treasury. Per DoD Regulation 7000.14-R, "Financial Management Regulation," volume 14, "Administrative Control of Funds and Antideficiency Act Violations," a department may not

augment its appropriation without specific statutory authorization. In this case, by not depositing the interest of \$33,846 in the U.S. Treasury, the contracting officer created a potential violation of the Antideficiency Act.

## Unexplained Inactivity in Dispositioning Reportable Audits

**Guidelines for Resolution and Disposition.** DoD Directive 7640.2 prescribes resolution and disposition standards for contract audits, including time frames. Contract audit reports should be resolved within 6 months of issuance and dispositioned as soon as possible after resolution. Audit reports are overage if not dispositioned within 12 months of issuance. Resolution is achieved when the auditor and the contracting officer agree on the action to be taken on audit report findings, or when the contracting officer determines a course of action. Disposition of the contract audit report is achieved when the contractor implements the audit recommendations or the contracting officer's decision, or a settlement is reached, or the contracting officer issues a final decision under the Disputes Clause and 90 days elapse without contractor appeal to the Armed Services Board of Contract Appeal. Deviations from the established time frames should be fully justified and documented in the contract file.

**Periods of Unexplained Inactivity in Settling Questioned Costs.** Contract files of six overage contract audit reports, with total questioned costs of \$3.6 million and delays of 11 to 54 months, contained no evidence of progress in dispositioning two open reports or explanation for delays in closing four reports. The six reports are listed in Table 2.

<u>Audit Report Number</u>	<u>Costs Questioned</u>	<u>Date Opened</u>	<u>Date Closed</u>	<u>Months of Unexplained Inactivity</u>
<u>OSC</u>				
3141-1997D17200002	\$1,028,803	2/24/97	8/24/98	11
3201-1999F19500001	398,017	6/23/99	Open*	21
3541-1995G10250092	263,161	3/15/95	10/26/99	49
3541-1997G10250095	1,657,891	9/29/97	1/3/00	19
6341-1996H10250006	124,906	9/30/96	Open*	54
<u>TACOM-ARDEC</u>				
3541-1997N42000001	<u>127,159</u>	3/17/98	3/8/01	31
<b>Total</b>	<b>\$3,599,937</b>			
*As of 3/31/01				

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**Impact of Unexplained Delays.** DoD Directive 7640.2 requires CAFU officials to establish procedures to monitor and ensure the proper and timely resolution and disposition of contract audit reports. The DoD acquisition and contract administration organizations shall maintain timely and complete information regarding the status of reportable contract audit reports from the time the report is received through final disposition. The unexplained delays jeopardize a contracting officer's ability to collect monies owed to the Government while increasing the amount to be collected as applicable interest charges accrue. Further, when events causing significant delays and attempts to resolve them are not documented, oversight officials cannot determine their causes and implement effective solutions.

As an example, DCAA Audit Report No. 3201-1999F19500001, June 23, 1999, detailed how a contractor had realized decreased costs of \$398,017 on a fixed price contract from a voluntary change to its cost accounting practices. Decreased costs to a fixed-price contract represent excess profits to a contractor and increased costs to the Government. FAR Subpart 52.230-2, "Cost Accounting Standards," requires an adjustment to the contract price for any increased costs resulting from a voluntary accounting change and reimbursement for any increased costs paid by the Government. The adjustment should include interest from the time of the overpayment by the Government to the time the adjustment is effected. Army officials at OSC responsible for dispositioning the audit informed us that several successive administrative contracting officers had been assigned to disposition the audit. However, the contract file contained little documentation to describe what settlement efforts each administrative contracting officer had made or to explain the delays. As a result, each new administrative contracting officer had to relearn the issues in this reportable audit in order to continue the settlement process, which had progressed little during the 33 months since the report was issued.

The contractor continues to benefit from the \$398,017 excess profits caused by the voluntary accounting change. However, interest is accruing against the contractor. The potential interest, calculated as simple interest using an average Department of Treasury rate of 8 percent over 33 months from the June 23, 1999, report date through March 31, 2002, would be approximately \$88,000 if the recommended price adjustment is settled for the full amount.

## **Notification to the DCAA of Final Disposition**

The records for 14 of 53 closed audits reviewed did not contain evidence that the Army notified the DCAA of the results from dispositioning a reportable audit. DoD Directive 7640.2 and local implementing procedures at the sites we visited state that a copy of the disposition memorandum shall be provided to the cognizant auditor when an audit report is closed. The DCAA requires the notification to update its management information system that is used to compile and report semiannual information to the OIG DoD for incorporation into reports to Congress. The contracting officer should therefore always prepare a memorandum addressing the disposition of all recommendations and questioned

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costs in a reportable audit, including the underlying rationale supporting their disposition. A copy of this memorandum should then be provided to the cognizant contract auditor whenever a reportable audit is closed. Although the Director for IMA stressed the need for Army compliance with overall disposition procedures in his December 21, 2001, memorandum, we believe special emphasis is required to ensure feedback to the cognizant contract auditor.

## **Recommendations and Management Comments**

**B.1. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) conduct a preliminary review pursuant to DoD Regulation 7000.14-R, “Financial Management Regulation,” volume 14, to determine whether a potential Antideficiency Act or other funding violation occurred in dispositioning audit report number 3541-1997N4200001, and take appropriate action.**

**Management Comments.** The Army concurred. On July 11, 2002, the Armament Research, Development and Engineering Center (ARDEC) issued a flash report for the Assistant Secretary of the Army, Financial Operations, Washington, DC. A team is being selected at ARDEC to review the situation and report their findings.

**B.2. We recommend that the Assistant Secretary of the Army (Acquisition, Logistics, and Technology) instruct contracting officers to:**

**a. Comply with guidance in the Director for Defense Procurement’s January 13, 1995, memorandum.**

**b. Ensure that contract modifications which implement settlement agreements include a formal and explicit release of all pertinent contractor claims.**

**c. Maintain timely and complete information regarding the status of reportable contract audit reports from the time the report is received through final disposition.**

**d. Provide a copy of the memorandum addressing the disposition of all recommendations and questioned costs in the reportable audit to the cognizant contract auditor.**

**Management Comments.** The Army concurred and stated that the organizations cited in the report are taking corrective actions to remedy the deficiencies noted in the report. The Army will also instruct contract audit followup monitors on current DoD and Army mandatory policies and procedures.

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# Appendix A. Scope and Methodology

## Scope

**Work Performed.** We evaluated the accuracy of the information in the Army's semiannual reports prepared to comply with the DoD Directive 7640.2 and reviewed Army policies and procedures implementing the Directive. We interviewed managers at the Office of the Deputy Assistant Secretary of the Army (Procurement) and at the Defense Contract Audit Agency, the Defense Contract Management Agency, and the U.S. Army Corps of Engineers Headquarters. We visited the Rock Island Arsenal, Illinois, and the U.S. Army Corps of Engineers in Savannah, Georgia. We also visited the Aviation and Missile Command, the Space and Missile Defense Command, and the U.S. Army Corps of Engineers, all located in Huntsville, Alabama. At all of the above locations, we:

- assessed the accuracy of data in the Army's semiannual reports to the OIG DoD by comparing the semiannual report information to the data in the DCAA monthly reports;
- determined whether audit reports were resolved and dispositioned in a timely manner by reviewing their chronology of events and ascertaining whether the resolution and disposition dates fell within the prescribed milestones, 6 months for resolution and 12 months for disposition. We identified the reasons for any delays and determined whether the delays were justified. For open audits, we evaluated the written plan of action to determine whether it was reasonable;
- evaluated the proper settlement of each reportable audit by examining whether settlement documentation was generally prepared in accordance with regulations and whether contracting officials addressed all significant audit recommendations and provided a rationale for not sustaining any costs questioned. We determined whether a timely demand letter was issued when necessary, whether there was any evidence of management oversight through review boards or other means, and whether a copy of the settlement agreement was sent to the DCAA auditor. We reviewed pre-negotiation objective memorandums, post-negotiation memorandums, contract modifications, demand letters, interest calculations, or other documentation, as deemed necessary; and,
- verified that superseded reportable audits were closed out with \$0 costs questioned and \$0 costs sustained.

We performed this audit from June 2001 through June 2002 in accordance with generally accepted government auditing standards. We included tests of management controls considered necessary. We did not validate the accuracy of the calculation and reporting of sustained questioned costs resulting from closed reportable audits nor verify that monies owed the Government were properly collected and accounted for by disbursing officials.

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## Methodology

**Use of Computer-Processed Data.** The Army did not maintain an Army-wide computer program for processing contract followup information. We relied on information assembled by the Army Headquarters for the semiannual reports submitted to our office. The results of testing the information in the reports showed an error rate that cast doubt on the validity of that information. However, when the data are reviewed in context with other available evidence, we believe that the opinions, conclusions, and recommendations in this report are valid.

We relied on computer-processed data from the DCAA Agency Management Information System to identify reportable audits sent to the Army for resolution and disposition. Although we did not perform a formal reliability assessment of the computer-processed data, we did determine that the assignment numbers and questioned costs for the selected audit reports generally agreed with the computer-processed data. We did not find errors that would preclude use of the data to meet the audit objectives or that would change our report conclusions.

**Universe and Sample.** To evaluate the accuracy of the information in the Army's CAFU system, we compared information in the DCAA monthly records of reportable audits submitted to the Army for the months of April 2000 through March 2001 to the Army's semiannual status reports for the periods ending September 30, 2000, and March 31, 2001. The two Army status reports combined included 209 audit reports and \$362 million in questioned costs. The DCAA records showed 94 reportable audits had been issued during the 12-month period.

To select a sample for evaluating the resolution and disposition of audit reports, we used DCAA records of open and closed reportable audits in Government fiscal years ending September 30, 1999 and 2000, and through March 31, 2001. We consolidated the DCAA records with the Army's semiannual submissions for September 30, 2000, and March 31, 2001, into a single database to facilitate the elimination of duplicate records, open audits with a report date after June 30, 2000, closed audits with a disposition date prior to October 1, 1999, and audits pending the outcome of litigation. The process yielded a universe of 245 audits consisting of all open audit reports dated prior to June 30, 2000, and all audit files closed after October 1, 1999. We provided the universe to the Office of the Assistant Secretary of the Army (Acquisition, Logistics, and Technology) with a request for documentation on the current status of open audits and the settlement of closed audits. The Army was not able to provide any information on 31 of the 245 reports. We received documentation on 214 of the 245 reportable audits and judgmentally selected 96 audit reports to evaluate, as follows:

- 34 audits at the Rock Island Arsenal, Illinois;
- 32 audits at 3 Army commands in Huntsville, Alabama;

- 
- 18 audits at the U.S. Army Corps of Engineers, Savannah, Georgia; and
  - 12 audits representing 9 field offices that had too few reportable audits to justify field visits by the team.

We selected field sites based on the number of audit reports available for review at each location.

## Management Control Program Review

The DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of controls.

**Scope of the Review of the Management Control Program.** We reviewed the adequacy of Army management controls over the contract audit followup system. Specifically, we reviewed the Army management controls for maintaining a complete and accurate contract audit followup database and ensuring the timely and appropriate processing of contract audit report recommendations. Because we did not identify a material weakness as defined by DoD Instruction 5010.40, we did not assess management's self-evaluation.

**Adequacy of Management Controls.** The Army management controls were adequate in that we identified no material management control weaknesses.

## Prior Coverage

During the last 5 years, the Inspector General of the Department of Defense has issued five reports related to the Contract Audit Followup process.

### Inspector General of the Department of Defense (IG DoD)

IG DoD Report No. 00-003, "The Air Force Contract Audit Followup System," October 4, 1999

IG DoD Report No. 99-057, "Settlement of Contractor Incurred Indirect Cost Audits," December 21, 1998

IG DoD Report No. 99-048, "Dispositioned Defective Pricing Reports at the Naval Air Systems Command," December 8, 1998

IG DoD Report No. 98-603, "Dispositioned Defective Pricing Audit Reports at the U.S. Army Aviation and Troop Command," December 23, 1997

IG DoD Report No. 97-045, "Evaluation Report on Dispositioned Defective Pricing Audit Reports at the Warner Robins Air Logistics Center," September 24, 1997

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## **Appendix B. Report Distribution**

### **Office of the Secretary of Defense**

Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Director, Defense Procurement

### **Department of the Army**

Assistant Secretary of the Army (Acquisition, Logistics, and Technology)  
Assistant Secretary of the Army (Financial Management and Comptroller)  
Auditor General, Department of the Army

### **Other Defense Organizations**

Director, Defense Contract Audit Agency  
Director, Defense Contract Management Agency

### **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Efficiency, Financial Management, and  
Intergovernmental Relations, Committee on Government Reform  
House Subcommittee on National Security, Veterans Affairs, and International Relations,  
Committee on Government Reform  
House Subcommittee on Technology and Procurement Policy, Committee on  
Government Reform



# Office of the Assistant Secretary of the Army (Acquisition, Logistics, and Technology) Comments



DEPARTMENT OF THE ARMY  
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY  
ACQUISITION LOGISTICS AND TECHNOLOGY  
ARMY CONTRACTING AGENCY  
5109 LEESBURG PIKE, SUITE 302  
FALLS CHURCH, VA 22041-320113 AUGUST 2002

SFCA-BS

MEMORANDUM FOR INSPECTOR GENERAL DEPARTMENT OF DEFENSE  
DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDIT  
POLICY AND OVERSIGHT, 400 ARMY NAVY DRIVE  
ARLINGTON, VA 22202-4704

SUBJECT: Response to DODIG Draft Report, Project No D-2001-CG-0139,  
dated June 13, 2002

The Army Contracting Agency (ACA), Business System Management Directorate, (BSMD) formerly known as the Information Management & Assessment (IMA) Directorate, Office of the Assistant Secretary of the Army (ASAALT-PA), responds as follows:

In Finding A, the DODIG report recommends the Army establish a process for accurate and complete reporting of the Contract Audit FollowUp (CAFU) semiannual information to the Office of the Inspector General of the Department of Defense. We concur with this finding. The Army is in the process of adopting a web-based system being developed by DCMAC-J. DODIG is aware of the status of this new system; in fact, the DODIG recommended the services adopt this system as a DOD wide standard system. However, until the new system is operational, the Army will continue to cross-reference Army generated audit reports with DCAA audit reports to ensure all reporting is as accurate and timely as possible.

Finding A also recommended the Army include the CAFU area as an Area of Special Interest in its FY 2003, Procurement Management Review Program. We concur with this recommendation. This office is recommending to the Deputy Assistant Secretary for Procurement and Policy that CAFU be added as an area of special interest to the FY 2003 Procurement Management Review Program.

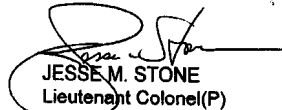
Finding B recommended that the Assistant Secretary of the Army (Financial Management and Comptroller) conduct a preliminary review pursuant to DoD Regulation 7000.14-R, "Financial Management Regulation," Volume 14, to determine whether a potential Antideficiency Act or other funding violations occurred in dispositioning audit report number 3541-1997N42000001, and take appropriate action. We concur with this recommendation. Armament Research, Development and Engineering Center (ARDEC) has prepared a flash report, dated July 11, 2002, for Assistant Secretary of the Army, Financial Operations, Washington, DC. A team is being selected at ARDEC to review the situation and report their findings. The POCs for this effort are,

-2-

Ms. Jennifer Baxter, Army Materiel Command (AMC) Internal Review & Audit Compliance Office and Mr. Peter Langevin, Assistant Secretary of the Army, Financial Management (ASA-FM).

Finding B2 recommended the Assistant Secretary of the Army (Acquisition Logistics, and Technology) instruct contracting officers on specific CAFU related procurement actions. We concur. Presently, the organizations cited in the report are taking corrective action to remedy the deficiencies noted in the report. The Army will also instruct CAFU monitors on current DOD and Army mandatory CAFU policies and procedures.

The POC for this action and further information is Steve White (703) 681-5409.

  
JESSE M. STONE  
Lieutenant Colonel(P)  
Director, Business Systems  
Management Directorate

# Office of the Assistant Secretary of the Army (Financial Management and Comptroller) Comments



REPLY TO  
ATTENTION OF

DEPARTMENT OF THE ARMY  
OFFICE OF THE ASSISTANT SECRETARY  
FINANCIAL MANAGEMENT AND COMPTROLLER  
109 ARMY PENTAGON  
WASHINGTON DC 20310-0109

July 1, 2002



MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR  
AUDITING, DoDIG, 400 ARMY NAVY DRIVE, (ROOM 801), ARLINGTON, VA  
22202-4704

SUBJECT: DoDIG Draft of a Proposed Report, The Army Contract Audit Follow-  
up Process (Project No. D-2001-CG-0139), dated June 13, 2002

We concur with comment to recommendation B-1. Our comments are  
attached.

Point of contact for this action is Mr. Peter Langevin who can be reached  
at (703) 614-8411 or email: [langepb@hqda.army.mil](mailto:langepb@hqda.army.mil).

William M. Landrum III  
Colonel, Finance Corps  
Acting Deputy Assistant Secretary of  
the Army (Financial Operations)

Attachment

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**DRAFT OF A  
PROPOSED REPORT**

**Office of the Inspector General, DOD**

**The Army Contract Audit Follow-up Process**

**Project No. D-2001-CG-0139**

**June 13, 2002**

**FINDING:**

**Army Resolution and Disposition of Reportable Audits**

**RECOMMENDATION:**

B.1. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) conduct a preliminary review pursuant to DoD Regulation 7000.14-R, "Financial Management Regulation," volume 14, to determine whether a potential Antideficiency Act or other funding violation occurred in disposition audit report number 3541-1997N42000001, and take appropriate action.

**Assistant Secretary of the Army (Financial Management & Comptroller) (ASA (FM&C)) COMMENTS:** Concur. The Army has sent a memorandum to the Commander, Army Materiel Command to conduct an investigation at the Tank-Automotive and Armaments Command-Armament Research Development and Engineering Center to determine whether a potential Antideficiency Act violation occurred.

## **Team Members**

The Deputy Assistant Inspector General for Audit Policy and Oversight, Office of the Assistant Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

Wayne C. Berry  
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