

# THE GOVERNMENT CONTRACTOR<sup>®</sup>



Information and Analysis on Legal Aspects of Procurement

Vol. 48, No. 6

February 15, 2006

## ***Focus***

¶ 52

### **FEATURE COMMENT: In Search Of A Better Audit—A Proposal For Instilling Greater Consistency And Transparency In The GSA IG Audit Process**

Recently, Multiple Award Schedule (MAS) contractors have noticed a renewed interest by the Government—particularly the Government Accountability Office, the General Services Administration Office of Inspector General and Congress—in expanding the number and scope of IG audits conducted in connection with the MAS program. As GSA IG audits continue to become more prevalent—and, with mounting pressure to expand the IG's audit authority to permit post-award, "defective pricing-type" audits, more invasive—it will become increasingly important for the GSA IG to conduct such audits reasonably, rationally and consistently.

This FEATURE COMMENT analyzes current inconsistencies in the IG's approach to MAS contract audits, and offers four simple strategies for increasing the efficiency and effectiveness of such audits. Each strategy focuses on maximizing communication among the auditor, the contractor and the Contracting Officer, as well as increasing the consistency and transparency of the audit process generally. Although the benefits of these strategies are widely recognized throughout the audit community, including by the Defense Contract Audit Agency, they sometimes are overlooked by individual IG auditors.

On March 11, 2005, GSA issued an Advanced Notice of Proposed Rulemaking (ANPR) requesting comments on whether it should include post-award audit provisions in MAS contracts and Government-Wide Acquisition Contracts (GWACs). 70 Fed. Reg. 12167

(March 11, 2005). Although the ANPR did not propose any specific changes to GSA's existing post-award audit clause, it was clear from the context that GSA was considering resurrecting its contractual authority to conduct "defective pricing-type" audits. The purpose of this particular type of post-award audit would be to determine whether the pre-award pricing, sales or other data a contractor submitted in connection with the negotiation of its MAS contract were current, accurate and complete.

GSA has not conducted routine defective pricing-type audits since 1997, when it issued a final rule permitting a CO to incorporate such audit rights into MAS contracts only upon issuing a determination that significant harm to the Government would result otherwise, and then obtaining the approval of the senior procurement executive. 62 Fed. Reg. 44518 (Aug. 21, 1997).

GSA's renewed interest in post-award audit rights is symptomatic of the mounting pressure on the agency to increase the number and scope of its MAS contract audits. The ANPR was the direct result of a recent GAO report concluding that "GSA's efforts to ensure most favored customer pricing has [sic] been hampered by the significant decline in the number of pre-award and post-award audits of MAS contracts." *Contract Management: Opportunities to Improve Pricing of GSA Multiple Award Schedule Contracts* (GAO-05-229) (hereafter "Contract Management"). The report recommended that GSA both issue guidance regarding the circumstances under which auditors should seek the right to conduct defective pricing audits and ensure that pre-award audits are conducted for all MAS offers and extensions with an expected value of more than \$25 million. *Id.* at 23.

The GSA IG and Congress have seized on the GAO report and the ANPR as an opportunity to expand the number and scope of MAS audits currently conducted by the IG. On July 26, 2005, the Subcommittee on Federal Financial Management, Government Information, and International Security of the Senate Committee on Homeland Security and Governmental Affairs held a hearing to ex-

plore whether the taxpayer is “getting the best deal” from GSA. At the hearing, Kathleen Tighe, the GSA IG’s outspoken and well-respected legal counsel, uttered words that caused MAS contractors everywhere to take notice: “[D]efective pricing is alive and well at GSA,” Ms. Tighe opined, “although the contractual right to audit for it is not.” *GSA – Is the Taxpayer Getting the Best Deal?: Hearings Before the Subcomm. on Fed. Fin. Mgmt., Gov’t Info. and Int’l Sec. of the Senate Comm. on Homeland Sec. and Governmental Affairs, 109th Cong., 2005 WL 1786562 (July 26, 2005) (prepared statement of Kathleen S. Tighe)*. Although Ms. Tighe’s testimony focused primarily on the purported need to resurrect defective pricing audits, she also expressed approval of recent increases in the number of pre-award audits being conducted by GSA. During the hearing, Ms. Tighe opined further that a “legislative fix” may be necessary if GSA does not voluntarily resume the practice of conducting defective pricing audits.

Sen. Tom Coburn (R-Okla.), who chaired the July 26 subcommittee hearing, agreed. Indeed, he clearly articulated his view that GSA should both resume defective pricing audits and continue to increase the number of pre-award audits. Coburn subsequently expressed this same opinion in a letter submitted to GSA in response to the ANPR.

Not surprisingly, industry groups overwhelmingly oppose expanding GSA’s post-award audit rights for many of the same reasons they articulated in the late 1990s when this issue previously reared its head. The Government Electronics & Information Technology Association (GEIA), for example, recently reiterated its position that post-award audit rights “do not satisfy the limitation on contract clauses established under the Federal Acquisition Streamlining Act as being either (1) necessary to implement provisions of law or executive order or (2) consistent with customary commercial practice.” Press release, GEIA, *GEIA Comments on GSA’s Proposed Rule on Postaward Audits (June 17, 2005)*. Moreover, post-award audits are quite burdensome, as GSA itself has recognized in its internal information bulletins. See, e.g., *Procurement Information Bulletin 97-14 (Sept. 3, 1997)* (“Post-award audits of pricing information provided during negotiations create an administrative burden for contractors and was [sic] not a common characteristic of commercial contracts.”).

Another industry group, the Contract Services Association (CSA), has explained that expanding post-

award audit rights would likely increase the cost of goods and services to the Government because “contractors, confronted with the possibility of a post-award audit, will factor the associated risk into their contract/extension prices.” Letter from Chris Jahn, president, CSA, to Laurie Duarte, GSA (May 10, 2005). CSA further noted that the burden of complying with post-award audits “likely would have an adverse impact on small businesses, which typically lack the financial and other resources to comply with Government-unique requirements.” *Id.*

Whatever the outcome of the current battle over defective pricing-type audits, one thing is clear: GSA is under mounting political pressure to expand the number and scope of its audits of MAS contractors. This current political climate undoubtedly will continue to fuel the increase in pre-award audit activity that has occurred in the past two years. By the end of Fiscal Year 2005—with the aid of \$2 million in funding that the Federal Supply Schedule program provided to the GSA IG to hire new auditors—GSA expected to conduct 70 pre-award audits covering a total of \$5.2 billion in expected MAS sales. *Contract Management, supra*, at 17; *Tighe Statement* at 4. This represents roughly three times the average number of pre-award audits conducted between 1998 and 2003. *Contract Management, supra*, at 14-15. Moreover, even if GSA does not amend its current post-award audit rights clause and Congress does not intervene, it is possible, if not likely, that GSA will succumb to pressure from GAO to issue guidance regarding the circumstances under which COs should consider seeking approval to incorporate additional post-award audit rights into particular MAS contracts. Both the trend toward increasing the number of pre-award audits and the prospect of expanded post-award audit rights highlight the need for rational audit procedures. As GSA IG audits of MAS contractors become more prevalent, and perhaps more expansive, it becomes increasingly important for the IG to “get it right” in the audit context. In particular, IG auditors must renew their focus on the fairness, efficiency, accuracy and consistency of their audits.

While many GSA IG audits are conducted by highly competent professionals operating in a fair and efficient manner, many contractors (and, in candid moments, many COs) recognize inconsistency in IG audits. Auditors often fail to understand the terms and conditions of the contracts they are auditing, and equally often are reluctant to seek guidance from the

contractor or even the CO. Frequently, document requests are unnecessarily broad and exceed the purported scope of the audit and, sometimes, even GSA's contractual audit rights. Further, contractors and COs tend to be excluded from (or at least marginalized during) the audit process, left unaware of the scope of the audit and unable to provide meaningful input until it is too late.

Contrary to the opinion of some contractors, these problems likely are not the result of bias, malice or neglect by the GSA IG. Instead, their primary cause appears to be the absence of a clear and transparent audit *process* that is known, understood and followed by all auditors, and a lack of communication between the auditor, the contractor and the CO.

The idea of maximizing the flow of information among the auditor, the contractor and the CO is not new. To the contrary, this understanding permeates the DCAA Contract Audit Manual (CAM). See, e.g., DCAA CAM §§ 4-302, 14-122. Procedures designed to promote communication between the auditor, the contractor and the CO have worked well for DCAA, and there is no reason to believe that they would not work equally well for the GSA IG. To this end, the GSA IG would be well advised to require its auditors to heed the following guidelines.

First, every GSA IG audit should begin—well before the auditors set foot in the contractor's facility or even review the first document—with a preliminary meeting among the auditor, the CO and the contractor. The meeting's purpose is to discuss the audit process generally, review the roles of the various parties and generally take steps to ensure that all parties understand what the coming weeks or months will involve. This preliminary meeting also would be a critical time to discuss the unique negotiated terms of the contract to be audited, and any changes in the terms of the contract (and in the schedule program generally) over the preceding five-year period.

The auditor has as much to learn as the contractor from such an early and meaningful preliminary conference. The requirements of a given MAS contract, like those of any other contract, must be interpreted according to the parties' intent. See *Xerox Corp.*, GSBCA No. 15190, 01-2 BCA ¶ 31,258. In many cases, the parties' intent cannot be ascertained by reference to the contract file alone. While most MAS contracts incorporate a price reductions clause for example, the structure of the clause, the specific non-

federal sales that can trigger the clause, and the types of transactions that are exempt from the clause vary from contract to contract. Unfortunately, as GAO has noted, contractors and COs often fail to document adequately the details of these negotiated terms. Contract Management, *supra*, at 12-14.

To ensure the auditor reviews the contract actually negotiated a meeting with the contractor and the CO should occur as early as possible. Involving the CO and the contractor in this process is critical, as they, not the auditor, ultimately are responsible for the contract's meaning. Experience teaches that meeting with the contractor and the CO early in the audit process facilitates the auditor's understanding of the contract, thereby rendering the auditor less likely to follow dead ends, request unnecessary documents or reach conclusions that are inapplicable to the parties' actual agreement.

For similar reasons, the auditor should engage the contractor and the CO in a dialogue on the meaning and scope of document requests. IG document requests frequently are imprecise, vague or even incomprehensible, not to mention unnecessarily broad. To be fair, this usually results from the fact that auditors draft the document requests well before they understand enough about the contract or the contractor to make an informed request. One well-respected IG auditor framed the issue this way:

Many times the auditor may not have an extensive knowledge of a contractor's accounting and/or computer systems and, as a result, may request information in a cumbersome manner. In addition, in these situations, an auditor may request more information than what may be needed.

*Advice from the Trenches—The Auditor's Perspective*, in John W. Chierichella & Jonathan S. Aronie, Multiple Award Schedule Contracting 465 (2002). By taking the time to understand the contractor's business processes and discuss the most efficient means to obtain necessary data, the auditor can save time and prevent unnecessary frustration.

At least one IG audit office consistently holds such preliminary meetings, but limits attendance to the auditors and the CO. By involving the contractor at this early stage, however, the IG would be able to set the parties' expectations, better explain the audit *process*, better understand the contract, and generally pave the way for a more meaningful, productive, efficient and cooperative audit.

Second, all IG on-site activities should begin with an entrance conference attended by the auditor, the contractor and the CO (in person where possible). See DCAA CAM § 4-302.1(a) (advising DCAA auditors to “hold an entrance conference with the contractor’s designated representative(s) at the start of each separate audit assignment”). The entrance conference should (1) confirm that the contractor understands the purpose and scope of the audit, (2) ensure that the auditor understands the terms of the contract and (3) ensure that all parties understand the needs of the other parties (i.e., the auditors seek current, accurate and complete information; the CO seeks impartial advice; and the contractor seeks a fair audit that minimizes disruption to its normal business day).

It is in the best interest of all parties that the contractor understand the purpose and anticipated scope of an audit. For this reason, the CAM advises DCAA auditors that during the entrance conference, they should “[a]s a minimum, explain the purpose of the audit, the overall plan for its performance including the estimated duration, and generally the types of books, records and operations data with which the auditor will be concerned.” DCAA CAM § 4-302.1(b). Although many GSA IG auditors do an excellent job in this area, such quality is not consistent throughout the office. As a result, contractors may appear uncooperative simply because they do not anticipate the amount of time and resources needed for the project. Further, an auditor who fails to clarify the purpose of an audit (even when that purpose has been explained in a preliminary meeting) risks losing valuable information that an informed contractor may have been able to provide, including information on the negotiation of the contract and the most efficient manner in which the auditor can obtain necessary data.

Third, GSA auditors should be encouraged to communicate with the contractor and the CO throughout the audit process, and to address potential concerns and audit findings with both as soon as they arise. Indeed, it would be useful to *require* a mid-audit meeting, in which all parties (including the CO) discuss the status of the audit, preliminary findings, problems that have emerged and any questions that have arisen on the negotiated terms of the contract. Such a meeting would likely reduce surprises for the CO and the contractor, and mistakes by the auditor. The concept of regular communications among all parties is not new, of course, and is articulated

throughout the DCAA CAM. See, e.g., DCAA CAM § 403.1. Unfortunately, it is a concept that is inconsistently followed by the IG.

This lack of communication and the consequent lack of transparency have detrimental effects on both contractors and auditors alike. The contractor is deprived of the opportunity to clarify any misunderstandings or misconceptions and to place all relevant information before the auditor before any conclusions are drawn. Likewise, the auditor is deprived of valuable information from the contractor and the CO, thereby increasing the probability that the auditor will waste the time and resources of all parties. Moreover, a lack of transparency leads to tension between the CO and the IG auditor—a result that benefits no one.

Despite the advantages of frequent communications throughout the audit process, many GSA auditors are reluctant to engage in such discussions, perhaps because they believe that contractors who understand the purpose of the audit and the auditor’s potential concerns will be more likely to manipulate the information being audited. Such concerns, however, are almost always misplaced. Contractors rarely seek to deceive auditors, and when they do, such manipulations can be detected by tests to verify the data’s integrity.

Fourth, the auditor should be required to show the contractor a copy of his or her draft audit report as early as possible and to hold a meaningful exit conference upon completion of the audit. Like contractors and COs, auditors are not perfect. There very well may be a flaw in the auditor’s analysis that can be corrected; documents may have been overlooked; inadequate sampling may have been used; the auditor may have misunderstood the business and how it operates and may have drawn incorrect conclusions; or there may be mitigating circumstances regarding some of the findings. By providing the contractor a copy of the draft audit report and discussing it at the exit conference, the auditor allows the contractor to clarify misconceptions or inaccurate conclusions and respond with mitigating information before the audit report goes to GSA.

The DCAA has recognized the benefits of sharing draft audit reports with the contractor and conducting exit conferences, and generally requires its auditors to do both. See, e.g., DCAA CAM §§ 4-304.1(a), 4-304.3(a). The GSA IG, however, typically takes the position that a contractor is not entitled to such infor-

mation. Many GSA auditors, nevertheless, conduct exit conferences and share their preliminary findings with the contractors, these practices are not universal. As a result, GSA auditors lose a valuable opportunity to resolve misconceptions or misunderstandings before they erupt into major disputes.

It would be naïve to contend that communication and transparency is the panacea for all that ails GSA audits. To be sure, some auditors lack adequate training in the concepts applicable to MAS contracts, particularly on unique, negotiated pricing/discount terms in a commercial services environment. Others simply do not understand the limited nature of GSA's contractual audit rights. Still others probably are stymied by inadequate documentation or uncooperative contractors or COs. Nevertheless, implementing the simple, practical and sensible changes set forth above in a consistent and process-oriented fashion would help make the GSA IG's audits less burdensome and more effective—goals that are shared by the contracting and auditing communities alike.



*This FEATURE COMMENT was written by Keith R. Szeliga, an associate at the law firm of Sheppard Mullin Richter & Hampton LLP, and Jonathan S. Aronie, a partner with the firm. Both specialize in Government contracts counseling and litigation.*

