

Government Contracts Update

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DCAA's Access to and Use of Defense Company Internal Audit Reports

Venable LLP Welcomes John Farenish

John M. Farenish, most recently General Counsel of the Defense Contract Audit Agency, has joined Venable as part of the Washington, DC and Tysons offices.

Mr. Farenish brings over thirty years of regulatory and prosecutorial experience, including General Counsel with DoD's Defense Contract Audit Agency, the Department of the Navy, and the Army's Judge Advocate General Corps where he oversaw a large legal staff charged with investigating and challenging defense contractors for cost overruns and other violations, and handled suspension/debarment matters, as well as ethics probes and litigation.

Mr. Farenish provides the following insight into a recently issued Government Accountability Office report which recommends that DoD take certain actions to improve DCAA's access and use of Defense contractor's internal audit reports.

Defense Contract Audits: Actions to Improve DCAA's Access to and Use of Defense Company Internal Audit Reports

Background of the Report

In a recent report, No. GAO-12-88 issued by the Government Accountability Office ("GAO") in December 2011 ("the Report"), the GAO was asked to assess the role of the defense companies' internal audit departments and their ability to provide the Defense Contract Audit Agency ("DCAA") with information on their internal controls. The DCAA has a critical role in contract oversight to include business systems reviews intended to provide reasonable assurance that defense companies' policies safeguard assets and comply with contract terms and conditions. Defense companies also maintain internal audit departments to monitor policies, procedures and business systems related to their government contracts. The GAO study assessed (1) selected defense companies' adherence to standards for internal audits, (2) the extent to which those companies' internal audit reports address defense contract management internal controls, and (3) DCAA's ability to examine internal audit reports and use information from these audits. GAO's study included seven defense contractors, including the five largest defense contractors and two smaller contractors.

Report Findings

What the GAO study found was that DCAA's access to and use of the internal audit reports and supporting workpapers is limited, in part, because of company interpretations of certain court decisions concerning DCAA's access to documents. The study also found that the selected companies had differing policies regarding DCAA's access to and use of company internal audit reports. The study further found that the DCAA auditors noted their inability to identify internal audit reports relevant to their work and uncertainty as to how useful the reports would be. Ultimately, the GAO found that the DCAA made very few requests for company internal audit reports and did not track those requests that were made. The GAO concluded that by not routinely obtaining access to relevant company internal audit reports, DCAA auditors are hindered in their ability to effectively plan work and meet auditing standards for evaluating internal controls.

GAO Recommendations

As a result of its findings in the Report, the GAO recommended that the Secretary of Defense direct the Director of DCAA to ensure that there is a central point of contact for each company to coordinate issues relating to internal audit reports. Further, the GAO recommended that these coordination responsibilities include (1) obtaining sufficient information from the companies on their internal audit reports so that DCAA auditors can better identify and request relevant audit reports and workpapers,

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and (2) tracking auditors' requests for access to internal audit reports and workpapers and the companies' disposition of those requests.

Potential Impact on Government Contractors

A consequence of this GAO study and attendant recommendations is that government contractors generally will see an increase in the number of requests from the DCAA for access to the company's internal audit reports. Additionally, the company should have its current policies and procedures for granting access to DCAA to internal audit reports reviewed to ascertain whether the current policies adequately protect the company or whether some modification of existing policy is in order. Further, government contractors need to remember that the DCAA can enforce a denial of access to records by resorting to the DCAA Director's subpoena authority. If the company receives a DCAA subpoena they should consider some of the following steps to include: contacting counsel immediately, segregating and protecting all correspondence both to and from the DCAA involving the denial of access to records issue, and in general, be prepared to defend against enforcement of the subpoena. Finally, based on the findings in the GAO Report, Congress may act to broaden the statutory authority of the DCAA to access a company's reports. Government contractors will need to continue to monitor developments in this area to ensure that they have adequate policies and procedures in place to address any future changes in this area.

For more information, please contact any of the attorneys in Venable's **Government Contracts Practice Group**.