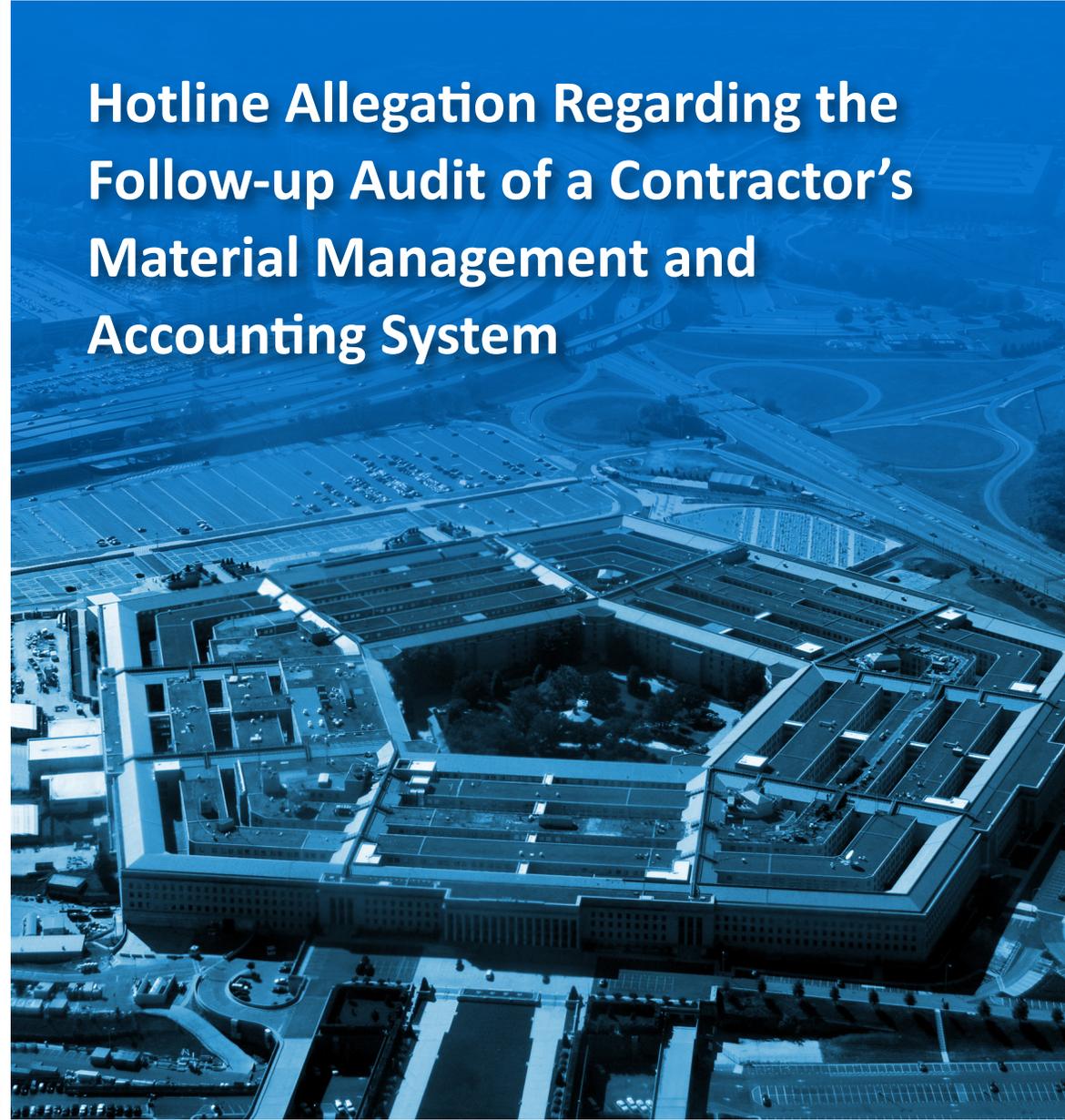




# INSPECTOR GENERAL

*U.S. Department of Defense*

OCTOBER 17, 2013



## Hotline Allegation Regarding the Follow-up Audit of a Contractor's Material Management and Accounting System

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October 17, 2013

## Objective

We reviewed a DoD Hotline complaint alleging that during a follow-up audit of a DoD contractor's Material Management and Accounting System (MMAS), a Defense Contract Audit Agency (DCAA) auditor:

- concluded that numerous outstanding deficiencies were corrected without obtaining sufficient evidence and
- reported the entire MMAS system adequate.

## Findings

We substantiated the allegation that DCAA reported several MMAS deficiencies as corrected without obtaining sufficient evidence to support the opinion. The Gathering Sufficient, Appropriate Evidence section of generally accepted government auditing standards requires that auditors obtain sufficient evidence in support of their conclusions. Of the 28 deficiencies DCAA reported as corrected, the auditor did not obtain sufficient evidence to conclude that 10 of them were corrected. As a result, the contractor might not have corrected the deficiencies and the Government could be incurring unnecessary material costs. In addition, we found that the DCAA field audit office (FAO) did not conduct a second follow-up of the remaining deficiencies in a timely manner.

## Findings Continued

We did not substantiate a second allegation that DCAA reported the entire MMAS system as adequate. DCAA reported the MMAS as "inadequate in part" based on two deficiencies which the contractor had not adequately corrected.

## Recommendations

DCAA should rescind the MMAS follow-up audit report because the auditor did not obtain sufficient evidence in support of the reported opinion. In accordance with DCAA policy, DCAA needs to initiate a full audit of the MMAS rather than a limited audit of the remaining MMAS deficiencies. Further, DCAA should assess whether auditors agency-wide are conducting follow-up audits of business system deficiencies in a timely manner.

## Comments and Response

In an August 9, 2013, memorandum, the Director of the Defense Contract Audit Agency agreed with the findings and adequately responded to one of two recommendations. The Director did not agree to conduct an agency-wide assessment on the timeliness of follow-up audits. Therefore, we request additional comments on this recommendation. Please see the recommendations table on the following page.

## ***Recommendations Table***

<b>Management</b>	<b>Recommendations Requiring Comment</b>	<b>No Additional Comments Required</b>
Director, Defense Contract Audit Agency	2	1

Please provide comments by November 18, 2013.



**INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500**

October 17, 2013

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY  
REGIONAL DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY  
NORTHEASTEN REGION

SUBJECT: Hotline Allegation Regarding the Follow-up Audit of a Contractor's Material Management and Accounting System (Report No. DODIG-2014-002)

We are providing this report for your review and comment. We substantiated an allegation that a Defense Contract Audit Agency field audit office did not obtain sufficient evidence to conclude that a DoD contractor had corrected several previously reported Material Management and Accounting System deficiencies. As a result, the deficiencies might still exist and result in increased material costs paid by the Government.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We considered management comments on a draft of this report when preparing the final report. The Director, Defense Contract Audit Agency, provided comments that were responsive to one of two recommendations. We request additional comments for Recommendation 2 by November 18, 2013.

Please provide comments that conform to the requirements of DoD Directive 7650.3. Send a PDF file containing your comments to the email address cited in the last paragraph on this memorandum. Copies of your comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to our staff. Please direct any questions to Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877), carolyn.davis@dodig.mil.

A handwritten signature in black ink, appearing to be "J. S. [unclear]", is positioned above the title of the Deputy Inspector General.

Deputy Inspector General  
Policy and Oversight

# Contents

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## Introduction

Objective \_\_\_\_\_ 1

Background \_\_\_\_\_ 1

## **Finding A. Auditor Concluded that Material Management and Accounting System Deficiencies Were Corrected Without Obtaining Adequate Evidence** \_\_\_\_\_ 3

Allegation \_\_\_\_\_ 3

Second MMAS Follow-up Audit \_\_\_\_\_ 4

Recommendations, Management Comments, and Our Response \_\_\_\_\_ 6

## **Finding B. Alleged Reporting of the Material Management and Accounting System as Adequate** \_\_\_\_\_ 9

Allegation \_\_\_\_\_ 9

## Appendixes

Appendix A. Scope and Methodology \_\_\_\_\_ 10

Appendix B. Deficiencies Reported as Corrected Without Obtaining Adequate Evidence \_\_\_\_\_ 11

Appendix C. Chronology of Events \_\_\_\_\_ 15

## Management Comments

Defense Contract Audit Agency Comments \_\_\_\_\_ 16

## Acronyms and Abbreviations \_\_\_\_\_ 19

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# Introduction

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## Objective

We conducted this review to determine the validity of a DoD Hotline allegation concerning the conclusions rendered by a Defense Contract Audit Agency (DCAA) auditor who performed a follow-up audit of a contractor's Material Management and Accounting System (MMAS). Specifically, the complainant alleges that the auditor:

- a. concluded the DoD contractor had corrected numerous system deficiencies without obtaining sufficient evidence and
- b. inappropriately reported the MMAS as adequate as a whole even though several significant deficiencies existed.

See Appendix A for details of our scope and methodology.

## Background

### ***Material Management and Accounting System Standards***

Defense Federal Acquisition Regulation Supplement (DFARS) clause 252.242-7004, "Material Management and Accounting System," requires DoD contractors to maintain an MMAS that reasonably forecasts material requirements, ensures material costs are based on valid time-phased requirements, and has a consistent, equitable, and unbiased logic for costing of material transactions.

The clause lists 10 system criteria (also known as "MMAS standards") for determining the acceptability of an MMAS. For example, DFARS clause 252.242-7004(d)(2), also known as "Standard 2," states that a DoD contractor's MMAS must, "Ensure that costs of purchased and fabricated material charged or allocated to a contract are based on valid time-phased requirements as impacted by minimum/economic order quantity restrictions."

For contracts that include DFARS clause 252.242-7005(e)(1), "Contractor Business Systems," contracting officers must withhold 5 percent of payments from a DoD contractor if significant deficiencies exist with one of the contractor's business systems (such as the MMAS).

### ***Defense Contract Audit Agency***

DCAA performs contract audits for DoD and provides accounting and financial advisory services to DoD Components responsible for procurement and contract

administration. The Agency issues reports resulting from several types of audits, such as audits of a DoD contractor's MMAS. DCAA performs MMAS audits to determine if the internal controls are effective and whether the system complies with the 10 standards contained in DFARS clause 252.242-7004.

DCAA includes a Headquarters, Field Detachment, and five regions: Central, Eastern, Mid-Atlantic, Northeastern, and Western. Each region maintains several field audit offices (FAOs), and each FAO is composed of multiple audit teams. A field audit office manager oversees each field audit office, and a supervisor leads each audit team.

### ***Audit Reports***

In September 2005, a DCAA FAO in the Northeastern Region issued an audit report (hereafter referred to as "the original audit") on a contractor's MMAS, citing 30 deficiencies involving 8 of 10 MMAS standards contained in DFARS clause 252.242-7004. In January 2007, the FAO initiated a follow-up audit to determine if the contractor had taken adequate corrective action on the 30 reported deficiencies (hereafter referred to as "the follow-up audit"). Different auditors performed the original and follow-up audits.

On September 8, 2008, the DCAA FAO issued its report on the follow-up audit, stating that the contractor had adequately corrected 28 of the 30 deficiencies. The report indicated that 2 of the 30 deficiencies were still outstanding. The DoD Hotline complaint addressed in this report involves the conclusions reached by the DCAA auditor who performed the follow-up audit. The auditor who performed the follow-up audit retired from DCAA in December 2011.

In August 2011, the FAO initiated a second follow-up audit on the two remaining deficiencies. The second follow-up audit is still ongoing.

## Finding A

### **Auditor Concluded that Material Management and Accounting System Deficiencies Were Corrected Without Obtaining Adequate Evidence**

We substantiated an allegation that DCAA did not have sufficient evidence to conclude that a DoD contractor had adequately corrected several MMAS deficiencies. Of the 28 deficiencies reported as adequately corrected in the follow-up audit, the auditor did not obtain sufficient evidence to conclude that 10 of them were corrected.

In FY 2011, the DoD contractor's MMAS addressed in this report processed approximately \$2.2 billion in material costs that were charged to Government contracts. Without an adequate MMAS, the Government does not have a reasonable basis for relying on the accuracy of material costs charged by the DoD contractor. Because the auditor inappropriately determined that the contractor had eliminated deficiencies without obtaining sufficient evidence, the deficiencies could still exist and result in increased material costs paid by the Government.

### **Allegation**

The complainant alleged that a DCAA auditor who performed a follow-up audit of a major DoD contractor's MMAS did not conduct an adequate audit and improperly concluded that the contractor had corrected several previously reported deficiencies. The complainant stated that the auditor did not obtain sufficient evidence and made "very few" visits to the contractor facility during the audit.

### ***Insufficient Evidence Obtained by the Auditor***

The Gathering Sufficient, Appropriate Evidence section of generally accepted government auditing standards (GAGAS), paragraph 6.56, requires that auditors obtain sufficient evidence in support of their findings and conclusions. In addition, DCAA Contract Audit Manual section 5-105(b), "Scope of Audit," requires that the auditor include tests to ensure that the contractor's internal controls (such as the MMAS internal controls) are in place and operating effectively.

The auditor who performed the follow-up audit (hereafter referred to as “the follow-up auditor”) failed to obtain sufficient evidence to determine that the contractor had corrected 10 deficiencies in the following areas:

1. Bills of Material,
2. Testing of Material Time-Phasing,
3. Material Transfers/Diversions,
4. Manufacturing Resources Planning Access,
5. Transaction Testing,
6. Incomplete Contractor-Furnished Materials Diversion Forms,
7. Borrow/Lend Transactions Without Approved Written Requests,
8. Access to Internal Reviews Performed by External Auditors,
9. Economic Ordering Policies and Procedures, and
10. Significant Changes to the MMAS.

In most cases, the follow-up auditor did not properly test the adequacy or effectiveness of new policies and procedures the contractor had created in response to the reported deficiencies. Without appropriate testing, the follow-up auditor did not have a sufficient basis to conclude that the contractor had implemented the new procedures or fully corrected the deficiencies. See Appendix B for details concerning evidence the follow-up auditor should have obtained to determine if the contractor had corrected the deficiencies.

Because the follow-up auditor did not obtain sufficient evidence for several of his conclusions, the FAO should rescind the follow-up audit report and instruct the contracting officer not to rely on its results.

## **Second MMAS Follow-up Audit**

The FAO is in the process of performing a second follow-up audit on the two deficiencies reported as outstanding in the first follow-up audit.

### ***The Second Follow-up Audit is Untimely***

According to DCAA Contract Audit Manual 5-104f, “Audit Objectives,” the auditor should place a high priority on conducting follow-up audits of previously reported business

system deficiencies (including MMAS deficiencies). In March 2010, the contracting officer requested that the DCAA FAO perform a second follow-up audit to review the contractor's efforts to eliminate the two outstanding deficiencies and provide the results of the review by May 2010. Yet, more than 3 years later, the FAO has still not completed the second follow-up audit. The FAO told us that the completion of the audit was delayed because of other priority work. It is unreasonable for the FAO to take more than 3 years to complete a limited follow-up audit of two deficiencies.

The failure of DCAA to conduct a timely follow-up audit compromises the contracting officer's responsibility in determining the adequacy of the MMAS, implementing withholdings in accordance with DFARS 252.242.7005, and reducing or eliminating withholdings to reflect the contractor's progress in correcting deficiencies. Contracting officers might not withhold payments if DCAA does not uphold its responsibility to conduct timely follow-up audits of contractor corrective actions.

We do not know the extent to which other DCAA FAOs have neglected to conduct timely follow-up audits of previously reported business system deficiencies (including MMAS deficiencies). DCAA should assess the timeliness of follow-up audits on an agency-wide basis and make appropriate improvements to its related quality assurance procedures.

### ***DCAA Should Conduct a Full MMAS Audit***

The FAO completed its last full audit of the contractor's MMAS (an audit of all 10 MMAS standards) on September 30, 2005, 8 years ago. DCAA Contract Audit Manual 5-103.1, "Internal Control Audit Policy and Approach," states,

It is DCAA's policy that each relevant accounting or management system that has a significant impact on Government contractor costs be audited on a cyclical basis (i.e., every 2 – 4 years) based on a documented risk assessment. If past experience is favorable and current audit risk is considered to be low, an audit may be performed on a less frequent basis (however, no less frequently than 4 years).

Therefore, the FAO should perform a full audit of the MMAS rather than a limited follow-up of the two reported deficiencies. A full review is also warranted because the follow-up auditor did not obtain sufficient evidence to support several of his conclusions.

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

### ***Recommendation 1***

We recommend that the Director, Defense Contract Audit Agency, direct the Northeastern Regional Director to:

**a. Advise the contracting officer that:**

- (1) the September 10, 2008, follow-up report of the Material Management and Accounting System report is being rescinded and should not be used for any purpose because the auditor did not obtain sufficient evidence in support of several reported conclusions; and**
- (2) the Field Audit Office plans to immediately initiate a full review of the contractor's Material Management and Accounting System.**

### ***DCAA Comments***

The Director, Defense Contract Audit Agency, agreed and stated that DCAA will notify the contracting officer that the FAO is rescinding the report and initiating a full audit of the contractor's MMAS in October 2013.

### ***Our Response***

The management comments are fully responsive, and no additional comments are required.

**b. Instruct the Field Audit Office to:**

- (1) Rescind the follow-up Material Management and Accounting System report issued on September 10, 2008;**
- (2) Cancel the second follow-up Material Management and Accounting System review; and**
- (3) Initiate a full audit of the contractor's Material Management and Accounting System in accordance with Defense Contract Audit Agency policy.**

### ***DCAA Comments***

The Director, Defense Contract Audit Agency, agreed and stated that DCAA will rescind the report, not issue a report on the second follow-up, and begin a full audit of the contractor's MMAS in October 2013.

### ***Our Response***

The management comments are fully responsive, and no additional comments are required.

- c. Provide training to the Field Audit Office staff (including the manager, supervisors, and auditors) covering the requirement for obtaining sufficient evidence in support of reported conclusions.**

### ***DCAA Comments***

The Director, Defense Contract Audit Agency, agreed "in principle." Since the issuance of the follow-up audit in September 2008, the Director pointed out that DCAA has already provided five agency-wide training programs to its audit staff and issued a new policy directly related to obtaining sufficient evidence. DCAA believes its continuing actions to train its audit staff are realizing tangible results.

### ***Our Response***

The management comments are responsive. DCAA has recently provided training to the audit staff and established policy on the requirement for obtaining sufficient evidence. In future reviews, we will continue to monitor DCAA's ongoing efforts to ensure that auditors obtain sufficient evidence in support of its conclusions.

## ***Recommendation 2***

**The Director, Defense Contract Audit Agency, needs to:**

- a. Assess the timeliness of business system follow-up audits agency-wide during the last 3 years;**
- b. Implement any necessary improvements to help ensure the timeliness of follow-up audits on business systems, and**
- c. Provide the results of the assessment and planned improvements to the Assistant Inspector General, Audit Policy and Oversight by March 31, 2014.**

### ***DCAA Comments***

The Director, DCAA, agreed “in principle.” DCAA recognizes that it can improve the timeliness of business system follow-up audits agency-wide. However, the Director stated that the requirements for DCAA services far exceed the available staffing and management must make decisions on which priority assignments take precedence. In addition, the Director does not believe “a detailed assessment of the timeliness of business systems follow-up reviews is a good use of DCAA’s limited resources.”

The Director also stated that established guidance allows auditors to report significant business system deficiencies throughout the course of performing other priority audits. In addition, the Director stated that the Agency issued a memorandum requiring milestone plans for all high-risk audits and, as a result, DCAA has seen improvements in meeting agreed-to-dates.

### ***Our Response***

The comments are not responsive, and we request that the Director, Defense Contract Audit Agency, provide additional comments. We disagree that assessing timeliness is not a good use of DCAA’s limited resources. An assessment could identify opportunities, best practices, and lessons learned for improving timeliness.

When DCAA reports that a major DoD contractor’s business system contains significant deficiencies as defined in DFARS 252.242-7005, DCAA asserts that the deficiencies materially affect the ability of DoD officials to rely on information produced by the system. If the contracting officer agrees with DCAA, the contracting officer must withhold payments until the contractor eliminates the deficiency. Therefore, DCAA plays a critical role in providing the contracting officer with timely information on the status of contractor corrective actions. If DCAA commits resources for conducting a full business system audit and reporting on significant business system deficiencies, then DCAA should place a high priority on performing a limited and timely follow-up of those deficiencies.

Although DCAA policy allows for the reporting of significant business system deficiencies in other audits, this does not address the need for performing timely follow-up audits of the deficiencies (including those identified in other audits). Additionally, milestone plans for individual assignments will not improve timeliness if the FAO designates the follow-up audit as a low priority and does not initiate it for several months or years. DCAA, while recognizing the importance of performing follow-up audits, should be willing to assess their timeliness and implement appropriate agency-wide improvements. We request comments in response to the final report by November 18, 2013.

## Finding B

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### **Alleged Reporting of the Material Management and Accounting System as Adequate**

We did not substantiate the allegation that DCAA reported the MMAS as adequate as a whole.

#### **Allegation**

The hotline complainant alleged that the follow-up auditor considered the entire MMAS system as adequate even though significant deficiencies remained.

#### ***DCAA Reported the System as “Inadequate in Part”***

As reflected in the working papers of the follow-up audit, the follow-up auditor concluded that the contractor had not corrected 2 of the 30 originally reported deficiencies. Consistent with existing DCAA guidance, the DCAA follow-up audit report, Results of Audit paragraph, describes the MMAS system as “inadequate in part.” DCAA did not report the MMAS as adequate. Therefore, we did not substantiate the allegation.

## Appendix A

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### Scope and Methodology

We conducted this review in accordance with the Council of the Inspectors General on Integrity and Efficiency “Quality Standards for Inspection and Evaluation.” To determine the validity of the complaint addressed in this report, we:

- interviewed DCAA auditors and supervisors who were involved with the original and follow-up audits of the contractor’s MMAS;
- examined DCAA files and correspondence related to the original and follow-up audits; and
- reviewed the follow-up audit to determine if it complied with applicable regulations, generally accepted government auditing standards, and DCAA procedures.

In conducting the interviews, we placed interviewees under oath, recorded the interviews, and obtained a transcript. We performed the review from October 2011 through April 2013. During this timeframe, we had to suspend the review to work on other priority projects.

### Use of Computer-Processed Data

We did not rely on any computer-processed data as part of our review.

### Prior Coverage

During the last 5 years, the DoD Inspector General conducted one Hotline review involving another DCAA audit of a DoD contractor’s MMAS.

- Report No. DODIG-2013-082, “Hotline Allegation Regarding the Failure to Take Action on Material Management and Accounting System Audit Findings,” May 29, 2013.

## Appendix B

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### Deficiencies Reported as Corrected Without Obtaining Adequate Evidence

Discussed below are details concerning why the follow-up auditor did not obtain sufficient evidence to conclude that the contractor had corrected 10 of the previously reported deficiencies.

#### **1. Bills of Material**

The original audit report stated that the contractor did not submit policies and procedures to describe how it creates bills of material, as DFARS clause 252.242.7004(d)(1) requires. The follow-up auditor concluded that the deficiency had been corrected based on the contractor's preparation of a flowchart and narrative descriptions depicting how bills of materials are prepared. However, we found no evidence indicating that the follow-up auditor tested the accuracy of the flowchart or determined if the contractor incorporated the flowchart into its policies and procedures.

#### **2. Testing of Material Time-Phasing**

The original audit concluded that the contractor did not 1) have written policies and procedures in place to assure material requirements are based on valid time-phase requirements or 2) measure the accuracy of the master production schedule to determine if it meets the 95-percent accuracy goal stated in DFARS clause 252.242.7004(d)(2). The follow-up auditor's working papers showed one milestone policy and several schedules. The auditor commented that the schedules "highlighted some measurement criteria which the contractor felt can be used to measure master production schedule accuracy." However, we found no evidence in the follow-up auditor's working papers that shows the contractor was actually computing a master production schedule accuracy rate or had policies and procedures in place requiring the periodic computation of master production schedule accuracy.

#### **3. Material Transfers/Diversions**

The original audit report stated that the contractor does not have controls in place to ensure that 1) material transfers/diversions comply with company policy and 2) inconsistencies are identified and reported, as DFARS 252.242.7004(d)(3)

requires. The follow-up auditor's working papers state that the contractor revised three policies and procedures to clarify the material/diversion process. In addition, the follow-up auditor included in his working papers 1) a listing of diversion audits done in the last 10 years showing nearly a 100-percent accuracy rate and 2) a "diversion checklist" used by the contractor to review diversions. However, we found no evidence that the follow-up auditor preformed tests to determine if the contractor followed the revised procedures or the contractor correctly calculated the 10-year accuracy rate.

#### ***4. Manufacturing Resources Planning Access***

The original audit determined that the contractor did not periodically review employee access to its Manufacturing Resources Planning system. In addition, the original audit noted that 14 employees who had access to the system stated they did not need to have access to perform their current duties. The follow-up auditor stated the contractor had revised several policies and procedures to monitor and keep current the names of those granted access. The follow-up auditor's working papers also contain a memorandum directing 11 employees to be removed from the access list. However, the follow-up auditor did not determine if any of the remaining employees needed access.

#### ***5. Transaction Testing***

The original audit report stated that the contractor did not comply with Standard 4, DFARS clause 252.242.7004(d)(4), which requires the contractor to have adequate MMAS audit trails and necessary records to evaluate system logic and to verify, through transaction testing, that the system is operating as desired. The follow-up auditor's working papers include a contractor memorandum, which states that 17 audits were performed within the Material Services department. According to the working papers, the contractor also told the follow-up auditor that six different types of audits were performed in the Material Management department and provided several policies and procedures involving the Planning department. However, the follow-up auditor did not verify that the policies were being effectively implemented or that audits were actually being performed.

#### ***6. Incomplete Contractor-Furnished Materials Diversion Forms***

The original audit report stated that the Material Services and Material Management departments did not consistently complete the Contractor-Furnished Materials Diversion forms in accordance with policy and department instructions. The follow-

up auditor documented that contractor management revised several policies and procedures and apprised supervisors and employees of the issue. The follow-up auditor's working papers also stated that the contractor performed two reviews of the diversion forms. One of the reviews reflected a 99-percent accuracy rate and the other showed a 71-percent accuracy rate. However, we found no evidence the follow-up auditor had verified that contractor employees were following the revised policies and procedures. In addition, although the follow-up auditor notes in his working papers that the 71-percent accuracy rate was below the "acceptable" level, he did not include this issue in the follow-up audit report.

## **7. Borrow/Lend Transactions Without Approved Written Requests**

In the original audit, DCAA reported that the contractor did not have a policy for reviewing or approving borrow/lend transactions<sup>1</sup> in accordance with Standard 6, DFARS clause 252.242.7004(d)(6). The follow-up auditor's working papers note that the contractor prepared a procedure related to borrow/lend transactions and provided a listing of employees authorized to approve borrow/lend transactions. However, we found no evidence suggesting the follow-up auditor had verified that either the policies were implemented or that only authorized employees were approving borrow/lend transactions.

## **8. Access to Internal Reviews Performed by External Auditors**

The original audit report stated the contractor could not demonstrate it had conducted internal reviews of the MMAS, as DFARS clause 252.242-7004(c)(2) requires. The working papers for the follow-up audit state that the follow-up auditor had considered the issue closed because the DCAA Contract Audit Coordinator<sup>2</sup> assumed responsibility for auditing the contractor's internal review efforts. However, the follow-up auditor's working papers showed no evidence that he attempted to obtain the audit results from the Contract Audit Coordinator. Even if the Contract Audit Coordinator had not yet completed its audit, the follow-up auditor should have qualified the reported opinion in accordance with DCAA policy for non-receipt of the Contract Audit Coordinator results.

<sup>1</sup> A borrow/lend transaction occurs when one contract borrows needed material from another contract in order to avoid a production delay.

<sup>2</sup> For larger DoD contractors with operations at multiple locations, DCAA often assigns a Contract Audit Coordinator who serves as a central point of communication between company representatives and DCAA auditors performing audits at the various locations.

## **9. Economic Ordering Policies and Procedures**

The original audit report stated that the contractor does not have policies and procedures in place for purchasing materials based upon economic ordering, as Standard 1, DFARS clause 252.242.7004(d)(1) requires. The follow-up auditor obtained a draft policy, instruction sheets, and a status report showing the savings associated with economic ordering. However, the follow-up auditor did not verify that the contractor had implemented the draft policy and instruction sheets or test whether the status report was accurate and reliable.

## **10. Significant Changes to the MMAS**

The original audit report noted that the contractor did not have written policies to describe the criteria for identifying and reporting significant MMAS changes to the contracting officer, as DFARS clause 252.242.7004(c)(3) requires. The follow-up auditor concluded that the contractor did not need such a policy because “the Government would be aware of significant changes in the MMAS through Government funding” of the changes. We strongly disagree with the follow-up auditor’s conclusion. Contractors generally charge the costs of significant MMAS changes as an overhead or general and administrative expense, not directly to a contract. Therefore, the Government does not separately fund these costs and it might not be aware of significant MMAS changes unless the contractor reports them to the contracting officer in accordance with DFARS clause 252.242.7004(c)(3). DCAA should recommend that the contractor establish procedures to help ensure compliance with the DFARS clause.

## Appendix C

### Chronology of Events

Date	Description
September 30, 2005	A DCAA FAO located in the Northeastern Region issued the original audit report, citing 30 deficiencies with the contractor's MMAS.
September 10, 2008	The FAO issued its follow-up audit report stating that the contractor corrected 28 deficiencies, but 2 of the 30 deficiencies still remained.
August 17, 2009	The contractor notified the contracting officer that it had corrected the two remaining deficiencies.
March 24, 2010	The contracting officer requested that the FAO perform a second follow-up on the two remaining deficiencies.
August 2011 (approx.)	The FAO initiated a second follow-up audit to determine if the contractor had adequately corrected the two deficiencies reported as outstanding in the September 10, 2008, follow-up audit. The second follow-up audit is still ongoing.

# Management Comments

## Defense Contract Audit Agency Comments



DEFENSE CONTRACT AUDIT AGENCY  
Office of the Director  
8725 JOHN J. KINGMAN ROAD, SUITE 2135  
FORT BELVOIR, VA 22060-6219

OFFICE OF THE DIRECTOR

August 9, 2013

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR POLICY AND  
OVERSIGHT, OFFICE OF THE INSPECTOR GENERAL,  
DEPARTMENT OF DEFENSE

SUBJECT: Response to Department of Defense Inspector General (DoDIG) Draft Report on a  
Hotline Allegation Regarding the Follow-up Audit of a Contractor's Material  
Management and Accounting System (Project Number D2012-DIPOAI-0030.000)

Thank you for this opportunity to respond to the subject draft report issued on June 11,  
2013. The requested response date was July 11, 2013; however, DCAA requested and received  
DoDIG approval to extend the due date for DCAA comment to August 9, 2013.

**DoDIG Recommendations.**

**Finding A.** *Auditor Concluded that the Material Management and Accounting System (MMAS)  
Deficiencies Were Corrected Without Obtaining Adequate Evidence*

**DoDIG Recommendation 1.a.:** We recommend that the Director, Defense Contract Audit  
Agency, direct the Northeastern Regional Director to advise the contracting officer that:

- (1) the September 8, 2008, follow-up report of the MMAS report is being rescinded and  
should not be used for any purpose because the auditor did not obtain sufficient  
evidence in support of several reported conclusions; and
- (2) the Field Audit Office (FAO) plans to immediately initiate a full review of the  
contractor's MMAS.

**DCAA Response:**

**Recommendation 1.a.: Concur.** We concur with rescinding the September 10, 2008  
follow-up report. We will notify the addressee that we are rescinding the report. We also will  
include a memorandum in the audit file stating that the engagement did not meet Generally  
Accepted Government Auditing Standards (GAGAS) and the work should not be relied on in  
other engagements or used as examples in other audits.

We concur that a full review of the contractor's MMAS is required; however, we are not  
immediately initiating the review. DCAA is in the process of establishing a team that will focus  
specifically on this assignment (i.e., Branch Manager, Supervisory Auditor, and a cadre of  
auditors). Prior to initiating the audit, the team will review the prior deficiencies and the second

## Defense Contract Audit Agency Comments (cont'd)

**SUBJECT:** Response to Department of Defense Inspector General (DoDIG) Draft Report on a Hotline Allegation Regarding the Follow-up Audit of a Contractor's Material Management and Accounting System (Project Number D2012-DIPOAI-0030.000)

follow-up audit in order to scope the audit appropriately, and align the prior issues with the current business system rule. This preliminary assessment is required in order to gauge the anticipated hours, and appropriately staff the audit team to complete the review in a timely manner. We plan to initiate the review in October 2013.

**DoDIG Recommendation 1.b.:** We recommend that the Director, Defense Contract Audit Agency, direct the Northeastern Regional Director to instruct the Field Audit Office to:

- (1) Rescind the follow-up MMAS report issued on September 10, 2008;
- (2) Cancel the second follow-up MMAS review; and
- (3) Initiate a full audit of the contractor's MMAS in accordance with Defense Contract Audit Agency policy.

**DCAA Response:**

**Recommendation 1.b.: Concur.** We concur with rescinding the September 10, 2008 follow-up report and will initiate a full audit of the contractor MMAS as discussed above. We also concur with not issuing the current MMAS follow-up examination. However, since we have identified deficiencies in the MMAS during this follow-up review, the management team will determine whether we have performed sufficient testing to issue deficiency reports at this time, or whether we should continue this effort in the full MMAS review scheduled to start in October 2013.

**DoDIG Recommendation 1.c.:** We recommend that the Director, Defense Contract Audit Agency, direct the Northeastern Regional Director to provide training to the Field Audit Office staff (including the manager, supervisors, and auditors) covering the requirement for obtaining sufficient evidence in support of reported conclusions.

**DCAA Response:**

**Recommendation 1.c.: Concur in principle.** As part of the DCAA quality initiative, the Regional and FAO staff (i.e., manager, supervisors, and auditors) has received and continue to receive training on various audit quality related topics. Since FY 2009, after the issuance of this report, DCAA has taken, and continues to take, significant steps to improve audit quality, such as providing extensive training and issuing a significant number of audit guidance memorandums. Although it will take time to realize the full effect of the completed and continuing corrective actions, we have already seen tangible results. We have taken the following steps to provide training to the Agency: (i) Training to Support Compliance with GAGAS; (ii) GAGAS Training (on-line Course 1440); (iii) Integrity and Quality Assurance Directorate Webpage; (iv) Supervisory Auditor Assignment Review Process Workshop; and (v) FAO Managers' Conference. In addition, in FY 2012 we issued policy on performing sufficient

## Defense Contract Audit Agency Comments (cont'd)

SUBJECT: Response to Department of Defense Inspector General (DoDIG) Draft Report on a Hotline Allegation Regarding the Follow-up Audit of a Contractor's Material Management and Accounting System (Project Number D2012-DIPOAI-0030.000)

testing. The FAO staff has received training covering the requirement for obtaining sufficient evidence in supporting our audit conclusions.

**DoDIG Recommendation 2:** The Director, Defense Contract Audit Agency, needs to:

- a. Assess the timeliness of business system follow-up audits agency-wide during the last 3 years;
- b. Implement any necessary improvements to help ensure the timeliness of follow-up audits on business systems; and
- c. Provide the results of the assessment and planned improvements to the Assistant Inspector General, Audit Policy and Oversight.

**DCAA Response:**

**Recommendation 2: Concur in principle.** We acknowledge that the Agency could improve on the timeliness of business system follow-up audits Agency-wide. However, the requirements for DCAA services far exceed available staffing and DCAA management must make decisions on which priority assignments take precedence. Because of these decisions, business system follow-up audits have taken longer to complete. As discussed above, we have established guidance for reporting significant deficiencies and material weaknesses when we identify a noncompliance with the DFARS criteria in other examinations. This allows us to report business system deficiencies throughout the course of performing our other higher priority examinations. In addition, the Agency issued MRD 12-PPS-001(R), dated January 25, 2012, for establishing milestones plans for audits of all high-risk proposals, major contractor incurred costs submissions, *business systems audits*, and other audits deemed significant by the FAO manager. Since this time, the Agency has seen improvements in meeting our agreed-to dates. Therefore, we do not believe a detailed assessment of the timeliness of business system follow-up reviews is a good use of our limited resources.

Direct any questions regarding this memorandum to the undersigned at (703) 767-3200 or Mr. Donald J. McKenzie, Assistant Director, Policy and Plans at (703) 767-3280.

  
Patrick J. Fitzgerald  
Director

## Acronyms and Abbreviations

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- DCAA** Defense Contract Audit Agency
- DFARS** Defense Federal Acquisition Regulation Supplement
- FAO** Field Audit Office
- MMAS** Material Management and Accounting System



# **Whistleblower Protection**

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