INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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APR 24 1987

MEMORANDUM FOR SECRETARY OF THE ARMY
SECRETARY OF THE NAVY
SECRETARY OF THE AIR FORCE
ASSISTANT SECRETARY OF DEFENSE (COMPTROLLER)

SUBJECT: Contract Audit, Internal Audit and Criminal Investigations Joint Policy Memorandum Number 2 - Coordination by Audit and Investigative Organizations in Cases Involving Allegations of Fraud

REFERENCES:

(a) DoD Directive 5106.1, "Inspector General of the Department of Defense," March 14, 1983.

(b) DoD Directive 7600.2, "Audit Policies," January 10, 1985.

(c) DoD Directive 7050.5, "Coordination of Remedies for Fraud and Corruption Related to Procurement Activities," June 28, 1985.

(d) DoD Instruction 5505.2, "Criminal Investigations of Fraud Offenses," June 20, 1985.

(e) DoD Instruction 7600.7-M, "Internal Audit Manual," June 1986.

(f) DoD Instruction 7640.4, "Department of Defense Contract Auditing Standards," September 4, 1986.

A. PURPOSE

1. This Policy Memorandum is issued under the authority of reference (a), in furtherance of the responsibility of the Inspector General, Department of Defense (IG, DoD), to coordinate audits and investigations involving DoD programs and operations. The memorandum establishes policy, responsibilities, procedures, and guidelines for coordination between DoD audit and DoD criminal investigative organizations. The coordination will improve the participation of those organizations in the implementation of the requirements in references (b) and (c) for a coordinated effort in carrying out audit, investigative, oversight, and procurement activities in dealing with the detection, investigation, resolution and prevention of fraud against DoD programs, activities and contracts.

2. The memorandum is not intended to confer any rights, benefits, privileges, or form of due process procedures upon individuals, associations, corporations, or other persons or entities.

B. APPLICABILITY AND SCOPE

This Policy Memorandum applies to the DoD audit organizations and the DoD criminal investigative organizations, as both are defined below.

C. DEFINITIONS

1. DoD Audit Organizations. For purposes of this memorandum, the term includes the Defense Contract Audit Agency; the Army Audit Agency; the Naval Audit Service; the Air Force Audit Agency; the Assistant Inspector General for Auditing, Office of the Inspector General, DoD (OIG, DoD); the audit elements of the Army Corps of Engineers; and the military exchange audit organizations.

2. DoD Criminal Investigative Organizations. The United States Army Criminal Investigation Command; Naval Investigative Service; Air Force Office of Special Investigations; and the Defense Criminal Investigative Service, OIG, DoD.

3. Fraud. For purposes of this memorandum, the term includes Government theft/embezzlement, bribery, gratuities, conflicts of interest, and violations of antitrust laws, as well as fraud (e.g., false statements and false claims) in such areas as pay and allowances; procurement; contract performance; property disposal; commissary/subsistence; nonappropriated funds; Civilian Health and Medical Program of the Uniformed Services (CHAMPUS); foreign military sales; and personnel matters; etc.

4. Referral. For purposes of this memorandum, the term includes suspicion of irregularity reports and formal fraud referrals. The purpose of such communication must be to seek consideration of the facts known for investigative action where warranted.

D. POLICY

1. The DoD audit and criminal investigative organizations shall encourage coordination and direct contact between their field personnel concerning referrals of suspected or potential fraud disclosed during audit activities.

2. The DoD criminal investigative organizations shall, within 60 days of receipt, evaluate and provide feedback, through the headquarters fraud monitors of the DoD audit organizations, regarding initial action taken as a result of referrals of suspected or potential fraud forwarded to them by the DoD audit organizations.

3. Audit support of criminal investigations is authorized by Subsection F.6.a. of reference (b), and encouraged to the greatest extent permitted by law, the availability of resources, and the guidelines set forth in Enclosure 2.

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4. The DoD criminal investigative organizations shall periodically provide, and the DoD audit organizations shall use, for internal purposes only, feedback regarding the status of investigations and their disposition for those investigations initiated as a result of referrals from the DoD audit organizations. Such informational exchanges shall take place in a manner and at such frequency as shall be established by the affected organizations, and in consideration of such concerns as the requirement for grand jury secrecy rules, the potential for compromise of informants or investigations, and prosecutorial concerns or guidance.

E. RESPONSIBILITIES

1. The Heads of the DoD audit organizations shall:

a. Establish policy and procedures for the issuance of referrals of suspected or potential fraud to cognizant DoD criminal investigative organizations. The procedures should include the assignment of an identifying number unique to each referral that will allow it to be tracked through any automated system.

b. Establish a fraud monitor, at the headquarters level, for fraud referrals who will maintain liaison regarding such matters with the DoD criminal investigative organizations.

c. Establish procedures that ensure the audit and criminal investigative organizations will consult and determine when, and by whom, the appropriate Government contracting personnel will be notified of the existence of a referral or criminal investigation regarding a contractor. Such notification should take place on a timely basis unless circumstances warrant withholding notice, e.g., the appropriate contracting personnel appear to be culpably involved in the fraud. Procedures already in existence under DoD Directive 7050.5 (reference (c)) will ensure further information flow to necessary contracting officials regarding investigations.

d. Establish procedures for evaluation of information received from DoD criminal investigative organizations for planning and performance of future audits, as well as for the effectiveness of the referral process (including future detection efforts and audit support procedures).

e. Establish policies and procedures, consistent with the guidelines contained in Enclosure 2, to ensure that:

(1) Annual audit plans will provide sufficient flexibility to enable the organization to support criminal investigations when necessary.

(2) Any competing Government interests will be properly considered and balanced when selecting and assigning audit personnel to support an investigation. However, in making such assignments,

particular attention will be given to any special requirements connected with the investigation.

(3) Auditors are given appropriate guidance concerning duties they are authorized to perform when acting in connection or coordination with an investigative effort or as part of an investigative team.

(4) Auditors are required to adhere to any special restrictions applying to investigations (such as the requirement for secrecy of matters occurring before the grand jury), if acting as part of an investigative team.

2. The Commanders and Directors of the DoD criminal investigative organizations shall:

a. Establish procedures for providing the information required under the Policy Memorandum to the DoD audit organizations in a timely manner.

b. Establish procedures to ensure timely evaluation (within 60 days) of and response to audit generated referrals concerning suspected or potential fraud. The procedures shall include provisions for transmitting a referral to the appropriate DoD criminal investigative organization for action if the original recipient of the referral does not have cognizance for the allegations per reference (d).

c. Establish procedures that ensure the criminal investigative and audit organizations will consult and determine when, and by whom, the appropriate Government contracting personnel will be notified of the existence of a referral or criminal investigation regarding a contractor. Such notification should take place on a timely basis unless circumstances warrant withholding notice, e.g., the appropriate contracting personnel appear to be culpably involved in the fraud. Such notification will be in addition to requirements for providing notification and information to the centralized points of coordination established under DoD Directive 7050.5 (reference (c)).

d. Establish policies and procedures, consistent with the guidelines contained in Enclosure 2, to ensure that:

(1) Audit support to an investigation will be requested in a timely fashion, giving the audit organizations as much advance notice as possible.

(2) Audit support is used as effectively as possible by assuring the formulation of a listing of audit tasks needed in connection or coordination with, or support of an investigation. The listing should normally be developed prior to the assignment of audit support of the investigation.

(3) Investigators do not request auditors to perform nonprofessional services or services that would fall outside the normal functions of the auditing profession.

F. EFFECTIVE DATE AND IMPLEMENTATION

This Policy Memorandum is effective immediately. The memorandum will remain in effect until it is incorporated into a DoD directive or instruction. Forward two copies of implementing documents to the Inspector General, DoD, within 120 days.

Derek J. Vander Schaaf
Deputy Inspector General

Enclosures

GUIDELINES FOR COORDINATION AND FEEDBACK REGARDING FRAUD REFERRALS

I. INTRODUCTION

Coordination is necessary for DoD audit and criminal investigative organizations to carry out effectively their responsibilities for DoD programs. The procedures and guidelines provided in this enclosure will better enable the audit organizations to plan for audit resources that may be needed in pursuing issues raised in referrals and in providing support for, or working in connection or coordination with, Defense criminal investigative organizations. Feedback obtained as part of the coordination process will also enable the audit organizations to more effectively evaluate and improve their future referrals. The enclosure also provides guidance to the audit organizations regarding continuing audit activity during the pendency of an investigation.

II. PROCEDURES

A. The DoD audit and criminal investigative organizations shall incorporate the procedures contained herein when carrying out their responsibilities under Section E of this Policy Memorandum.

B. The DoD audit organizations shall:

1. Encourage dialogue between audit and investigative field personnel regarding the need for and content of referrals for suspected or potential fraud.

2. Ensure that:

(a) Auditors performing contract audits will not make reference to or discuss with the contractor the fact that a fraud referral has been made. Nor will any attempt be made by the contract auditors to resolve with the contractor their suspicions that a possible fraud has occurred. Discussions will be limited to the auditors' judgments and conclusions on matters other than fraud and to the underlying facts that support those judgments and conclusions.

(b) Internal auditors will follow DoD 7600.7-M, "Internal Audit Manual," (reference (e)), Chapter 15, Subsection F.3.f, which provides, in part, "...the auditors shall notify the top official of the audited entity of the situation, unless the top official is believed to be a party to or implicated in the improper acts or unless the auditors were advised to the contrary by the investigative organization." The subject is further addressed in Section VI of Enclosure 2 to this Policy Memorandum.

3. Ensure that after making a referral of suspected fraud, or after notification of the initiation of an investigation, no actions are taken that would compromise the investigation. Audit

scope may, after consultation with the investigative organization, be expanded to determine the impact of the suspected fraud or other unlawful activity on the audit objectives. Audit scope should not be expanded, however, for the sole purpose of gathering additional information to support an investigation into possible fraud or other unlawful conduct. Audit activities outside the area of investigative interest will continue unless a written request from the investigative organization recommends a deferral for investigative reasons. If the auditor believes the requested deferral will result in financial harm to the Government or will unnecessarily impede the audit mission, the matter will be elevated for management resolution between the respective organizations.

4. Ensure when an audit report is issued for any audit in which there has been a related referral to a criminal investigative organization, the audit report includes or is accompanied by a statement of cautionary language regarding the existence of the referral or an investigation resulting from the referral. Further guidance regarding reporting audit results when fraud or illegal acts are suspected may be found in: DoD Instruction 7600.7-M, "DoD Internal Audit Manual" (reference (e)), Chapter 15, Section G; and DoD Instruction 7640.4, "Department of Defense Contract Auditing Standards" (reference (f)), Enclosure 1, Section E.5., Report Contents. Particular attention should be paid to dealing with circumstances under which audit reports are not to be issued.

5. Ensure coordinated activities between the organizational fraud monitor and appropriate field personnel. The field audit personnel will ensure that the organizational fraud monitor is kept apprised of all referrals. The field audit personnel will provide the monitor with copies of information received from the DoD criminal investigative organizations necessary to fulfill the responsibilities enumerated under Subsections E.1.b. and d. of this Policy Memorandum.

6. Assess the information received regarding investigations conducted based on referrals for identification of lessons learned and for use in developing audit techniques and tests that will help to disclose the existence of similar situations in future audit activities.

C. The DoD criminal investigative organizations shall:

1. Provide, in a timely manner (within 60 days), to the headquarters fraud monitor designated by the DoD audit organization the following types of information:

(a) When a case is opened based on a referral, the case title, case control number, investigative agency and office of primary responsibility, date opened, predication and suspected offense(s), case agent (if an agent has been assigned).

(b) When an investigation will not be conducted, an explanation of that decision and the reasons for it, specifically including any informational deficiencies in the referral.

(c) When the referral is forwarded to another investigative organization for consideration or further action: the name, address and phone number of a point of contact in that organization; the reason why the referral was sent to another organization.

2. Ensure that personnel evaluating referrals from audit personnel will contact the referring audit personnel during the evaluation process.

3. Ensure that once a case is opened based on a referral, the DoD criminal investigative organization will maintain contact, during the course of the investigation, with audit personnel as designated by the cognizant DoD audit organization. The audit organization will be advised during those contacts as to whether any subsequent audit actions regarding the subject contract, contractor, or organizational entity may compromise the investigation.

4. When an investigation is closed, provide the audit organization copies of information indicating the disposition of the case and any information that will enable the audit fraud monitor to carry out the responsibilities enumerated in Subsection E.1.d. of this Policy Memorandum and Subsection II.B.6. of this enclosure.

ENCLOSURE 2

GUIDELINES FOR AUDIT SUPPORT OF FRAUD INVESTIGATIONS

I. INTRODUCTION

The DoD criminal investigative organizations frequently request support from DoD audit organizations. Audit support to criminal investigations, as required by Subsection F.6.a of reference (b), furthers significant DoD interests, by facilitating the identification of information and evidence needed for the effective accomplishment and coordination of criminal, civil, administrative, and contractual remedies under the requirements of DoD Directive 7050.5 (reference (c)). Such support may include the provision of audit advice, the transmission of results of or information obtained during separate cooperative or coordinated audit activity initiated by the audit organization, or, on occasion, the assignment of auditors to a team investigating an accounting related suspected irregularity. Investigative team members may include contract auditors, lawyers, procurement specialists, engineers, quality assurance personnel, and others who can supply needed expertise for the investigation. From time to time, questions have arisen concerning various aspects of the relationship created by an auditor's cooperation/coordination with, or assignment to, an investigative team. The purpose of this enclosure is to provide guidance regarding the most frequently encountered issues concerning audit support of investigations and, in particular, to address the issues that arise as a result of an auditor's assignment to an investigative team.

II. REQUESTS FOR AUDIT SUPPORT

A. Requests for audit support from a DoD criminal investigative organization to a DoD audit organization will be made in writing. The request should be directed to the DoD audit organization originating the fraud referral in response to which the investigation was initiated. When no fraud referral was involved in initiating the investigation, the request for audit support should be directed to the DoD audit organization that has primary audit cognizance, under DoD Directive 7600.2 (reference (b)), for the contract, contractor, organization, or activity under investigation. The request will provide a list of the audit tasks needed to support the investigation.

B. The list of audit tasks may be amended from time to time, depending on investigative developments or as the audit organization deems necessary to properly fulfill its mission or functions.

C. The DoD audit organization concerned will, on request, assist the DoD criminal investigative organization in framing the list of audit tasks being requested.

D. When a DoD audit organization elects to conduct an audit after a request for support by a DoD criminal investigative

organization, steps to accomplish the requested tasks will be included in the audit plan, and the audit will be conducted in coordination or cooperation with the requesting organization.

III. SELECTION AND ASSIGNMENT OF AUDIT PERSONNEL TO INVESTIGATIVE TEAMS

A. Occasions will arise when it will become necessary to actually assign an auditor to act as a member of an investigative team. Selection of an auditor for assignment to an investigative team is a matter for determination by the concerned audit organization. Audit officials making the selection should take into consideration such factors as a request by an investigator or prosecutor for a particular auditor; future expected assignments of the potential selectees; special skills or work experience that may be required as a member of the investigative team; credentials of the possible selectees (Certified Public Accountant, Certified Internal Auditor, etc.); the needs of the field unit that the selectees are assigned to; and the desires of potential selectees to serve on the team.

B. Any disagreements between the audit organization and the investigative organization regarding which auditors will be assigned to an investigative team will be resolved by the headquarters of the respective organizations. Inability to resolve the disagreement at that level will, where applicable, be referred to the appropriate higher level of the Military Department(s) involved for resolution. All such situations must also be reported to the Assistant Inspector General for Audit Policy and Oversight and the Assistant Inspector General for Criminal Investigations Policy and Oversight in the OIG, DoD.

IV. ROLE OF THE AUDITOR ON THE INVESTIGATIVE TEAM

A. The auditor will not perform clerical or other nonprofessional services on behalf of the investigators. The investigative organization has the responsibility for arranging adequate clerical resources. Audit resources should be conserved whenever possible. The auditor should request the assignment of clerical support if certain procedures can be organized and performed by nonauditors working under general supervision of the contract auditor. An example would be the examination of a large volume of documents for indications of erasure, whiteouts, or other alterations.

B. The auditor will not undertake duties that are traditionally the role of the criminal investigator.

C. To the extent that information obtained by auditors or investigators is not a matter occurring before a grand jury, covered by the Federal Rules of Criminal Procedure, Rule 6(e) on grand jury secrecy, such information may be shared for both audit and investigation purposes.

V. HANDLING DOCUMENTARY EVIDENCE

A. The DoD audit organizations, in the performance of their official responsibilities, frequently maintain audit work papers that would be of use to DoD criminal investigative organizations. Such work papers should be made available for inspection and copying by the investigative organization on request.

B. The DoD audit organizations occasionally obtain, in conjunction with exercising their existing authorities, custody and control of original documents, including contractor records, which reflect indicators of fraud or other unlawful activity. The audit organization must, in such an instance, immediately notify the cognizant criminal investigative organization so that appropriate measures can be taken for the Government to maintain custody and control over the documents. The Government, in examining such a situation, may retain custody and control of the documents and the records may be used as evidence in subsequent criminal proceedings.

VI. NOTICE TO THE AUDITEE AND RESPONSES TO INQUIRIES

A. The decision on whether to inform an auditee that an audit is being conducted in connection or coordination with a criminal investigation is the responsibility of the cognizant criminal investigative organization in consultation with the Department of Justice prosecutor when necessary.

B. Auditors who are assigned to a criminal investigative team will not, directly or indirectly, state or indicate that their presence at the auditee's premises is for any purpose other than to assist in a criminal investigation.

VII. OBTAINING NECESSARY RECORDS

A. Records and information needed to conduct an audit in support of an investigation can be obtained by various means including, but not limited to, the access to records clause of a contract, voluntary disclosure by the auditee, Inspector General subpoena, search warrant, and grand jury subpoena.

B. An auditor who is assigned to support an investigation will not use his position to gain access to information or documents that would not normally be available to the audit organization in performing its audit mission. If the investigation requires documents that are not available under the audit organization's authority, those documents will be obtained through other authorities.

C. Criminal investigators, as well as auditors, can be the authorized representative of a contracting officer under the access to records clause of a contract.

VIII. GRAND JURY INVESTIGATIONS

A. Rule 6(e) of the Federal Rules of Criminal Procedure requires matters occurring before the grand jury to be kept secret. An auditor or investigator must obtain, and act in accordance with, guidance from the cognizant Assistant United States Attorney or his designee in addition to the minimum guidance provided herein.

B. The following guidance must be used to prevent even the appearance that matters occurring before a grand jury have been improperly disclosed to support DoD audit functions.

1. An auditor will not be involved in any other audit that relates to any aspect of the matter under investigation while assigned to a criminal investigation being pursued under the auspices of a Federal grand jury. This concept should be kept in mind when selecting an auditor to serve on such an investigative team.

2. An audit supervisor should not continue to exercise normal audit responsibilities for a contractor or entity in the event that audit supervisor, having cognizance of a contractor or entity, is designated as a member of a grand jury investigative team examining matters relating to that contractor or entity. The audit supervisor will not resume audit responsibility for the contractor or entity until completion of the criminal investigation and all related criminal prosecutions brought by the United States.

3. Audit and investigative organizations should, when possible, use auditors as witnesses rather than having them made agents of the grand jury. By carefully structuring the role of an auditor in this regard, it may be possible to limit adverse impact of grand jury secrecy on the auditors normal duties and responsibilities.

MEMORANDUM FOR: CC

3 JAN 1990

Subject: Releasability of Audit Records/Law Enforcement Records

1. The Supreme Court of the United States has recently ruled that DCAA audit reports given to the FBI for criminal investigation purposes may be withheld under the Freedom of Information Act (FOIA) (John Doe Agency v John Doe Corporation).

2. In 1978, DCAA conducted a routine audit of the contractor. As a result, DCAA claimed that the contractor had misallocated 4.7 million dollars. The corporation disagreed. The controversy was dormant for eight years.

3. In 1985 the United States attorney began to investigate the contractor for possible fraud. Thereafter, the contractor submitted a FOIA request to DCAA for any documents "that are related in any way" to the earlier audit. DCAA denied the request and gave the records to the FBI.

4. FOIA permits the withholding of records "compiled for law enforcement purposes" in certain circumstances. The issue here was whether DCAA audit records were "compiled for law enforcement purposes" because they were given to the FBI. The court held that such records, originally compiled for a non-law enforcement purpose, were recompiled for law enforcement purposes upon delivery to the FBI. Therefore the records could be withheld from the contractor.

5. This ruling should give DOD another tool where genuine fraud issues are raised during an audit. This decision allows the DOD to deny FOIA requests for records given to the FBI, if a bona fide criminal investigation is underway. We believe this decision is not limited to DCAA audits. Any government agency may utilize this technique in appropriate circumstances.

THOMAS G. JETER, Brig Gen, USAF
Staff Judge Advocate

cc: CV
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