



DEFENSE CONTRACT AUDIT AGENCY
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IN REPLY REFER TO

PPD 730.5.13.1

December 29, 2005
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MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Recovery Audits

This memorandum provides information and guidance on the new DoD Financial Management Regulation 7000.14-R, Volume 10, Chapter 22, "Recovery Audit," (see Enclosure). This new chapter establishes the DoD program to implement the requirements of Title 31, United States Code, Sections 3561-3567, "Identification of Errors Made by Executive Agencies in Payments to Contractors and Recovery of Amounts Erroneously Paid." The regulation requires Government agencies entering into contracts with a total value in excess of \$500 million in a fiscal year to carry out a cost-effective program for identifying payment errors that includes the use of recovery audits. The DoD regulation explains:

"A recovery audit is a post-payment review and analysis of the DoD Component's books, supporting documents, and other available information supporting its payments that is specifically designed to identify overpayments to contractors that are due to payment errors. It is not an audit in the traditional sense. Rather it is a control activity designed to assure the integrity of contract payments, and as such, it is a management function and responsibility."

Since the focus of these audits is the DoD Component's books and records, DCAA would not normally become involved in recovery audit effort. DCAA performs contract audits of the books and records of a Federal contractor pursuant to the allowable cost and payment clause at FAR 52.216-7 incorporated into the contract. As distinguished from the recovery audit, a contract audit is normally performed for the purpose of determining if amounts claimed by contractors are in compliance with the terms of the contract and applicable laws and regulations.

DCAA's role in support of the Department's recovery auditing effort should be determined by the extent, if any, of the access required to contractors' books and records. If such access is required, DCAA is best positioned to perform procedures in support of the recovery audits to avoid duplication and the inherent problem of multiple auditors looking at contractors' records on behalf of the Government. Recovery auditing should rarely require such access, and therefore, DCAA should normally have no role in most recovery audits.

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If FAO personnel have any questions, they should contact regional personnel. If regional personnel have any questions, they should contact Policy Programs Division, at (703) 767-2270.

/Signed/
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Assistant Director
Policy and Plans

Enclosure:

DoD Financial Management Regulation 7000.14-R
Volume 10, Chapter 22 – Recovery Audit

DISTRIBUTION: C

DoD Financial Management Regulation Volume 10, Chapter 22 December 2005

DOD 7000.14-R, VOLUME 10, CHAPTER 22

“RECOVERY AUDIT”

This is a new Department of Defense Financial Management Regulation
 (“DoDFMR”) chapter.

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CHAPTER 22
RECOVERY AUDIT

2201 OVERVIEW

220101. Purpose. This chapter establishes the DoD program to implement the requirements of Title 31, United States Code, sections 3561-3567, "Identification of Errors Made by Executive Agencies in Payments to Contractors and Recovery of Amounts Erroneously Paid," as outlined in the Office of Management and Budget (OMB) issuance, "Programs to Identify and Recover Erroneous Payments to Contractors," (OMB M-03-07).

220102. Applicability. The DoD Components shall have a cost effective program of internal control to prevent, detect, and recover overpayments to contractors resulting from payment errors. A program of internal control may include policies and activities such as prepayment reviews, a requirement that all relevant documents be made available before making payment (e.g., invoice, packing list, receiving report, inspection report, etc.), payment of only original invoices (as opposed to photocopies), and performance of contract audits. For DoD Components that enter into contracts with a total value of more than \$500 million in a fiscal year, a recovery audit program is a required element of their internal controls over contractor payments. When determining the cost-effectiveness of the use of recovery audit contingency contracts, Defense Finance and Accounting Service (DFAS) resources used to assist the recovery auditing contractor shall be taken into consideration. This includes the cost of providing government records, researching claims, and recovering amounts due the government. DoD Components shall report the results of their recovery auditing program in accordance with OMB Circular No. A-136, "Financial Reporting Requirements."

2202 DEFINITIONS

220201. Contract Audit. A contract audit refers to a post-award examination of the books and records of a federal contractor that is performed by the contracting officer, or an authorized representative of the contracting officer, pursuant to the audit and records clause incorporated in the contract. A contract audit is normally performed by an auditor that serves in an advisory capacity to the contracting officer. A post-award contract audit, as distinguished from a recovery audit, is normally performed for the purpose of determining if amounts claimed by the contractor are in compliance with the terms of the contract and applicable laws and regulations. For example, the scope of a post-award contract audit may include a review of the direct and indirect costs claimed to have been incurred or anticipated to be incurred under a negotiated contract. Such reviews involve the contractor's accounting records, including the contractor's internal control systems. A post-award contract audit may also include a review of other pertinent contractor records, e.g., reviews to determine if a contractor's proposal was complete, accurate, and current; reviews of contractor prices charged for commercial items sold to other federal and non-federal customers; and reviews of the contractor's systems established for identifying and returning any erroneous payments received under its federal contracts.

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220202. DoD Component. The Office of the Secretary of Defense, the Military Departments, the Chairman of the Joint Chiefs of Staff, the Combatant Commands, the Office of the Inspector General of the DoD, the Defense Agencies, the DoD Field Activities, and all other organizational entities in the DoD are considered DoD Components.

220203. Management Improvement Program. A management improvement program is a program to address the flaws in the DoD Component's internal controls over contractor payments discovered during the course of implementing a recovery audit program or other control activities over contractor payments.

220204. Payment Errors. Payment errors are errors resulting from duplicate payments; errors on invoices or financing requests; failure to reduce payments by applicable sales discounts, cash discounts, rebates, or other allowances; payments for items not received; mathematical or other errors in determining payment amounts and executing payments; and the failure to obtain credit for returned merchandise. The procedures used in the recovery audit may identify one or more of these types of payment errors.

220205. Recovery Activity. A recovery activity is any activity by the DoD to attempt to recover overpayments identified by a recovery audit.

220206. Recovery Audit. A recovery audit is a post-payment review and analysis of the DoD Component's books, supporting documents, and other available information supporting its payments that is specifically designed to identify overpayments to contractors that are due to payment errors. It is not an audit in the traditional sense. Rather it is a control activity designed to assure the integrity of contract payments, and as such, it is a management function and responsibility.

220207. Recovery Audit Contingency Contract. A recovery audit contingency contract is a contract for recovery audit services in which the recovery audit contractor is paid a portion of the amount recovered. The amount the contractor is paid, generally a percentage of the recoveries, is based on the amount actually collected based on the evidence discovered and reported by the recovery audit contractor to the appropriate official.

220208. Recovery Audit Program. A recovery audit program is a DoD Component's overall plan for the performance of recovery audits and recovery activities. The head of the DoD Component will determine the manner and combination of recovery audits and activities that are expected to yield the most cost-effective recovery audit program for the Component. This program should include a management improvement program as defined above and discussed in section 2209.

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2203 SCOPE OF RECOVERY AUDITS

220301. Subject to the exceptions in paragraph 220302 for recovery audit contractors, all classes of contracts and contract payments should be considered for recovery audits. DoD Components should review their different types of contracting categories and identify those classes of contracts that have a higher potential for payment errors, i.e., contract categories where the benefits would likely exceed the Component's costs of the recovery audits and recovery activities.

220302. The following classes of contracts are excluded from recovery audits performed by recovery audit contractors:

A. Cost-type contracts that have not been completed where payments are interim, provisional, or otherwise subject to further adjustment by the government in accordance with the terms and conditions of the contract.

B. Cost-type contracts that have been completed, subjected to a final contract audit and, prior to final payment of the contractor's final voucher, all prior interim payments made under the contract were accounted for and reconciled.

C. Other contracts that provide for contract financing payments or other payments that are interim, provisional, or otherwise subject to further adjustment by the government in accordance with the terms and conditions of the contract.

D. Payments that were made 180 days or less from the date of the disbursement.

220303. Recovery audit contractors may, with the consent of the employing DoD Component, communicate with the Component's contractors for the purpose of verifying the validity of potential payment errors they have identified. A recovery audit contractor shall not maintain a presence on the property of the contractors that are the subject of the recovery audit.

220304. DoD Components shall take steps to ensure that the implementation of their recovery audit program does not result in duplicative audits of contractor records. In this regard, actions to follow-up with contractors on potential overpayments identified through recovery audits of Component records do not constitute audits of contractor records. However, recovery audit activities should not duplicate other audits, to include other post-payment reviews or Defense Contract Audit Agency audits, of the same (contractor or DoD Component) records that specifically employ recovery audit techniques to identify and recover payment errors. At a minimum, DoD Components should coordinate with their Inspector General and other organizations with audit jurisdiction over their contracts.

220305. In addition to identifying and documenting specific overpayments resulting from payment errors, recovery audit contractors should also analyze the reasons why payment errors occurred and, where appropriate, recommend cost-effective controls

to prevent such overpayments in the future. The results of such analysis and related recommendations

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should be considered by the DoD Component as part of its management improvement program. These submissions shall be timely and cover a period not to exceed 12 months. The DoD Component should provide such information to DFAS, the Inspector General of the DoD, and, where applicable, the Inspector General of the Military Service.

220306. Instances of potential fraud discovered through recovery audits and recovery activities shall be reported immediately to the Inspector General of the DoD, and, where applicable, the Inspector General of the Military Service.

2204 SOURCES OF RECOVERY AUDITS

Recovery audits may be performed by employees of the DoD Components, by any other DoD Component, department or agency of the United States Government acting on behalf of the DoD Component, or by contractors performing recovery audit services under contracts awarded by the DoD Component.

2205 ROLE AND AUTHORITY OF THE INSPECTOR GENERAL OF THE DOD AND THE INSPECTOR GENERAL OF THE MILITARY SERVICE

220501. Nothing in this guidance should be construed to impair the authority of an Inspector General under the Inspector General Act of 1978 or any other law. However, because the recovery audit program required by this guidance is an integral part of DoD Component's internal control over contract payments, and therefore a management function, independence considerations would normally preclude the Inspector General of the DoD and, where applicable, the Inspector General of the Military Service, and other DoD Component external auditors from carrying out management's recovery audit program.

220502. The Inspector General of the DoD, and, where applicable, the Inspector General of the Military Service, and other authorized auditors are encouraged to assess the effectiveness of DoD Components' recovery audit programs as part of their internal control work on existing audits (e.g., the annual financial statement audit, or as a separate audit).

2206 RECOVERY AUDIT SERVICES PERFORMED BY CONTRACTORS

220601. Contracts entered into by DoD Components to obtain recovery audit services from the private sector are limited to contingency contracts that pay the contractor an amount equal to a fixed or graduated percentage of the net total amount actually collected by the United States (e.g., collections net of paybacks and adjustments to vendors that prove all or part of a claim or deduction to be invalid).

220602. In addition to provisions that describe the scope of recovery audits (and any other provisions required by law, regulation, or DoD Component policy), any contract with a private sector firm for recovery audit services shall include contract provisions that prohibit the recovery audit contractor from:

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A. Requiring production of any records or information by the DoD Component's contractors. Only duly authorized employees of the DoD Component can compel the production of information or records from the DoD Component's contractors, in accordance with applicable contract terms and DoD regulations;

B. Establishing or otherwise having a physical presence on the property or premises of any other DoD contractor for the purpose of performing the contract;

C. Acting as an agent for the Federal Government in the recovery of funds erroneously paid to contractors;

D. Using or sharing sensitive financial information with any individual or organization, whether associated with the Federal Government or not, that has not been released for use by the general public, except for the purpose of fulfilling the recovery audit contract; and

E. Disclosing any information that identifies an individual, or reasonably can be used to identify an individual, for any purpose other than performing the recovery audit.

2207 RECOVERY ACTIVITY

Recovery activity shall be carried out by federal employees. The DoD Components shall follow applicable laws and regulations governing collection of amounts owed to the Federal Government.

2208 DISPOSITION OF RECOVERED AMOUNTS

220801. Funds collected under a recovery audit program less any amounts needed to make payments under the related contract(s) shall be available to the DoD Component for the following purposes:

A. To reimburse the actual expenses for the administration of the program incurred by the DoD Component and DFAS. For DFAS, these expenses include the cost of providing government records, researching claims and recovering amounts due the government.

B. To pay recovery audit contractors.

220802. Except as provided in paragraph 220803, any amounts erroneously paid by a DoD Component that are recovered under a recovery audit program that are not used

to reimburse actual expenses for the administration of the program or pay recovery audit contractors under paragraph 220801 shall be credited to:

A. The appropriations from which the erroneous payments were made, shall be merged with other amounts in those appropriations, and shall be available for the purposes and period for which such appropriations are available; or

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B. The general fund of the Treasury as miscellaneous receipts if no such appropriations remain available.

220803. When required or authorized by other provisions of law, any funds remaining after reimbursing the actual expenses for the administration of the program and paying recovery audit contractors, shall be credited to the non-appropriated fund instrumentality, revolving fund, working capital fund, trust fund, or other fund or account from which the erroneous payments were made. For example, a recovery audit contractor may identify an erroneous payment during its review of a Defense Agency's working capital fund. Upon recovery of the payment, the agency would use the proceeds recovered to reimburse the Department's administration expenses and pay the recovery audit contractor's contingency fee. The remaining balance, if any, would then be credited back to the agency's working capital fund.

220804. Contingency fee contracts shall preclude any payment to the contractor performing recovery audit services until the recoveries are actually collected by the DoD Component.

220805. All funds collected and all direct expenses incurred as part of the recovery audit program shall be accounted for specifically. The identity of all funds recovered shall be maintained as necessary to facilitate the crediting of recovered funds to the correct appropriations and identify applicable time limitations associated with the appropriated funds recovered.

2209 MANAGEMENT IMPROVEMENT PROGRAMS

Title 31, United States Code, section 3564, authorizes federal agencies to implement management improvement programs. Such programs shall take the information gleaned from the recovery audit program, as well as other audits, reviews, or information that identify weaknesses in a DoD Component's internal controls, and ensure that actions are undertaken to improve the Component's internal controls governing contract payments.

2210 GRANT PROGRAMS

DoD Components whose grant programs fund significant contract activity by grant recipients may consider including contracts at the grant recipient level in their recovery audit program. The DoD Components can engage contractors on a contingency basis to the extent otherwise authorized by law.

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