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GUIDELINES
FOR
CONDUCTING EXAMINATIONS
AT
CONTRACTOR PLANTS



UNITED STATES
GENERAL ACCOUNTING OFFICE
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GUIDELINES

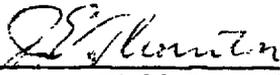
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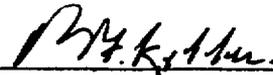
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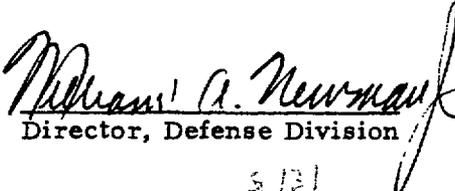
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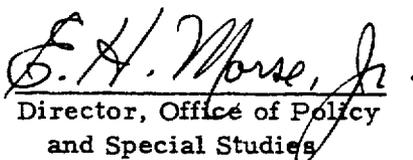
CONTRACTOR PLANTS

The following guidelines have been prepared for the use of General Accounting Office personnel with the objectives of providing more uniform and systematic procedures for audit work at the plants of Government contractors to minimize the problems of access to contractors' records and to provide procedures for the resolution of those problems. These guidelines, prepared by the Field Operations Division and the Defense Division and reviewed by the Office of General Counsel and the Office of Policy and Special Studies, relate primarily to Defense contract audit work but are being issued as a supplement to the Comprehensive Audit Manual, Part V, Procurement, as guidance for general use in the conduct of contract audit work.


Director, Field Operations
Division 6160


General Counsel 570


Director, Defense Division 5131


Director, Office of Policy
and Special Studies 64

U.S. GENERAL ACCOUNTING OFFICE

GUIDELINES FOR CONDUCTING EXAMINATIONS
AT CONTRACTOR PLANTS

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GUIDELINES FOR
CONDUCTING EXAMINATIONS
AT CONTRACTOR PLANTS

INTRODUCTION

What is your authority?--Why did you select this company for review?--Why are you requesting these data when we have already furnished such data to the Government? --Defense contract auditors were here last month on the same question; why are you duplicating their work? These and similar questions are frequently asked by Government contractors. Can you answer these questions to the contractor's satisfaction? If you cannot, you are off to a bad start and your experience with the contractor may be destined for unnecessary quibbling, delaying tactics, and access-to-records problems. Perhaps this condition might have been avoided had you done your "homework."

The term "homework" means adequate preparation prior to the initiation of work at contractor locations. It is the type of work contemplated by the Comprehensive Audit Manual, particularly in those chapters dealing with preliminary survey and preliminary review work. It should be noted that these chapters frequently refer to the agency and its activities and make no specific mention of Government contractors. This is proper, since the primary objective of the examinations performed by the General Accounting Office is to make for the Congress independent examinations of the manner in which Federal agencies are discharging in their financial responsibilities.

These guidelines are designated to reemphasize basic Office policies, with particular attention on planning and doing work at contractors' locations in a way that will avoid unnecessary conflicts with contractors in gaining access to records and, assuming that problems will arise, on practical means for handling such situations. In addition, the guidelines are consistent with the basic audit objectives and policies set forth in the Comprehensive Audit Manual, other internal memorandums of the Office, and statements in the

booklet, "Audits of Government Contracts," a publication prepared primarily for the information of Government contractors.

OVERALL OBJECTIVE

The overall objective of the Office is to review the manner in which the activities of Federal agencies are administered and to recommend, where appropriate, corrective or improvement actions deemed necessary or desirable to promote greater efficiency or economy in Federal expenditures. This has been and continues to be the Office's objective in performing reviews, including those performed at contractor locations.

In view of the foregoing objective, the approach to contract work will normally be through the agency. A review of the agency's actions and procedures relating to the particular contracts or activities to be reviewed, prior to our performing work at contractor locations, will provide us with basic knowledge which will enable us to deal more effectively with the contractor and to better demonstrate the Government's legitimate interest in the contractor's actions and records.

We will also be in a better position to conduct our work at contractor locations in a more systematic and orderly manner if there is a proper understanding of the circumstances and conditions surrounding the contractual relationship between the Government and the contractor and of the related administrative actions and procedures of the agency.

In line with this overall objective, there is a wide variety of reasons why work may be undertaken at a contractor's plant. For example, work may be undertaken

- pursuant to requests for information from Congressional committees or from members of the Congress,
- to follow up on information coming to our attention from previous or current work on other matters,
- because a contractor is participating in a new program of unusual importance,

--as a result of a contractor's particular role, such as that of a weapon system contractor,

--as part of a broad review of some aspect of contracting or procurement policy or practice,

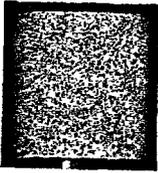
--because, in the case of subcontractors, it is considered necessary to test the effectiveness of the prime contractor's management of procurement for the account of the Government, and,

--because the contractor is known to be engaged in Government work under a negotiated contract and we have not recently made an examination at that location.

During the past several years, because of the reporting of individual cases of waste, inefficiency, or overpricing, there has been a tendency on the part of some GAO auditors (and contractors) to regard audits at contractor locations as ends in themselves rather than as the means by which the Office may evaluate the activities of Federal agencies and promote needed improvements in the management of these activities.

While reports on individual cases of management deficiencies have contributed to significant improvements in Federal contracting activities and to substantial savings in public funds, the current view of the Office is that the efforts of GAO can be made still more productive if extensive inquiry is made to determine and analyze the basic causes of unsatisfactory conditions and develop recommendations for improvement. In line with this broadened scope, current and future reviews of contracts and contractor operations will devote increased attention to broad subject areas, although individual cases of unusual significance or substantial monetary amounts will continue to be an important part of GAO's audit effort and reporting to the Congress.

However, we do not have to make an exhaustive analysis in all cases to prove our point. In some instances, we can save time and effort by advising the agency of the nature of the problem and request it to determine the underlying cause and to develop the necessary cure.



Generally, individual cases of waste, inefficiency, or overpricing are now being used in reports to illustrate the need for management improvements, rather than each deficiency being treated as a separate self-contained report. We will, however, continue to report on individual cases where special action is warranted, directing attention particularly to possible improvements in the management of contracted activities. Concerning such cases, when an important principle or a substantial monetary amount is involved, reports will be made to the Congress. Reports on individual cases involving less significant matters will be made either to the Secretary of Defense or to lower echelons.

This broadened approach not only will make GAO reviews more productive but will also serve to place the work performed at contractor locations in the proper perspective for those auditors who may have chosen to regard such reviews as the objective rather than as the means to improve Federal management.

PREPARATION FOR THE REVIEW

Since Federal agencies are the focal points of the reviews conducted by the Office, it follows that adequate preparatory work should be performed at the agencies prior to the selection of activities for examination. Failure to perform such work could create access-to-records problems, could result in unnecessary duplication of effort, and does not afford the attention to and the consideration of the agencies' administrative actions and controls, including internal and contract audit work relative to activities to be examined at the contractor location.

Section 117(a) of the Budget and Accounting Procedures Act of 1950 requires that, in the determination of his examinations, the Comptroller General give due regard to generally accepted principles of auditing, including consideration of the effectiveness of accounting organizations and systems, internal audit and control, and related administrative practices of the Federal agencies. Consideration of the work performed by the agencies prior to initiation of work at contractor locations is an important part of GAO's compliance with the requirements of the act.

Unfortunately, in the past, in order to expedite the work or for other reasons, there have been instances where work has been initiated at contractors' plants prior to performing or completing preparatory work at the Federal agency(s). In such instances, the lack of basic information about the Government's financial interest and entitlement to information concerning the contractor's operations has placed the auditor at a disadvantage in dealing with questions raised by the contractor and has reflected adversely on both the auditor and the Office.

For example, at the initiation of one of our assignments, no arrangements had been made for any preparatory work to be performed or for information to be obtained concerning the contractor. The firm had been selected for examination on the basis of knowledge that it manufactured equipment in the electronic field. At the entrance conference, the contractor's representative was requested to provide, at his earliest possible convenience, a complete listing of all Government contracts awarded to the firm, showing for each the contract number, procuring activity, date awarded, items procured, pricing provision, and the current contract price.

The contractor's representative stated that he would be glad to comply but that he would like to know the specific authority for such a request. He was not satisfied, however, by a statement that each negotiated contract is required by law to contain a provision providing for access by the Comptroller General, or his representatives, to all pertinent books, documents, and records relating to the contract, and he asked, "What contract do I have that contains this clause?" Lacking basic information concerning the Government's financial interest and legitimate entitlement to information concerning the contractor's activities, the auditor was not in a position to deal effectively with this question. Consequently, the professional image of the auditor concerned as well as that of the Office was impaired.

Most contractors, as a matter of courtesy, will comply with such requests. However, such requests should not be necessary under our approach to contract audit work through the responsible contracting agency, at which the contracts

and applicable records clauses can be determined. In this instance, the auditor had to go to appropriate Government agencies to obtain the necessary information concerning the authority for his request.

There are a number of sources where information concerning the award of contracts or agency contract administration and controls may be obtained. These include such agencies and offices as the Defense Contract Administration Services Offices, the Defense Contract Audit Agency, plant representatives of the cognizant agency, and procuring activities. Other sources which may be useful are the Renegotiation Board, the permanent files from prior reviews, and existing publications on Government contract awards.

Survey and review work, therefore, should, as set forth in the Comprehensive Audit Manual, be performed prior to the initiation of work at the contractor's plant. An integral part of this work should include the development of a program for the performance of the assignment, a portion of which may apply to work required at selected contractor locations. Information obtained at Government agencies should be used to the extent possible in the development of this program, which should include

- the purpose,
- the scope,
- background information, and
- the guidelines required to perform the review.

The amount and type of data to be obtained from the agency for the development of a program, in most instances, will depend on the management area selected for review. The area selected may involve an overall procurement program, or a major segment of a procurement program, and include such aspects as contract negotiation, award, administration, pricing, and/or performance. In other instances, a specific function or a new important procedure may be reviewed on a service- or Defense-wide basis, such as a review of value engineering or the control and use of Government-owned facilities.

In any event, once a specific area has been chosen, appropriate information should be accumulated to formulate criteria for selecting contracts for review. In the area of contracting, GAO examinations must be selective. Not all contracts can be examined. In formulating the criteria it may be necessary to consider such matters as the size and type of contract, basis for award, nature of cost or pricing data furnished, if any, and a wide variety of other factors affecting the Government's interest. The consistent application of the criteria in selecting a contract or contractor for review of a specific area may simplify the explanation to contractors and others as to why we are doing work at a given plant.

Once specific contracts and/or contractors are selected, additional information may be required, depending on the objective of the review. For example, if the review concerns utilization of Government-owned facilities, an examination of surveillance reports prepared by the agency's facilities inspection staff on the condition and care of facilities at the selected contractor's plant would be appropriate. In the case of a pricing review, examining such reports probably would be unnecessary but other types of data, such as price proposals, minutes of negotiation, etc., would be required.

Regardless of the objective of a review at a contractor's plant, certain basic knowledge should be obtained concerning the contractor's operations to enable us to discuss with the contractor the overall objective of the review in relation to the contractor's operations. Generally the following data will be obtained to gain basic knowledge.

- copy of selected contracts or appropriate excerpts therefrom,
- background data on the product or service being procured under the selected contract,
- background information on the contractor, such as his principal products, annual sales volume, location of plants and offices, extent of Government business, etc., and

PERFORMANCE OF WORK
AT CONTRACTOR'S PLANT

All GAO staff members assigned to a review at a contractor's plant are expected to have a working knowledge of Office policies and statutory authority. In addition, it is important that each staff member be thoroughly familiar with the scope and objectives of the audit program as well as with the ground rules and other procedures established with the contractor during the entrance conference.

Normally, adequate preparatory work, including the development of firm selection criteria and program, together with the establishment with the contractor of acceptable working conditions will enable the staff to perform the work in an expeditious manner. Occasions may arise, however, when there will exist a difference of opinion between staff members and contractor personnel as to our authority to have access to certain records. In other cases, staff members may be confronted with a departure by the contractor from the ground rules established or restrictions or delaying tactics may be imposed, which would impede the progress of our work. Every effort should be made to resolve such problems in a timely manner, under a satisfactory working relationship with the contractor, to avoid undue delay in the completion of review.

With respect to those cases where access is denied, the majority of the problems normally can be related to a difference of opinion between GAO and the contractor over the interpretation of the access-to-records clause. Generally, the problems are centered about the question of determining exactly what GAO has a right to examine. The laws require, in general terms, that all contracts negotiated without advertising shall contain a clause which provides that GAO has access to and the right to examine information which (1) meets the criteria of books, documents, papers, and records, (2) is directly pertinent, and (3) involves transactions relating to the contract. The Office has given the statutory authority a broad interpretation but some contractors have given it the opposite interpretation.

One contractor stated that, until GAO's interpretation of the statute and the clause was upheld in judicial decisions, the meaning [of directly pertinent] was a matter of speculation, and until that time, GAO's interpretation was not legally binding. In the absence of judicial decisions GAO work is governed by administrative interpretations of the statutory authority; however, it is recognized that such interpretations are not legally binding on contractors.

There has been only one judicial decision concerning the statutory authority which, although it is being appealed, will assist in interpreting the statute and the examination-of-records clause. The decision in the Hewlett-Packard case does not answer all the questions of interpretation of the examination-of-records clause. It does decide that GAO has access to cost records, even though costs were not a factor at the time of negotiation. The court's decision, however, does not decide which records of a contractor are "directly pertinent," beyond records of direct material costs, direct labor costs, and overhead costs.

It should be noted that, in certain instances, formally advertised fixed-price contracts are required to contain a clause providing GAO with the right to examine the underlying data supporting negotiated contract changes exceeding \$100,000. The purpose of this provision is to provide a means by which the cost or pricing data submitted in conjunction with the contract changes can be verified as to accuracy, completeness, and currency.

The position of the General Accounting Office concerning access to contractors' records is set forth on pages 7, 13, and 14 of the booklet, "Audits of Government Contracts." The statements contained in the booklet concerning that position should be of assistance in effectively presenting and supporting, on the basis of law or reasonableness, our requests for records and information necessary to perform the reviews provided for, and expected of us by, the Congress. (See appendix for excerpts from pertinent laws.)

Careful preparation and planning should enable the staff to convey to contractors that the work at their plants is directly related to the Office's overall responsibilities for auditing Government procurement activities and certain Government contracts and thus avoid giving them the impression that the assignment is a "fishing expedition."

Also, the attitude of the staff in meeting and dealing with contractor personnel is very important in the avoidance of access to records problems. A "demanding" attitude may generate problems whereas a "reasonable" attitude may result in contractor personnel exhibiting a willingness to cooperate. Therefore, staff members should be aware of the fact that their attitude can have a direct bearing on the amount of cooperation extended by a contractor and, consequently, the timely completion of the assignment.

If difficulties do arise, staff members should not engage in debates or arguments with contractor personnel. Rather, in these situations, a senior staff member, and designated liaison personnel, through discussions, should reach a common understanding of the issue (this may show that there really is no problem). If the issue cannot be quickly resolved at the established working level, it should be brought to the attention of the audit manager for his resolution. Staff members should carefully document the files when records or other data are denied or unreasonable delays or other restrictions are imposed.

After the audit manager has discussed the circumstances with the staff members involved and determined that the problem will hamper performance of work at the contractor's plant, he should attempt to resolve the problem through personal contact, preferably with the highest contractor official who attended the entrance conference. If the audit manager is unable to resolve the problem, he should immediately advise the regional manager. The regional manager may wish to pursue the matter further through personal contact with contractor officials. Once he has determined that the problem cannot be resolved on a personal basis, however, he should advise the appropriate Assistant or Associate Director of the facts of the situation, along with submitting his recommendation as to how the matter should be pursued.

Prior to submission of any formal written request to the contractor, that is, a letter prepared for the signature of either the regional manager or an official within the operating division, the situation should be discussed between, and an official course of action agreed upon by, representatives of the regional office, operating division, General Counsel, and Office of Policy and Special Studies. If the refusal relates to an assignment undertaken at the request of a congressional committee or member of Congress, the special instructions relative to such refusals are applicable. (See Comprehensive Audit Manual, Part I, Chapter 14.)

If it is the consensus of opinion that the matter not be pursued, the work should be discontinued and an exit conference held with the contractor. Under such circumstances, a forthright statement of the reason for leaving may encourage a relationship of mutual respect and understanding between the contractor and GAO. However, if it is determined that the best course of action under the circumstances should be to continue the examination, the first formal written request to the contractor should then be prepared for signature by the regional manager or an official of the operating division. The letter should

- be addressed to an official, normally higher than the one previously contacted,
- explain the purpose of the examination, the nature of the information requested, and why it is needed,
- make reference to the various statutory authorities and specific contracts and contract provisions on access to records,
- be firm but contain no threats, either expressed or implied, and
- request the official to reconsider the position previously taken and to advise us by letter of his decision.

If this initial written request is denied, arrangements should be made for a meeting between a corporate official,

preferably higher than the one to whom the formal request was addressed, and representatives of the regional office, operating group, and General Counsel's office. If such meeting is of no avail, a letter should be prepared for signature of the Comptroller General. The letter should be accompanied by a complete summary of the facts of the situation, including the various attempts to resolve the problem, and should be reviewed prior to its release by the regional office, operating division, General Counsel, and Office of Policy and Special Studies.

If the Comptroller General's letter does not result in obtaining the requested data, the action to be taken should be determined, on an individual case basis, at the top levels of the Office. In the event that the matter cannot be resolved, reporting to the Congress on the individual case may be in order.

COMPLETION OF WORK AT CONTRACTOR'S PLANT

When work at the contractor's plant is complete or work cannot continue for any reason, exit conferences should be arranged with appropriate contractor and agency officials. As a general rule the conferences should include the same officials who were present at the entrance conferences.

The primary purpose of the exit conference is to present the results of our efforts at the contractor's plant. It is normally appropriate at such meetings to restate the purpose and scope of the audit and relate any significant facts or findings developed that the Office may report to the agency or the Congress. In this connection, all matters of significance should have been brought to the attention of appropriate officials sufficiently in advance of the exit conference so as to enable a meaningful meeting.

Exit conferences are an important part of any review since they afford the contractor the opportunity to present his views concerning our findings and any additional information that he believes should be considered. In some situations, it may be necessary to perform additional work to clarify any question raised. Staff members are encouraged to freely discuss the information developed in a case, its

apparent significance, and our concern relative to any problem aspects which appear to be in need of attention. It should be made clear, however, that the purpose of the conference is to obtain a clear and complete understanding of the situation for use in our evaluation and determination of an Office position on the matter.

APPENDIX

Excerpts From Laws Assigning Audit Authority and Responsibility to the General Accounting Office

Budget and Accounting Act, 1921 (31 U.S.C. 53)

“(a) The Comptroller General shall investigate, at the seat of government or elsewhere, all matters relating to the receipt, disbursement, and application of public funds, and shall make to the President when requested by him, and to Congress at the beginning of each regular session, a report in writing of the work of the General Accounting Office, containing recommendations concerning the legislation he may deem necessary to facilitate the prompt and accurate rendition and settlement of accounts and concerning such other matters relating to the receipt, disbursement, and application of public funds as he may think advisable. In such regular report, or in special reports at any time when Congress is in session, he shall make recommendations looking to greater economy or efficiency in public expenditures.

“(b) He shall make such investigations and reports as shall be ordered by either House of Congress or by any committee of either House having jurisdiction over revenue, appropriations, or expenditures. The Comptroller General shall also, at the request of any such committee, direct assistants from his office to furnish the committee such aid and information as it may request.

“(c) The Comptroller General shall specially report to Congress every expenditure or contract made by any department or establishment in any year in violation of law.

“(d) He shall submit to Congress reports upon the adequacy and effectiveness of the administrative examination of accounts and claims in the respective departments and establishments and

upon the adequacy and effectiveness of departmental inspection of the offices and accounts of fiscal officers.”

Budget and Accounting Procedures Act of 1950 (31 U.S.C. 67)

“Except as otherwise specifically provided by law, the financial transactions of each executive, legislative, and judicial agency, including but not limited to the accounts of accountable officers, shall be audited by the General Accounting Office in accordance with such principles and procedures and under such rules and regulations as may be prescribed by the Comptroller General of the United States. In the determination of auditing procedures to be followed and the extent of examination of vouchers and other documents, the Comptroller General shall give due regard to generally accepted principles of auditing, including consideration of the effectiveness of accounting organizations and systems, internal audit and control, and related administrative practices of the respective agencies.”

Armed Services Procurement Act (10 U.S.C. 2313(b))

“Each contract negotiated under this chapter shall provide that the Comptroller General and his representatives are entitled, until the expiration of three years after final payment, to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or subcontract.”

Federal Property and Administrative Services Act (41 U.S.C. 254(c))

“All contracts negotiated without advertising pursuant to authority contained in this chapter, chapter 11C of Title 5, chapter 10 of Title 40, and chapter 11 of Title 44 shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall until the expiration of three years after final payment have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors

engaged in the performance of and involving transactions related to such contracts or subcontracts.”

Atomic Energy Act (42 U.S.C. 2206)

“No moneys appropriated for the purposes of this chapter shall be available for payments under any contract with the Commission, negotiated without advertising, except contracts with any foreign government or any agency thereof and contracts with foreign producers, unless such contract includes a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment, have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of, and involving transactions related to such contracts or subcontracts: Provided, however, That no moneys so appropriated shall be available for payment under such contract which includes any provision precluding an audit by the General Accounting Office of any transaction under such contract: And provided further, That nothing in this section shall preclude the earlier disposal of contractor and subcontractor records in accordance with records disposal schedules agreed upon between the Commission and the General Accounting Office.”

Anti-Kickback Act (41 U.S.C. 53)

“For the purpose of ascertaining whether such fees, commissions, compensation, gifts, or gratuities have been paid or granted by a subcontractor, the General Accounting Office shall have the power to inspect the plants and to audit the books and records of any prime contractor or subcontractor engaged in the performance of a negotiated contract.”