
November 6, 2002



Audit Oversight

DoD Oversight of Contractor
Purchasing Systems
(D-2003-6-001)

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Acronyms

ACO	Administrative Contracting Officer
CAM	Contract Audit Manual
CPSR	Contractor Purchasing System Review
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation
FAR	Federal Acquisition Regulation
GAGAS	Generally Accepted Government Auditing Standards
PSA	Purchasing System Analyst
RAMP	Risk Assessment Management Program



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
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November 6, 2002

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE CONTRACT MANAGEMENT
AGENCY

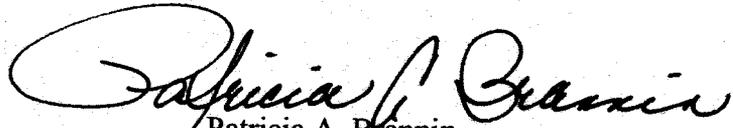
SUBJECT: Report on DoD Oversight of Contractor Purchasing Systems
(Report No. D-2003-6-001)

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

Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Contract Management Agency comments were partially responsive. We request additional comments on Recommendation A. by December 12, 2002. The final comments should include an agenda for coordination with the Defense Contract Audit Agency and an action plan for revising the Directive 1.

If possible, please provide management comments in electronic format (Adobe Acrobat file only). Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the /Signed/ symbol in place of the actual signature.

We appreciate the courtesies extended to the staff. For additional information on this report, please contact Mr. Wayne C. Berry at (703) 604-8789 (DSN 664-8789) or Ms. Madelaine E. Fusfield at (703) 604-8739 (DSN 664-8739). See Appendix C 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-2003-6-001
(Project No. D2001OA-0106)

November 6, 2002

DoD Oversight of Contractor Purchasing Systems

Executive Summary

Who Should Read This Report and Why? This report should be read by DoD purchasing system analysts and auditors who review contractor purchasing systems and administrative contracting officers (ACOs) who determine the need for the reviews, receive the resulting reports, and approve the purchasing systems. The report explains how analysts and auditors can improve planning and review coverage, while avoiding duplicative or overlapping reviews.

Background. The report discusses the planning, coordination, and performance of DoD reviews and audits of contractor purchasing systems by Defense Contract Management Agency (DCMA) procurement analysts and Defense Contract Audit Agency (DCAA) auditors. A contractor purchasing system is the process and procedures by which a contractor obtains subcontracts and purchases other material. The ACO must consider the need for a review of the purchasing system if a contractor's negotiated sales to the Government are expected to exceed \$25 million during the next 12 months. The review results are used to support the approval of a contractor's purchasing system, which is crucial for mitigating the risks associated with contracts awarded non-competitively or subcontract costs passed to the Government.

Results. Although the purchasing system reviews were generally adequate for the 13 reviews and 12 audits done by DCMA and DCAA, respectively, improvements were needed in planning, coordination, and documentation. The DCMA and DCAA review the same contractor purchasing system. Therefore, DCMA and DCAA should jointly reengineer their processes to more effectively meet the needs of both organizations, avoid duplication, and effectively leverage the resources of both organizations. Excellent examples of effective planning and coordination between DCMA and DCAA were demonstrated at three contractor facilities (see Finding A). In addition, although DCMA reviews were adequate, the risk assessment that they used needed improvement (see Finding B).

Management Comments and Evaluation Response. The Executive Director, Contract Management Operations, DCMA agreed with the recommendations. However, in response to the recommendation to jointly, with DCAA, reengineer the planning process for the system revisions, he proposed reemphasizing the same procedures that have not worked in the past. To reengineer the CPSR process, DCMA needs to work with DCAA to develop new policies and procedures to accommodate the needs of both organizations

and address the deficiencies raised in this report. A final response should include an agenda for working with the DCAA and an action plan for revising the DCMA Directive 1 Contract Management "One Book." We request that the Director, DCMA provide additional comments by December 12, 2002.

The Assistant Director, Policy and Plans, DCAA concurred in principle and will work with DCMA to re-evaluate its planning and coordination processes for conducting audits of contractor purchasing systems. By January 31, 2003, DCAA will issue a Memorandum for Regional Directors, after coordination with DCMA, to provide audit guidance to field auditors on the enhanced coordination and planning process.

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Background

Contractor management is responsible for establishing and maintaining adequate internal controls. A good system of internal controls provides reasonable assurance that assets are safeguarded against losses, that transactions are executed with management authorization and properly recorded, and that applicable laws and regulations are met. A contractor's purchasing system should encompass adequate internal controls over purchasing transactions.

Contractor Purchasing System. A contractor's purchasing system is the processes and procedures by which a contractor obtains subcontracts and purchases other materials. These processes include make or buy decisions, the selection of vendors, analysis of quoted prices, negotiation of prices with vendors, the placing and administration of orders, and expediting delivery of materials. The Government is at risk when prime contracts are awarded noncompetitively or when the contract with the Government allows the contractor to pass all subcontract costs on to the Government. The Consent to Subcontract/Contractor Purchasing System Review process provides the most effective and efficient means to deal with these risks.

Consent to Subcontract. In certain circumstances, the contract may include a Consent to Subcontract clause, which requires the contractor to obtain Administrative Contracting Officer (ACO) approval of the subcontract when the contractor itself does not have an approved purchasing system. An effective purchasing system, approved by the ACO, can substantially reduce the number of subcontracts that must first be approved by the ACO.

Contractor Purchasing System Reviews. A Contractor Purchasing System Review (CPSR) assists a contracting officer in determining whether to approve a contractor's purchasing system. An approved system allows the contracting officer to waive subcontract advance notifications or consent to subcontract actions. The CPSR also provides early cost accounting standard information on which to base source selection decisions and profit/fee negotiation positions.

Federal Acquisition Regulation (FAR) Subpart 44.201, Consent and Advance Notification Requirements, specifies that unless a contractor has an approved purchasing system, contracting officer consent to subcontract is required for certain contracts. The FAR specifies that the ACO shall determine the need for a CPSR based on, but not limited to, the past performance of the contractor and the volume, complexity, and dollar value of subcontracts. The need for a CPSR must be considered if a contractor's negotiated sales to the Government are expected to exceed \$25 million during the next 12 months.

Performance of the Reviews. The Defense Federal Acquisition Regulation (DFARS) Subpart 244.3, CPSRs, specifies that the ACO is responsible for reviewing contractor purchasing systems. Therefore, members of other organizations, such as audit or program management activities, should not conduct separate reviews of a contractor's purchasing system but may participate in a review conducted for the ACO by Purchasing System Analysts (PSAs).

During FYs 1998 through 2000, the Defense Contract Management Agency (DCMA) completed 445 CPSRs, or an average of 148 reviews per year. At the time of our evaluation, the DCMA had a CPSR staff of 32 compared to personnel strength of 42 in 1999 and 102 in 1994. The staff size represents a 69 percent decline since 1994. As a result of declining resources, DCMA guidance emphasizes risk assessments to plan and conduct reviews for maximum efficiencies.

Defense Contract Audit Agency Audits of Internal Controls. The Defense Contract Audit Agency (DCAA) audits contractor internal controls to determine whether the controls are adequate to permit the preparation of Government cost representations in accordance with generally accepted accounting principles and applicable laws and regulations. A contractor's internal controls consist of five interrelated components: control environment; risk assessments; control activities; information and communication; and monitoring. DCAA also uses the results of their audits of internal controls to plan other necessary audits at contractor facilities.

To avoid audit duplication or overlap with CPSRs, DCAA guidance requires the auditor to notify the ACO prior to initiating an audit of purchasing system controls and to coordinate with the CPSR team. The DCAA performed 498 purchasing system audits in FYs 1998 through 2001 or about 125 audits per year. The DCAA audit program, summarized in Appendix B, Comparison of Review Coverage, incorporates procedures for reviewing the adequacy of those components of internal controls.

Objectives

The objective was to evaluate the overall adequacy of CPSRs performed jointly by the DCAA and the DCMA. The review included an evaluation of the use of audit support services and the overall quality and extent of audit services the DCAA provides to the DCMA. In addition, we assessed the adequacy of the management control programs at DCAA and DCMA field offices relative to the overall objective (see Appendix A).

A. Planning and Coordination of Reviews

Based on our evaluation of 13 DCMA reviews and 12 DCAA audits, planning and coordination of reviews of contractor purchasing systems, including the sharing of annual plans and review guides, and the use of audit services, needed improvement. Although the DCMA CPSRs and DCAA audits of purchasing system internal controls have different objectives, the reviews to a large extent covered the same areas. However, the agencies did not share annual plans, and the DCMA guidance did not stress the importance of auditor participation in joint reviews to avoid duplication. The DCMA requested only limited audit support from DCAA at locations where DCAA audited significant contractor dollars. Further, of 11 DCAA audits that required coordination with the ACO or the CPSR team, 6 did not include adequate information to explain the extent of coordination attempts. The DCAA standard audit program emphasizes the need to coordinate with the ACO in an introductory note that does not instruct the auditor to document all coordination efforts. The conditions occurred because DCMA and DCAA do not have joint planning processes. Excellent examples of effective planning and coordination were demonstrated at three contractor facilities. Inadequate coordination may result in overlapping reviews and inefficient use of resources.

Comparison of Review Objectives

The DCMA and DCAA have different objectives when reviewing a contractor's purchasing system. However, to accomplish the objectives, the two agencies need access to the same contractor information.

Defense Contract Management Agency. A CPSR performed by the DCMA provides the ACO the basis for granting, withholding, or withdrawing approval of a contractor's purchasing system. According to the DCMA One Book, Chapter 7.4, "Consent to Subcontract/CPSR," the primary objective of the Consent to Subcontract/CPSR process is to improve the effectiveness and efficiency of contractors' purchasing systems. A second objective is to reduce the risk to the Government when prime contracts are awarded noncompetitively or when the prime contract allows the prime contractor to pass all subcontract costs on to the Government.

Defense Contract Audit Agency. The DCAA audits of purchasing system internal controls are designed to meet the audit requirements outlined in the Contract Audit Manual (CAM) Chapter 5-600, "Audit of Purchasing System Internal Controls," that implement Generally Accepted Government Auditing

Standards (GAGAS). The fieldwork standard for financial audits on internal controls, GAGAS 4.21, states that auditors should obtain a sufficient understanding of internal controls to plan the audit and determine the nature, timing, and extent of tests to be performed.

The DCAA is concerned with assessing the adequacy of internal controls at major contractor* locations but considers the materiality of transactions processed through a system when determining the need for an audit of that system. The CAM, Chapter 3-305, "Preparation of the Internal Control Audit Planning Summary," instructs the auditor to assess the adequacy of internal controls for those contractor accounting and management systems that may have a significant impact on the pricing, administration, or settlement of Government contracts. A contractor's purchasing system is 1 of 10 accounting and management systems to which the audit guidance applies. The auditor should consider performing a purchasing system internal control review if the transactions processed through the system are material in relation to the magnitude of the contractor's total operations.

Not only does the audit of the internal controls tell management whether the controls are working as planned, but the auditor uses the results of internal control reviews when planning all other audits, for example incurred costs, forward pricing, and defective pricing at major contractor locations.

Comparison of Review Coverage

The DCMA One Book, Chapter 7.4, Attachment 3, of the CPSR Guidebook, explains that a CPSR should cover a review of policies, procedures, and forms; a review of a random sample of purchase orders and subcontracts; a compilation and analysis of statistics; interviews with contractor personnel; and input from technical specialists, including auditors. Although the DMCA One Book outlines the areas for review of a contractor's purchasing system, the guidance does not include detailed instructions for the review, or a review guide.

Scope of Work in a CPSR. The 13 reviews we evaluated in the 3 DCMA offices covered all areas described in the CPSR Guidebook. The extent of review coverage was based on CPSR report contents and discussions with the eight analysts that performed the reviews. When reviewing a sample of purchase orders, the CPSR team completed the following procedures:

- Reviewed purchase order files for required certifications and documentation;
- Compiled data from review of purchase order files using the CPSR software program or spreadsheets; and,
- Analyzed the compiled statistical data for trends and indicators.

* For DCAA planning purposes, a major contractor is a contractor with \$80 million or more in costs subject to audit in a single fiscal year.

The team also interviewed contractor management personnel to cover specific areas not covered by the purchase order file review and gathered information from DCAA auditors and Government specialists in engineering, property, transportation, and other areas.

Although the CPSR Guidebook did not contain explicit instructions for completing the reviews, all the PSAs (Purchasing System Analysts) used similar review procedures. Each PSA had 16 years or more experience. One analyst demonstrated that the actual scope of review performed closely compared to the instructions in the 1991 edition of the Defense Federal Acquisition Regulation Supplement (DFARS), Appendix C. We compared the 1991 DFARS guidance to the CPSR Guidebook and concluded that the specific procedures outlined in the DFARS provides better instructions than the CPSR Guidebook and may be used to tailor a CPSR review program. A CPSR review program is essential to identify the areas and review procedures that should be coordinated with auditors. The detailed instructions and procedures outlined in a review program should also serve as an instructional tool to benefit new employees. The need to plan for new hires is identified as one of the initiatives in the President's Management Agenda for FY 2002, which addresses the problem that may be caused by large-scale retirements of eligible employees within a few years. The knowledge and expertise of current employees must, therefore, be conveyed to new employees through clear instructions or training tools.

Similarity of DCMA and DCAA Procedures. We compared the audit areas covered in the DCAA standard audit program with the CPSR scope of review and determined that six of the eight main sections in the DCAA audit program potentially overlap with the CPSR coverage. Appendix B, "Comparison of DCAA and DCMA Review Procedures," shows the areas that overlap.

Current Planning and Coordination

DCAA and DCMA currently have separate planning processes but are supposed to coordinate their work efforts.

DCMA Planning. The DCMA One Book requires the CPSR team to develop a master schedule of CPSRs to be conducted during the next 12 months and provide copies to the district CPSR focal point, DCAA, Headquarters NASA, the cognizant ACOs and, when warranted, the Procurement Contracting Officers. The reviews to be scheduled are determined based on risk assessments (see finding B).

Coordination of Annual Plans. Two of the three DCMA offices visited sent an annual schedule of CPSRs to the cognizant audit offices. The third office established a master schedule on a local shared network for the use of ACOs but did not provide the information to the affected DCAA field audit offices. The DCAA manager of one audit office cognizant of several major contractors stated that an annual schedule of planned CPSRs would be very useful for developing the DCAA audit plans. However, he had never received an annual CPSR schedule.

Requesting Audit Services. The planning and coordination of the DCMA reviews should include considerations of when and how to use DCAA audit assistance. The CPSR Guidebook, instructs the CPSR team chief on the role of the DCAA auditor when participating on CPSR teams. Accordingly, DCAA should be assigned three specific topics: material estimating, prompt payment discounts, and interdivisional transfers. Audit coverage of prompt payment discounts is incorporated into the standard audit program for purchasing system internal controls. DCAA reviews material estimating as part of an audit of the internal controls of the contractor's material estimating system. Contractor procedures for interdivisional transfers may be tested during incurred cost audits or price proposal reviews. Therefore, DCMA requests of DCAA cover only a part of what DCAA is required to address in a purchasing system internal control audit. The team supervisor should also conduct a pre-review meeting with Government personnel, including DCAA, on the first day of the on-site field visit. Government personnel should be invited to share with the team any purchasing system-related reviews and audits that may have been conducted during the previous 12 months, which may enable the team to forgo duplicative effort.

The audit support appeared adequate for the requested audits. However, three of the seven audits concerned major contractors, where DCAA is required to complete audits of purchasing system internal controls to meet GAGAS. Therefore, the DCMA could have requested audit coverage of more than three areas. At those locations, the DCMA requests for audit support should have been based on joint planning with DCAA.

Coordination to Determine the Scope of Review. DCMA did not meet or coordinate with DCAA prior to issuing requests for audit. Where meetings took place, they were held the first day of the DCMA field visit, per DCMA One Book guidance. The following are examples of inadequate or no coordination:

- The CPSR team performed a review at the Northrop Grumman Corporation without notifying the resident audit office or inviting an auditor to be part of the review team. The DCAA auditors learned several months later that the CPSR team had completed a review and had to conduct a separate audit to address additional audit areas.
- At one DCMA field office, the Chief of the Corporate Support Team had prepared a standard letter to respond to DCAA notices of planned audits of purchasing system internal controls or requests for information. The letter reiterated the DFARS 244.301 guidance that members of other organizations such as audit or program management activities should not conduct separate reviews but may participate in a future review to be conducted for the ACO by the CPSR team. The standard letter was sent without consideration of why the information request was made. For example, in one case, a DCAA field audit office inquired from the cognizant DCMA field office whether a CPSR was planned in the near future and explained the reasons why an audit of the contractor's purchasing system internal controls was considered. The DCMA responded with the standard letter, which did not ask DCAA to explain or justify the need for an audit at an earlier time.

-
- At another DCMA office, five CPSR team complaints concerned perceived DCAA initiations of reviews that appeared to duplicate CPSRs and resulted in findings that, occasionally, were contrary to the DCMA findings. The five complaints were unsupported and were the direct result of inadequate communication and coordination between the two agencies.

DCAA Planning and Coordination Requirements. If no CPSR is scheduled, the CAM, Chapter 5-603, “General Audit Policy,” requires the auditor to perform a purchasing system review at a major contractor location within the normal cycle (2 to 4 years) for accounting and management systems audits. The CAM also requires the auditor to coordinate with the ACO before initiating a review of the contractor’s purchasing system. Eleven of the 12 audits evaluated at 6 DCAA field audit offices required coordination with the ACO or CPSR team. Six of the 11 audits did not fully document the extent of coordination or any failed attempts. The other five audits contained sufficient information to support DCAA coordination efforts with the ACO or CPSR team.

The CAM audit guidance conflicts with instructions in the DCAA Audit Program for Purchasing Controls. The CAM, Chapter 5-603, “General Audit Policy,” advises that if no CPSR is scheduled within the DCAA normal cycle for systems audits (2 to 4 years), the auditor should perform a purchasing system internal control review in accordance with CAM guidance. However, the audit program states that if no CPSR review is scheduled in a reasonable time, and the auditor feels the Government is at risk, the concerns should be elevated to the regional offices prior to any audit effort.

Although DCMA had not scheduled a review, a supervisor at one of the six field offices had followed the CAM instructions and proceeded with a planned audit without contacting the regional office. To avoid confusion, the CAM guidance should be amended to conform to the instructions in the audit program.

Differences in DCMA and DCAA Planning and Coordination Guidance. The DCMA and DCAA guidelines on coordination of purchasing system review activities differed. The CPSR Guidebook explains that CPSR teams may reduce DCAA on-site audits by sharing CPSR work papers with auditors planning to conduct internal control system audits. However, the guidance does not stress the importance of auditor participation in a joint review to address audit concerns and avoid duplication, nor does it explain the kind of work papers that the auditor would need to reduce on-site audits. The emphasis is different in the DCAA CAM, Chapter 5-1302.3, “Auditor Participation on CPSR Teams.” CAM stresses that the auditor and the PSA have related responsibilities; therefore, it is imperative that they coordinate and correlate their activities.

Examples of Successful Coordination. Excellent examples of successful coordination between DCMA and DCAA existed at three contractor locations. At two of the locations, Lockheed Martin Space Systems, Mississippi, and General Dynamics Advanced Technology Systems, North Carolina, the auditor and the PSA used the DCAA audit program to divide the work to be performed with excellent results. The DCAA standard audit program covers all areas addressed by the CPSR team as well as electronic data processing not reviewed as part of a CPSR. The joint use of the same program ensured that duplication did not occur

while the auditor and the PSA could each accomplish their review objectives. At Lockheed Martin Federal Systems, Virginia, a team composed of the PSA, DCAA auditor, and contractor internal auditors compared purchasing system review procedures to avoid duplication, using the DCAA audit program as a baseline. The team examined 42 review elements and determined that 30 elements contained overlapping procedures for review of contractor policies and procedures, purchase order and subcontract clauses, and management of purchasing. According to the DCMA team participant, the extensive pre-planning effort benefited only the review performed at Lockheed Martin Federal Systems, and lessons learned were not incorporated into the DCMA guidance. Further, in each of the three cases, either the ACO, the auditor, or the contractor had coordinated the effort. Improved DCMA and DCAA guidance should aid the CPSR team leader in initiating similar cooperation.

Summary

The DCMA CPSRs and the DCAA audits of purchasing system internal controls are two reviews of the same processes. Each is for equally important but different purposes. Joint annual (or other cycle) planning for the reviews with coordinated implementation of the plans would provide more efficient and effective use of DCMA and DCAA resources. In the past decade, DoD has reduced the acquisition work force by about 50 percent. The DCMA CPSR staff has been reduced by 69 percent, whereas the DCAA staff reduction since 1990 is about 44 percent. Because of the reduction in the number of DCMA and DCAA staff to perform the CPSRs in recent years, joint planning becomes critical to effectively use the organizations' resources. DCMA and DCAA should together review their processes to determine how best to plan, coordinate, and accomplish their reviews.

A DCMA and DCAA joint process for planning and coordinating performance of purchasing system reviews should correct problems identified in this report:

- Inconsistent dissemination of DCMA review schedules to DCAA;
- Requests for audit services not tailored to the DCAA audit environment where internal control systems audits must be performed;
- Insufficient CPSR Guidebook explanations of auditor need to participate in a CPSR to obtain purchasing system information and plan related audits;
- Inconsistent DCAA guidance for coordination with ACOs and the CPSR team; and,
- Inadequate support for DCAA reliance on the work of others (finding B).

Further, a jointly developed DCMA/DCAA review program could facilitate coordination of review coverage and avoid duplication and overlap during CPSRs and audits of purchasing system internal controls. A jointly performed review

could also expand the review coverage. The DCAA audit program includes procedures that do not overlap or duplicate DCMA reviews. The audit program requires the auditor to develop a sufficient understanding of the contractor's electronic information and communication processes to identify significant classes of transactions and how they are processed, controlled, and reported. Auditors also perform transactional testing using statistical sampling methods. The insights gained from audit tests of the electronic data processing system should make the CPSR more useful to ACOs.

Management Comments on the Finding and Evaluation Response

DCMA Comments on Audit Participation in a Review. The Executive Director, Contract Management Operations, concurred with the finding and stated that the DCMA Directive 1 (the One Book), Chapter 7.4, Contractor Purchasing System Review, contains guidance on audit participation, but said that the guidance was adequate.

Evaluation Response. We disagree that existing guidance is adequate. Although the guidance encourages a coordinated team approach to promote the sharing of data and reduction of duplicate effort, effective teamwork did not occur. The guidance does not explain that coordination with DCAA is necessary to avoid duplicative reviews and address the concerns of both organizations. Also, sharing annual schedules after the fact, does not ensure the most efficient use of resources. A joint planning process would be more efficient.

Recommendations, Management Comments, and Evaluation Response

A. We recommend that the Director, Defense Contract Management Agency and the Director, Defense Contract Audit Agency jointly reengineer their processes and procedures for performing reviews and audits of contractor purchasing systems to establish joint planning and coordination processes that will more effectively meet the needs of both organizations, avoid duplication, and effectively leverage the resources of both organizations. The review processes and procedures should address the specific deficiencies identified in this report.

DCMA Comments. The Executive Director, Contract Management Operations, DCMA concurred and stated that Directive 1, Chapter 7.4, and the DCAA CAM provide sufficient procedures for planning and coordination of reviews. DCMA will issue an Information Memorandum to re-emphasize the need for such coordination when performing a CPSR.

Evaluation Response. Although the Executive Director concurred, the comments are not responsive. Issuing an Information Memorandum to emphasize existing guidance is not sufficient. We recommended that the Director, DCMA,

and the Director, DCAA, jointly reengineer their processes and procedures for performing reviews and audits of contractor purchasing systems. We included a statement that the specific deficiencies identified in the report should be addressed. The intent of the recommendation will therefore be implemented if the DCMA Directive 1 is amended to fully address auditor participation in a CPSR. A final response should include an agenda for coordination with the DCAA and an action plan for revising the Directive.

DCAA Comments. The Assistant Director, Policy and Planning, DCAA concurred and will coordinate with DCMA to re-evaluate its planning and coordination processes for conducting audits of contractor purchasing systems and related internal controls to ensure the processes will facilitate sufficient audit coverage and avoid duplication. By January 31, 2003, DCAA will issue a Memorandum for Regional Directors, after coordination with DCMA, to provide audit guidance to field auditors on the enhanced coordination and planning process. The guidance will include a reminder for auditors to coordinate with DCMA when initiating a purchasing system review and a requirement for auditors to document the results of this coordination in the working papers. In April 2003, DCAA will also make any necessary revisions to the standard audit program, Reviewing and Reporting on Contractor Purchasing System and Related Internal Controls. Necessary revisions to the guidance contained in the Contract Audit Manual will be made for the July 2003 update.

Evaluation Response. The Assistant Director's proposed action plan is acceptable. We believe that DCMA and DCAA, working together, can develop the most effective processes for both organizations.

B. Performance of Reviews

Although the DCMA PSAs adequately covered prescribed review areas and supported reported findings, risk assessments and the documentation of work performed during the reviews could be improved. The conditions occurred because the DCMA One Book guidance was inadequate. In addition, auditors relied on work performed by the CPSR teams without sufficient justifications, which was not in compliance with GAGAS and DCAA audit guidance.

As a result of inconsistent risk assessments, reviews may not be scheduled when needed or unnecessary reviews may be performed. Auditor noncompliance with GAGAS when relying on work performed by others lessened the usefulness of the audit report.

Risk Assessments

The DCMA One Book, Chapter 7.4, “Consent to Subcontract/CPSRs,” Attachment 3, contains the CPSR Guidebook, which explains that the ACO, in consultation with the CPSR Team, should manage the risk associated with contractor purchasing systems based on two risk assessments. The initial risk assessment determines the need for an on-site CPSR. The CPSR Guidebook identifies 13 risk factors to be considered during the initial assessment and provides 2 sample formats to be used in the rating process. One format assigns a numerical rating to the 13 risk factors based on specific conditions. The other format allows for a narrative on each factor. When a CPSR is required, a second risk assessment determines the scope of the review. The CPSR Guidebook does not explain what to consider in the second risk assessment.

DCMA also has a Risk Assessment Management Program (RAMP), which is an on-line system for assessing elements of a contractor’s business and financial services, including the purchasing system. The guidance on the RAMP is included in the DCMA One Book, Chapter 3.1, “Supplier Risk Management,” which requires the operations team or functional specialist to assign a risk rating to significant elements of contractor financial and business systems, including the purchasing system. The CPSR Guidebook does not clarify how the RAMP ratings relate to the initial assessments that identify contractors to be reviewed and the second assessments that should determine the scope of the individual reviews.

Performance of Risk Assessments. Although the CPSR Guidebook discusses the need to perform initial and second risk assessments, DCMA only completed initial assessments, which were used for dual purposes. Thirty-three initial risk assessments at two of three DCMA offices visited were adequately documented with explanations for the assigned risk ratings. However, the third location did not complete initial risk assessments to determine whether a CPSR was required but scheduled reviews for all contractors that met the threshold on a 3-year cycle. The two offices that completed initial risk assessments used them to schedule CPSR reviews and to plan the scope of the reviews with the ACOs. At the third

office, at least one CPSR should not have been performed because the contractor no longer met the threshold. The analyst was half way through the review before realizing that.

One of the two offices that completed initial risk assessments used four different methods, including the CPSR Guidebook sample format, the RAMP system, and two forms designed by the CPSR team chief to adjust for omissions or inadequacies in the CPSR Guidebook and the RAMP. For one contractor, the analyst used more than one risk assessment format with conflicting results.

Guidance on Initial Assessments. The CPSR Guidebook instructions for performing the initial risk assessment could be improved. The numerical rating from 1 (low risk) to 5 (high risk) assigned to the 13 risk factors shown in 1 of the 2 sample formats in the CPSR Guidebook Appendix D should be reevaluated. For example, 4 of the 13 factors assign only a medium risk to a new contractor with no status history. Therefore, the calculated weighted average may yield a medium, or lower, risk rating and indicate no immediate need for a review. A new contractor with no status should be assigned a high risk to ensure that a CPSR is included in the review plan. The second format allows for a narrative to be used instead of a rating factor. However, the illustration shows only the first 3 of the 13 risk factors to be rated and does not clarify that an assessment should be made for all 13 factors. As a result, at least one analyst believed the second format only covered three factors and was not useful.

Guidance on Second Assessments. The instructions related to the second risk assessment could also be improved. The second assessment should be used to determine where to concentrate the review effort and to determine how much transactional testing may be necessary. In a discussion of the second risk assessment, the CPSR Guidebook instructs the CPSR specialist to identify key processes, defined as those that can adversely affect contract performance, cost, or schedule. At a minimum, the CPSR Guidebook requires an assessment of four specific key processes that are incorporated into the RAMP system:

- Contractor vendor rating;
- Contractor best value;
- Contractor make/buy; and,
- Contractor internal purchasing system audits.

Field personnel did not agree that the mandatory four key processes were the most critical to be covered in all reviews. Field personnel believed other processes would yield more accurate and relevant risk information. One manager identified the following processes as more indicative of risk inherent in the purchasing system:

- Source selection (including vendor rating and competitive procurements);
- Contractor performance of price and cost analysis of vendors;

-
- Contractor compliance with public laws; and,
 - Terms and conditions of the contract (for example, flow down clauses, restrictive language, and advance consent requirements).

The CPSR Guidebook should emphasize the difference between the risk to consider for planning the annual workload and the risk to consider that is inherent in contractor internal controls when planning the CPSR. Further, rather than mandate the coverage of four specific key processes, the CPSR Guidebook should provide criteria to assist analysts in identifying key processes for risk assessments and incorporation into a review plan. Where no knowledge exists to support a low or medium risk assessment, the guidance should instruct analysts to assign a high risk and to adjust the risk factors based on actual review results.

Documentation of Review Procedures

The DCMA One Book guidance includes only limited instructions for documentation of review efforts. The DCMA One Book, Chapter 7, section 4.6.5, “Risk Documentation,” states that the operations teams or functional specialists must record and maintain documentation of risk assessments, risk handling, and risk monitoring results, as applicable. However, the guidance contains no requirements that the reviewers document the methods and techniques used in the reviews performed based on the risk assessments. Although the DCMA One Book explains that the CPSR teams may reduce DCAA on-site audits by sharing CPSR work papers, it contains no instructions or descriptions of what type of work papers may be useful to that end.

Documentation to Support Findings. The 13 CPSR files did not contain documentation of analytical procedures, sampling methods, or information regarding the criteria used to evaluate contractor-provided data other than purchase orders. Some documentation existed to explain the criteria used in the review of purchase orders, which was the only area subject to transactional testing. However, the sampling methodology and trend analyses related to purchase orders were not explained.

Without sufficient documentation to describe methods and techniques, including criteria used in the reviews, considerable effort must be expended to reconstruct and understand what the analysts have covered. The success of this effort depends on the availability of the analyst who has performed the review. Adequate documentation would ensure that the personal assistance of an analyst is minimized. The existence of documentation would also facilitate on-the-job training of new employees.

Auditor Reliance on Work Performed by Others

DCAA may avoid duplicating review procedures by relying on work performed by others, in this case the DCMA CPSR team, and still meet the audit objectives. GAGAS 6.14 through 6.16 on “Considering Others’ Work” requires auditors to perform procedures that provide a sufficient basis for that reliance. Auditors can determine the sufficiency, relevance, and competence of other auditors’ evidence by reviewing their report, audit program, or working papers or making supplemental tests of their work, if necessary. Auditors face similar considerations when relying on the work of nonauditors. GAGAS 6.16 requires the auditors to obtain an understanding of the methods and significant assumptions that nonauditors used.

CAM 5-603 specifies that it is not the auditor’s responsibility to review the quality of the CPSR team’s work. However, the auditor must understand the scope of the work performed in order to determine whether additional audit procedures are necessary to satisfy any DCAA concerns.

DCAA Auditor Reliance on Work of Internal Auditors and Nonauditors. Of the nine audits that required coordination with DCMA, six did not document how the auditor relied on work performed by the CPSR team or internal auditors. The auditor relied on both the contractor’s internal auditors and the CPSR team in one of the six audits, on contractor internal auditors in two audits, and on the CPSR team in three audits. None of the six audits included sufficient explanations to support reliance on the internal auditors and the CPSR team. For example:

- In one of the audits, the auditor incorporated CPSR report findings into the DCAA audit report, recording 80 hours for audit program procedures that were not performed but merely referred to the CPSR team with no additional explanations or supplemental tests to justify reliance.
- In another example, the auditor included work papers from the internal audit but did not document the internal auditor’s qualifications and independence.

Although internal auditors may have work papers that enable an auditor to determine the sufficiency, relevance, and competence of the auditor’s work, work papers alone do not provide a basis for reliance. The auditor must also show that the internal auditors are qualified and independent.

The CPSR team’s documentation may not be sufficient to enable an auditor to render an audit opinion on the evidence supporting the report. In that case, the auditor should attempt to understand the review methods and techniques through discussions with the PSAs and, if necessary, perform supplemental tests to support audit reliance on the CPSR team’s work.

Results of Related Quality Assurance Reviews. The DCAA completed an internal quality assurance review of internal control systems audits, including audits of purchasing system internal controls, in FY 2000. The internal review disclosed, among other findings, that auditors relied on internal audit results without adequately determining the sufficiency/reliability of the internal auditors efforts. Because DCAA took corrective actions, we are making no further recommendations concerning auditor reliance on work performed by others.

Recommendations and Management Comments

B.1. We recommend that the Director, DCMA clarify guidance on risk assessments. At a minimum, the guidance should:

a. Clearly differentiate between risks to consider for annual planning purposes and the risks to consider when planning the scope of a specific review;

b. Advise that a high risk factor should be assigned until adequate information exists to support a medium or low risk; and,

c. Amend instructions to base the identification of key processes on an understanding of the contractor's system rather than four specific requirements.

Management Comments. The Executive Director, Contract Management Operations, DCMA concurred and plans to revise the One Book to correct the disconnect between risk planning and risk rating. The DCMA will also ensure that the One Book provides instructions that will allow the performance of a CPSR for qualifying contractors when lack of information inhibits a risk rating to be assigned. Key processes listed in the Directive 1, Chapter 7.4, Paragraph 4.6.1.3 will be revised to include more appropriate processes.

B.2. We recommend that the Director, DCMA instruct analysts to improve documentation in files in sufficient detail to enable a reviewer to understand the methods, techniques, and criteria used to support the findings without the personal assistance of the analyst.

Management Comments. The Executive Director, Contract Management Operations, DCMA concurred and will issue an Information Memorandum to re-emphasize the need for adequate and proper documentation of files.

Appendix A. Scope and Methodology

We visited three DCMA field offices that performed risk assessments and CPSRs and seven DCAA field offices that provided support to DCMA on request or audited purchasing system internal controls. An additional DCAA office not visited provided information on seven DCMA requests for limited audit services. We based our review on the FAR and DFARS requirements for consent to subcontract and CPSRs, the DCMA One Book, including the CPSR Guidebook, for performing risk assessments and conducting CPSRs, and the DCAA CAM guidance for auditors.

At the DCMA field offices, we used the following methodology.

- To determine the adequacy of planning procedures, we evaluated the criteria used in 33 risk assessments and determined whether the results were used to plan subsequent CPSRs. We also interviewed ACOs in regard to the results of CPSRs and risk assessments.
- To evaluate the overall adequacy of the CPSRs, we reviewed the file documents supporting 13 reviews and interviewed analysts and supervisors to determine the scope of review, the methods, and techniques used in conducting the CPSRs. We compared the resultant coverage to the One Book requirements. We also received a demonstration of the new CPSR software program and discussed the benefits and deficiencies of the new software with the analysts.
- To evaluate the adequacy of current guidance, we interviewed analysts and supervisors and reviewed superseded DFARS instructions for performing CPSRs.
- To evaluate the adequacy of support for findings in the CPSR reports, we reviewed contractor-provided data, including written purchasing policies and procedures, sales, organizational and purchase order file information; handwritten question sheets, checklists used by the analysts during the on-site review of purchase order files, and printouts of data from software used during the review.
- To evaluate the use of audit support services, we compared the scope of review specified in 17 DCMA requests.

At the DCAA field audit offices, we verified whether an audit was performed at the request of DCMA or set up to examine the contractor's purchasing system internal controls. We used the following methodology to evaluate the performance of the audits.

-
- To evaluate the adequacy of audits performed in response to DCMA requests, we reviewed seven audit files at four DCAA field offices, including three requests that DCAA incorporated into an expanded audit of the contractor's purchasing system internal controls. We reviewed the work papers completed to respond to the request.
 - To evaluate the adequacy of DCAA audits of purchasing system internal controls, we reviewed audit files for documentation of planning, risk assessments, coordination with the ACO and CPSR teams, and extent of reliance on work performed by others. We used a quality assurance checklist developed by DCAA for evaluation of internal control systems audits.
 - To supplement audit documentation and determine whether unrecorded discussions had been held with the ACO and the CPSR teams, we interviewed auditors and supervisors. We also contacted ACOs and analysts per telephone concerning meetings or conversations to coordinate the audits evaluated at the DCAA sites visited.

Use of Computer-Processed Data. We did not rely on computer-processed data for the evaluation of DCMA performed risk assessments and CPSRs. We relied on computer-processed data from the DCAA Management Information System to identify field audit offices performing purchasing system reviews. Although we did not perform a formal reliability assessment of DCAA computer-processed data, we determined that the assignment numbers, dollars examined, and questioned costs for the selected audit assignments generally agreed with the computer-processed data. We did not find errors that would preclude use of the data to meet the evaluation objectives or that would change our report conclusions.

Universe and Sample. We judgmentally selected three DCMA field offices and eight DCAA audit offices from three regions. The DCMA office selections were based on our analysis of DCMA workload for FYs 1998 through 2000 and proximity to DCAA field offices. We evaluated 33 of 55 risk assessments and 13 of 76 CPSRs completed during the time period selected. To select the CPSRs, we considered the type of review performed (comprehensive or followup) and whether the review resulted in ACO approval or disapproval of the contractor's purchasing system.

The DCAA office selections were based on an analysis of data extracted from the DCAA Management Information System from October 1, 1997, through September 10, 2001. We were unable to determine how many of the audits performed during the period were requested by DCMA and how many DCAA initiated because all audits were performed under the same DCAA activity code, 12030. However, we selected six field audit offices with large audit assignments, as indicated by the number of hours recorded in the Information System, and two offices in close proximity to DCMA with several small audit assignments. The 6 offices had completed 12 audits of purchasing system internal controls from October 1, 1997, through September 10, 2001, which we evaluated.

We also obtained copies of DCMA audit requests from two audit offices in close vicinity to DCMA field offices and visited one of the two audit offices. The 8 offices had received 17 DCMA requests for audit support in a CPSR, which we reviewed.

Evaluation Dates and Standards. We performed this evaluation from May 2001 through July 2002, according to standards issued by the Inspector General of the Department of Defense.

Management Control Program Review

The DoD Directive 5010.38, "Management Control Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control Program Procedures," August 28, 1996, require the Department of Defense 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 DCMA management controls over CPSRs. Specifically, we reviewed the management controls for maintaining a complete and accurate CPSR database and ensuring the timely and appropriate scheduling of reviews based on risk assessments.

We reviewed the DCAA management controls over purchasing system internal control reviews. Specifically, we reviewed management controls over audit programs, documentation of coordination with ACOs and CPSR teams, and audit reporting.

Because we did not identify a material weakness, we did not assess managements' self-evaluations.

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

Prior Coverage

No prior coverage has been conducted on the subject during the last 5 years.

Appendix B. Comparison of Review Coverage

The table compares the planned audit coverage in the DCAA standard audit program to observed CPSR coverage.

DCAA Audit Procedures	DCMA CPSR Team Procedures	Potential Overlap
PRELIMINARY AUDIT EFFORT:		
Obtains pertinent contractor data from permanent files and the contractor. Conducts entrance conference.	Obtains pertinent information from the contractor. Conducts entrance conference.	Yes
CONTROL ENVIRONMENT:		
Reviews organization structure and overall control environment of company, drawing from prior reviews and experience with contractor.	Reviews organization structure, contractor's conflict of interest form and any prior CPSRs.	Partial
CONTRACTOR'S RISK ASSESSMENT:		
Obtains understanding of contractor's management processes in handling risk associated with the purchasing system.	Reviews management reports, internal audit reports, and associated policies and procedures such as rotation of buyers.	Yes
INFORMATION & COMMUNICATION:		
Obtains understanding of contract cost data processes and traces selected transactions through the manual or electronic data processing system.	Not performed by the CPSR analyst.	No
MONITORING:		
Obtains understanding of management and supervisory activities, internal audit involvement, and external party involvement in monitoring process.	Reviews management reports, and internal audit reports.	Yes
CONTROL OBJECTIVES AND ACTIVITIES:		
Reviews training, policies & procedures, purchase orders & subcontract clauses, purchase file data, source selection process, pricing & negotiation, subcontract award and administration.	Reviews policies & procedures using FAR checklist, training records for purchasing personnel, purchase order files, certifications and forms, source selection data, price analysis data, and subcontract awards.	Yes
ASSESSMENT OF CONTROL RISK:		
Analyzes and summarizes results of audit and determines audit opinion on adequacy of the system.	Analyzes results of review and determines approval/withheld recommendation for ACO.	Yes
SUMMARY AUDIT STEPS:		
Prepares audit report for ACO.	Prepares report for ACO.	Yes

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Director, Defense Procurement
Under Secretary of Defense (Comptroller)/Chief Financial Officer

Other Defense Organizations

Director, Defense Contract Management Agency
Director, Defense Contract Audit 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

Defense Contract Audit Agency Comments



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PQA 225.4[D2001-OA-0106]

September 30, 2002

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDIT
POLICY AND OVERSIGHT, DEPARTMENT OF DEFENSE,
INSPECTOR GENERAL

SUBJECT: Response to Draft Oversight Report on DoD Oversight of Contractor Purchasing
Systems (Project No. D2001-OA-0106)

Thank you for the opportunity to respond to the subject report. We have limited our response to the report recommendation, restated below, as it relates to DCAA.

DoDIG Report Recommendation No. 1

We recommend that the Director, Defense Contract Management Agency and the Director, Defense Contract Audit Agency jointly reengineer their processes and procedures for performing reviews and audits of contractor purchasing systems to establish joint planning and coordination processes that will more effectively meet the needs of both organizations, avoid duplication, and effectively leverage the resources of both organizations. The review processes and procedures should address the specific deficiencies identified in this report.

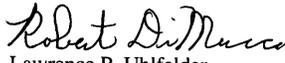
DCAA Response

Concur in principle. DCAA in coordination with DCMA will re-evaluate its planning and coordination processes for conducting its audits of contractors' purchasing systems and related internal controls to ensure the processes will facilitate sufficient audit coverage and avoid duplication. DCAA will issue a Memorandum for Regional Directors (MRD), after coordination with DCMA, providing audit guidance to the field auditors on the enhanced coordination and planning process. We will issue this MRD by January 31, 2003. The MRD will include (1) a reminder for auditors to coordinate with DCMA when initiating a purchasing system review and (2) a requirement for auditors to document the results of this coordination in the working papers. We will make any necessary revisions to the DCAA's standard audit program, *Reviewing and Reporting on Contractor Purchasing System and Related Internal Controls*, for the April 2003 APPS update. Necessary revisions to the guidance contained in the DCAA Contract Audit Manual will be made for the July 2003 update.

PQA 225.4[D2001-OA-0106]

SUBJECT: Response to Draft Oversight Report on DoD Oversight of Contractor Purchasing Systems (Project No. D2001-OA-0106)

Questions regarding this memorandum should be directed to Mr. Ken Saccoccia, Quality Assurance Division at (703) 767-2250.


FOR Lawrence P. Uhlfelder
Assistant Director
Policy and Plans

Defense Contract Management Agency Comments



DEFENSE CONTRACT MANAGEMENT AGENCY
6350 WALKER LANE, SUITE 300
ALEXANDRIA, VA 22310-3241

OCT | 2002

IN REPLY
REFER TO

DCMA-OCS

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL, POLICY AND
OVERSIGHT, DEPARTMENT OF DEFENSE

SUBJECT: Response to DoD IG Draft Report on DoD Oversight of Contractor
Purchasing Systems, Project No. D2001-OA-0106

This is in response to the Department of Defense Inspector General audit report, subject as above. The Defense Contract Management Agency comments to the findings and recommendation are attached. Please refer any questions you may have to Ms. Penelope A. Langlois, email: planglois@hq.dcmamail.mil, telephone, (703) 428-0963.

A handwritten signature in black ink, appearing to read "R. Schmitt".

ROBERT W. SCHMITT
Executive Director
Contract Management Operations

Attachment

SUBJECT: DoDIG Draft Report, DoD Oversight of Contractor Purchasing Systems
(Project No. D20010A-0106)

FINDING A: Planning and Coordination of Reviews. Based on our evaluation of 13 DCMA reviews and 12 DCAA audits, planning and coordination of reviews of contractor purchasing systems, including the sharing of annual plans and review guides, and the use of audit services, needed improvement. Although the DCMA CPSRs and DCAA audits of purchasing system internal controls have different objectives, the reviews to a large extent covered the same areas. However, the agencies did not share annual plans, and the DCMA guidance did not stress the importance of auditor participation in joint reviews to avoid duplication. The DCMA requested only limited audit support from DCAA at locations where DCAA audited significant contractor dollars. Further, of 11 DCAA audits that required coordination with the ACO or the CPSR team, 6 did not include adequate information to explain the extent of coordination attempts. The DCAA standard audit program emphasized the need to coordinate with the ACO in an introductory note that does not instruct the auditor to document all coordination efforts. The conditions occurred because DCMA and DCAA do not have joint planning processes. Excellent examples of effective planning and coordination were demonstrated at three contractor facilities. Inadequate coordination may result in overlapping reviews and inefficient use of resources.

DCMA comments: CONCUR. DCMA Directive 1, Chapter 7.4, Contractor Purchasing System Review (CPSR) specifies in paragraph 3.4 that "A coordinated team approach, which promotes the sharing of data and reduction of duplicate effort, is encouraged." Additionally, the same paragraph discusses the CPSR team members that include DCAA auditors to either participate or provide input. In addition, annual schedules of CPSR's are required to be shared with DCAA (reference DCMA Directive 1, Chapter 7.4, Paragraph 4.6.3.4). Because adequate instructions and guidance are currently in place, an Information Memorandum will be issued to emphasize the importance of adhering to the DCMA Directive 1 guidance.

Disposition:

- (X) Action is ongoing. ECD: November 30, 2002
- () Action is considered complete.

SUBJECT: DoDIG Draft Report, DoD Oversight of Contractor Purchasing Systems
(Project No. D20010A-0106)

Recommendation A: We recommend that the Director, Defense Contract Management Agency and the Director, Defense Contract Audit Agency jointly reengineer their processes and procedures for performing reviews and audits of contractor purchasing systems to establish joint planning and coordination processes that will more effectively meet the needs of both organizations, avoid duplication, and effectively leverage the resources of both organizations. The review processes and procedures should address the specific deficiencies identified in this report.

DCMA Comments: CONCUR. DCMA recognizes the need for joint planning and coordination processes. Additionally, DCMA recognizes that *DCAA auditors are expected to exercise independent judgment in planning the type and extent of audit testing sufficient to render unqualified audit opinions, but will consider and address special areas of concern or informational needs of requesters.* (See DCAA Contract Audit Manual (CAM), Section 1-403.1b.) The DCMA Directive 1, Chapter 7.4, and the DCAA CAM provide sufficient procedures for planning and coordination of reviews. DCMA will issue an Information Memorandum to re-emphasize the need for such coordination when performing a CPSR.

Disposition:

- Action is ongoing. ECD: November 30, 2002
- Action is considered complete.

SUBJECT: DoDIG Draft Report, DoD Oversight of Contractor Purchasing Systems
(Project No. D20010A-0106)

Finding B: Performance of Reviews. Although the DCMA PSAs adequately covered prescribed review areas and supported reported findings, risk assessments and the documentation of work performed during the reviews could be improved. The conditions occurred because the DCMA One Book guidance was inadequate. In addition, auditors relied on work performed by the CPSR teams without sufficient justification, which was not in compliance with GAGAS and DCAA audit guidance.

As a result of inconsistent risk assessments, reviews may not be scheduled when needed or unnecessary reviews may be performed. Auditor noncompliance with GAGAS when relying on work performed by others lessened the usefulness of the audit report.

DCMA Comments: CONCUR: The DCMA Directive 1, Chapter 7.4 is being re-written. The information required in the performance of a risk assessment is contained in the DCMA Directive 1 Chapter and the FAR. This information will be identified and referenced within the aforementioned policy.

Disposition:

- (X) Action is ongoing. ECD: November 30, 2002
- () Action is considered complete.

SUBJECT: DoDIG Draft Report, DoD Oversight of Contractor Purchasing Systems
(Project No. D20010A-0106)

Recommendation B.1: We recommend that the Director, DCMA clarify guidance on risk assessments. At a minimum, the guidance should:

- a. Clearly differentiate between risks to consider for annual planning purposes and the risks to consider when planning the scope of a specific review;
- b. Advise that a high risk factor should be assigned until adequate information exists to support a medium or low risk; and,
- c. Amend instructions to base the identification of key processes on an understanding of the contractor's system rather than four specific requirements.

DCMA Comments: CONCUR. (a) DCMA recognizes that there is a disconnect between risk planning and risk rating. Although all the information is contained between DCMA Directive 1 and the CPSR Guide, it is not easily understood. A revision of the One Book will correct this situation. (b) The suggestion to assign a high risk factor until adequate information exists to support a medium or low risk is tantamount to scheduling a CPSR for a contractor where no information exists to make a risk determination. DCMA will ensure that DCMA Directive 1 provides instructions that will allow the performance of a CPSR for qualifying contractors when lack of information does not allow for a risk rating to be assigned. (c) Key processes listed in DCMA Directive 1, Chapter 7.4, Paragraph 4.6.1.3 will be revised to more appropriate processes.

Disposition:

- Action is ongoing. ECD: November 30, 2002
 Action is considered complete.

SUBJECT: DoDIG Draft Report, DoD Oversight of Contractor Purchasing Systems
(Project No. D20010A-0106)

Recommendation B.2: We recommend that the Director, DCMA instruct analysts to improve documentation in files in sufficient detail to enable a reviewer to understand the methods, techniques, and criteria used to support the findings without the personal assistance of the analyst.

DCMA Comments: CONCUR. An Information Memorandum will be issued to re-emphasize the need for adequate and proper documentation of files.

Disposition:

- (X) Action is ongoing. ECD: November 30, 2002
- () Action is considered complete.

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
Madelaine E. Fusfield
Patricia A. Bartron
Krista S. Gordon
Ashley A. Harris