

Cooperative Audit Strategy



Guiding Principle - The creation and maintenance of rigorous business, financial, and accounting systems by the Contractor are crucial to ensuring the integrity and reliability of the cost data used by the Department of Energy's CFO, IG, and CO. To ensure the reliability of these systems, the Department requires that Contractors maintain an internal audit activity that is responsible for

- i) performing operational and financial audits (including incurred cost audits) and
- ii) assessing the adequacy of management control systems to support the IG as part of the Cooperative Audit Strategy.

Reference: DEAR 970.5203-1, entitled, Management Controls; DEAR 970.5232-3, entitled, Accounts, Records and Inspection; Chapter 4 of the Accounting Handbook, and Chapter 18 of the Inspector General Audit Manual.

Overview

This chapter provides guidance to contracting officers (CO) in their review of (1) INTERNAL AUDIT IMPLEMENTATION DESIGN, submitted within 30 days of contract award and at each 5th year of contract performance or upon the exercise of an option or any contract extension; (2) the ANNUAL AUDIT PLAN, the plan for audit activities during the next fiscal year; (3) the ANNUAL AUDIT REPORT, a summary of the audit activities undertaken during the previous fiscal year, and the plans for resolution of audit findings; and (4) the annual submission of the STATEMENT OF COSTS INCURRED AND CLAIMED (SCIC). The contractor is required to provide these documents and perform supporting activities pursuant to DEAR 970.5232-3, Accounts, Records, and Inspection and 970.5203-1, Management Controls.

This chapter also explains the responsibilities and interactions of the cognizant CO, the Office of the Inspector General (IG), and the cognizant Chief Financial Officer (CFO) in the operation of the cooperative audit strategy.

Background

The IG, in consultation with the CFO, the Office of Procurement and Assistance Management (OPAM), and the Contractor Internal Audit Council, developed and implemented the Cooperative Audit Strategy in October 1992 to maximize the overall audit coverage at management and operating (M&O) contractors and fulfill its responsibility for auditing the costs incurred by the Department's major facilities contractors. The Cooperative Audit Strategy enhances the Department's efficient use of available audit resources by allowing the Department to rely on the work of Contractor internal audit activities. The IG has implemented the Cooperative Audit Strategy at most major contractor locations.

The success of the Cooperative Audit Strategy depends on the IG and Contractor Internal Auditors working closely with the CFO, OPAM and NNSA's Office of Acquisition and Supply Management (OASM), the Department's Contracting Officers, and related the Department's cognizant program personnel. The IG, Contractor Internal Auditors, and the Department's officials have established a Steering Committee for Quality Auditing to address current issues and implement on-going improvements.

Definitions

ANNUAL AUDIT PLAN is a plan submitted by the **INTERNAL AUDIT ACTIVITY** by June 30 of each year of contract performance. This document identifies the planned internal audit activities for the next fiscal year. In preparing the plan, contractors consider the results of prior year audits as presented in the **ANNUAL AUDIT REPORT**, the status of audit activities for the current year until the issuance of the **ANNUAL AUDIT PLAN**, and other factors such as risk assessments and emerging audit issues.

ANNUAL AUDIT REPORT of Internal Audit Activity is a report submitted by the **INTERNAL AUDIT ACTIVITY** by January 31 of each year of contract performance. This report summarizes audit activities undertaken during the previous fiscal year

INTERNAL AUDIT ACTIVITY means an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps its corporate organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and corporate governing processes. Its duties include (1) conducting independent and objective reviews of the SCIC to assess the allowability of incurred contract costs in accordance with the applicable cost principles of the contract and (2) evaluating the efficiency and effectiveness of the contractor's system of controls and operations using standards promulgated by the Institute of Internal Auditors (IIA).

INTERNAL AUDIT IMPLEMENTATION DESIGN means a plan provided by the Contractor

either upon (1) contract award and (2) at each 5th year of contract performance or upon (3) the exercise of an option or (4) any contract extension to describe or design the overall INTERNAL AUDIT ACTIVITY's goals, reporting structure within the Contractor and parent organization, audit strategies, staffing requirements, use of government and external auditors, and other pertinent information to provide the Department assurance of independence, objectivity, and comprehensive audit coverage during the contract performance.

STATEMENT OF COSTS INCURRED AND CLAIMED (SCIC) means the statement that reconciles contract costs incurred under the contract for the prior 12 month period. Contractors operating under an integrated accounting are required to prepare and submit the SCIC to the CO annually. The Contracting Officer is responsible for coordinating the review of the SCIC with the IG and the CFO. Submission and processing of the SCIC is discussed in Section 2d(2) of Chapter 4 of the DOE Accounting Handbook and attachment 4-1, <http://www.cfo.gov/policy/actindex/index.html-ssi>.

CHIEF AUDIT EXECUTIVE (CAE) means the senior position within the contractor's INTERNAL AUDIT ACTIVITY. The CAE must possess relevant education and experience qualifications. The CAE is responsible for reporting internal audit activities to and follow-up of audit results with the Contractor's senior management and the board of directors, audit committee, or an equivalent corporate independent board. In managing the INTERNAL AUDIT ACTIVITY, the CAE can employ an external service provider, a person or firm, independent of the contractor's organization that has special knowledge, skill, and experience in a particular discipline, necessary to assist the internal audit activities. External service providers may include, among others, actuaries, accountants, appraisers, environmental specialists, fraud investigators, lawyers, engineers, geologists, security specialists, statisticians, information technology specialists, external auditors, and other auditing organizations. In any event, the CAE is responsible for the accuracy and adequacy of the services provided.

Responsibilities

Contracting Officer (CO): The CO, in conjunction with the IG and the CFO, is responsible for reviewing and for approving (1) the INTERNAL AUDIT IMPLEMENTATION DESIGN; (2) the ANNUAL AUDIT PLAN; (3) the ANNUAL AUDIT REPORT; and (4) the STATEMENT OF COSTS INCURRED AND CLAIMED. The CO shall provide comments to the Contractor for suggested or required revision. Most importantly, where the INTERNAL AUDIT IMPLEMENTATION DESIGN or any ANNUAL AUDIT PLAN fails to provide a sufficient basis for reliance on the SCIC as to costs incurred or management controls, the CO shall require the Contractor to correct identified deficiencies. The CO shall use the ANNUAL AUDIT PLAN, the ANNUAL AUDIT REPORT, and the copies of responses to audit reports and any other information in the administration of the contract and provide relevant information, as requested, to the Head of Contracting Activity (HCA) or site manager to aid in the oversight of the instant contract or other contracts. Should any of the parties who are signatories refuse to sign the

SCIC, the CO shall undertake an effort to reconcile all parties. If the refusal to sign indicates a failure of Contractor management systems, the CO shall take corrective actions appropriate to the circumstances that protect the Government's interest.

The Inspector General (IG): The Office of Inspector General develops audit policy for the Department's programs and operations. In that capacity, the IG is the cognizant Auditor for the Department's major facilities contractors. The IG relies upon the contractors' INTERNAL AUDIT ACTIVITIES to support the Cooperative Audit Strategy. The IG provides guidance to cognizant COs, HCAs, Department site or office managers, and cognizant CFOs on the sufficiency of the design and operation of INTERNAL AUDIT ACTIVITIES, particularly as they support the SCIC.

Representatives of the IG periodically evaluate the actions of the contractors' INTERNAL AUDIT ACTIVITIES and audits using the American Institute of Certified Public Accountants' Statement on Auditing Standard No. 65 or its successor. The IG will coordinate these evaluations and audits with the cognizant COs, HCAs, and CFOs in order to avoid duplication of effort and ensure that all issues are addressed.

The Cognizant Chief Financial Officer (CFO): The cognizant CFO offers expert counsel and guidance to cognizant COs, HCAs, and Department site or office managers on the adequacy of the Contractor's financial management system to provide proper accounting in accordance with the Department requirements. In this capacity, the cognizant CFO assists the CO in the review of the (1) INTERNAL AUDIT IMPLEMENTATION DESIGN; (2) the ANNUAL AUDIT REPORT; (3) the ANNUAL AUDIT PLAN; and (4) the STATEMENT OF COSTS INCURRED AND CLAIMED. The CFO approves plans for new financial management systems and/or subsystems and major enhancements and/or upgrades to the currently existing financial systems and/or subsystems and planned implementation of any substantial deviation.

Preparation and Submission of Documents by Internal Audit Activity.

1. INTERNAL AUDIT IMPLEMENTATION DESIGN.

DEAR 970.5232-3 requires, among other things, that the Contractor organize and maintain an internal audit activity. This requirement is manifested by the obligation of the Contractor to submit the INTERNAL AUDIT IMPLEMENTATION DESIGN that is satisfactory to the CO, within 30 days of contract award and at each 5th year of contract performance, or upon the exercise of an option or any contract extension.

The INTERNAL AUDIT IMPLEMENTATION DESIGN should include (1) the INTERNAL AUDIT ACTIVITY's placement within the contractor's organization including reporting requirements; (2) its size and the experience and educational standards of the audit staff; (3) its relationship to the corporate parent(s) of the contractor; (4) the audit standards to

be used; (5) an overall audit strategy for relevant performance period of this contract, considering particularly the method of auditing costs incurred in the performance of the contract; (6) the intended use of external audit resources; (7) the plan for pre-award and post-award audit of subcontracts; and (8) the schedule of peer review of the INTERNAL AUDIT ACTIVITY.

To be acceptable, the Contractor's INTERNAL AUDIT IMPLEMENTATION DESIGN must provide assurance of independence, objectivity, and of systematic organizational resolution of issues that result from internal audits. The INTERNAL AUDIT IMPLEMENTATION DESIGN must also provide assurance of sufficient internal audit personnel and other resources to validate cost allowability and validate those management systems that underlie SCICs. The INTERNAL AUDIT IMPLEMENTATION DESIGN must be comprehensive and have adequate evidence of discipline with professional standards. The INTERNAL AUDIT IMPLEMENTATION DESIGN must discuss such matters as how the Contractor will ensure that incurred contract costs are allowable under the cost principles of the contract, plans for peer review of the Contractor's internal audit activity, the universe of payments by the Contractor, areas of high risk, the use of the Defense Contract Audit Agency (DCAA), and the process for auditing subcontracts.

a. Organizational Independence and Objectivity.

The Contractor's INTERNAL AUDIT ACTIVITY should be structured organizationally to be sufficiently independent so as to remove any impairment to fair and objective reporting.

- ? This includes the ability to make impartial and unbiased judgments concerning the conduct of audits without fear of management reprisal.
- ? The CAE should report functionally to the Board of Directors, audit committee, or equivalent corporate independent governing body(ies).

The INTERNAL AUDIT ACTIVITY's unhindered access to and regular direct communication with the corporate governing authority is critical to its independence. Direct communication entails such things as (1) regular attendance and participation in corporate meetings which relate to the CAE's oversight responsibilities for auditing, financial reporting, corporate governing, and control; and (2) reporting privately (at least annually) to the corporate board or the committee to discuss audit related topics including status of that year's audit plan and management's corrective actions.

This direct communication should ensure that audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan. Such reporting includes review and approval of the annual risk assessment and audit plan, as well as any significant changes thereto; and providing input to (1) the appointment or removal of the CAE; (2) the CAE's performance appraisal; (3) staff size; and (4) budget.

In fulfilling the Contractor's internal audit responsibilities, the CAE is responsible to assure that the INTERNAL AUDIT ACTIVITY performs its work objectively and is not impaired in accomplishment of its charter.

In this context, objectivity means a mental attitude that allows an individual internal auditor to perform each audit assignment free from bias or impairment. Objectivity requires that internal auditors do not subordinate their personal judgment on audit matters to that of others, including the corporate entity of which they are a part.

In this context, impairment means any circumstance that would have a negative effect on a person's or organization's ability to render a fully informed and objective analysis of the audit assignment. The term includes, among other considerations, personal conflicts of interest; inappropriate limitations on the scope of an audit; restrictions on access to records, personnel, and properties; or resource limitations (funding), intentional or unintentional, which has a negative impact on the work product of an internal audit or the internal audit activity.

b. Size, Experience, and Educational Requirements.

The contractor's INTERNAL AUDIT ACTIVITY must be of appropriate size and include trained professional auditors who meet standards established by the Institute of Internal Auditors (IIA). Auditors should receive at least 80 hours of continuing professional training every two years. To enhance the level of professionalism, certifications in internal audit, accounting, and other business-related areas should be encouraged for the internal audit staff and the CAE. Appropriate staff size is dependent on numerous factors, including but not limited to:

- ? The mission of the contractor.
- ? The magnitude of the contract and the size and complexity of the contractor's organization.
- ? The extent to which non-audit work is requested of internal audit staff.

c. Audit Standards.

The INTERNAL AUDIT ACTIVITY performs financial, financial-related, performance, and specific audits requested by the contractor's board or management or by the CO. Those audits must, at a minimum, meet the audit standards prescribed by the IIA.

d. Audit of Allowable Costs.

The contractor's INTERNAL AUDIT ACTIVITY should perform an audit of allowability of costs as claimed on the SCIC at least once a year unless the CO specifically approves

otherwise. The risk assessment to determine the scope of the audit should cover all contractor incurred costs for the year. The audit should be comprehensive and performed in accordance with the audit program approved by the IG. A sample audit program is included in the OIG Audit Manual Chapter 18 along with additional guidance for contractor internal audit departments and can be accessed at <http://www.ig.doe.gov/audits/am18.doc>.

Deviations from the IG audit program must be approved by the CO after consultation with the IG and the CFO. The Contractor's INTERNAL AUDIT ACTIVITY should report any questioned costs, including those identified through other performance or compliance audits, to the CO, and those costs should be excluded from the SCIC and described in the ANNUAL AUDIT REPORT.

The SCIC is the document used to validate the allowability and allocability of the contractor's costs in performance of each contract year. This document is not a voucher. It is a statement of annual costs that the contractor certifies, to the best of its knowledge and belief, are allowable under the terms of the contract. It must be countersigned by the cognizant CFO or other cognizant financial management official, the field Director of Procurement, the cognizant IG, the CO, and the cognizant HCA. Each of these signatures is made in reliance upon a system of audit that begins with the INTERNAL AUDIT ACTIVITY of the Contractor and other appropriate criteria. Should any of the parties who are signatories refuse to sign the SCIC, the CO shall undertake an effort to reconcile all DOE parties. If the refusal to sign indicates a failure of Contractor management systems, the CO shall decide corrective actions appropriate to the circumstances that protect the Government's interest.

Certain major contractors may no longer file the SCIC. Where that is the case, Department field offices receive support from the DCAA for the audit of contract costs.

e. Audit of Subcontracts.

The INTERNAL AUDIT IMPLEMENTATION DESIGN should indicate the process for pre-award and post-award audit of subcontractors. To accomplish the audits, the contractor may (1) use its internal auditors or contract auditors, or (2) request through the CO for DCAA assistance.

f. Peer Review.

The purposes of peer review is to (1) evaluate the INTERNAL AUDIT ACTIVITY's compliance with the *Standards for the Professional Practice of Internal Auditing*, (2) to appraise the quality of the INTERNAL AUDIT ACTIVITY, and (3) make recommendations for improvement. Secondly, peer reviews serve as a factor in the IG's determination as to the degree of reliance on the work done by the INTERNAL AUDIT ACTIVITY.

Peer reviews are conducted every five years by a team that is led by (1) the CAE of a non-affiliated contractor and staffed with internal auditors from other DOE Contractor INTERNAL AUDIT ACTIVITIES or (2) independent external reviewers. A Steering Committee of DOE Contractor Internal Audit Directors oversees the process.

Peer reviews are not intended to duplicate or eliminate the need for DOE evaluations of the contractor INTERNAL AUDIT ACTIVITIES. However, the IG and Department field elements should consider the outcome of a peer review in evaluating the efficiency and effectiveness of a Contractor's INTERNAL AUDIT ACTIVITY.

2. ANNUAL AUDIT PLAN.

DEAR 970.5232-3, as revised and attached, requires that by each June 30 of the contract performance period, the contractor shall submit to the contracting officer an ANNUAL AUDIT PLAN that reflects the activities to be undertaken during the next fiscal year. This plan should generally be consistent with the INTERNAL AUDIT IMPLEMENTATION DESIGN, but must be updated annually to reflect identified high-risk areas such as findings by the General Accounting Office or the DOE IG or other developments that have occurred since the previous plan. The ANNUAL AUDIT PLAN should also consider high risk issues specified in the IG Annual Audit Guidance Memorandum provided by February 1st of each year. The ANNUAL AUDIT PLAN will be evaluated by the cognizant IG office, the cognizant CFO, and the CO to establish that results of prior audits are used to determine the need for additional audits in specific areas, or continue audit activities in areas of ongoing high risk. The CO shall coordinate review of the ANNUAL AUDIT PLAN with the CFO and the IG by July 15th of each year.

The ANNUAL AUDIT PLAN must include programs that sufficiently test the contractor's internal controls over costs to ensure that costs incurred in operation of the Department's facilities are allowable under the terms of the contract and applicable acquisition regulations. The Plan should be coordinated with the IG to avoid duplication of planned DOE IG and other audits of the Contractor's financial and management functions by Government activities. Furthermore, annual audits of incurred costs and other audits conducted during the year must establish the sufficiency of the contractor's SCIC, representing the allowability of costs incurred under the contract. The audit program must describe the statistical sampling methodology that will be employed to evaluate incurred costs for allowability.

3. ANNUAL AUDIT REPORT.

The contractor's INTERNAL AUDIT ACTIVITY is required to submit an ANNUAL AUDIT REPORT by January 31st which describes and summarizes the results of the activities undertaken pursuant to the previous fiscal year's ANNUAL AUDIT PLAN. The ANNUAL PLAN should include the Contractor's plans for addressing the findings disclosed during the

fiscal year and summaries of specific contractor practices, which resulted in unallowable costs. It should describe the allowability of costs audit methodology. The ANNUAL PLAN is distributed to the CO and the HCA with a copy to the cognizant IG office. The ANNUAL AUDIT REPORT should include the dollar value of the cost element or audit population, the dollar value of the sample, and the dollar value of the projected questioned costs.

