

The New Era of Transparent Internal Audit: What You Should Know

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In general

Respond to **all** polling questions

The rule

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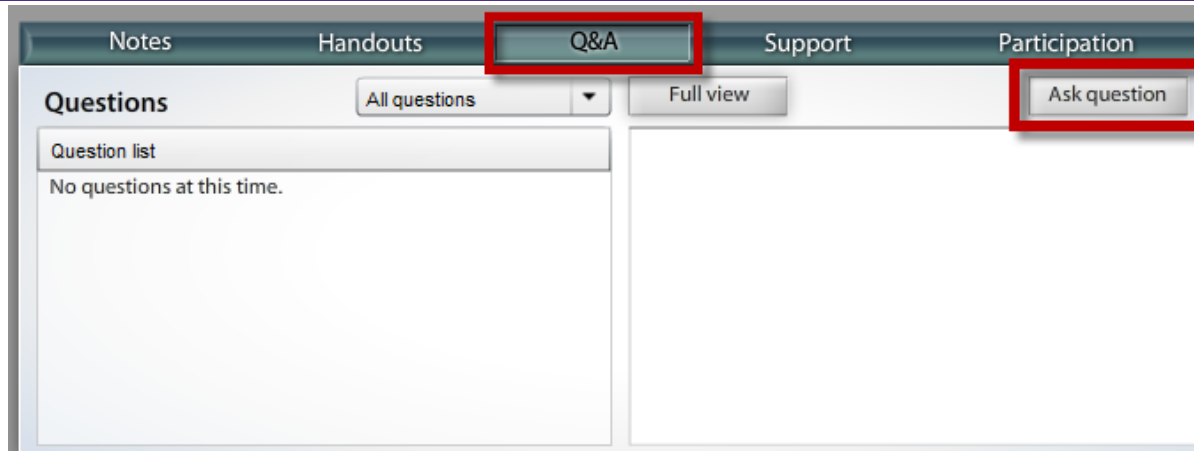
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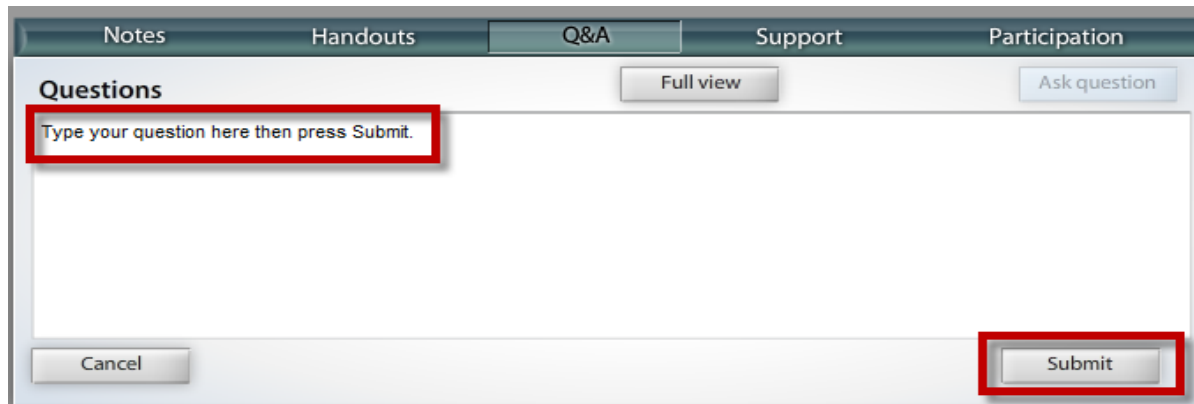
Addressing your questions through Q&A

Step 1



The screenshot shows a web interface with a top navigation bar containing 'Notes', 'Handouts', 'Q&A', 'Support', and 'Participation'. The 'Q&A' tab is selected and highlighted with a red box. Below the navigation bar, there is a 'Questions' section with a dropdown menu set to 'All questions' and a 'Full view' button. To the right of the 'Questions' section, there is a button labeled 'Ask question', which is also highlighted with a red box. The main content area on the left shows a 'Question list' with the text 'No questions at this time.'

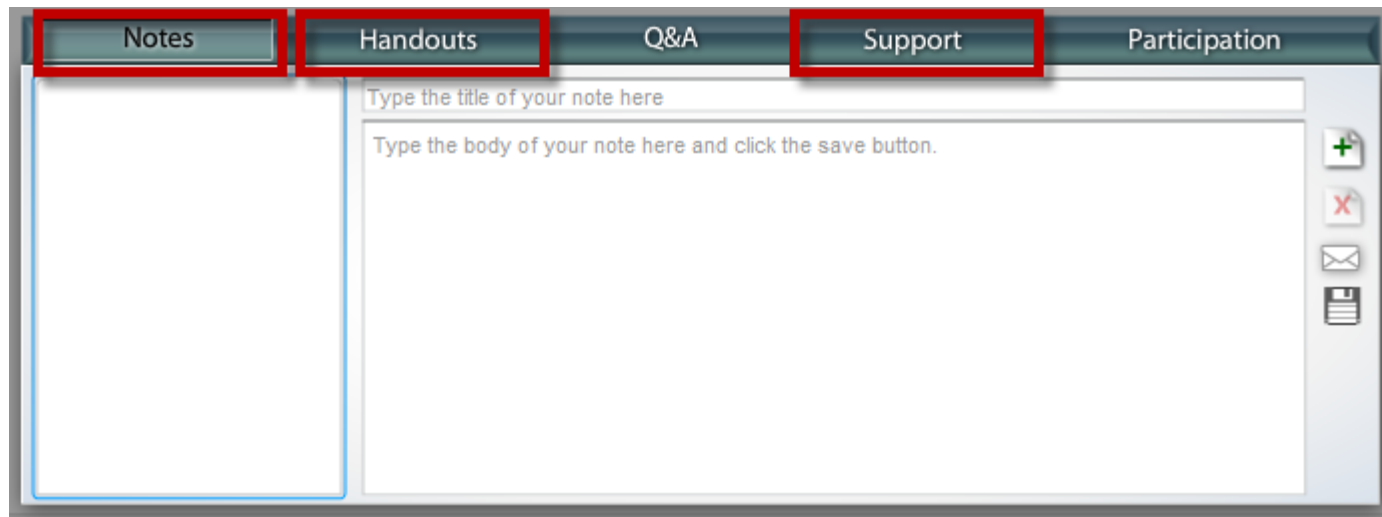
Step 2



The screenshot shows the same web interface as Step 1, but now the 'Ask question' button is disabled. The main content area is a large text input field with the placeholder text 'Type your question here then press Submit.' This text is highlighted with a red box. At the bottom of the input field, there are two buttons: 'Cancel' on the left and 'Submit' on the right. The 'Submit' button is highlighted with a red box.

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Today's presenters



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Learning Objectives



- Discuss statutes and case law governing the Government's rights to access a company's internal audit
- Explore considerations in developing corporate policies for granting access to internal audit
- Identify the risks internal audit departments should consider
- Cite considerations in audit documentation approaches

Overview (Legal Issues)

- GAO report on improving access to defense company internal audit reports
- Background on the government's audit rights and access to internal audits
- Subsequent developments impacting company decisions related to providing the government access to internal audits
- Potential concerns of disclosing internal audits

Overview (Audit Issues)

- Lessons learned from GAO report
- Audit support and maintenance of documentation
- Enforcement and compliance environment
- Risk management

Polling question #1: Does your company (or client(s)) have a resident DCAA auditor at one or more of its facilities?

A. Yes

B. No

C. Uncertain

GAO Report

- Report issued December 8, 2011
- GAO assessed:
 - (1) Adherence to internal auditing standards
 - (2) Extent to which internal audits address internal controls
 - (3) DCAA's ability to examine and use those reports in carrying out its oversight responsibilities

GAO Reviewed Adherence to Selected Standards

- Organizational characteristics
 - Independence and objectivity
 - Risk-based audit plan
 - Proficiency
 - Continuing professional education
 - External quality assurance review

GAO Reviewed Adherence to Selected Standards

- Standards for individual audits
 - Planning the engagement
 - Conducting fieldwork including testing
 - Reporting findings
 - Tracking corrective actions

GAO Findings on Company Internal Audit Functions

- Internal audit departments generally adhered to IIA standards
 - Organizational characteristics
 - 2 of 7 have no external assessments / quality review
 - Standards for individual audits
 - 5 of 7 met the standards
 - 2 did not provide information

Polling question #2: How many internal audit staff are employed by your company?

- A. Less than 10
- B. 10 to 24
- C. 25 – 74
- D. 75 or more
- E. Uncertain

GAO Findings on Company Internal Audit Functions (continued)

- Internal audit reports contain information relevant to DCAA audits
 - Business systems, specific DoD programs, compliance
- Access to and use of company internal audits are limited
 - reports
 - workpapers
 - Requests / responses not tracked

GAO Conclusions

- “DCAA is not making full use of internal audits to help accomplish its critical oversight role.”
- “DCAA auditors do not routinely request access to the reports due to limited visibility into the scope and objectives of internal audits.”
- “We believe that by not routinely obtaining access to relevant company internal audits that can inform their audits of the companies’ control environments, as well as audits of specific business systems and contracts, DCAA auditors are hindered in their ability to meet the GAGAS requirements for assessing internal controls.”

GAO Recommendations

- Ensure that DCAA's central point of contact for each company coordinates issues pertaining to internal audits
- Periodically assess information regarding their disposition
- Reaffirm with DCAA staff through guidance and training how and under what circumstances company internal audits can be accessed and used

DoD's Response

- DoD partially concurred with the first recommendation and concurred with the remaining two recommendations.
- DoD will issue guidance and training by June 30, 2012.

Polling question #3: Which of the following was not a GAO recommendation?

- A. DCAA central point of contact coordination
- B. Periodically assess information compiled by central points of contact
- C. Expand scope of DCAA reviews at large government contractors
- D. Reaffirm with DCAA staff circumstances for internal audit access and use

Government's Audit Rights

10 U.S.C. §2313. Examination of records of contractor

- (a) Agency Authority.—(1) The head of an agency, acting through an authorized representative, is authorized to inspect the plant and audit the records of—
 - (A) a contractor performing a cost-reimbursement, incentive, time-and-materials, labor-hour, or price-redeterminable contract, or any combination of such contracts, made by that agency under this chapter; and
 - (B) a subcontractor performing any cost-reimbursement, incentive, time-and-materials, labor-hour, or price-redeterminable subcontract or any combination of such subcontracts under a contract referred to in subparagraph (A).

FAR Audit Provision

- FAR 52.215-2 “Audit and Records-Negotiation”
 - “The Contracting Officer, or an authorized representative of the Contracting Officer, shall have the right to examine and audit all records and other evidence sufficient to reflect properly all costs claimed to have been incurred or anticipated to be incurred directly or indirectly in performance of this contract.”

“Newport News I”

- *United States v. Newport News Shipbuilding and Dry Dock Co.*, 837 F.2d 162 (4th Cir. 1988)
 - Held that DCAA’s subpoena authority does not extend to contractors’ internal audits.
 1. The internal audits are not related to any particular government contract.
 2. The reports were not compilations of contract cost charges and supporting documentation, but rather subjective evaluations of the company’s operations and suggestions for changes.

“Newport News I” (Cont.)

- Interpreted the government’s statutory audit rights to be “construed principally to provide access to cost information related to particular contracts.”
- “Cost verification data, not the work product of internal auditors, is the proper subject of a DCAA subpoena. DCAA performs a critical auditing mission, but it is not running the company.”

DCAA vs. Inspector General

- *United States v. Westinghouse Elec. Corp.*, 788 F.2d 164 (3d Cir. 1986).
 - Held that the Inspector General has authority to subpoena a contractor's internal audits as part of an investigation.
 - The *Newport News I* court distinguished between the two because the IG Act vests the IG with authority to “investigate fraud waste and abuse.”
 - Both agencies serve important but different functions.

“Newport News II”

- *United States v. Newport News Shipbuilding and Dry Dock Co.*, 862 F.2d 464 (4th Cir. 1988)
 - Enforces subpoena seeking contractor’s tax returns and supporting schedules
 - Rejected the argument that access is limited to only materials used to determine or allocate costs to a specific contract
 - Held that the government’s audit rights include access to “objective factual materials useful in verifying the actual costs”

Polling Question #4: Has your company (or client(s)) established policies for disclosing internal audits to DCAA or other government auditors?

A. Yes

B. No

Considerations in Developing Policies for Granting Access to Internal Audits

- Legal standards
 - No recent cases on the subject
 - Limited to Fourth Circuit
- Industry practice
 - Six companies have policies that provide for DCAA access to at least some internal audits.
 - Four of the six companies have policies granting access to supporting workpapers.
 - One company adopted a policy of not providing DCAA with access to its internal audit reports.

Other Considerations

- Attorney-Client Privilege
- Business Systems Rule
- Ethics/Compliance/Mandatory Disclosure Requirements
- Fraud allegations

Initial Steps

- Review the types of contracts the company is performing
- Review the types of internal audits that the company performs
- Review the company's procedures for handling matters discovered in the course of an internal audit

Polling Question #5: Which of the following is not a suggested step to take in response to the GAO report?

- A. Review the types of contracts the company is performing
- B. Review the types of internal audits that the company performs
- C. Review documentation to ensure every preliminary observation is retained
- D. Review procedures for handling matters discovered in the course of an internal audit

Other Related Guidance

- COSO – Enterprise Risk Management
 - Inherent Risk – control and control system
 - Residual Risk – Other
- FAR Acquisition Regulation
 - Contractor Code of Business Ethics
 - Internal Controls System
 - Communication of Fraud Hotline

Risk Assessment

- Risk assessment emphasized in report
 - evidence for planning steps
 - assessments specific to audit's scope
 - chart cited as supporting rationale for inclusion in audit scope
- Ensure you invest sufficient time in your risk assessment
- Document effectively

Audit Documentation

- Questions to ask – beyond the basics
 - Does it leave questions unanswered?
 - Could it cause confusion?
 - Are paper and electronic sources both documented adequately?
- User-developed applications

Enforcement and Compliance Environment

- Dodd Frank
 - Whistleblower provisions
- Continued FCPA enforcement
- Prosecution of individuals

Polling Question #6: The GAO report did NOT reference the following regarding assessing the risk of fraud.

- A. Noting evidence in planning steps
- B. Fraud risk assessments specific to audit scope
- C. Consulting with private investigators when planning the audit
- D. Risk assessment chart with supporting rationale for inclusion in audit scope

Summary

- DCAA may pursue internal audit reports more frequently
- Establish or review company policy regarding access to internal audit reports
- Ensure information in internal audit reports is well documented

Q&A

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