

Office of Inspector General
Administration of
Department of the Treasury
Contract Audits

OIG-99-CA-010

August 20, 1999



Office of Evaluations/GPRA

Office of Inspector General

United States Department of the Treasury

CONTENTS

CONTENTS	i
OVERVIEW	1
BACKGROUND	2
Treasury Contract Audit Process	3
• The OIG’S Bureaus’ Roles	
• ITC System	
SCOPE AND METHODOLOGY	4
FINDINGS	5
Treasury Contract Audit Results.....	6
• Potential Monetary Benefits and the ITC System	
• Accuracy of ITC System Data	
• Contract Audit Follow-up Proactive Approaches	
SUGGESTIONS	9
• Potential Monetary Benefits and the ITC System	
• Accuracy of ITC System Data	
• Contract Audit Follow-up Proactive Approaches	
MANAGEMENT RESPONSE AND OIG COMMENTS	10

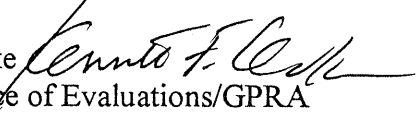


OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

AUG 20 1999

MEMORANDUM FOR DENNIS S. SCHINDEL
ASSISTANT INSPECTOR FOR GENERAL FOR AUDIT

FROM: Kenneth Clarke 
Director, Office of Evaluations/GPRA

SUBJECT: OIG Administration of Department of the Treasury Contract
Audits

The attached report presents our review of the Department of the Treasury's contract audit process and more specifically the bureau's response to audit recommendations. We performed an analysis of the total universe of 348 contract audits by the Office of Inspector General (OIG) between October 1992 and September 1996 to identify savings recommendations, and reviewed data from the Inventory, Tracking and Closure (ITC) System to determine the amounts that have been sustained, and the number of audits that have been closed.

Our analysis determined that 74 contract audits had cumulative differences between potential and actual monetary benefits totaled \$179,754,342. We also examined the need for the Department and the OIG to track contract audit recommendations through the ITC System, and found the process to be of little value either to the Department or the OIG. We have considered your comments and adjusted the report to reflect them. In addition, we offered three suggestions to improve the contract audit process:

- Potential Monetary Benefits and the ITC System
- Accuracy of ITC System Data
- Contract Audit Follow-up Proactive Approaches

We are pleased that we obtained general concurrence with our suggestions and that work to address these suggestions has begun.

We would like to extend our appreciation to your managers and staff for their cooperation and courtesies extended to our staff during this review.

If you have any questions or require any further assistance, you may contact me at (202) 283-1607 or a member of your staff may contact Chris Heppe, at (202) 283-1596.

OVERVIEW

The Office of Inspector General (OIG) conducted a review of the Department of the Treasury's contract audit process to determine how Treasury's bureaus respond to recommendations made by the Defense Contract Audit Agency (DCAA) and independent public accountants (IPAs).

Recognizing that the role of a contract auditor is to advise the contracting officer on opportunities for savings, we analyzed the auditors' recommendations compared with the subsequent negotiated amounts following 348 contract audits and found that for 74 of these the cumulative difference between potential and actual monetary benefits totaled \$179,754,342. We also examined the need for the Department and the OIG to track contract audit recommendations through the Inventory, Tracking and Closure (ITC) System and found that process to be of little value to either the Department or the OIG. Finally, so long as contract audits continue to be tracked in the ITC, we noted that the OIG does not ensure that bureaus are forthcoming with information. For example, U.S. Customs Service (Customs) in several instances closed contract audits in the ITC System before Price Negotiation Memorandums (PNMs) were provided to the auditors.

We are offering the following suggestions to assist the OIG in improving the Department's contract audit process.

Potential Monetary Benefits and the ITC System - The OIG Audit Directorate should: (1) draw a sample of contract audit recommendations and perform an in-depth analysis to determine the causes for the disparity between potential and actual monetary benefits, along with solutions for reducing the difference; and (2) conduct an analysis to determine whether contract audit recommendations should be included in the ITC System or be tracked by some other method.

Accuracy of ITC System Data - The OIG Audit Directorate should ensure that bureaus are not prematurely closing contract audits in the ITC System before PNMs are provided to the OIG and actual monetary benefits are entered into the system.

Contract Audit Follow-up Proactive Approaches - The OIG Audit Directorate could institute a customer satisfaction questionnaire, to be completed by the contracting officer, rating the auditor's responsiveness and the value of the audit report itself, and providing an opportunity for the contracting officer to state specific disagreements. In discussion with the Assistant Inspector General for Audit, the Deputy Assistant Inspector General for Program Audit, and the Director, Procurement and Contract Audits, we obtained general concurrence with our suggestions that the Assistant Inspector General for Audit agreed to implement.

BACKGROUND

Each year up through Fiscal Year 1998, the OIG issued approximately 70 to 80 contract audit reports based on work performed by DCAA and IPAs. In Fiscal Year 1997, contract audits identified nearly \$26 million in funds to be put to better use and over \$6.7 million in questioned costs. The corresponding figures for Fiscal Year 1998 were in excess of \$5.2 million and over \$2.6 million respectively. (The DCAA reimbursable figures for Fiscal Years 1995 through 1998 are \$488,386, \$336,557, \$390,829, and \$267,553.)

Within the Department, incurred costs contracts usually were not adjusted until the contracts were closed, and many bureaus closed out contracts without requesting an audit. In addition, a 1997 review conducted by the OIG's Office of Evaluations¹ determined that bureaus might be closing contract audits before the OIG received a copy of the PNMs, which should present the contracting officer's degree of reliance upon the audit findings.

¹ That report was OIG-96-E18, Department of the Treasury Audit Follow-up Systems, issued in June 1997.

Treasury Contract Audit Process

The OIG's and Bureaus' Roles. All Treasury bureau requests for preaward, cost incurred, and other contract audits are referred to the OIG's Procurement and Contract Audit staff within the Audit Directorate. The Procurement and Contract Audit staff generally either refers the audits to DCAA and other cognizant Government audit agencies, or contracts with an IPA to do the audits.

Contracting officers in negotiating contracts use preaward audits, which provide information on whether pricing proposals are fair and reasonable. Incurred cost audits are used to determine the allowability of direct costs and indirect cost rates under flexibly priced contracts, and to establish audit-determined indirect rates to facilitate the close out of contracts.

Once contract audits are completed by DCAA or an IPA and issued by the OIG, the OIG enters the audits, along with any questioned costs, into the ITC System. Under Treasury Directive 76-06, Treasury bureaus are to provide the OIG with copies of the PNMs for all contract audits. The Procurement and Contract Audit staff tracks sustained costs on an electronic spreadsheet. Any actual benefits that appear in the ITC System for contract audits are entered by the bureaus themselves. In the five bureaus interviewed -- the Bureau of Engraving and Printing (BEP), Customs, the Departmental Offices, the Financial Management Service (FMS), and the Internal Revenue Service (IRS) -- none of the procurement offices had access to the ITC System. Rather, Planned Corrective Action (PCA) and monetary benefits data were entered by other bureau components, such as Customs' Oversight and Analysis Staff or the Departmental Offices' Financial Management Division.

ITC System. The ITC System is a Treasury-wide database that monitors progress on internal control issues within the Department. The Audit Subsystem is one of the ITC System's five subsystems and tracks the findings, recommendations, and corrective actions associated with audit reports issued on the

Department by the OIG, IRS², and the General Accounting Office. Managers from the OIG, Treasury's bureaus, and the Offices of the Assistant Secretary for Management/Chief Financial Officer (CFO) and the Deputy CFO have access to the audit information contained in the ITC System through the Department's Executive Information System.

The Audit Subsystem (hereinafter referred to as the ITC System) serves as the Department's primary automated tool for monitoring and tracking the status of unimplemented recommendations. Users can choose from 20 different types of reports to generate information about audit reports, findings, recommendations, and PCAs.

When an OIG audit report is issued, the OIG uploads the findings and recommendations to the ITC System. The appropriate bureau then enters PCAs, including original due dates, into the ITC System for each recommendation. Audit reports are tracked through the ITC System until final action is completed for every PCA.³

SCOPE AND METHODOLOGY

Our approach was to first obtain an understanding of the Department's contract audit process. We performed an analysis of the total universe of 348 contract audits issued by the OIG between October 1992 and September 1996 to identify savings recommendations, and reviewed data from the ITC System to determine the amounts that have been sustained and the number of audits that have been closed. We conducted our work between July 1997 and March 1999 in accordance with the President's

² Subsequent to this review, as part of IRS reform legislation, the Treasury Inspector General for Tax Administration was created and assumed responsibility for producing IRS internal audit reports, including contract audits.

³ The bureaus are responsible for entering status descriptions, revised due dates, and closing dates, as appropriate, for each PCA.

Council on Integrity and Efficiency Quality Standards for Inspections.

We reviewed policies, procedures, and other relevant documentation; and interviewed management officials from Treasury bureaus. Among the documents we analyzed were: Office of Management and Budget Circular No. A-50; Treasury Directive 76-06; the Department of the Treasury Acquisition Regulation; Federal Acquisition Regulation Part 31, Contract Cost Principles and Procedures; the Federal Acquisition Streamlining Act of 1994; and the Defense Authorization Act for Fiscal Year 1996.

Detailed interviews were conducted with management officials from BEP, Customs, the Departmental Offices, FMS, IRS, and the OIG. These interviews involved documenting the bureaus' processes for requesting and responding to contract audits, and included questions related to officials' roles and functions, offices' methods for recording and tracking contract audit recommendations, and individuals' concerns in the area of contract audit results.

FINDINGS

We found that:

- comparing the potential versus actual monetary benefits for the 348 contract audits analyzed, there were 74 reports with a cumulative difference between potential and actual monetary benefits of \$179,754,342;
- including contract audit reports in the ITC System is of questionable value; and
- during the time period examined, Customs appeared to be routinely closing contract audits in the ITC System before PNMs were provided.

Treasury Contract Audit Results

Potential Monetary Benefits and the ITC System. We found that questioned costs are overstated because the auditors do not have all of the information they need, such as technical evaluations, which frequently are performed simultaneously with the contract audit itself due to time constraints. As a result, many of the bureau procurement officials we interviewed believe that contract audits should be viewed as tools for negotiation, rather than as hard and fast savings determinations. This position also is supported by the Federal Acquisition Regulation.

Comparing the potential versus actual monetary benefits for the 348 contract audits analyzed, we identified 74 reports, in which the two figures differed by more than \$60,000 and which resulted in a cumulative difference between potential and actual monetary benefits of \$179,754,342. All \$207,578,869 of the potential monetary benefits for the 74 reports was included in the Statistical Summaries section of the appropriate issues of the Semiannual Report to the Congress. The sustained total, reflected in the ITC System, was \$27,824,527.⁴ At least four reports⁵, which previously had been included in the Semiannual Report with total potential monetary benefits of \$22,896,526, had their PCAs in the ITC System canceled, resulting in no actual monetary benefits.

Several bureaus now question the value of including contract audits in the ITC System. The *Summary Report of the SWAT Team on Civilian Agency Contracting: Improving Contracting Practices and Management Controls on Cost-Type Federal Contracts*, issued on December 3, 1992, recommended that the Treasury OIG ensure that all contract audit findings are incorporated into the ITC System. However, none of the procurement offices in the five bureaus interviewed has access to the ITC System. In addition,

⁴ Supporting documentation was presented with the draft report and will be made available to the Director, Procurement and Contract Audits and his staff.

⁵ Those audit reports are OIG-94-109, OIG-94-122, OIG-94-134, and OIG-95-054.

Customs' procurement office does not receive copies of the system's entries or its reports; and even the OIG's Procurement and Contract Audit staff, which uses an electronic spreadsheet to track sustained costs, does not review data entered into the ITC System after a contract audit has been uploaded.

Along with BEP, IRS is one of the two bureaus that most closely track contract audits entered into the ITC System by the OIG. However, IRS officials believe that contract audits should not be included in the ITC System, but should instead be tracked in a separate system. They maintain that the current approach involves entering negotiating tools into a monetary tracking system. In addition, an official from the Departmental Offices' Financial Management Division further questioned the value of including contract audits in the ITC System, and indicated that, if this process is to continue, it would be far more efficient for the Procurement Office to be directly tied into the ITC System and be able to enter its own PCAs. The current centralized system of having a single office within each bureau enter audit PCA data into the ITC System has resulted in two contract audit tracking methods, one within each bureau's procurement office and the OIG's Procurement and Contract Audit staff, and the other within the ITC System itself. The ensuing duplication of effort has led numerous bureaus to question the need for including contract audits in the ITC System.

Accuracy of ITC System Data. The analysis of the 348 contract audits issued by the OIG between October 1992 and September 1996 confirmed that data entered into the ITC System is generally accurate and complete. A few minor problems were identified, including 5 audit reports⁶ (3 with monetary benefits) that did not appear in the ITC System at all. Of greater significance was the fact that 17 audit reports appeared to have been closed before PNMs were provided to the OIG. Fourteen of those reports were on Customs, and all but three involved questioned costs exceeding

⁶ Those audit reports are OIG-94-130, OIG-95-023, OIG-95-029, OIG-95-030, and OIG-95-031.

\$69,000. For the majority of these reports, Customs appeared to be routinely closing the PCAs within days of their entry into the ITC System with the notation, "A memo will be sent to the OIG".

Contract Audit Follow-up Proactive Approaches. We found that three of the Department's bureaus--BEP, FMS, and IRS--have taken a proactive approach to contract audit follow-up.

- BEP Contract Audit Follow-up

BEP closely tracks contract audits in the ITC System, noting actual cost savings, and has implemented a number of verification processes for contract audit data. If an extension is required for a contract audit PCA, a reason must be provided and the change must be approved by the Office Chief, the Associate/Assistant Director, and the CFO. In addition, the BEP procurement office approves all summaries, such as those for due date extensions or PCA close out, before their inclusion in the ITC System.

- FMS Contract Audit Follow-up

FMS' Program Integrity Division is responsible for entering bureau PCA information into the ITC System. Of the 36 FMS contract audit reports included in the 348 that were analyzed, the Program Integrity Division had validated corrective action for 19 (or 53 percent).

- IRS Contract Audit Follow-up

IRS' Cost and Price Analysis Branch maintains its own contract audit database, which is reconciled with the OIG's Procurement and Contract Audit staff's electronic spreadsheet to ensure accuracy. The branch also produces a monthly report on open and closed contract audit reports, and the costs sustained. As a further enhancement to the contract audit process, IRS officials suggested that the OIG institute a questionnaire, rating the auditor's responsiveness and the value of the audit report

itself, to be completed by the contracting officer. The officials believe that the questionnaire, which also could provide an opportunity for the contracting officer to state specific disagreements, would increase bureau responsiveness to the contract audit process.

SUGGESTIONS

We are offering the following suggestions, which we believe will better enable the efficient, prompt, and proper resolution of contract audit recommendations.

Potential Monetary Benefits and the ITC System. We suggest that the OIG Audit Directorate:

- Draw a sample of contract audit recommendations and perform an in-depth analysis to determine the causes for the disparity between potential and actual monetary benefits, along with solutions for reducing the difference. (Prior to this review, the Procurement and Contract Audit staff initiated a review comparing questioned costs and costs sustained, which examined bureau justifications for not using questioned cost information and searched for any identifiable patterns. However, the review was never completed due to staffing limitations, workload, and other priority issues.)
- Conduct an analysis to determine whether contract audit recommendations, which involve dollars for negotiating purposes only, should be included in the ITC System or be tracked by some other method.

Accuracy of ITC System Data. We suggest that the OIG Audit Directorate:

- Ensure that bureaus are not prematurely closing contract audits in the ITC System before PNMs are provided to the

OIG and actual monetary benefits are entered into the system.

Contract Audit Follow-up Proactive Approaches. We suggest that the OIG Audit Directorate:

- Institute a customer satisfaction questionnaire, to be completed by the contracting officer, rating the auditor's responsiveness and the value of the audit report itself, and providing an opportunity for the contracting officer to state specific disagreements.

MANAGEMENT RESPONSE AND OIG COMMENTS

We met with the Assistant Inspector General for Audit, Deputy Assistant Inspector General for Program Audit and the Director, Procurement and Contract Audit to discuss our suggestions. Because we determined that neither the Department nor the OIG was using the ITC to track contract audit recommendations, they accepted our suggestion that the Director, Procurement and Contract Audit will track the recommendations with a spreadsheet⁷ and cease input of contract audit recommendations to the ITC. To facilitate this ITC change, the AIGA agreed to discuss its merits with the Department. Because – in compliance with the FAR – questioned costs are advisory, tracking them as audit recommendations requiring the Department's implementation would serve no purpose. However, to be of greater service to the Department, the AIGA said he will institute a new report numbering process to clarify which audits are program, financial, or contract. They also agreed that during Fiscal Year 2000, the Procurement and Contract Audit group will: draw a sample of contract audit recommendations and analyze the causes for the disparity between potential and actual monetary benefits, along with solutions for reducing the difference; and

⁷ The new Audit Management Information System, once designed and implemented, likely will supersede the spreadsheet.

institute a customer satisfaction questionnaire, to be completed by the contracting officer, rating the auditor's responsiveness and the value of the audit report itself, and providing an opportunity for the contracting officer to state specific disagreements. Because the response in our discussion accepted our suggestions, we did not seek written comments.

MAJOR CONTRIBUTORS TO THIS REPORT

Audit Directorate

Office of Evaluations\GPRA

Kenneth F. Clarke, Director
Christopher Heppe, Deputy Director
Stacey Brahmey, Program Analyst

REPORT DISTRIBUTION

DISTRIBUTION

NO. OF COPIES

Audit Directorate

Assistant Inspector General for Audit	1
Deputy Assistant Inspector General for Program Audit	1
Director, Audit Policy and Coordination	1
Director, Procurement and Contract Audit	1

Management Services Directorate

Assistant Inspector General for Management Services	1
---	---

Total	5
--------------	----------