

Testimony

of

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before the

Senate Committee on Homeland Security and Governmental Affairs

September 10, 2008

Mr. Chairman, members of the Committee, thank you for the opportunity to appear before you today; I am pleased to be here.

As requested, I will describe the actions taken by the Defense Contract Audit Agency (DCAA), as a result of the July 2008 GAO Report regarding allegations that certain DCAA audits did not meet professional standards. (*DCAA Audits: Allegations that Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated.*) Please be assured that we take the GAO's findings very seriously, and we are taking the necessary steps to review and correct the issues cited in the report.

To ensure that the DCAA is fully transparent and accountable, we are committed to supporting any review of our procedures, and we are taking immediate action to fix any problems found.

Background on DCAA

Mr. Chairman, DCAA is a distinct agency of the Department of Defense (DoD) that reports to the Under Secretary of Defense (Comptroller). The DCAA mission is to perform all necessary contract audits for DoD components responsible for the negotiation, administration, and settlement of contracts and subcontracts.

In FY 2007, DCAA performed 33,801 audits covering \$391 billion in proposed or claimed contractor costs. These audits recommended reductions in proposed or billed costs of \$14.2 billion (referred to as questioned costs), and \$4.6 billion in estimated costs where the contractor did not provide sufficient information to explain the basis of the estimated amounts (referred to as unsupported costs).

In total, the DCAA has about 4,000 employees and 79 field audit offices. The three audit offices addressed in the GAO report, performed a combined total of 4,786 audits covering \$76 billion of proposed or claimed contractor costs, with \$1.9 billion of questioned costs, and \$2 billion of unsupported costs, for the five year period covered by the GAO report.

As you may know, the DoD Inspector General is responsible for the oversight of DCAA's quality control system, and the IG has previously determined both that DCAA's system of quality control is designed in accordance with Government Auditing Standards, and that the quality control system being used on audits is adequate.

GAO Report Findings and Root Causes

For purposes of my testimony today, Mr. Chairman, we have categorized the GAO's findings into three general areas: Deficient Working Papers and Audit Work; Lack of Independence, and; Management Abuses of Employees and Impediments to the GAO Investigation.

Deficient Working Papers and Audit Work

With regard to Deficient Working Papers and Audit Work, the GAO concluded that the working papers did not adequately support the final conclusion and opinion for any of the 13 cases it investigated. The GAO also concluded that, in some of the cases, the auditors did not perform sufficient work to support draft audit conclusions, and that their supervisors did not instruct or allow them to perform additional work before issuing final reports.

We agree that the audit work should have been better documented in the working papers. We also agree that, in some of the cases, the supervisors should have assessed the need to

perform additional audit effort prior to issuing the audit report. Supervisors and managers who changed the audit findings should have documented their decision in the working papers. Changing draft audit findings without adequate explanation, documentation, and review, is not acceptable, and does not follow the auditing standards that DCAA strives to uphold.

So, why did this happen?

In our discussions with the management team involved, they stated that the audit results were not supported and that they did not want to include inadequately supported audit findings in the report. They felt pressured to issue the audit reports by the due date, and made an inappropriate decision to remove the audit findings rather than to assess the need to perform additional audit work to determine whether the finding had merit.

Mr. Chairman, I do not offer this explanation as an excuse, but rather as management's reason for removing the findings. Audit work must be complete prior to issuance of an audit report or in the case of an external constraint, the audit report should clearly state the reasons that the audit work could not be completed as required by the auditing standards.

Lack of Independence

With regard to the second area, Lack of Independence, the GAO concluded that, in three audits, the contractor or the DoD contracting community improperly influenced the audit scope, conclusions, and opinions. The primary root cause that led to the GAO's conclusion was DCAA's participation in Integrated Product Teams (IPTs). IPTs were established by DoD in the mid-1990s as a means of expediting the assessment of contractor bid proposals as well as a mechanism to expedite the resolution of outstanding issues.

In the specific example cited by the GAO, the IPT was established to expedite the resolution of a labor estimating system issue at a major contractor. As the contractor developed revised draft procedures, the IPT, including the auditor, provided feedback. The DCAA field office manager informed the IPT that DCAA would audit the final estimates and provide feedback on the draft estimates during the IPT process.

After several rounds of reviewing the draft procedures, the contractor provided the final procedure for audit. DCAA notified the contractor that it planned to test a sample of estimates over a prospective four-month time period although the auditor did not specifically state which estimates would be reviewed. The GAO concluded that the DCAA's participation in the IPT by providing feedback on the draft procedures and then auditing the final procedures was a violation of the independence requirements under the auditing standards. The GAO also objected to the auditor providing the time period of the sample selection.

We appreciate the GAO's concern with the appearance of a lack of independence by DCAA's participation in IPTs. As a result, we have ceased participation in all IPTs. Although audit services will be provided during an IPT when requested by a contracting officer, DCAA is no longer a member of an IPT, and DCAA will no longer provide feedback during an IPT. DCAA will audit only final contractor approved submissions and will have no involvement with draft submissions. We have notified the procurement community of this change in DCAA policy.

Management Abuses and Impediments to the GAO Investigation

With regard to Management Abuses and Impediments to the GAO Investigation, the GAO concluded that there existed a pattern of frequent management actions that served to

intimidate some of the auditors and create an abusive environment at two of the three locations covered by its investigation. The GAO stated that its conclusions were based on confidential interviews and e-mail documentation.

Since the GAO did not provide specific information upon which any personnel action could be taken, we requested the services of the DoD Inspector General to investigate the matter. The Inspector General expects to issue its draft report in January 2009. Rest assured, inappropriate management actions will not be tolerated, and necessary disciplinary actions will be taken in accordance with personnel laws and regulations.

DCAA Actions

Mr. Chairman, as a result of the GAO report, we have taken a number of actions. The appendix to my submitted testimony contains a list of actions completed to date as well as actions that are in process as of today . However, I would like to discuss some of the more significant actions at this time.

Structure

1. With regard to the organizational structure of DCAA, we are performing a top-to-bottom assessment, including an assessment of staffing for the quality assurance function, to determine whether we have the appropriate staffing at all levels of the organization.

We are assessing whether additional staffing will be needed, including additional auditors, supervisors, and managers. We will continue to work with the Department on how best to address future staffing needs.

2. Prior to the issuance of the GAO report, DCAA recognized that the span of control of supervisors to auditors needed to be lowered, especially in areas with a significant number of auditor trainees.

In June 2008, I approved a reduction in the supervisory span of control, lowering the number of auditors to each supervisor to provide greater oversight by each supervisor.

Although some locations had made use of temporary positions to deal with the need for fewer auditors to each supervisor, we felt the Agency-wide reduction would be more effective.

3. I have approved additional field audit offices to lower the span of control for the office manager. Three additional offices were approved earlier in the year, and three more offices were approved after the issuance of the GAO report. These actions will be financed out of existing resources.

We envision that additional offices may be needed once we complete our staffing assessment.

4. DCAA assessed the quality assurance function and changed the alignment from being a division in the Policy and Plans directorate at Headquarters to a direct report to the Deputy Director. This change will bring additional daily oversight to the quality assurance function at a very high level in the organization and demonstrates our emphasis on the quality of our audits.

Culture

With regard to the culture of DCAA, we are

1. Assessing whether the agency is using the appropriate metrics and benchmarks, as well as assessing whether those metrics are driving the right behavior. The team performing the assessment includes representatives from across the audit organization. We are also utilizing focus groups at all levels, including auditors, to provide feedback on the use of metrics. We plan to have this assessment complete by September 30th.

In the meantime, we have emphasized, through various venues, the need to perform quality audits. One way this was accomplished was by declaring August, “Audit Quality Month” in which each location held a stand-down day to discuss audit quality and to resolve impediments to audit quality such as metrics, budgets, due dates, or external pressures.

2. We plan to conduct an Agency-wide survey to identify additional cultural issues. The survey will be based on a standard Federal government survey developed and administered by the Office of Personnel Management, together with additional questions unique to the issues raised in the GAO report. We anticipate that this survey will be distributed by September 30th.
3. As mentioned earlier, we ceased participation in IPTs to avoid the appearance of a lack of independence. We also reminded the workforce of our audit policy on the appropriate audit opinion to provide when contracting officers place restrictions on the audit such as time constraints.

Processes

Finally, to address the improvements in processes, we have

1. Increased the number of levels of management to resolve disagreements. Prior to the GAO review, Agency policy provided that the auditor could elevate the issues to two levels of management: the supervisor and the manager. We changed the policy to call for four levels of management. This raises the issue to the level of a senior executive, if needed. We believe this change will bring more objectivity to the resolution process.
2. Based on our own quality assurance reviews in February 2008, we decided to change the signature authority for internal control audits to the level of the field office manager; previously the supervisory auditor could sign certain reports. As a result of the findings in the GAO report, we decided to require the manager to sign all audit reports, regardless of findings. The added review by the manager should improve the quality of the audits.
3. We expanded our next round of quality assurance reviews, which started this month, to include additional offices and additional assignments.
4. We initiated an internal assessment of audit work at other locations to identify additional areas of improvement. This assessment used a stratified sample of high risk assignments identified in the GAO report, such as audit reports issued in the last week of the fiscal year. We anticipate that this review will be completed by September 30th.

In addition to the actions taken by DCAA, we have asked the DoD Inspector General to review the actions taken to address the audit work in the specific 13 cases cited by the GAO, in addition to assessing the abusive management environment.

For all 13 cases, we have either completed additional audit work or have assignments in-process to mitigate the risk associated with the assignments the GAO determined did not comply with auditing standards.

Closing

In closing, Mr. Chairman, I want to underscore the seriousness with which DCAA is taking this matter. Inadequate work is unacceptable, and disciplinary and personnel actions will be taken as appropriate. As I have indicated, a number of steps to resolve these issues have already been taken and completed. Others in process, such as the Agency-wide organizational assessment, will require more time to complete, but DCAA is committed to ensuring that the agency is above reproach – that all of its audits are performed in accordance with auditing standards, that its culture promotes the kind of vigilance and quality that protects the interests of the American taxpayers.

Mr. Chairman, I thank you again for the opportunity to address the committee, and I look forward to your questions.

**Appendix to Written Statement of Ms. April G. Stephenson
Senate Committee on Homeland Security and Governmental Affairs
Specific DCAA Actions in Response To The GAO Report**

Structure

- Realigned the Chief, Quality Assurance to report directly to the Deputy Director (completed in August)
- Submitted a request to OSD for a Senior Executive Service level position for the quality assurance function (completed in August)
- Expanded the next round of quality assurance reviews started in September by including additional assignments and offices (completed in August)
- Realigning the regional quality assurance employees to report directly to Headquarters (planned to complete in September)
- Assessing the incremental need for additional quality assurance staff due to additional reviews planned for FY 2009 and beyond (planned to complete in September)
- Revamping the ombudsman program to align with the quality assurance organization (planned to complete in September)
- Realigning the DCAA hotline program to the quality assurance function (planned to complete in October)
- Approved reduction in supervisor span of control (completed in June)
- Approved six new field audit offices (completed in May, June, and July)
- Approved three new regional audit manager positions (completed in May and July)
- Initial staffing assessments due to the Director by September 9th with additional staffing assessments to continue as corrective actions are implemented (initial staffing request estimated to be provided to the DoD Comptroller by the end of September)

Culture

- Ceased participation in Integrated Product Teams to avoid the appearance of a lack of independence (completed in August)
- Held stand-down day for audit quality at all DCAA locations (70 completed in August, 15 planned for early September)
- Completed annual independence training and signed certificate of independence by all auditing personnel (planned to complete in September)
- Confirmed policy on audit opinion due to contracting officer scope limitations (completed in July)
- Revised policy on resolving difference in audit results and opinions – changed from two levels to four levels (completed in July)
- Issued several memorandum reiterating the importance of cooperating with GAO, IG, and other reviewers/investigators (completed in July and August)

- Assessing whether DCAA has the appropriate metrics and performance benchmarks (planned to complete in September)
- Assessing whether metrics and performance benchmarks are implemented appropriately across the Agency (planned to complete in September)
 - Held separate focus groups of employees at all levels of the organization including auditors (completed in August)
- Revamping the metrics process (initial assessment planned for September with complete implementation no later than December)
- Distributing an organizational assessment survey via OPM to DCAA employees (survey planned to be distributed in September with results analyzed and corrective actions developed by December)
- Completion of Agency-wide organizational assessment in FY 2009
 - Assessment includes all major areas of the organization including strategic plan, leadership, staffing, workforce issues, and process management
- Revised all DCAA training courses to reflect issues reported by the GAO (completed in August)
- The Director, DCAA visited the regional office and the three audit offices addressed in the GAO report to assess the issues and environment in the offices (completed in July)

Processes

- Raised the field office signature authority for all audit reports to the level of the manager or higher (completed in August)
- Submitted proposal to the union to bargain the new proposed independent referencing process (completed in August)
- Aggressively completing open actions from IG oversight review (planned to complete in September)
- Aggressively completing the current round of quality assurance reviews (planned to complete in October)
- Completing internal assessment of a sample of 40 audits across the Agency stratified in the high risk areas identified by the GAO (planned to complete in September)

Additional Actions

- Completing audit effort to mitigate the risks of the 13 cases identified by the GAO (four completed to date with the remainder due for completion no later than November)
- Requested the DoD IG review DCAA's actions in the specific 13 cases identified by the GAO and investigate the findings of an abusive management environment (draft report estimated to be issued in January)
- Established Strategic Plan Objective to assess improvements to audits of contractor internal controls (Objective established in June, estimated for completion in FY 2009)