

1 IMPROVING FEDERAL CONTRACTING AUDITING

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3 TUESDAY, FEBRUARY 1, 2011

4 United States Senate,
5 Committee on Homeland Security and Governmental Affairs,
6 Ad Hoc Subcommittee on Contracting Oversight,
7 Washington, D.C.

8 The Subcommittee met, pursuant to notice, at 2:40 p.m.,
9 in Room SD-342, Dirksen Senate Office Building, Hon. Claire
10 McCaskill, Chairman of the Subcommittee, presiding.

11 Present: Senators McCaskill and Brown.

12 OPENING STATEMENT OF SENATOR MCCASKILL

13 Senator McCaskill. The Committee will come to order.

14 I am told that Senator Brown is on his way. So we will
15 begin, and I am sure he will not mind it if I begin my
16 opening statement, and we will have plenty of time for his
17 opening statement when he gets here.

18 If there is not enough evidence that I am strange, I
19 will add more to the record, and that is that we are going
20 to deal with two of my favorite topics today, auditing and
21 the oversight of contracts.

22 This Committee hearing is all about how those two
23 things need to be merged together so that we are doing the
24 best job we know how to, in fact, manage contracts in the
25 Federal Government.

1 This is not a gotcha hearing. This is an informational
2 hearing. This is a hearing so that we understand what
3 contract oversight is ongoing through the very important
4 management tool of contract audits.

5 Last Congress the Subcommittee held a number of
6 hearings that reviewed the fundamentals of contract
7 management and oversight across the Federal Government.
8 This afternoon's hearing continues that work with an
9 examination of contract audits, one of the most important
10 components of effective and efficient contract oversight.

11 This is a subject which may sound dry to almost
12 everyone except those sitting inside this room, and likely
13 some of this room would also agree that it is a very dry
14 subject matter, but this is essential to good contractor
15 registration.

16 Contract audits help ensure the government gets what it
17 pays for and are one of the best weapons the government has
18 to safeguard taxpayer dollars against waste, fraud, and
19 abuse.

20 Last year the Subcommittee asked for information from
21 22 Federal agencies about how they use contract audits. My
22 staff has prepared a fact sheet summarizing this
23 information, and I ask for unanimous consent that the fact
24 sheet and the underlying data be admitted into the record.
25 I think I have unanimous consent.

1 [The information follows:]

2 / SUBCOMMITTEE INSERT

1 The information the Subcommittee received showed that
2 there is a wide variation in the agencies' use of contract
3 audits. The Defense Department which relies on DCAA, the
4 Defense Department Contract Audit Agency, to perform audits
5 conducted approximately 17,000 contract audits in 2009.

6 All of the civilian agencies combined conducted fewer
7 than 1800 contract audits; 17,000 in DOD, fewer than 1800 in
8 the rest of the government.

9 Let us put it another way. The Defense Department
10 conducted an average of one audit for every 25 million it
11 spent on the contracts. The rest of the government on
12 average conducted one audit for every 511 million spent
13 through contracts.

14 Of course, there is a lot of variation among the
15 agencies. The Department of Energy, who will testify today,
16 conducted one audit for every 82 million in contracts.
17 Another witness, the Department of Education, conducted one
18 audit for every 1.5 billion spent through contracts.

19 I am interested to hear from these witnesses about the
20 different approaches their agencies take to contract
21 auditing. I am also looking forward to the perspectives of
22 Patrick Fitzgerald, the Director of the Defense Contract
23 Audit Agency, and Brian Miller, the Inspector General of
24 GSA, who can provide expert testimony regarding the conduct
25 and the importance of contract auditing for the Federal

1 Government.

2 Let me pause for a moment and congratulate Brian
3 Miller, the Inspector General of GSA, because I realize that
4 today we had something that does not happen very often. We
5 had very good news about the oversight capacity of the
6 Federal Government.

7 Oracle agreed to pay \$46 million to settle a kickback
8 complaint that came about in part because of the audit work
9 of the Inspector General at GSA. A number of computer firms
10 were paying government employees to recommend them for IT
11 contracts; and in fact, it was the work on contract auditing
12 that exposed some of these problems and ultimately brought
13 about a number of different actions by the Department of
14 Justice; and today the announcement that Oracle is going to
15 repay the Federal Government \$46 million or repay \$46
16 million for the problems that they are responsible for.

17 We will also hear testimony on behalf of the Chamber of
18 Commerce as well as from the Project on Government Oversight
19 and the Government Accountability Office who will help us
20 take a broader look at this issue.

21 I am proud, very proud to be a former government
22 auditor and a passionate defender of the importance of
23 auditing but that does not mean that I think that more
24 audits alone is the answer to good contract management and
25 oversight.

1 If the government is going to be a good steward of
2 taxpayer dollars, we need to have an integrated
3 comprehensive contract management; and everyone involved in
4 the process, from the line contracting officials to senior
5 leadership and department heads, they need to be involved,
6 engaged, and probably most important accountable.

7 Auditing is one part of that continuum and I hope that
8 today we can have an open conversation about how auditing
9 can and should fit into the overall framework of contract
10 oversight.

11 In a time of scarce government resources and an
12 inadequate contracting workforce, the government must
13 evaluate where it is most vulnerable and focus resources
14 where they can most effectively protect taxpayer dollars.

15 I look forward to the witnesses' testimony and the
16 opportunity to discuss how we can better use contract audits
17 to oversee government contracting and I encourage all of our
18 witnesses, particularly the witnesses on the second panel
19 this afternoon, to speak frankly and openly about what
20 improvements are necessary.

21 I was going to compliment Senator Brown right now and I
22 bet he would rather wait to be here to hear it. That is a
23 disease that most of us have around here. We love to hear
24 good things about ourselves. So I will wait to compliment
25 Senator Brown for when he gets here, and now I will

1 introduce the opening panel of witnesses that we will be
2 hearing this morning.

3 First, we have Thomas Skelly, who currently serves as a
4 Director of Budget Service for the Department of Education
5 and has been the Department's Acting CFO since 2008.

6 In that capacity, Mr. Skelly coordinates internal
7 controls and audit follow-up and manages contracts and
8 acquisitions for the Department.

9 He is also responsible for the Department's 77 billion
10 annual budget. Mr. Skelly has served as a Federal employee
11 since 1974 and is a member of the career senior executive
12 service.

13 Welcome, Mr. Skelly.

14 Ingrid Kolb has been the Director of the Office of
15 Management for the Department of Energy since her
16 appointment in 2005. As Director, she is responsible for
17 the Department's project and acquisition management.

18 Ms. Kolb has served in budget and financial management
19 roles for both the Department of Homeland Security--that is
20 a tough one--and the Department of Energy.

21 Prior to joining the Department of Energy, Ms. Kolb was
22 the Director of the training and development center at the
23 Department of Education.

24 Brian Miller has served as the Inspector General for
25 the General Services Administration since his conformation

1 by the Senate in July of 2005. He is also the vice chair of
2 the National Procurement Fraud Task Force and a member of
3 the Department of Justice's Recovery Act fraud working
4 group. Mr. Miller received the Attorney General's
5 Distinguished Service Award in 2008.

6 Patrick Fitzgerald has served as the Director of the
7 Defense Contract Audit Agency since his appointment in
8 November of 2009. As Director, Mr. Fitzgerald is
9 responsible for all management and operational decisions at
10 the agency.

11 He previously served as the Auditor General for the
12 United States Army.

13 Before we turn to your testimony, Mr. Skelly, I will
14 tell Senator Brown I finished my opening statement, and my
15 last paragraph of my opening statement was complimenting
16 you, and I said I was going to hold off on the paragraph
17 because I knew you would want to be here to hear it.

18 Senator Brown. Absolutely.

19 Senator McCaskill. I would like to take a moment to
20 recognize his contribution to this Subcommittee. There are
21 not a lot of people who wake up in the morning excited about
22 talking about contract oversight and auditing. So I felt
23 very lucky to have the opportunity to work with Senator
24 Brown over these months.

25 I do not think we know yet for sure who is going to be

1 ranking member on the Subcommittee for this Congress, but I
2 am confident that he and I will continue to work together on
3 important oversight issues I hope in this Committee; but if
4 not, I know that that work will continue.

5 And I turn to you for your opening statement.

6 OPENING STATEMENT OF SENATOR BROWN

7 Senator Brown. Thank you, Madam Chair. I apologize
8 for being a little late. I lost track of time.

9 First of all, as the ranking member of the
10 Subcommittee, it has also been my honor and pleasure to work
11 with you in exploring important issues of this Subcommittee
12 that go to the core of how government conducts its business.

13 Unfortunately, this may be my last meeting as ranking
14 member as you are aware of. So I want to just take a brief
15 minute to thank you and your staff for being so cordial and
16 thoughtful and helpful in welcoming me to the Committee and
17 also providing me with the opportunity to kind of spread my
18 wings a little bit and be part of something that is very
19 important. It has been a great experience and I look
20 forward to continuing to work with you.

21 As you know, in Fiscal Year 2009, the Federal
22 Government contracted over \$530 billion on goods and
23 services. And while I intend to work with my fellow members
24 of Congress to reduce this amount, it also means that we
25 must be incredibly vigilant in ensuring that the effective

1 contract oversight actually occurs.

2 With \$530 billion taxpayer dollars at stake, the
3 government needs strong controls to provide reasonable
4 assurance that these contract funds will not be lost to
5 waste, fraud, and abuse.

6 I want to commend the chairwoman and former Missouri
7 state auditor for calling this hearing to focus on a key
8 part of the contract control system which is contract
9 audits.

10 While contract auditing can be an important control
11 mechanism, in our current fiscal environment the reality is
12 we cannot audit everything nor should we. We must focus our
13 limited resources on examining those activities presenting
14 the greatest risk to the government and which justify the
15 return on the investment.

16 For the audits that are necessary, we must have an
17 efficient system that accomplishes the task in a cost
18 effective and timely manner.

19 The current system is not working the way it was
20 intended and this is evidenced by the backlog in audits that
21 prevents contracts from closing down in a timely manner.
22 This delay on closing out contracts increases cost to
23 contractors and to the government.

24 And while I understand today's hearing will not discuss
25 far-reaching reforms to the Federal acquisition system, we

1 should keep in mind whose money we are spending and try to
2 operate a government more like a business.

3 In today's hearing, I am interested in finding
4 solutions to the problems in Federal contract auditing, look
5 forward to hearing those witness perspectives on the
6 critical issues, and I thank the witnesses obviously for
7 being here today.

8 And on a more personal note, in one of the bills we
9 were able to work in a bipartisan, bicameral manner, it
10 really started in this Committee with the Arlington National
11 Cemetery.

12 It was something that not only provided great insight
13 to me as to what the process is but it really served a real
14 need with our Nation's heroes.

15 You should be commended for that and it has been an
16 honor to be here in this Committee. I am actually going to
17 still be involved in the Committee if it, in fact, works out
18 that it will be obviously the contracting arm associated
19 with it. I am hopeful I will still be able to participate.
20 I still am on this Committee if I am not mistaken so it is
21 not like you are losing me totally. So thank you.

22 Senator McCaskill. Thank you, Senator Brown.

23 It is the custom of the Subcommittee to swear in all
24 witnesses that appear before us. So if you do not mind, I
25 would ask you all to stand.

1 Do you swear that the testimony you will give before
2 the Subcommittee will be the truth, the whole truth, and
3 nothing but the trust so help you God?

4 Mr. Skelly. I do.

5 Ms. Kolb. I do.

6 Mr. Miller. I do.

7 Mr. Fitzgerald. I do.

8 Senator McCaskill. Thank you all.

9 We will be using a timing system today. We would ask
10 that your oral testimony be no more than five minutes.
11 Obviously your written testimony will be printed in the
12 record in its entirety, and we will not be, as long as you
13 do not get closed to seven, eight, nine, ten minutes, we are
14 going to be very tolerant if you go over slightly. I do not
15 want anyone to feel like they are under the gun, so to
16 speak, in terms of finishing their testimony.

17 We will turn to you, Mr. Skelly, for your testimony.

18 Thank you very much for being here.

1 TESTIMONY OF THOMAS SKELLY, ACTING CHIEF FINANCIAL
2 OFFICER, U.S. DEPARTMENT OF EDUCATION

3 Mr. Skelly. And thank you, Chairman McCaskill and
4 Ranking Member Brown. Thank you for this opportunity to
5 discuss Federal contract auditing and thank you for your
6 leadership on this important issue.

7 As you know, my name is Tom Skelly. I am the Director
8 Budget Service in the U.S. Department of Education. Since
9 2008, I have also been delegated the authority to perform
10 the functions and duties of the Chief Financial Officer.

11 In this role, I lead the organization that provides
12 accurate and timely accounting and financial management
13 information, coordinates internal controls and audit follow-
14 up, and manages contracts and acquisitions.

15 I am proud to report that the Department's financial
16 statements received a clean opinion for the ninth straight
17 year and we also have achieved recognition for excellence in
18 financial reporting from the Association of Government
19 Accountants.

20 In the past, we have not had many opportunities to
21 benefit from contract audits. In our April 2010 response to
22 you, we identified only one external audit, and we expect
23 only one this year. The primary reason for not having many
24 contract audits is that most of our contracts are fixed-
25 price, and the government's cost risk on that type of

1 contract is relatively low.

2 The Department also has many competing priorities for
3 administrative funding. Therefore, even with cost-
4 reimbursement contracts, we limit the use of contract audits
5 to those situations that need a review of incurred costs to
6 help us closing out contracts.

7 Although the Department has one of the largest
8 discretionary budgets, the Department also has the smallest
9 workforce of any cabinet-level agency. Less than one
10 percent of our annual funding is spent on administrative
11 activities.

12 In fiscal year 2010, the Department had approximately
13 4,200 employees. This number represents a decrease of about
14 10 percent over the past decade, even though the workload
15 has grown during that period.

16 For example, the enactment of the Ensuring Continued
17 Access to Student Loans Act of 2008 and the more recent
18 Student Aid and Fiscal Responsibility Act of 2010 greatly
19 expanded our student loan work.

20 These loan programs and related increase in Pell Grant
21 applications have been the main drivers of our increased
22 work, but the Department also had a key role in the Recovery
23 Act implementation through which innovative and competitive
24 kindergarten through 12 education reform efforts we expanded
25 through such grants as Race to the Top and Investing in

1 Innovation.

2 The majority of our funds, though, are really for
3 grants and loans. They are not for contracts. We have used
4 contracts to perform much of the increased work involving
5 delivery of Federal student aid, and the dollar volume of
6 contracts has increased.

7 For example, we spent approximately \$1.5 billion on
8 contracts in 2009 and approximately \$1.8 billion in 2010.
9 Most of the increase was for student-aid processing and
10 loan-servicing contracts. These contracts tend to require
11 performance of high volumes of routine and similar tasks,
12 like application processing, loan origination, and loan
13 servicing and collection.

14 We have contracted for these kinds of activities, and
15 we have done these kinds of contracts for even three
16 decades, but the work volume has increased dramatically in
17 recent years.

18 In fiscal year 2010, only 21 percent of the contract
19 dollars and 9 percent of the contract actions awarded by the
20 Department were cost-reimbursement, and we are further
21 reducing our reliance on cost-reimbursement contracts each
22 year.

23 In fact, eight of the Department's top ten contracts,
24 representing 96 percent of the spending on our largest
25 contracts, are fixed-price. Examples of cost-reimbursement

1 awards that we do have include contracts to analyze student
2 achievement data from the National Assessment of Educational
3 Progress and an ongoing contract we had with Reading Is
4 Fundamental which distributes inexpensive books to children
5 and undertakes other activities that promote reading and
6 literacy.

7 The Department's Office of Inspector General conducts
8 independent audits, investigations, inspections, and other
9 reviews of programs and operations. Part of this
10 responsibility includes contract audits. In determining
11 what to review, our Inspector General's Office considers
12 internal risk assessments, Department requests,
13 Congressional requests, and hotline information and other
14 sources that contain allegations of concern.

15 As noted in last April's response to you about contract
16 audits, in fiscal year 2009, OIG completed an incurred cost
17 audit of a contract that the Department had entered into for
18 the administration of part of the National Assessment of
19 Educational Progress.

20 The purpose of the audit was to determine whether the
21 costs incurred in fiscal year 2006 under the contract were,
22 quote, reasonable, allowable, and allocable in accordance
23 with the terms and conditions of the contract and applicable
24 acquisition regulations. The approximate cost to the
25 Department to perform this audit was \$255,000.

1 As a direct result of this audit, our Inspector
2 General's Office recommended that: one, the Department
3 recoup unallowable costs paid to the contractor; and, two,
4 to then conduct a follow-up review of the costs not included
5 in Inspector General's sample. The Department recouped
6 229.7 thousand dollars from the contractor for the fiscal
7 year 2006 costs identified by the Inspector General.

8 In addition, the contractor disclosed during the audit
9 that it had inappropriately billed the Department for post-
10 retirement medical benefits during the period September 2002
11 through December 2007. The contractor returned to the
12 Department \$2.7 million in April 2009 for these improper
13 billings.

14 I point this out because it shows we did get some
15 additional benefits from the contract audit in addition to
16 the amounts we recovered throughout negotiations with the
17 vendor. So there is obviously some deterrent effect from
18 doing audits. It encourages vendors to keep good records,
19 revise their procedures, and maybe return things to us
20 before we actually get into the audit.

21 We considered several options for the follow-up audit
22 that the IG had recommended. The IG itself decided not to
23 devote limited resources to a broader audit. Then the
24 Department initiated a request to the Defense Contract Audit
25 Agency for audit support to review the incurred costs not

1 included in OIG's sample.

2 To obtain this support, the Department representatives
3 worked with DCAA in 2010 to determine the scheduling and the
4 cost of the follow-up audit, which was estimated to cost
5 \$27,000.

6 In December 2010, DCAA confirmed that the requested
7 audit was not programmed in its schedule for fiscal year
8 2011. As a result, since the IG did not want to do it, the
9 DCAA did not want to do it, we contracted on our own for
10 audit support services. The contract we obtained includes
11 performing incurred cost audits of this and other kinds of
12 activities and it will be providing services this fiscal
13 year.

14 The Department faces challenges regarding contract
15 audits in deciding whether they take priority over other
16 demands for other limited funds. The Department's Inspector
17 General has multiple priorities, and DCAA cannot always
18 accommodate non-DOD requests for audit support. Obtaining
19 audit support from a non-governmental firm can be costly and
20 time-consuming.

21 In conclusion, we support efforts to maximize the
22 performance of contractors in delivering Department
23 services. We rely on many contractors to get the work done.
24 We believe that fixed-price contracts are the preferred
25 option over cost-reimbursement contracts as they provide a

1 better value to the taxpayer.

2 Thank you, Madam Chairman, for your attention to this
3 important issue, and I would be happy to answer any
4 questions.

5 [The prepared statement of Mr. Skelly follows:]

1 Senator McCaskill. Thank you very much.

2 MS. Kolb.

1 TESTIMONY OF INGRID KOLB, DIRECTOR, OFFICE OF
2 MANAGEMENT, OFFICE OF DEPUTY SECRETARY, U.S.
3 DEPARTMENT OF ENERGY

4 Ms. Kolb. Thank you. Thank you, Chairman McCaskill
5 and Senator Brown, and I, too, appreciate your leadership on
6 this very important topic.

7 My name is Ingrid Kolb. I am the Director, Office of
8 Management at the U.S. Department of Energy. I am pleased
9 to be here today to discuss with you how the Department uses
10 audit services to detect and prevent waste, fraud, and abuse
11 in government contracts, to provide contracting officers
12 with reasonable assurance whether contractor submissions are
13 free of material misstatement, and also to provide
14 contracting officers with assistance and advice in the
15 establishment of fair and reasonable prices for products and
16 services.

17 In fiscal year 2010, the Department spent approximately
18 \$26 billion on contracts. The bulk of the dollars, about 80
19 percent, was spent on the Department's unique management and
20 operating contracts. These contracts are used primarily to
21 manage Department's laboratories, its national laboratories
22 as well as other government-owned or controlled facilities.

23 The Department's Office of Inspector General is the
24 auditor for management and operating contracts; and in
25 fiscal year 2010, the Department spent approximately \$1.1

1 million for 17 of these IG audits.

2 The Defense Contract Audit Agency has traditionally
3 been the primary auditor for our other contracts. In fiscal
4 year 2010, the Department spent approximately \$9.4 million
5 for 273 audits of varying types, performed by DCAA. The
6 majority of these are for incurred cost audits.

7 DCAA has provided us with excellent service in the past
8 and remains our primary source of audit service for non-M&O
9 contracts.

10 However, over the past few years as DCAA has
11 experienced challenges with an increasing workload and fewer
12 resources which have caused some concern for the Department
13 of Energy, our ability to obtain cost-incurred audits in a
14 timely manner has diminished and in some instances at some
15 procurement sites this has caused a backlog of closeouts for
16 our contracts.

17 In response to the increased workload associated with
18 the American Recovery and Reinvestment and Recovery Act and
19 the corresponding demand for the DCAA audit services around
20 the government, the Department of Energy conducted a
21 competitive procurement to obtain supplemental audit
22 services.

23 In coordination with DCAA, a private accounting firm
24 was awarded a contract in May of 2010 to provide audit
25 services primarily for financial assistance awards. The

1 contract also provides full contract audit services, and to
2 date the contractor's performance has been timely and we
3 have been satisfied with the quality of their work.

4 Last month senior officials from the Department along
5 with three other civilian agencies met with Pat Fitzgerald,
6 the head of DCAA, who will be testifying in a few moments,
7 to explore ways to work more efficiently with DCAA.

8 And I am glad to report the meeting was very productive
9 and there are future discussions that we have planned to
10 help streamline the process. I believe that this ongoing
11 dialog with DCAA will strengthen our audit function at the
12 Department of Energy.

13 Again thank you for this opportunity to testify before
14 the Subcommittee. This completes my oral statement and I am
15 happy to answer any questions Subcommittee may have.

16 [The prepared statement of Ms. Kolb follows:]

1 Senator McCaskill. Thank very much.

2 Mr. Miller.

1 TESTIMONY OF THE HONORABLE BRIAN MILLER, INSPECTOR
2 GENERAL, U.S. GENERAL SERVICES ADMINISTRATION

3 Mr. Miller. Madam Chair, Ranking Member Brown, ladies
4 and gentlemen, thank you for the opportunity to testify on
5 the importance of contract audits in detecting and
6 preventing fraud, waste, and abuse in government contracts,
7 and thank you for your continued support of Inspectors
8 General and for the Subcommittee's strong commitment to
9 oversight.

10 This hearing is especially important as the President
11 and the Congress look to aggressively pursue fraud, waste,
12 and abuse in Federal spending. Contract auditing plays a
13 vital role in fighting fraud.

14 A key component of the President's plan to reduce the
15 national debt is rooting out fraud, waste, and abuse from
16 Federal programs such as healthcare programs. This is no
17 less true in the procurement area.

18 Across the government, contract audits result in saving
19 billions of taxpayer dollars and ensuring that, when Federal
20 dollars are spent, they are spend wisely.

21 My office has a great deal of experience with contract
22 audits. In my view they provide a critical oversight
23 mechanism for GSA's handling of billions of taxpayer
24 dollars.

25 Over the last two years, my office has identified about

1 \$1.1 billion in potential cost avoidances and \$33 million in
2 questioned costs. We have also worked very closely with the
3 Department of Justice in obtaining over \$400 million in
4 False Claims Act recoveries.

5 And thank you, Madam Chairman, for mentioning the
6 recovery yesterday from Oracle and from Sun Microsystems of
7 \$46 million.

8 Overall, GAO's 2008 report recognize that for every
9 dollar budgeted, our office had a return on investment of
10 19. I am proud of the work our office does in saving
11 taxpayer dollars.

12 I agree with the President and the Congress that we
13 need restore fiscal discipline to the Federal Government and
14 to find ways to make the government more effective.
15 Contract auditing is one way to do so.

16 Unlike other government programs, contract auditing
17 saves Federal dollars. It identifies wasteful spending and
18 ensures that taxpayer dollars are spent wisely. Most other
19 Federal programs, however useful and good, do not return
20 dollars to the treasury or prevent Federal dollars from
21 being spent.

22 At a time when the acquisition workforce is stretched
23 thin, overworked, and under trained, contract audits are
24 crucial to protecting taxpayer dollars. Contract audits are
25 the taxpayers last line of defense against losing money to

1 fraud, waste, and abuse.

2 To prevent overcharging, our office reviews the pricing
3 that contractors give to GSA. Too often, the prices given
4 to GSA are not fair and reasonable. As the largest volume
5 buyer, the Federal Government deserves the best prices. Yet
6 our auditors often find that contractors have given better
7 prices to other customers.

8 Our success hinges on both our autonomy from the agency
9 and on our contract expertise. However, we do face
10 perennial oversight challenges.

11 Contractor lawyers and consultants have sometimes
12 delayed responses to information requests for months and,
13 yes, at times even for years. These kinds of delays should
14 not be tolerated.

15 Thank you for calling attention to the need for more
16 contract audits and for more effective contract audits. In
17 these times of tight budgets and calls for smaller
18 government, we need to continue to be serious about rooting
19 out fraud, waste, and abuse.

20 I am proud of the record of the GSA Office of Inspector
21 General and hope that we can do more in the coming years to
22 save Federal money.

23 Thank you for your attention. I ask that my statement
24 and written materials be made a part of the public record
25 and I would be pleased to respond to the questions.

1 Thank you.

2 [The prepared statement of Mr. Miller follows:]

1 Senator McCaskill. Thank you.

2 Mr. Fitzgerald.

1 TESTIMONY OF PATRICK FITZGERALD, DIRECTOR, DEFENSE
2 CONTRACT AUDIT AGENCY, U.S. DEPARTMENT OF DEFENSE

3 Mr. Fitzgerald. Good afternoon, Chairman McCaskill,
4 Ranking Member Senator Brown. Thank you for the opportunity
5 to appear before you today. I am pleased to provide you
6 with an overview of the role that the Defense Contract Audit
7 Agency plays in performing contract audits for agencies
8 other than the Department of Defense.

9 I became the Director of the Defense Contract Audit
10 Agency 15 months ago, and prior to that, I was the Auditor
11 General of the Army and headed up the Army audit agency. I
12 am a certified public accountant and have over 30 years of
13 government auditing experience.

14 The Defense Contract Audit's mission supports efforts
15 to obtain the best value for dollars spent in government
16 contracts.

17 To carry out this mission, we have about 4700 dedicated
18 employees at 114 field offices around the world. We have
19 hired 500 auditors in the last two years. Currently 99
20 percent of our auditors have a four-year college degree, and
21 in addition 29 percent hold advanced degrees and 28 percent
22 are certified public accountants.

23 I consider the work we do for civilian agencies an
24 important part of our contract audit mission. The Defense
25 Contract Audit Agency has performed contract audits for

1 civilian agencies since its creation in 1965. The type and
2 scope of our efforts in civilian agencies are very similar
3 to the audits we perform in the Department of Defense.

4 Since 2000, the percent of our total budget devoted to
5 the reimbursable work has ranged from 9 to 13 percent, and
6 the total reimbursable funding has ranged from about 45
7 million to 58 million.

8 In an average year, we provide audit services to more
9 than 30 civilian agencies. However, our reimbursable work
10 is heavily weighted toward just a few civilian agencies.
11 For example, just two civilian agencies, NASA and the
12 Department of Energy, make up more than 50 percent of the
13 reimbursable work that we do.

14 As a result of our DOD audits, we have already
15 established a presence at many of the civilian agency
16 contractors. In 2010, over 90 percent of the contractors we
17 audited were engaged in some type of DOD work.

18 Using DCAA for contract audit at these locations is a
19 cost-effective use of both government and contractor
20 resources and provides assurance that comprehensive audits
21 are accomplished.

22 Over the past several year, the Department of Defense
23 has taken initiatives that have improved contract processes.
24 I would like to highlight three that, in my opinion, will
25 provide similar benefits throughout the Federal Government.

1 These are, one, establishing a formal adjudication
2 policy that ensures that contract audit findings and
3 recommendations receive timely and adequate consideration;
4 two, developing new business system rules that will
5 strengthen contractor systems to prevent fraud, waste, and
6 abuse by improving the transparency and oversight of these
7 systems.

8 And finally, creating a risk-based approach to ensure
9 that the limited auditing resources are focused on the areas
10 with the greatest risk and largest payback to the taxpayer.

11 Let me assure you we are committed to providing
12 civilian agencies with high-quality audits that protect the
13 interests of the American taxpayer.

14 Over the past year, we have implemented many
15 initiatives to improve the quality of our audits and improve
16 the work environment of our talented workforce. To assist
17 in developing our workforce, we are overhauling our training
18 programs as well as making changes to our hiring and
19 promotion policies.

20 We have also issued extensive audit policy and process
21 changes to improve the quality of our audit services and
22 audits. These changes have resulted in auditors performing
23 additional tests of contractors' controls and transactions.

24 We are reaching out to our stakeholders to better
25 inform them of our process improvements while working with

1 them to revisit the contracting time frames to allow
2 sufficient time to perform thorough audits that are
3 necessary to protect the taxpayers interest.

4 In summary, we have changed the way the Defense
5 Contract Audit Agency does audits by using a more
6 collaborative and comprehensive approach to contracting
7 audits.

8 We have institutionalized these initiatives in our
9 recently issued strategic plan that provides a clear roadmap
10 for executing these changes. We believe we have made
11 significant strides but recognize there is more work to be
12 done, and I know our workforce is committed to providing
13 high-quality audits that serve the American taxpayer.

14 Again I appreciate the opportunity to testify before
15 you today, and I would be glad to answer any of your
16 questions. Thank you.

17 [The prepared statement of Mr. Fitzgerald follows:]

1 Senator McCaskill. Thank you, Mr. Fitzgerald. Let me
2 start by, I am trying to get a handle on, I know that the
3 work you are doing, the majority of it is in a few agencies
4 and I know the majority of it are with agencies that have
5 some connection to the Department of Defense.

6 The large policy issue that I want this hearing to talk
7 about is are there sufficient contract auditing resources in
8 the Federal Government, do agencies have the ability to be
9 aggressive about contract audits, and how is that process
10 working now.

11 It is not clear to me; and if you can help, is there an
12 overall risk assessment that is being done across all of the
13 agencies that anybody has responsibility to look at and say,
14 you know, we have got a cost-plus contract over here at
15 Interior that no one has ever looked at and there has never
16 been a question asked about it and it, you know, has grown
17 and it is a fairly large contract now.

18 Is there someplace that there should be--I mean, are we
19 doing this in stove pipes and you are just being called in
20 on a piecemeal basis? Reassure me that there is some
21 overall strategy here as to where these audit resources are
22 going.

23 Mr. Fitzgerald. Senator McCaskill, from the defense
24 contract audit point of view, we have worked over the last
25 year with the Department of Defense and all the stakeholders

1 involved with that to make sure that our auditors are being
2 allocated to the highest risk, the highest priority work.

3 We are now starting to work with each individual
4 civilian agency to do that, realizing that one, you know, a
5 risk-based approach for DOD may not be the same thing for
6 DOE or something like that.

7 So we are working civilian agency by civilian agency to
8 make sure that we are providing the service and allocating
9 our resources, you know, where we believe and they believe
10 are the highest risk area.

11 Senator McCaskill. So is there some document that is
12 being prepared in each civilian agency about a risk
13 assessment in terms of contract audit work?

14 Mr. Fitzgerald. Senator McCaskill, I am not sure but
15 what I would like to do is, because I think I can meet the
16 needs of the civilian agencies if I know what that workload
17 is--

18 Senator McCaskill. Right.

19 Mr. Fitzgerald. --for the future so I can build the
20 workforce capacity to do that.

21 Senator McCaskill. Well, it looks like you by default
22 are it. Is that a fair assessment?

23 I do not mean you are the only game in town.
24 Therefore, we got to use you. I mean, obviously you are a
25 strong agent, audit agency with a lot of professionals.

1 Well, let me ask. I mean, do you sense, Ms. Kolb, is
2 there a risk assessment that your agency is doing that
3 prioritizes contract audit work within your agency?

4 Ms. Kolb. Yes, we definitely prioritize contract audit
5 work within our agency. We have certain dollar thresholds
6 that trigger an audit, trigger a contracting officer to
7 request an audit. And so that is how we go about
8 determining the risk level.

9 Senator McCaskill. And in Education the same thing?

10 Mr. Skelly. Pretty much. Our biggest audit, our
11 biggest contracts are fixed-price so we do not see as much
12 need for that; but if we are closing out one of the cost-
13 plus contracts, then we do see a need to.

14 Senator McCaskill. Well, there has actually been some
15 waste in fixed-price contracts, too. I know they are not as
16 risky as cost-plus.

17 Mr. Skelly. Just overall I think our strategy is to
18 try to maximize fixed-price contracts. That is the biggest
19 contract reform we are trying to implement and we have
20 direction from the White House and the Office of Management
21 and Budget on doing that.

22 Senator McCaskill. If I could just make sure that the
23 Defense Department had as many fixed-price contracts as you
24 have, I would be a happy camper. There is certainly not the
25 level of cost-plus going on in your agency that there is in

1 Defense.

2 So I guess what I am getting at here is that it appears
3 to me that we have never really had across the government
4 anyone going, okay, are we doing the right audit work? You
5 know, your priority has to be defense because you are the
6 Defense Contracting Audit Agency and the other agencies.

7 And what is a comparison of price? When you get
8 reimbursed for your cost, Mr. Fitzgerald, how does that
9 compare with contracting with private sector auditors to do
10 contract work?

11 Give me an apples to apples comparison here.

12 Ms. Kolb. I can give you a comparison with the
13 experience we have had with our independent auditor. The
14 price that we pay for DCAA is about \$114 an hour. The
15 comparison with our independent private sector auditor is
16 \$150 an hour.

17 However, I will say that one of the big issues for us
18 is timeliness, and DCAA is stretched fairly thin, and
19 sometimes it is very difficult for them to free up auditors
20 to perform high priority work. So we have had to go to our
21 independent auditor.

22 But for us, it is worthwhile because we need the audit
23 work in order to make timely business decisions. So we have
24 had to pay that extra amount in order to get that service.

25 Senator McCaskill. Right.

1 Senator Brown.

2 Senator Brown. I guess my biggest concern when we do
3 all these hearings is are we getting the most bang for our
4 buck, is there something we can do better or you can do
5 better or we can give you guidance to do better.

6 So why do I not just start with Mr. Fitzgerald, if that
7 is okay. Is there something we are not doing correctly to
8 the maximum bang for our buck?

9 Mr. Fitzgerald. Well, Senator, I think having this
10 hearing is helpful to bring some light on contract auditing.
11 Our agency did not grow through the boom that happened in
12 DOD. As result of some external reports, we have gotten the
13 support from the Department to grow our workforce.

14 We are making sure that we are doing a quality product
15 for not only DOD but our civilian agencies and it is far too
16 early to tell.

17 We have made some changes over the last year but we
18 believe we are seeing, as result of doing a better quality
19 product and service, that the amount of dollars that we are
20 questioning, that has significantly gone up over the last
21 two years as we have done, in what we believe, a more
22 comprehensive and thorough approach to our audits.

23 Senator Brown. At some point does it not lose its cost
24 effectiveness? There are some audits that just, you know,
25 it is like, gosh, I cannot believe we are auditing there

1 people. Do you ever, like, have that moment in your office?

2 Mr. Fitzgerald. I think one of the first things we did
3 was to look at a risk-based approach, and we have made some
4 adjustments where we have decided, based on the risk, that
5 we would reallocate our auditors to contracts above a
6 certain dollar threshold, and only do below that threshold
7 if there was additional risk or we do believe we might kind
8 of use the IRS model where we will do some work in that area
9 just on a random basis but clearly our focus will be on
10 higher dollar value, higher risk contracts because we will
11 never have nor would we be purporting to have auditors be
12 able audit every contract.

13 So we are looking to make sure that our limited audit
14 capability is applied and allocated to the highest risk
15 area.

16 Senator Brown. So you are doing that now?

17 Mr. Fitzgerald. Yes, sir.

18 Senator Brown. Is it true that you are about 10
19 percent over in terms of the actual close-outs that, you
20 know, there are some that have been going on for, as I think
21 has been discussed already, for a while.

22 Is it about 10 percent or do you have that number?

23 Mr. Fitzgerald. Senator Brown, to be very up front
24 with you, our costing hurdle which are the audits that we do
25 at the end of the contract, and many times they are needed

1 to close out the contract, that backlog has quadrupled over
2 the last eight years. So again that is why we are using--

3 Senator Brown. Quadrupled from what to what, just in
4 rough numbers so everyone knows approximately. We do not
5 need an exact number. I mean, has it gone from like one to,
6 you know, four?

7 Mr. Fitzgerald. No, no. It is a significant backlog
8 that we have to work. I could give you specific numbers.

9 Senator Brown. The reason I am kind of zeroing in on
10 this particular area because, you know, we have a lot of
11 Massachusetts businesses that deal in this type of work.

12 And not only are they waiting for close-out, it is
13 costing them real money, real dollars. So in addition to
14 the healthcare bill and the taxes they are paying and the
15 regulations that they are dealing with and now they have
16 audits so it is like what is next.

17 They need closure and they need certainty and they need
18 closure. And is there a way, is there something that we can
19 provide you or is there something that you need that we are
20 not giving you to get these things done? They have been
21 going on some of them for years.

22 Mr. Fitzgerald. Senator, we have to get after that
23 backlog. Hiring 500 new auditors over the last two years
24 will be helpful in that. And I would add, not to mitigate
25 that at all, but we do work closely with the contracting

1 officers to make sure that their billing rates are
2 appropriate so that there are no overages or shortages so
3 that the contractors get the money that they need to be paid
4 as we monitor the billing throughout the contract before we
5 do a final cost-incurred audit. We work closely to make
6 sure that is a minimum amount.

7 Senator Brown. Sure. You know, you are saying you are
8 hiring 500 new auditors. Can you believe it, folks? We are
9 doing 500 new auditors in addition to the thousands of other
10 new auditors in various agencies.

11 I mean, at what point do we actually just like hire new
12 workers like new construction folks, new, you know, just a
13 regular private sector employee.

14 The fact that we are hiring 500 new auditors just
15 smacks of me of saying, wow, something is broken somewhere.
16 There is a disconnect somewhere.

17 So hiring 500 new auditors to deal with a load that has
18 been quadrupled after a period of time, some of these audits
19 have gone on for years.

20 So I guess at what point do we say, my gosh, something
21 is broken. Are we auditing the proper folks that need to be
22 audited, the entities that need to be audited? Where is the
23 breakdown?

24 It is not kind of working for me really.

25 Mr. Fitzgerald. Senator, just to try to put it a

1 little in perspective. You know, the DOD procurement budget
2 just exploded from 2000 to 2010. DCAA's workload was flat
3 throughout that period.

4 In the early 1990s the Defense Contract Audit Agency
5 was about 7000 folks. That steadily went down and then
6 stayed flat. We are working to both adjust to workload
7 requirements and build the workforce capacity to get a good
8 balance there so that we can effectively provide a quality
9 product which is, in my opinion, a timely product, is a
10 quality product.

11 Senator Brown. I will reserve for the next round.

12 Senator McCaskill. I wanted to point out that Senator
13 Brown was not yet a Senator when all hell broke loose at
14 DCAA. To say that Mr. Fitzgerald had a challenge is an
15 understatement. It was determined that DCAA was not meeting
16 yellow book standards for government auditing.

17 There were some real management challenges, not that
18 there are not, and I want to say this on the record,
19 thousands of wonderful auditors at DCAA. I do not mean to
20 disparage the wonderful people that work at DCAA because
21 literally we would not have known about the problems if
22 somebody at DCAA had not come forward. But they had some
23 real management issues.

24 And Mr. Fitzgerald was drafted to take over an agency
25 which had traditionally only had the people move up in the

1 organization to head the organization. I think it may have
2 been, I do not know, was it the first time, Mr. Fitzgerald,
3 that somebody came from outside the organization to head it?

4 Mr. Fitzgerald. Yes, Senator.

5 Senator McCaskill. So they never had anybody come from
6 outside in a management capacity. So I am usually not the
7 one making, I do not mean to sound like I am making excuses
8 but I know the challenges that he faced.

9 And while I do not think they are there yet, they have
10 made significant progress in, I think, turning around the
11 management capacity at DCAA since his arrival. So for what
12 that is worth.

13 Senator Brown. May I make a note on that?

14 Senator McCaskill. Sure.

15 Senator Brown. Listen, I do not disagree. I am aware.
16 I have obviously done my homework and I am aware of your
17 challenges. I just want to make sure that we are auditing
18 the right entities and that we are not wasting our money and
19 that the audits that we are participating in, you know, it
20 affects real people, real jobs, real companies, not only in
21 my state but in yours, and you know, that is why I asked is
22 there something that we can do or that we are missing to
23 help you get that closure so people can move on and just
24 start creating real jobs.

25 Senator McCaskill. I certainly agree. I think that

1 this is one of those areas where we got to be careful
2 because there are areas of government where the investment
3 that we make comes back.

4 That segues into the question I want to ask you all and
5 that is pre-award and post-award auditing. I would like any
6 of your all's take on that. I just think there is, I know
7 that you have done a lot of it at GSA but it appears to me,
8 Mr. Miller, that you all could do a lot more of it because
9 every time you have done it, we found real money, have we
10 not?

11 Mr. Miller. We have, Madam Chair, and we could do a
12 lot more of it. And I think it would save Federal moneys.
13 That may sound ironic but we will save money if we do more
14 contract audits, if we invest the money there.

15 I would like to say briefly that we do not currently
16 use DCAA. We have used DCAA in the past a few times in
17 relatively limited capacities but currently we do the
18 auditing at GSA and that has worked out very well.

19 One of the areas that you point out is the pre-award
20 and post-award audits. The Sun Microsystems settlement of
21 \$46 million that you mentioned earlier started off as an
22 audit in our office that we worked up, developed, and
23 referred over to the Department of Justice. It was later on
24 combined with the Que Tam action and settled.

25 But we do save lots of money. As I pointed out in my

1 testimony, \$1.1 billion in cost avoidances for the last two
2 years, 1.1 billion. So thank you for asking that.

3 Senator McCaskill. Well, and I think many times those
4 pre-award audits have what I would call a deterrent effect
5 because everyone who is out there competing for Federal
6 contracts it gives them a heads up that somebody is going to
7 be paying attention to their numbers before all the
8 documentation is signed and before the contract is executed.

9 And I think that kind of has everyone on better
10 behavior as it relates to Federal contracting.

11 Let me address Mr. Skelly and Ms. Kolb. As we began
12 what I am going to call the lean era in the Federal
13 Government which I believe the next decade will be, I do not
14 think you are going to see much expansion of either one of
15 your departments.

16 I think, in fact, you will see some contraction at both
17 the Department of Education and Department of Energy. I am
18 not saying that we are talking about massive layoffs. But I
19 am just thinking that the whole footprint, I believe, will
20 shrink to some extent just because we are going to have a
21 real obligation to begin to cut back on all kinds of
22 spending, including discretionary.

23 Be honest with me. What kind of pressure is that going
24 to put on you to squeeze the resources you spend on contract
25 auditing because there will be some other pressure to keep

1 the money in programming at your agencies?

2 Mr. Skelly. I think it is going to be a significant
3 pressure. We have been squeezed already. I think I have
4 mentioned that we declined about 10 percent in the last
5 decade in staff already.

6 We have tried to make investments in key areas such as
7 contract officers, contract officers' representatives so
8 they can do a better job at monitoring our contracts. I
9 think that is a priority since we are going to rely on
10 contracts to get a lot of our student loan and student aid
11 work done in particular.

12 I think it is a good investment, though, and I
13 encourage you not to reduce our footprint at the Department
14 of Education, particularly our administrative funds.

15 We need the money to make sure that we award these
16 contracts and deliver our aid. And indeed, in our direct
17 loan program which we went to 100 percent as a result of the
18 SFRA legislation, we believe we will actually save about \$5
19 billion a year.

20 It will be a savings of \$5 billion per year or more in
21 the mandatory area but we are going to have to spend a
22 couple hundred million dollars more as noted in contracts in
23 our discretionary budget.

24 I think there will be pressure on things like contract
25 audits and anything else that is not directly related to

1 some of our providing our services and doing them very well.

2 Senator McCaskill. Who is doing the audits now? You
3 are contracting with people in terms of the application
4 process. Who is doing the checking on whether or not the
5 people that are getting this money actually even exist on
6 the Pells? Who is the check on--you know, there is always a
7 different thing.

8 I think the current cable TV ads are that you can
9 become a culinary chef online which I think is tricky but
10 that is the latest profit center for some of these
11 institutions is, you know, stay in your kitchen and become a
12 world-class chef if you just sign up to make sure we get
13 your Pell grant money. Who is doing that audit work?

14 Mr. Skelly. Well, our Inspector General is independent
15 in the Department of Education and can decide which areas to
16 look into and looks into areas that have the highest risk
17 where there might be abuses on the part of some parties in
18 our programs.

19 We also have, in looking at the contracts that provide
20 our services, we are relying primarily on our first line of
21 defense with our contract officers and our contract
22 officers' representatives.

23 Those are the employees in the Department of Education
24 who work with the contracts, make sure they are doing what
25 they are supposed to do. If the work statement is clear, if

1 the expectations are clear, if their performance measures in
2 the contract, then it is easier for those employees to check
3 up on whether the contractor is performing.

4 These contracts are just providing the mechanical
5 operation in getting the aid to the students and colleges.
6 We have other people who are assigned the job of making sure
7 that colleges are complying with the rules.

8 They have certain reports they have to file. We are
9 reviewing those. Both our program officers are doing that
10 but also our Office of Inspector General is looking into
11 that.

12 Senator McCaskill. I would give them a heads up. I do
13 not think we need a hotline to figure out that there may be
14 a little bit of over marketing in the area of the become a
15 world-class culinary chef from the comfort of your own home.

16 Mr. Skelly. Also I think one of the other committees
17 here in the Senate got a report from the General Accounting
18 Office recently where they had also looked into the
19 situation.

20 Senator McCaskill. Right.

21 Ms. Kolb, the question about whether or not your
22 auditing resources are going to get squeezed as the top line
23 budget may get squeezed.

24 Ms. Kolb. Actually, I think that we do a very
25 efficient job of ensuring that we have the audits available

1 that we need to make business decisions.

2 Last year, for example, we spent a total of about \$10
3 million for \$32 billion worth of contracts and financial
4 assistance awards that were made. That is a very small
5 percentage. I would envision us staying committed to
6 providing that level audit work.

7 So I do not think that the consolidation will impact
8 our commitment to putting forward those dollars. We will
9 stay with that.

10 Just to pick up on a few points that Pat Fitzgerald was
11 making. First of all, he was talking about moving to a more
12 risk-based approach. We completely support that, and we are
13 doing a few things at the Department to try and move in that
14 direction.

15 And that is, first of all, we do not always need a
16 comprehensive audit, and DCAA does a very thorough job, and
17 their preference is to conduct a thorough audit, a thorough,
18 comprehensive audit.

19 We want to work with DCAA to make sure that where a
20 targeted audit is all that is needed that that is what we
21 end up doing. So we believe that is very important and will
22 ensure that there is a more efficient use of resources. So
23 that is something that we can do.

24 Then also I had mentioned earlier that we have
25 thresholds that trigger an audit. We are in the process of

1 raising those thresholds to make sure that we are really
2 targeting those contracts where we need the audit work
3 completed.

4 Senator McCaskill. That is great. That is great.

5 Senator Brown.

6 Senator Brown. Thank you, Ms. Kolb.

7 Also you speak of a decline in the DCAA audit support
8 for the use of contractor's price proposals which has
9 impacted the Department's ability to negotiate fair and
10 reasonable prices, and we have heard from other agencies,
11 business groups, and POGO that DCAA's current practices
12 submitting these audits to the GAGAS standards is both
13 unnecessary and may contribute to these reviews taking more
14 time and is uncstly.

15 Is that your opinion of what they are saying about this
16 whole process?

17 Ms. Kolb. The concern that we have had with the
18 services provided by DCAA, and Pat Fitzgerald and I have
19 talked about this, really is one of timeliness.

20 We think that DCAA does a very good job. Again, we
21 would like to see more targeted audits as opposed to
22 comprehensive audits unless they are absolutely needed. But
23 the timeliness issue has to be addressed and DCAA is
24 committed to making those improvements.

25 Senator Brown. Should proposal reviews of cost and

1 pricing data be considered financial advisory services which
2 are not subject to all the GAGAS requirements?

3 Ms. Kolb. In the pre-award area, we depend heavily on
4 DCAA to examine the prices and we want to continue to have
5 them look at the proposed prices above a certain threshold.

6 Senator Brown. Mr. Skelly, you have been awfully lucky
7 tonight so I figured I just you--

8 Mr. Skelly. My whole life, I think, Senator.

9 Senator Brown. I know the feeling.

10 According to your testimony, the Department of
11 Education spent approximately \$1.5 billion on contracts in
12 fiscal year 2009 and \$1.8 billion in fiscal year 2010.

13 A key concept in contract auditing is that the cost of
14 control activity should not outweigh the benefit.

15 With over a billion dollars at stake, what contract
16 controls does the Department of Education have in place to
17 ensure that the taxpayers' money is spent wisely in
18 accordance with applicable regulation and the Department is
19 receiving the best value possible for its money?

20 Kind of an extension of what I asked Mr. Fitzgerald.

21 Mr. Skelly. Our main strategy is to use fixed-price
22 contracts. Approximately 71 percent of our contract dollars
23 are awarded through fixed-price contracts at least where the
24 unit price is fixed in a contract.

25 We found that that is the best solution. One ounce of

1 prevention is worth a pound of cure. We are better off
2 doing at the start, stipulating what is expected to be
3 delivered under the contract, having good performance
4 measures, following up that work through the work of our
5 contract officers and our contract officers'
6 representatives. We have got to do that to make sure that
7 we are spending our money well.

8 When we do use contract audits, it is for the incurred
9 costs. It is sort of after-the-fact, after the contract is
10 finished, and we are trying to close it out. But because we
11 have relatively few cost reimbursement contracts, there is
12 not as much for the auditors to find.

13 Senator Brown. So based on your experience, just
14 somebody who is listening or watching, if somebody is not
15 adhering to the terms of their contract, what do you
16 actually do? What is a typical scenario?

17 Mr. Skelly. It is notifying them that they are not
18 living up to the standard. A report has come in. We are
19 monitoring the activity. We get management information
20 reports, for example, on how many people are applying, how
21 many people are using the free application for Federal
22 student assistance, the FAFSA form.

23 About 20 million people use that form to apply. Many
24 of them are doing it over the web. So it is easy to monitor
25 how many are coming in and going out. We check those

1 management information reports to see are they coming in
2 timely.

3 There is actually an incentive built into the contract
4 for the contractor to process those quickly. We have
5 incentives in our default, in our servicing contracts where
6 the contractors are given additional funds if they make sure
7 that people do not go into delinquencies or defaults.

8 So we try to build those incentives into the contract
9 up front, and we try to monitor that as closely as we can.

10 Senator Brown. Have there ever been any instances that
11 you are aware of where there has just been a total breach of
12 the contract or not adherence to the terms of the contract?

13 Mr. Skelly. I am sure we have lots of humans involved
14 in this and we are making mistakes but I do not recall
15 specifically.

16 Senator Brown. I have nothing further. Thank you.

17 Senator McCaskill. Thank you, Senator Brown.

18 I want to thank the panel very much for your work and I
19 appreciate the time and effort you put into appearing at
20 this hearing today.

21 And we will take the second panel.

22 I said I would not put the witnesses in a hot box. As
23 it turned out, it kind of is hot. Is it as hot out there as
24 it is up here? Hot out there. Man, it is hot in here. It
25 is not going to kill us.

1 I want to thank the witnesses.

2 First, let me introduce this panel.

3 Jeanette Franzel is the Managing Director of the
4 Financial Management and Assurance Team at the Government
5 Accountability Office, GAO. In her role, she heads GAO's
6 oversight of financial management and auditing issues across
7 the Federal Government which includes review of internal
8 control, financial management systems, cost management,
9 improper payments and accountability, and corporate
10 governance issues.

11 Ms. Franzel is also responsible for overseeing the
12 GAO's development of the Government Auditing Standards, also
13 known to all of us who know and love it as the yellow book,
14 the standards used in the U.S. and as a model for the
15 private sector and governments around the world as it
16 relates to auditing standards.

17 Nick Schwellenbach is the Director of Investigations
18 for the Project on Government Oversight. Mr. Schwellenbach
19 conducts investigations which include examination of the
20 effectiveness of government oversight.

21 He has previously worked as a writer for the Center for
22 Public Integrity and is a reporter and researcher for the
23 Nieman Watchdog, a project of the Nieman Foundation for
24 Journalism at Harvard University.

25 E. Sanderson Hoe is a partner at the law firm of

1 McKenna, Long, and Aldridge. He has practiced government
2 contract law for over 36 years. He has expertise in areas
3 including contract formation, the structuring of complex
4 private financing of government contracts, and resolution of
5 post-award contract disputes.

6 He co-chaired the Committee on Privatization,
7 Outsourcing, and Financing at the Public Contract Law
8 section of the American Bar Association since 1999, and he
9 is currently serving as a pro-bono counsel to the government
10 of Liberia in the drafting of a new procurement code.

11 Thank you all for being here, and we will begin, oh, I
12 have to swear you in.

13 It is the custom to swear in the witnesses in the
14 Subcommittee. I would ask you to stand.

15 Do you swear that the testimony you will give before
16 this Subcommittee will be the truth, the whole truth, and
17 nothing but the truth? So help you God. Thank you very
18 much.

19 Ms. Franzel. I do.

20 Mr. Hoe. I do.

21 Mr. Schwellenbach. I do.

22 Senator McCaskill. Ms. Franzel, we welcome your
23 testimony.

1 TESTIMONY OF JEANETTE FRANZEL, MANAGING DIRECTOR,
2 FINANCIAL MANAGEMENT AND ASSURANCE, U.S.
3 GOVERNMENT ACCOUNTABILITY OFFICE

4 Ms. Franzel. Good afternoon, Madam Chairman.

5 Thank you for the opportunity to be here today to
6 discuss the role that contract audits can serve in effective
7 contract oversight and internal control in the government.

8 As the government has become increasingly reliant on
9 contractors over recent years, effective contract oversight
10 is key to protecting the taxpayers interests. In fiscal
11 year 2010, Federal agencies reported obligating
12 approximately \$535 billion for contracted goods and
13 services. The sheer size of Federal contract spending
14 poses significant risk if effective oversight and controls
15 are not in place.

16 Today I will describe the contracting cycle and related
17 internal controls, DCAA's role in performing contract
18 audits, and risks associated with ineffective contract
19 controls and auditing.

20 In preparing this testimony, we relied on the work we
21 performed during our DCAA engagements as well as our
22 extensive body of work on Federal contract management.

23 The contracting cycle consists of activities
24 throughout the acquisition process including pre-award and
25 award, contract administration and management, and

1 ultimately the contract closeout.

2 Effective contract oversight includes internal control
3 throughout the process, and the standards for internal
4 controls cover agencies control environment, risk
5 assessment, control activities, information and
6 communication, and monitoring.

7 As we heard in the previous panel, the type of contract
8 used really determines the types of internal control and
9 contract auditing activities needed to help protect the
10 government's interest.

11 Specifically, contract types can be grouped into three
12 broad categories: fixed price, cost reimbursable, and time
13 and materials contracts.

14 For fixed-price contracts, the government agrees to pay
15 a set price for goods or services regardless of the actual
16 cost to the contractor. So in those cases, the contractor
17 is assuming most of the cost risk.

18 Under cost reimbursement contracts, the government
19 agrees to pay contractor costs that are allowable,
20 reasonable, and allocable based on the contract.
21 Consequently, the government assumes most of the cost risk
22 in a cost reimbursement contract, and it is a similar
23 situation for time and materials contracts.

24 Contract audits are intended to be a key control in the
25 contracting process to help ensure that prices paid by the

1 government for goods and services are fair and reasonable
2 and that contractors are charging the government in
3 accordance with applicable laws, the Federal Acquisition
4 Regulation which is known as the FAR, cost accounting
5 standards and contract terms.

6 DCAA plays a critical role in contract oversight by
7 providing contract auditing services that DOD and other
8 agencies rely on when making these contract decisions and
9 when providing oversight.

10 The majority of DCAA audits focus on cost reimbursable
11 and time and materials contracts as these contract types
12 pose the highest risk to the government.

13 For example, the FAR requires government contracting
14 officers to determine the adequacy of a contractor's
15 accounting system before awarding a cost reimbursement or
16 other flexibly priced contract.

17 Also billing system audits support decisions to
18 authorize contractors to submit invoices directly to the
19 government for payment without further government review.

20 Audits of contractor incurred costs, claims and voucher
21 reviews directly support the contract payment process by
22 providing the information necessary to certify payment of
23 claimed costs.

24 And finally, closeout audits include reviews of final
25 vouchers and the cumulative costs and may include

1 adjustments and recoveries, if necessary.

2 Our work has identified significant contract management
3 weaknesses in Federal agencies, problems with agency
4 controls, over payments, and weaknesses in contract
5 auditing; and all of these pieces need to fit together in
6 order to have effective contract oversight. These
7 weaknesses increase the risk of improper payments; and
8 fraud, waste, abuse; and mismanagement.

9 For example, our work at various agencies have found
10 that contract officers are not performing detailed reviews
11 of invoices prior to paying invoices. In some cases even if
12 the contract officer had attempted to review the invoices,
13 the invoices provided by the contractor did not provide
14 sufficient detail to facilitate such a review.

15 There were also instances in which contracting
16 officials decided to rely primarily on DCAA's audits rather
17 than performing normal internal control procedures.

18 We also discovered cases in which contracting officers
19 did not even use the DCAA audits that are available to them.
20 We also found instances in which the agency was not
21 obtaining the required audits of contractors' accounting
22 systems and incurred audits.

23 Finally, our work has found problems with contracting
24 auditing itself. In 2009, we reported on audit quality
25 problems at DCAA offices nationwide. We found serious

1 quality problems in the 69 audits that we reviewed including
2 compromise of auditor independence, insufficient audit
3 testing, and inadequate planning and supervision.

4 As a result of our work, DCAA rescinded over 80 audit
5 reports and has been making many changes in its operations.

6 We concluded that at the root of DCAA's audit problems
7 was DCAA's focus on a production oriented mission that
8 emphasized performing a large quantity of audits with
9 inadequate attention to performing quality audits.

10 In our 2009 report, we made 17 recommendations to DOD
11 and the DOD IG to improve DCAA's management environment,
12 audit quality, and oversight.

13 And in response DOD and DCAA have taken a number of
14 actions. Our 2009 report also offered some potential
15 actions for strengthening the organizational effectiveness
16 of DCAA and the contract audit function in the Federal
17 Government.

18 Those potential actions would require further study as
19 well as potential congressional action and include actions
20 intended to strengthen DCAA's independence, including
21 potential organizational changes.

22 Madam Chairman, this concludes my statement and I will
23 be happy to answer any question that you have.

24 [The prepared statement of Ms. Franzel follows:]

1 Senator McCaskill. Thank you very much.

2 Mr. Hoe.

1 TESTIMONY OF E. SANDERSON HOE, PARTNER, MCKENNA,
2 LONG, AND ALDRIDGE, ON BEHALF OF THE U.S. CHAMBER
3 OF COMMERCE

4 Mr. Hoe. Madam Chairwoman, my name is Sandy Hoe, and I
5 am a partner at the law firm of McKenna, Long, and Aldridge.
6 I am pleased to be here to testify before you today on the
7 half of the United States Chamber of Commerce.

8 As you indicated in your opening, I have been
9 practicing government contract law on behalf of the
10 contractor community for more than 36 years.

11 Today's hearing is very important to the government
12 contractor community. Contractors understand and accept
13 that by providing goods, supplies, and services to the
14 Federal Government in exchange for taxpayer funds, they are
15 agreeing to contract auditing requirements.

16 The need for such audits is not being questioned. How
17 the audits are conducted is something on which the
18 contractor community has definite views.

19 Of the three auditing organizations who have appeared
20 here today, the Government Accountability Office, the
21 Inspector General, and the DCAA, government contractors
22 interface most frequently with the DCAA.

23 There are a number of concerns that the government
24 contracting community has as it works with the DCAA, and you
25 have heard many of these issues before, such as the length

1 of time it takes to complete an audit and the quality of the
2 audits themselves.

3 There are, however, more recent issues facing the
4 contractor community. The first is the role that the
5 auditor is taking in relation to the contracting officer.
6 Both traditionally and by law, contracting officers have
7 exercised authority to make decisions regarding the
8 implementation and performance of government contracts.

9 Recently, however, there is evidence that the auditing
10 community may be usurping some of that contracting officers'
11 role. Let me provide you a specific example from the
12 Department of Defense.

13 On January 4 of this year, DOD published a memorandum
14 assigning new roles for the Defense Contract Management
15 Agency, which houses the administrative contracting officers
16 for the Department of Defense and the DCAA regarding forward
17 pricing rates for contracts.

18 The memorandum provides that contracting officers shall
19 adopt the DCAA's recommended rates. This is a significant
20 change of policy and conflicts with current law.

21 Under current law, contracting officers have the
22 authority to administer contracts, taking advice from
23 auditors, lawyers, and technical experts.

24 Industry does not see the wisdom of separating this one
25 auditing function from the contracting officer who otherwise

1 is the final arbiter for the government on all contract
2 matters. We perceive this change may well cause problems in
3 the future.

4 Another issue that concerns industry today is DCAA's
5 recent stridency in its application of regulations during
6 the conduct of audits. Some in the industry have noticed a
7 sharp upturn in DCAA's reluctance to engage in the
8 discussion of audit issues when they arise through the
9 performance of an audit.

10 The Federal Acquisition Regulation cost principles and
11 other cost and price compliance regulations are relatively
12 explicit but still cannot and do not cover every
13 circumstance that may arise. A judgment often is necessary
14 in applying the regulations to resolve issues.

15 Unfortunately, since 2008 and 2009, DCAA seems to have
16 lost its appetite for analysis of the intent of a regulation
17 versus its literal interpretation.

18 Once it has applied the literal language, DCAA seems
19 little moved by any argument that the result reached is
20 nonsensical or that it could not have been what the drafters
21 intended.

22 This has confounded some in the contractor community
23 who believe that the goal of regulations and of government
24 contracting generally is to reach correct and rational
25 results.

1 I would like to end my statement with an idea of how to
2 improve government contracting. Consider that an audit can
3 have at least two perspectives and, Madam Chairwoman, you
4 mentioned this in your comments earlier.

5 An audit can be forward looking where the intent is to
6 identify steps to ensure that a contractor's system,
7 policies, and procedures will comply with government
8 contract requirements.

9 A contract audit also can be backward looking where its
10 purpose is to test the contractor's actual compliance with
11 the contract and regulatory requirements.

12 The first is affirmative, seeking to assure future
13 compliance. The latter is more investigative and often
14 associated with the concept of rooting out fraud, waste, and
15 abuse.

16 Each one is important but the first could be referred
17 to as the carrot, in the affirmative emphasis by the
18 government and the contractor on getting things right up
19 front; and the other is this stick.

20 Both will incentivize a contractor to be in compliance,
21 as, Senator McCaskill, you noted I believe earlier.
22 However, we believe the carrot is much more likely to
23 achieve the goal.

24 And by analogy from the manufacturing sector, there is
25 a saying you cannot inspect your way to a quality product.

1 It is a praise that is often heard. The lesson from this is
2 that quality needs to be built into a product up front.

3 Inspecting in quality after the fact is far less
4 effective, and I think that lessons from the manufacturing
5 industry can provide some lessons for the auditing
6 community.

7 Thank you again for inviting me to testify and I look
8 forward to any questions you may have.

9 [The prepared statement of Mr. Hoe follows:]

- 1 Senator McCaskill. Thank you, Mr. Hoe.
- 2 Mr. Schwellenbach.

1 TESTIMONY OF NICK SCHWELLENBACH, DIRECTOR OF
2 INVESTIGATIONS, PROJECT ON GOVERNMENT OVERSIGHT

3 Mr. Schwellenbach. Chairwoman McCaskill, thank you for
4 inviting me today to testify in ways to improve contract
5 auditing including the possible benefits of an independent
6 contract audit agency.

7 This hearing is an important step. We need an
8 independent and muscular contract audit agency that protects
9 the taxpayer. We believe that there should be an
10 independent Federal Contract Audit Agency or FCAA.

11 This is not a new idea but has been around since at
12 least the 1980s when DCAA whistle blower George Spanton
13 exposed serious problems at DCAA. In 2009, the GAO laid out
14 recommendations for congressional consideration.

15 This included, in the long term, possibly creating an
16 FCAA. While some knowledgeable insiders tell us that the
17 location of the agency is not a key issue, POGO believes an
18 FCAA that conducts most contract auditing for the entire
19 Federal Government makes sense, and I believe the statistics
20 that your staff prepared today I think bear that out to some
21 extent.

22 While DOD contracts and contract proposals still
23 represent the bulk of DCAA's work, the DCAA has evolved
24 since its inception in 1965 to become a de facto FCAA.

25 There are several reasons why this happened.

1 Contracting has greatly grown outside of the DOD. DCAA has
2 deep institutional knowledge of contractors and utilizing
3 the DCAA may be cheaper for organizations than hiring or
4 training their own cadre of contract auditors.

5 DCAA provides a critical check on contractors. It
6 helps insure that we pay reasonable prices and spots
7 attempts by contractors to charge unallowable costs.

8 DCAA estimates that it saves slightly more than five
9 dollars for one dollar invested in it. It is, however,
10 horribly understaffed given its workload.

11 For example, during the early 1990s, it had more than
12 2000 more employees than it currently does while there is a
13 greater amount of contracting now.

14 Non-DOD agencies can request DCAA services if they are
15 willing to pay. This is a disincentive to utilize DCAA. If
16 adequately and centrally funded, an FCAA would remove this
17 disincentive.

18 There are other possible benefits to an FCAA, the most
19 significant being independence. Currently, the DCAA reports
20 to the DOD Comptroller. Along with the GAO, we have some
21 reservations whether this structure ensures adequate
22 independence.

23 Furthermore, it is apparent to us that the DCAA Office
24 of General Counsel is not independent. Its attorneys are
25 evaluated by the Defense Legal Services Agency.

1 A similar independence problem previously existed with
2 the Pentagon IG; and in 2008, the IG Reform Act gave the
3 Pentagon IG its own independent General Counsel. We think
4 this has some relationship with the unwillingness of DCAA to
5 issue subpoenas to contractors, and I can get into that
6 later.

7 But in the meantime, we need to improve DCAA as much as
8 possible, and we are concerned about its current direction.
9 You only have to read the hundreds of comments posted on the
10 government executive website by people claiming to work at
11 DCAA to understand that some part of its workforce is deeply
12 angry with its direction.

13 As I mentioned, DCAA has not issued a subpoena to a
14 contractor in over two decades despite long-standing access
15 to records problems they have faced from contractors. And
16 we believe this is an indication that it is risk adverse.

17 We are also concerned with the tenfold increase in the
18 proposal review threshold at DOD. You mentioned earlier,
19 Chairwoman, that pre-award audits are highly important,
20 especially in negotiating better deals for the taxpayer.

21 Essentially, DOD has cut out DCAA from performing many
22 of those pre-award audits. An audit often with the smaller
23 contract proposals is where they find the biggest amount of
24 questioned cost as a percentage of the proposal.

25 Without the help of DCAA auditors, contracting officers

1 may not be armed with the knowledge they need to negotiate
2 the best deal for the taxpayer.

3 We also understand that whistle blowers who testified
4 before the full Committee in 2008 feel they have not
5 received adequate and public recognition from agency
6 leadership.

7 There is also a belief by some within the DCAA that
8 there is not enough accountability for the deletion of audit
9 findings or the gagging of a whistle blower. Bad managers
10 must be held accountable, and DCAA's promotion process needs
11 to emphasize merit.

12 And I will quickly conclude here.

13 Besides creating a FCAA, there are opportunities to
14 strengthen contract auditing. DCAA should have its own
15 general counsel. While the staffing increase of 500
16 auditors is a step in the right direction, they need,
17 perhaps, a larger workforce.

18 DCAA needs more transparency. Little is known about
19 what it does and we believe some reporting could be made
20 public or to the Congress.

21 We would also like to see more transparency with how
22 contracting officers handle DCAA recommendations. Often
23 DCAA auditors find large amounts of questioned costs or
24 unallowable costs; but at the end of the day, it is up to
25 the contracting officer to actually sustain those findings.

1 Congress also needs to take a look at how the role of
2 contract auditors has been systematically reduced over the
3 last two decades, and I would also take a look at the
4 complaint system at the DCAA. Is it working?

5 Contract auditors provide a great return on investment
6 and save far more money than they cost. We believe an FCAA
7 makes sense; but even if DCAA remains within DOD, it needs
8 to be strong as possible.

9 And I am open to questioning.

10 [The prepared statement of Mr. Schwellenbach follows:]

1 Senator McCaskill. Thank you very much. Thank all
2 three of you.

3 I think legitimate points have been raised by both Mr.
4 Hoe and Mr. Schwellenbach. I see validity in some of the
5 points you have made; and being fairly knowledgeable about
6 the situation at DCAA, I do think that I understand why
7 maybe some of the points that you are bringing up, Mr. Hoe,
8 have surfaced.

9 Let me talk for a minute about your testimony, Mr. Hoe.
10 It is very hard for me. I will expose my bias right now. I
11 think that the independence of an auditor, by definition,
12 does not produce warm and fuzzy relationships between
13 auditors and those people who are being audited. You know,
14 the biggest lie that was ever told to me as we went into a
15 state agency to audit was, gosh, we are glad to see you.

16 Mr. Hoe. I have heard that, too.

17 Senator McCaskill. It is not a pleasant experience
18 because human nature makes one feel very defensive when they
19 are being audited. In fact, a lot of the good work that
20 audits do gets lost because the auditee is too busy being
21 defensive and is not in the right place to get the
22 constructive criticism that comes inevitably with an audit.

23 I guess my problem with, let me talk about two things.
24 The DCMA directive as it relates to DCAA. I mean is it not
25 true that the contracting officers have an ongoing

1 relationship with the contractors that sometimes impact
2 their ability to see everything clearly as it relates to
3 some of the behavior of the contractors?

4 Mr. Hoe. Senator McCaskill, In my experience which
5 goes back a number of decades now, it has been the rare
6 circumstance if I was even aware of single circumstance
7 where I believed that the contracting officer was co-opted
8 by the contractor with whom he was dealing as a contracting
9 officer.

10 Senator McCaskill. I do not think you spent much time
11 in Iraq then.

12 Mr. Hoe. I have not spent time in Iraq.

13 Senator McCaskill. Clearly, it is the best example I
14 can think of. LOGCAP by and large, there was a co-opting of
15 the contracting officers. In fact, the contracting officers
16 on the ground generally were just the low man on the totem
17 pole that were handed a clipboard and had no training, had
18 no capability of even asking a question like why in the
19 world are we monogramming the towels in a cost-plus
20 contract.

21 Those are the kinds of things that went on there. You
22 understand that.

23 Mr. Hoe. Oh, yes, I do and I do understand that a
24 large part of the analysis that explains that was the need
25 to get into the country quickly, to set up quickly, to

1 provide contract services.

2 Senator McCaskill. I do not think that explains
3 monogramming the towels, Mr. Hoe.

4 Mr. Hoe. Excuse me.

5 Senator McCaskill. I do not think that explains
6 monogramming the towels. That is not consistent with
7 getting in there quickly. That is consistent with running
8 up the price to maximize the amount of money the contractor
9 was being paid, you know.

10 We could sit here all day. I mean I guess what I am
11 saying is I do not want businesses to feel like they are
12 being punished for doing business with the Federal
13 Government.

14 But it is hard for me from where I sit in this
15 Committee and the work we have done to think that we are
16 being so aggressive with our auditing that they believe that
17 it is no longer a place they want to do business. I mean I
18 guess I have to tell you it is hard for me to think that.

19 Mr. Hoe. I do not think the solution to the problem
20 that you state is necessarily to take the authority that
21 contracting officers have held for decades and decades if
22 not a century in handling government contracts.

23 They are currently by law, as well as by tradition, the
24 central clearinghouse, if you will, for all aspects of
25 contracting and, of course, contracting involves not just

1 cost accounting and billing and estimating and so forth, it
2 involves performance and full compliance with many other
3 socio-economic provisions.

4 All of that currently filters through a single source,
5 the contracting officer, and I think there is good reason
6 for that. There may be with further thoughts some reason to
7 separate out some portion of the audit function, but it
8 would be a very unique circumstance and I think it would be
9 an unfortunate assessment of what contracting officers are
10 and what they do.

11 There are problems, there were problems and probably
12 currently exist problems, as you say, in Iraq and
13 Afghanistan and some of those areas. I do not think that
14 that is representative of the entirety and history of
15 Federal Government contracting.

16 Senator McCaskill. I will not belabor the point. I
17 think there is a fine line between cooperation and being co-
18 opted, and I think independence, an auditor always has to
19 err on the side of not being co-opted which means maybe a
20 little less cooperation.

21 I am not sure that the contracting officers
22 traditionally, particularly in the Department of Defense,
23 have taken that. Their independence is not something that
24 was front and center like it is with an auditor's.

25 So if we are talking about pricing information, I will

1 look into what we talk about today and make sure I
2 understand what has occurred and make sure it is lawful.

3 But I like the idea that auditors are telling
4 contracting representatives what the prices should be, you
5 know, in my book that is good news.

6 Mr. Hoe. If I may, Madam Chair, that assumes that the
7 questions related to audited costs or prices up front on the
8 fixed-price contract are quite clear.

9 And I do not think that is a true picture of the
10 situation. There are many areas, as I mentioned in my
11 opening statement, of the regulations that state certain
12 standards or principles for the allowability of a cost or
13 the accounting for a cost that create a good bit of debate
14 and discussion amongst the auditors, the contracting
15 officers and the contracting that goes on every day.

16 Often the outcome is not precisely what one party or
17 other stated at the beginning. It is the result of a
18 negotiation, and contracting officers hold the role of the
19 party negotiating on behalf of the government.

20 They certainly do and they are commanded by the Federal
21 Acquisition Regulations to take input from their advisors
22 which include the auditors, the lawyers, the technical
23 people.

24 That all ought to come through the contracting officer.
25 But it is the contracting officer that centralizes all those

1 facts, all those considerations and renders a final
2 judgment.

3 If the view is to take a different tact going forward,
4 I think it deserves some debate.

5 Senator McCaskill. Some discussion.

6 Mr. Hoe. Yes.

7 Senator McCaskill. Fair enough.

8 Ms. Franzel, you talked about preventative controls. I
9 think this is a huge point that needs to be made here. I
10 think that accounting system reviews, invoice reviews, all
11 of the things are incredibly important.

12 Do you think the right balance is being struck now
13 between time being spent on those measures versus the time
14 we spend on auditing?

15 Ms. Franzel. I think that we do need to evaluate this
16 both from the contract management side of the house as well
17 as the auditing side of the house because if contract
18 management or contracting officers are not doing their job
19 then a huge preventive mechanism is being lost.

20 There are also certain types of audits that have great
21 value as a preventive mechanism. And rather than waiting
22 for the detective mechanism, you know, we have seen examples
23 in agencies where because the final billing rates, indirect
24 billing rates were never determined, the contractors were
25 actually booking payables of their financial statements to

1 the government because they knew they owed the government
2 money and there is a backlog in these audits.

3 But if this could have been handled properly up front,
4 these types of problems would not be occurring.

5 But I want to emphasize that this is really on both
6 sides of the house. The contracting officers need to do
7 their jobs properly and implement the appropriate preventive
8 controls on their responsibilities.

9 And then the audits, I think there is certainly room
10 for taking a look at the different types of audits that are
11 being conducted, where do we get the best bang for the buck.

12 It is not always going to be a one size fits all
13 though. Some contractors are very risky for unique reasons,
14 and for those contractors it may be best to go in and do an
15 after-the-fact audit to try to recover certain fraudulent
16 charges.

17 So everybody needs to be working diligently on this but
18 there is certainly benefit for those detective audits.

19 Senator McCaskill. I believe the number is \$55 billion
20 in improper payments at HHS. Does that sound right?

21 Ms. Franzel. I think that is about right, yes. The
22 government-wide total is 125, and I think HHS is a very
23 large chunk of that.

24 Senator McCaskill. I will make one bold statement here
25 that would never happen in the private sector, ever, ever,

1 ever happen in the private sector.

2 We would not let that money go out the door as we have
3 without putting more preventative controls in place up
4 front, and it is very hard to get the government's attention
5 about improper payments because it is not like it impacts
6 anybody's bottom line.

7 It does not impact profit margin. It does not impact
8 their discussions with the bank. It does not impact
9 anything of that.

10 So I think that we need to do more work in this
11 Committee about preventative measures as it relates to
12 contracting. Maybe drill down even deeper as to help what
13 is being done in the various agencies and what is not being
14 done, just through the lens of preventative measures before
15 the money goes out the door because I think it is something
16 that we have to focused on to the extent that we need to.

17 I know GAO has done some good work here but we have a
18 lot more we need to be doing.

19 Mr. Schwellenbach, I understand, you know, I like to
20 say that in government we can grow when somebody has a good
21 idea and gets enough votes.

22 Businesses cannot grow unless they have got the revenue
23 stream to pay for it; and if they do grow and their idea
24 about growing does not work, they cut it.

25 So government is very inefficient when it relates to

1 creating the programs. I am beyond reluctant, after looking
2 at what happened when we create Homeland Security and
3 looking what happens whenever we create a new program.

4 We generally do not check to see if it is really
5 duplicative. We generally do not check to see if there is
6 any metrics, if the program is doing what is supposed to be
7 doing very well. Job training is a great example.

8 Broadband deployment is another great example. We have
9 got two different agencies that are both ostensibly running
10 broadband deployment programs, both Agriculture and
11 Commerce.

12 I am really not excited about creating a new agency
13 even if it is auditing. If there ever was going to be a
14 subject matter I would want to create a new agency, it would
15 the auditing.

16 Why can we not make DCAA, why can we not just improve
17 DCAA to be the main repository of auditors that agencies can
18 go to when they need audit work done within the agencies?

19 Mr. Schwellenbach. Chairwoman, I think you are
20 absolutely right. I think as GAO recognized in their 2009
21 report it is a risky suggestion. You could possibly make
22 things worse. If you created a new agency, there could be a
23 lot of up front costs.

24 Senator McCaskill. And the wrong kind of competition.

25 Mr. Schwellenbach. Absolutely. Absolutely.

1 So we do believe in a perfect world you would have an
2 FCAA that is centrally funded, that removes the disincentive
3 for non-DOD agencies to utilize its services.

4 We think obviously that would be the best of all
5 worlds. Clearly, we have budget limitations. You yourself
6 mentioned, you know, we are probably entering some lean
7 times. So why not make the system as it exists now work
8 better which is one thing I tried to address in my
9 testimony.

10 I think there are a lot of more modest reforms such as
11 giving the DCAA its own independent general counsel, another
12 issue the GAO pointed out in its 2009 report. I think that
13 could do a lot of good.

14 Senator McCaskill. Like we did for the IGs?

15 Mr. Schwellenbach. Yes, as we did for the IGs. I
16 think that is a common sense solution. I do not think there
17 would be much cost involved beyond what we are already
18 paying.

19 There are also ways DCAA uses its workforce that
20 perhaps need to be reviewed. I am not entirely convinced
21 that only looking at large contract dollars is a risk-based
22 approach.

23 For example, a lot of the smaller contracts involve
24 nontraditional government contractors that may not have the
25 internal control systems that are government-compliant in

1 place.

2 So sometimes they are the riskier actors rather than
3 the Boeings and Lockheeds of the world, not to say they have
4 been doing anything wrong which they clearly have in the
5 past.

6 So I do think there are a lot of modest measures that
7 need to be looked at. The subpoena, the lack of subpoenas
8 over the last two decades I think is a major issue.

9 We know DCAA has problems with getting access to
10 records. A few successful uses of the subpoena by DCAA
11 could really shake up the contractor community and make
12 them, you know, open up their books more often and reduce a
13 lot of the issues with access to records and timeliness that
14 currently exists.

15 Senator McCaskill. I think you are right about that.
16 I think that we do need to begin to ask the question has
17 there never been an occasion that DCAA has not gotten the
18 information it needed; and if there has been, what is the
19 reason.

20 And we will propose that question for the record for
21 Mr. Fitzgerald and his agency.

22 I recall vividly that it was, in fact, a lawyer at DOD
23 who wrote the very offensive letter to the whistle blower
24 basically telling the whistle blower that she was not
25 allowed to speak. It was very un-American, the letter that

1 was composed by the counsel at the Department of Defense as
2 it related to what happened at DCAA.

3 Mr. Schwellenbach. I would say that because that
4 general counsel is not directly accountable to the Director
5 of DCAA, it is more difficult to hold that general counsel
6 accountable.

7 Senator McCaskill. Yes. We had a hard time. We have
8 a hard time.

9 Let me ask. Are there any other barriers to businesses
10 that you see, Mr. Hoe, that I need to make sure that we keep
11 on the radar as it relates to auditing work?

12 Is there something we could be asking of our
13 contractors that they do on their side of the equation that
14 would prevent some of the less than productive interaction
15 with the auditors?

16 Should we be requiring them to do more of the internal
17 audits that then can be sampled and approved by auditors
18 within the IG Departments of these various agencies?

19 Mr. Hoe. Senator McCaskill, I think that is an
20 excellent suggestion, and in fact, there are in place
21 currently a number of programs that are designed to
22 encourage, if not require, contractors to examine their own
23 operations prior to a government auditor or investigator
24 coming to the company to assess its systems or its
25 performance.

1 The voluntary disclosure program that has been in
2 existence for a number of years now replaced or supplemented
3 with the mandatory disclosure requirement that is placed in
4 new contracts that obligates contractors to come forward and
5 disclose on their own certain acts that may rise to a
6 certain level of malfeasance that encourages--

7 Senator McCaskill. Like looking at the competitor's
8 fact sheet on the joint tanker competition?

9 Mr. Hoe. Yes, very definitely.

10 Senator McCaskill. That would definitely be one.

11 Mr. Hoe. I believe that would be very definitely one
12 and certainly others, and I can say from my own experience
13 that there are many contractors out there who, since the
14 implementation of that program, have been raising questions
15 with people like myself to understand what the requirements
16 are and what kind of looking they need to do within their
17 company and how extensive and what needs to be disclosed,
18 what does not rise to the level.

19 So it is having a substantial effect. So I think
20 taking into account what is already in place, one would want
21 to consider that before deciding whether there is additional
22 affirmative steps that would be required by law or otherwise
23 for the contractor to undertake themselves.

24 But there are many incentives currently for
25 contractors to look at their own systems and make them

1 complaint or try to make them as complaint as they can.

2 Senator McCaskill. I am sure, Ms. Franzel, you are
3 familiar with the single audit and the way the decisions are
4 made in terms of prioritization of audits that are done
5 under the single audit.

6 And I guess, and I should have asked Mr. Fitzgerald
7 this when he was testifying. It seems to me that the way in
8 which states are told they must prioritize audit work for
9 the Federal Government, that that exercise would be fairly
10 simple to implement within the Federal Government.

11 In other words, agencies deciding how many of their
12 programs are what, in the single audit I think it is "A",
13 "B" and "C" I think, is it not?

14 Ms. Franzel. "A" and "B".

15 Senator McCaskill. "A" and "B". We probably did a lot
16 of "C"s where I was because I like doing some of the smaller
17 programs. And "A" is the size of the program. "B" is those
18 that are high risk for other reasons. And then if you
19 wanted to do other programs, then it had to be in
20 consultation and cooperation with the Federal Government
21 signing off on it.

22 Do we have that kind of risk assessment going on in
23 each agency so that in a very simple way DCAA could look at
24 government-wide where are the big threshold programs?

25 But then on the other hand, where are these programs?

1 I mean the example I like use is weatherization under AWRA.
2 That was a lot of money getting pumped into a program that
3 had, up until that time, had very modest appropriations. A
4 lot of labor involved, a lot of a shotgun-type approach
5 across the country in how the money was used.

6 And even though it was not as large as say a Medicaid
7 and Medicare program, the opportunity for lack of internal
8 controls, the opportunity for a lot of money walking away
9 with somebody's nephew in a pickup truck was real.

10 The other part of the question I want to ask is is
11 anyone using the software programs that are out there right
12 now that allow the integration of data point sets to really
13 expose risks similar to what we did on AWRA where we
14 contracted with a company to try to detect fraud by overlays
15 of integrated data sets to show where there might be the
16 most risk?

17 Ms. Franzel. Certainly. I do believe that the risk
18 assessment function can be made better and bolstered, and I
19 think it is being done inconsistently across agency. So I
20 think that is really the next big step in terms of looking
21 at how contract audits are done and to what extent across
22 the Federal Government.

23 And let me emphasize across the Federal Government
24 because similar to the single audit for contracting, there
25 is the cognizant agency concept. And so one contractor may

1 actually be doing work for multiple agencies but one agency
2 is the cognizant agency.

3 So what kind of communication and coordination is
4 happening for all of the affected agencies? I think that is
5 probably something else that can be improved and that can
6 feed back into this risk assessment process.

7 And frankly if the agencies are coordinating, one would
8 hope it would make it a little easier on the affected
9 contractors.

10 So I think risk assessment is something that definitely
11 needs to be looked at and probably improved as well as
12 coordination across the government agencies.

13 Senator McCaskill. Is that something we could get the
14 IG counsels to do, to do a better job of coordination of
15 risk assessment across all agencies that would then be a
16 document that could be a point of reference for DCAA when
17 they get requests?

18 Ms. Franzel. Yes. That would certainly be one place.
19 In fact, we were having this discussion at GAO, how would
20 this coordination happen, you know, perhaps it could be
21 under OMB. It would have be some sort of centralized--

22 Senator McCaskill. Let us do not go there.

23 Ms. Franzel. --that really it could be an IG. It
24 could be the SIGI. So we do need some kind of centralized
25 risk assessment function, I think, in coordination across

1 agencies, and frankly, somebody or an entity to serve as
2 technical expertise and consultation to the agencies because
3 we have seen varying degrees of internal controls over the
4 contracting function and the contracting officer's diligence
5 to the preventive controls and other controls.

6 So there is just huge room for improvement here.

7 Your final question was about taking the data points
8 that were used for the recovery monies and I do believe that
9 the recovery board is looking at how to get that out to
10 agencies and use that going forward, but that is something
11 that we need restitution in government going forward.

12 Senator McCaskill. Really. I have seen the software
13 demonstrated. In fact, I believe they are using it with
14 SERP.

15 Ms. Franzel. It is very impressive.

16 Senator McCaskill. They are overlaying attacks versus
17 population versus SERP money to make the assessment of
18 whether not the SERP funds are truly getting at the cause
19 that we want them to get at in terms of stabilizing
20 different regions of Afghanistan.

21 I think that is something that we will continue to take
22 a look at because I think that technology that is available
23 now, as long as we do not create a new agency to do this
24 technology, if we could effectively and efficiently access
25 the technology that is out there right now, I think we could

1 save a lot of man-hours just by data that is available and
2 that can be digested, synthesized, and spit back out in a
3 way that helps us manage risk.

4 I want to thank all of you today. I think we have got
5 some things to work on. I think this risk assessment
6 government-wide is important, getting some consistency.

7 I think looking at some of the things we have talked
8 about in terms of DCAA and making sure they have the
9 independence they need if they are going to be the go-to
10 contract agency and importantly looking at preventative
11 measures going forward and making sure they are getting the
12 emphasis they need so we are not trying to claw back but
13 rather we are preventing up front.

14 So most Americans cannot even comprehend over \$100
15 billion in improper payments. That dog does not hunt. We
16 have to figure how to get at that.

17 I appreciate everyone's time today, and we will
18 continue to follow up with you because we will have a few
19 more questions for the record.

20 Thank you very much.

21 This hearing is adjourned.

22 [Whereupon, at 4:28 p.m., the Subcommittee was
23 adjourned.]