

September 23, 2009



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The Honorable Gordon S. Heddell

Inspector General
Department of Defense

before the

Senate Homeland Security and
Governmental Affairs Committee

on

"Defense Contract Audit Agency:
Who is Responsible for Reform"

Chairman Lieberman, Ranking Member Collins, and distinguished members of this committee— thank you for the opportunity to appear today before the committee to discuss continuing actions by my office to enhance the Defense Contract Audit Agency’s (DCAA) key role as a Department of Defense (DoD) watchdog over the billions of dollars spent by the Department in contracts. DCAA is critical to the Department’s ability to effectively execute its diverse mission.

It is an objective of the Department of Defense Inspector General, (DoD IG), to verify that DCAA audits and the audits of all DoD audit agencies comply with stringent standards. The DoD IG is engaged and continues its commitment to monitoring and evaluating the effectiveness of DCAA, DoD’s largest audit agency, in performing contract audits and providing accounting and financial advisory services to all DoD components as well as other federal organizations.

We recognize, based on our efforts and those of the Government Accountability Office, that significant vulnerabilities continue to exist in DCAA’s implementation of auditing standards in terms of guidance and execution. DCAA auditors must be properly trained, developed, and managed so that they can conduct audits within required standards. We are pleased to note that senior DoD leadership is now actively engaged in addressing DCAA’s deficiencies and

management challenges. This focus is necessary to ensure that DCAA audits and financial advisory services are accurate, timely, and responsive, so as to prevent and detect fraud, waste, and abuse and ensure the proper use of public funds.

DCAA MANAGEMENT ISSUES

Compliance with Audit Standards

The hearing held by this committee last year highlighted several issues within DCAA that were identified by my office and the GAO.

On May 1, 2007, we concluded the “Review of the Defense Contract Audit Agency Quality Control System” (the “peer review”) and issued a report (D-2007-6-006). We determined that DCAA warranted an “adequate” opinion, because the 10 deficiencies identified were not cumulatively significant enough to have a material impact on the overall system of quality control. In that report, we made 20 recommendations for improvement to DCAA audits and its quality assurance program. DCAA has taken action on 16 of these recommendations.

On July 22, 2008, GAO issued a report titled, “Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated,” GAO-08-0857. GAO reported on 13 cases involving 76 audits that did not comply with generally accepted government auditing standards (GAGAS).

DCAA Workplace Environment

In the July 2008 report, GAO also found that an abusive work environment existed at two field audit offices (FAOs). Problems identified included involuntary reassignment, threats of disciplinary action against auditors because they would not drop audit findings or draft favorable reports, and fear of retaliation among auditors for speaking with GAO representatives.

ONGOING IG DOD OVERSIGHT

IG DoD Followup Review, August 31, 2009

We have monitored DCAA's efforts to correct the deficiencies noted in our May 2007 peer review, and we conducted a significant review in response to the July 22, 2008, GAO report. Our audit report entitled "Follow-up Review on Audit Work Deficiencies and Abusive Work Environment Identified by the Government Accountability Office Report" (D-2009-6-009) was issued on August 31, 2009, to address findings in the GAO report.

We reviewed DCAA audit documentation for 13 cases and interviewed auditors for 12 cases. When available, we also reviewed the current audits DCAA performed to correct the deficient audits identified by GAO. We visited two DCAA Western Region field audit offices and interviewed 68 audit employees, including supervisors and managers, to assess whether an abusive work environment existed.

Some of our more significant findings included:

1. Employee concerns with time pressures, uncompensated overtime, changes to audit results and opinions, and unprofessional behavior created a work environment not conducive to performing quality audits at two DCAA offices in the Western Region.
2. A flawed audit could have allowed a contractor to recover \$271 million in unallowable costs on the Evolved Expendable Launch Vehicle (EELV) program. Of the \$271 million, \$101 million has been paid to date. In our October 20, 2008, Memorandum to Commander, Air Force Space and Missile Systems Center, and Director, DCMA, we recommended SMC take immediate action to withhold any further payments from the EELV joint venture for unabsorbed Program Management and Support costs, immediately cease negotiations on a \$114 million proposal containing these same unallowable costs, and reassess the propriety of existing advance agreements between SMC, DCMA and the contractor.
3. DCAA provided ineffective audit advice and services to a contracting officer and DCAA had insufficient evidence to support a contractor's participation in the direct bill program.
4. Seventeen of 18 forward pricing audits performed by trainee auditors at a third Western Region office did not comply with standards.
5. DCAA did not adequately qualify the audit results of a compensation system report and had insufficient evidence to support a purchasing system audit opinion.
6. DCAA did not have sufficient basis for dropping four findings, and did not report a contractor's uncompensated overtime practice which increased the risk of cost mischarging.

On the basis of these findings, we recommended that:

1. DCAA rescind five audit reports and notify contracting officials not to place reliance on the reports' conclusions.
2. DCAA address management actions and behaviors that have a negative impact on the work environment.
3. DCAA create a mechanism for reporting external impairments to auditor independence in the DCAA Contract Audit Manual.

4. The Commander, Air Force Space and Missiles Systems Center, withhold future payments for certain unallowable costs on the affected contract
5. The Executive Director, Contracts, Defense Contract Management Agency, reassess the identified advance agreements pending receipt of newly initiated DCAA audits.

Our report also recommended that DCAA take “appropriate corrective action” regarding the performance of the two supervisors associated with nine of the thirteen cases of the non-compliant audits reviewed. DCAA has reported that the two supervisors will re-take supervisory courses at the Defense Contract Audit Institute, and their managers will identify other appropriate training activities. Legal review by DCAA determined that adjustments to prior performance ratings would not be appropriate.

DCAA concurred with 23 of our 24 recommendations and reserved comment on one other recommendation. We requested that the DCAA reconsider its position on the recommendation to rescind DCAA Audit Report No. 4461-2006A210000001, and comment on it in response to our final report. We also requested that DCAA reconsider its responses to three recommendations which did not meet the intent of the recommendations, and to provide comment on one recommendation we added.

The Air Force Space and Missile Systems Center concurred with our recommendations as did the Defense Contract Management Agency.

We will continue to monitor DCAA actions regarding our recommendations.

Senior Official Investigations

My office conducted a senior official investigation and concluded that the former Regional Audit Manager with responsibility for DCAA's Resident Office at Boeing, Huntington Beach, California, was not free from external impairments to independence as required by GAGAS and DCAA audit policy. Her direction resulted in a flawed audit that could have allowed Boeing to recover \$271 million in unallowable costs. Additionally, we received allegations that she created an abusive working environment.

Because this Regional Audit Manager was promoted to Deputy Director, Western Region, DCAA, the allegations were addressed in a senior official investigation that resulted in a report issued September 11, 2009. The investigation concluded that the individual failed to meet GAGAS standards for independence and objectivity by improperly directing changes to the audit report and that she engaged in conduct that was inconsistent with established leadership standards for senior officials. The report was provided to the Director, DCAA, for review and appropriate action.

We also conducted separate investigations into allegations that two other DCAA senior officials abused their authority by improperly directing changes to audit opinions. Those allegations were not substantiated.

Expiration of 2007 Peer Review Opinion

Based on the recent review of DCAA by GAO together with deficiencies identified in our May 2007 peer review, I took the extraordinary action of notifying DCAA that our May 2007 “adequate” opinion on DCAA’s system of quality control would expire as of August 26, 2009. On the basis of our action, I recommended that DCAA immediately begin to qualify its audits with a statement noting an exception to compliance with the Quality Control and Assurance Standard. Additionally, I recommended that DCAA publicly disclose the concerns of the GAO, including the questioning of the reliability of audit reports issued during the period ending September 30, 2006.

2009 Peer Review

The peer review of DCAA for the period ending September 30, 2009, was announced on August 5, 2009, and will be performed in three or four projects. We will assess whether DCAA’s quality control system provides reasonable assurance of compliance with standards in design and effective operation and compliance in practice. The review will follow up on various DCAA corrective actions in response to GAO and DoD IG findings and will also consider repeated non-compliances with government auditing standards identified in our May 2007 and December 2003 opinion reports on the DCAA quality control system. Additionally, when planning our review, we will take into consideration

deficiencies found by GAO in its July 2008 report and the report it is releasing today.

On September 1, 2009, DCAA sent a request to GAO to delay the announced peer review by at least two years to be able to continue its internal improvements to address previously noted deficiencies. I am not convinced that this is the right strategy at this time. Whether or not the peer review is delayed, the DoD IG continues to have a statutory responsibility to provide audit oversight. In the event the peer review is postponed, we would undertake a number of targeted reviews of DCAA high risk areas.

Hotline Complaints - Whistleblower Protection

Since the hearing last September, the Defense Hotline has continued to receive allegations of misconduct at DCAA. At this time we have 36 open Hotline complaints involving DCAA. Of those, 14 complaints concern potentially inappropriate contractor practices and have been referred to either DCAA or to the Defense Criminal Investigative Service. The 22 remaining cases include allegations such as changing findings and scope of audits, noncompliance with standards, lack of audit independence, and management abuses.¹ We are diligently pursuing these allegations and will take into consideration relevant

¹ Two cases involve allegations of inappropriate action by DCAA personnel. The allegations do not relate to audit quality or overall management issues and have been referred to DCAA for review.

Hotline complaints as part of our risk assessment of DCAA for the peer review, or for other high risk assessment projects.

A concern raised at the hearing last September was how the DoD IG protects the identity of whistleblowers who wish to remain confidential. Whistleblowers are critical sources of information to Inspectors General and it is vital that we protect their identities to the greatest extent possible. We have conducted a comprehensive review of the Defense Hotline and as a result have issued new Hotline operating procedures that implement several steps to improve our processes. One such step was to revise the warning statement that accompanies all Hotline documents to emphasize that access to Hotline information is limited to those responsible for responding to the DoD IG. This is intended to ensure information that may include the identity of a complainant is not provided to those without a need to know. Additionally, we have implemented additional checks to ensure that we identify if a complainant has consented to the release of his or her identity. We are also reviewing cases more closely to determine if referral to another agency could place a complainant at greater risk of reprisal, or should instead be retained by the DoD IG for investigation.

Conclusion

In closing, I emphasize the importance of the mission of DCAA and its impact on the Department of Defense. I am dedicated to helping improve DCAA

operations. Our oversight role is essential to helping DCAA identify weaknesses and where problem areas exist.

I welcome your questions.