

Report to Congress on FY 2011 Activities at the Defense Contract Audit Agency

U.S. Department of Defense

March 30, 2012





DEFENSE CONTRACT AUDIT AGENCY

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OFFICE OF THE DIRECTOR

March 30, 2012

Congressional Defense Committees:

I am pleased to submit DCAA's first annual Report to Congress pursuant to Section 805 of the National Defense Authorization Act for Fiscal Year 2012. This report provides an overview of DCAA's critical mission and outlines Agency audit performance in FY 2011. Specifically, it provides information regarding the number of audit reports completed by DCAA, the length of time to complete audits, and the priority given to each type of audit. This report also provides recommendations to address significant deficiencies identified by DCAA during the conduct of contract audits in FY 2011.

DCAA's mission is vital to ensure that our warfighters receive the best value for critical equipment and services. FY 2011 was a very successful year for DCAA. We examined over \$128 billion in defense contractor costs and issued over 7,000 audit reports. These reports recommended \$11.9 billion in cost reductions. Overall, our efforts assisted contracting officials achieve \$3.5 billion in documented savings to the Government. Based on these savings, the return on taxpayers' investment in DCAA was approximately \$5.80 for each dollar invested. This \$5.80 return represents actual savings that DoD can reinvest in other ways to help the warfighter.

Our success in FY 2011 was a result of our commitment to the workforce and audit process. The main focus of our Agency-wide efforts was twofold: improving the quality of our audits, and supporting and enhancing our workforce. I believe we had major success on both fronts. I am extremely proud of our employees for their work in ensuring that our warfighters receive the best value for critical equipment and services. They continue to demonstrate the importance of conducting independent financial audits, identifying potential cost discrepancies, and providing recommendations to support acquisition officials.

I am confident that the progress we made in FY 2011 and our plans for the future will allow us to continue providing critical value to the warfighter and taxpayer. I appreciate the Congressional support for a DCAA staffing increase to address incurred cost workload and look forward to 2012 with great anticipation of how DCAA can serve the Department of Defense with even greater effectiveness.

Respectfully,

A handwritten signature in black ink, reading "Patrick J. Fitzgerald", is positioned below the word "Respectfully,".

Patrick J. Fitzgerald

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1. DEFENSE CONTRACT AUDIT AGENCY MISSION

The Defense Contract Audit Agency (DCAA) provides audit and financial advisory services to Department of Defense (DoD) and other Federal entities responsible for acquisition and contract administration. It is DCAA's mission to perform all contract auditing for DoD and provide accounting and advisory audit services to facilitate the negotiation, administration, and settlement of contracts and subcontracts. In serving DoD, DCAA protects the public interest, and its work benefits the American taxpayer and our armed forces. It operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller), Chief Financial Officer, DoD.

DCAA's role in the financial oversight of government contracts is critical to ensure DoD gets the best value for every dollar spent on defense contracting. DCAA's primary function is to conduct contract audits and related financial advisory services. Contract audits are independent, professional reviews of financial representations made by defense contractors. Contract audits and financial advisory services performed by DCAA protect the U.S. taxpayer by helping to ensure that the prices the Government pays for goods and services are fair and reasonable.

Specifically, DCAA assists in determining whether contract costs are allowable, allocable, and reasonable. This requires DCAA auditors to audit, examine, and review contractors' and subcontractors' accounts, records, and general business practices and procedures to ensure they are in accordance with the Federal Acquisition Regulation (FAR), the Defense Federal Acquisition Regulation Supplement (DFARS), and other applicable laws and regulations. Additionally, DCAA conducts audits in accordance with Generally Accepted Government Auditing Standards (GAGAS), a set of professional standards that ensure that audit conclusions are well supported by evidence. The type and extent of DCAA's audit work varies based on the type of contract awarded, but its audit services are generally limited to acquisitions under FAR Part 15 (Contracting by Negotiation.) DCAA audits only contractors; it has no internal audit responsibilities in DoD.

In a typical year, DCAA will provide recommendations to contracting officers that become incorporated into Government negotiation positions for about 8,000 contractors. DCAA provides this support to procuring contracting officers and administrative contracting officers throughout the contracting process—from pre-award accounting systems surveys and reviews of forward pricing proposals before contract award, during contract execution, and during contract close-out.

2. ORGANIZATIONAL STRUCTURE AND STAFFING

A. Organizational Structure. DCAA consists of about 4,900 employees located at over 350 office locations throughout the United States, Europe, the Middle East, Asia, and the Pacific. To manage the geographically dispersed and complex work, DCAA is organized into five regions and a Field Detachment that handles classified work:

Headquarters is located at Fort Belvoir, VA. Principal elements of Headquarters are the Director, Deputy Director, General Counsel Office, Internal Review Directorate, and the Assistant Directors for Operations, Policy and Plans, Integrity and Quality Assurance, and Resources.

Regional offices are located in Irving, TX; Smyrna, GA; Philadelphia, PA; Lowell, MA; and La Mirada, CA. Each region directs and administers the accomplishment of the DCAA audit mission at over 50 locations within a designated geographic area.

Field Detachment Headquarters is similar to a regional office but it specializes in contract audits related to sensitive compartmented information and special access programs regardless of geographic area.

Branch Offices are strategically situated within the regions and are responsible for the majority of contract audit services within the assigned geographical area. Branch offices often have smaller suboffices to ensure adequate oversight of contractors.

Resident offices are established at contractor locations where the audit workload justifies the assignment of a permanent staff of auditors and professional support staff. These offices allow auditors to work on location with the largest contractors such as Boeing, Lockheed Martin, and Raytheon.

DCAA liaison activities are conducted at DoD acquisition or contract administration offices to directly communicate and coordinate audit processes with acquisition, contract administration, and contract audit personnel.

B. Staffing. DCAA has a highly professional workforce. About 90 percent of employees have at least a bachelor's degree, 29 percent of employees also have a degree beyond the baccalaureate level, and 24 percent of employees are Certified Public Accountants. As would be expected of an agency focused solely on contract audits, about 87 percent of DCAA employees are Auditors. The remaining 13 percent are other professionals in a variety of occupational series such as human resources, budget, information technology, and administrative support.

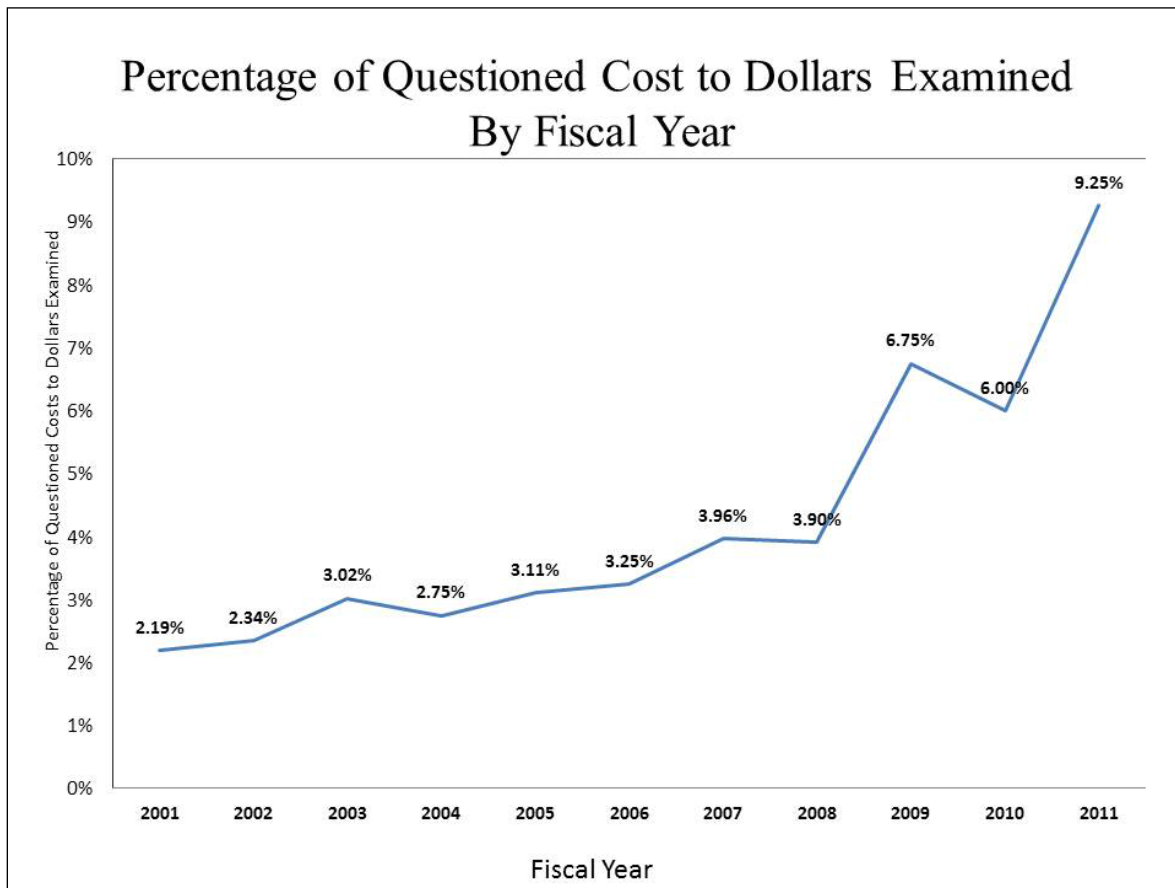
DCAA Workforce at September 30, 2011

Auditors	4,225
Other Professionals	651
Total	4,876

3. FY 2011 AUDIT PERFORMANCE

In fiscal year 2011, DCAA examined roughly \$128 billion in defense contractor costs, issued more than 7,000 audit reports, and recommended reductions in proposed or claimed contractor costs of \$11.9 billion. A key indicator of DCAA's effectiveness is the increasing ratio of DCAA questioned cost to dollars examined as depicted in Figure 1.

Figure 1



In FY 2011, DCAA implemented a number of strategies to improve audit quality, conduct more rigorous evaluations of contractor data, increase communication with stakeholders, and support DCAA audit recommendations at negotiations. Overall, DCAA's efforts assisted contracting officials achieve \$3.5 billion in documented savings to the Government in FY 2011. Based on these savings, the return on taxpayers' investment in DCAA was approximately \$5.80 for each dollar invested. This \$5.80 return represents actual savings that DoD can reinvest in other ways to help the warfighter.

A. Audit reports completed in FY 2011. DCAA conducts a variety of different types of audits. Each audit that DCAA completes, whether it is before or after contract award, supports Government officials who negotiate prices and settle contracts for major weapons systems, services, and supplies using DCAA recommendations. When conducting an audit, DCAA evaluates whether contractor business practices and procedures are in accordance with the FAR, DFARS, Cost Accounting Standards (CAS) and other applicable Government laws and regulations. Contracting officers may also request an independent financial opinion on specific elements of a contract, or an assessment of

compliance with specific acquisition regulations or contract terms, contractor’s business system, and the like. DCAA typically categorizes these types of requests as “Special” or “Other” audits.

Importantly, Government officials draw on DCAA audit findings throughout the acquisition process. At the front end, DCAA’s findings can directly impact the price that the Government pays for contracted work. Even after a contract is underway, DCAA findings may address instances where the Government overpaid contractors for work, uncover potential fraud or misuse of funds, and impact future contract prices by addressing inadequacies early on. Before contract completion, DCAA assesses if the contractor’s final annual incurred costs claimed for contract performance are allowable and reasonable in accordance with applicable acquisition regulations and contract provisions prior to the contract being officially closed out, which prevents excess costs charged to the Government.

The total number of audit reports completed by DCAA in FY 2011 and their subsequent total dollar value of questioned and unsupported costs are depicted in Figure 2.

Figure 2 - Audit Reports Completed by DCAA in FY 2011

Type of Audit Report	Number of Audit Reports	Dollar Value of Questioned Costs (Millions)*	Dollar Value of Unsupported Costs (Millions)**
Forward Pricing (1)	2,599	\$ 9,609	\$ 10,077
Special Audits (2)	2,555	\$ 1,691	N/A**
Incurred Cost (3)	349	\$ 440	N/A**
Other Audits (4)	1,887	\$ 189	N/A**
Total	7,390	\$ 11,929	\$ 10,077

* Questioned Costs are costs the auditor considers not acceptable for negotiating a reasonable contract price or not acceptable for reimbursement under existing contracts.

** Unsupported Costs denote instances where the contractor has not provided specific evidence or documentation to support assertions related to the cost of future work. Unsupported costs are not applicable in the case of Incurred Cost Audits, Special Audits, and Other Audits, because the contractor is not making a claim about the cost of future work. Any potential cost discrepancies identified by DCAA in the case of Incurred Cost Audits, Special Audits, and Other Audits are classified as “Questioned Costs” where the contractor has not provided adequate documentation to support a claim about the actual costs the contractor has incurred.

1. Forward Pricing Audits. Forward Pricing Audits are generally completed *before* contract award where DCAA evaluates a contractor’s estimate of how much it will cost the contractor to provide goods or services to the Government. Accurate contract prices are the starting point for fair and reasonable prices throughout the acquisition process as subsequent costs are often based on the initial estimated contract costs. In FY 2011, DCAA issued 2,599 forward pricing reports, and identified over \$9.6 billion in cost discrepancies.

2. Special Audits. Special Audits can be conducted *before or after* contract award. Most of the reports in this category are issued in response to requests from contracting officers who need an independent financial opinion on specific elements of a contract or on a contractor's accounting business system in order for the contract work to proceed—making special audits a high priority. Special Audits conducted *after* contract award primarily address circumstances where contracts are adjusted for changes or are partially or fully terminated before completion. These circumstances represent complex and high-risk audits where DCAA must carefully evaluate the cost of original contract work from the changed scope of work. In FY 2011, DCAA issued 2,555 special reports and identified \$1.69 billion in questioned costs.

3. Incurred Cost Audits. Incurred Cost Audits determine the accuracy of contractor's annual allowable cost representations. When a contract price is not fixed, DCAA conducts an incurred cost audit *after* contract award to determine the accuracy of contractor cost representations. DCAA expresses an opinion as to whether such costs are allowable, reasonable, and applicable to the contract, based on Government accounting and acquisition provisions. Incurred cost audits allow the contracting officer to recover the questioned costs before the contract is officially closed out, which prevents excess payments by the Government. In FY 2011, DCAA issued 349 incurred cost reports, and identified \$440 million in questioned costs.

4. Other Audits. Other audits primarily consist of audits performed *after* contract award and can be requested by a contracting officer or initiated by DCAA. DCAA typically initiates this type of audit when there is potential for a high risk, such as where the contractor has inadequate business systems. The majority of the audit effort in this category focuses on adequacy of the contractor's Cost Accounting Standards Disclosure Statement, compliance with Cost Accounting Standards, assessment of contractor Cost Impact Statements for noncompliances, review of contractor business systems, and contractor compliance with the Truth in Negotiation Act. Other Audits also include real-time testing of labor and material costs—verification of current actual cost and price data that cannot be confirmed in the following year—allowing DCAA to immediately notify the contracting officer of any deficiency before the contract is closed out. In FY 2011, DCAA issued 1,887 Other Audits, and identified \$189 million in questioned costs.

B. Pending Audits. DCAA's management information system does not formally separate audits into a "pending" category. However, DCAA considers contractors' adequate annual incurred cost submissions awaiting final DCAA action as pending. A contractor is required to submit a certified incurred cost submission of its costs incurred for each year of contract performance where the contract price is not fixed at time of contract award. Incurred cost submissions may be provided to DCAA at any time and can cover a range of prior fiscal years. For example, DCAA could receive an audit request in FY 2011 for contract work completed in FY 2007. This submission would then become part of DCAA's FY 2011 incurred cost audit inventory.

After receiving an annual incurred cost submission, DCAA auditors will review it to determine if the submission and supporting data are adequate and in accordance with FAR 42.705-1(b). If the submission is not adequate it is returned to the contractor for correction and resubmission. When a submission is determined to be adequate, it becomes part of DCAA's list of "pending" incurred cost audits.

At the end of FY 2011, DCAA had about 15,000 adequate annual contractor incurred cost submissions on hand with a total value of about \$254 billion. Additionally, DCAA was either awaiting receipt of, or had not made an adequacy determination for approximately 9,000 incurred cost submissions with a total value of about \$320 billion. In prior years, DCAA did not have sufficient

staffing to perform lower-risk incurred cost audits. As a result, the average length of time from the date an adequate contractor incurred cost submission was received by DCAA to issuance of an audit report was 965 days in FY 2011. Based on DoD budget guidance, DCAA plans to increase its staffing from about 4,900 employees in FY 2011 to about 5,600 employees by 2016 and will use this increased staffing to perform incurred cost audits to reduce the number of pending incurred cost submissions.

C. Prioritization of Audits. DCAA uses a risk-based planning process to ensure audit resources are focused on the highest-payback areas to DoD, the warfighter, and the taxpayer. When prioritizing work, DCAA plans its audits based on the highest-risk areas to the Government. This means that DCAA does not automatically prioritize audits based solely on the type of audit being conducted. Rather, DCAA examines the risk factors involved in each individual audit—whether it is a Forward Pricing, Special Audit, Incurred Cost, or Other Audit—when prioritizing audit work. Contracts considered “high-risk” typically involve significant costs, poor contractor performance in the past, or circumstances where contractors may have less incentive to control costs such as on cost-type contracts.

In FY 2011, the highest priority audits were those related to Overseas Contingency Operations (OCO) and to Forward Pricing. In both categories, the audits were time sensitive, significant risk factors had been identified, or deferral of audit would significantly impact the Government or contracting process. OCO audits include both Forward Pricing and Incurred Costs audits and represent one of the highest-risk contracting areas to DoD. Foreign contractors are subject to the same laws and rules as contractors in the U.S. but might not be fully familiar with these laws and rules. This circumstance requires more scrutiny to ensure that the prices the government pays for contracted work are fair and reasonable. For example, DCAA may encounter situations where contractor and subcontractor proposals are not subject to true competition due to foreign contractor relationships, or U.S.-based contractors may not adequately implement the same level of internal controls in a contingency operation setting. A significant portion of the costs the Government is paying for OCO includes subcontracted work—a historically high-risk area. In FY 2011, DCAA audited roughly \$9 billion for OCO contracts, and recommended nearly \$2 billion in reductions. Additionally, the majority of all Forward Pricing audits were a high priority for DCAA in FY 2011. These audits are extremely time sensitive because they must be completed before contract negotiations occur to be of value to the contracting officer.

DCAA assigns priority to Incurred Cost Audit, Special Audits and Other Audits based on individual contract and audit risks to the Government. DCAA generally classifies Incurred Cost audits as low risk because they are performed after contract award and a senior contractor official must certify to the allowability of the contractor’s claimed costs. However, specific Incurred Cost audits can be a high priority for DCAA if DCAA or the contracting officer identifies significant risk factors. Special Audits are a high priority when requested by contracting officers who need an independent financial opinion on specific elements of a contract or on a contractor’s accounting business system in order for the contract work to proceed. Additionally, Other Audits are a high priority when DCAA or the contracting officer deems it to be a high risk area such as where the contractor has inadequate business systems.

D. Length of time to complete audits. DCAA does not have mandatory timelines for the completion of various contract audits as the scope of each audit varies based on the type of audit, dollars involved, and risk. Instead, DCAA measures the responsiveness and value to the contracting officer in evaluating the appropriate length of time to complete audit assignments. When an audit is self-initiated—or not requested by the contracting officer—DCAA evaluates whether the amount of

time taken from the time the audit work began until audit report issuance is satisfactory based on the quality and value of the audit report to the Government.

Measuring audits by the responsiveness and value to the customer ensures that DCAA provides timely, quality, and GAGAS-compliant audits. This is in opposition to relying upon arbitrary due dates that do not take into account the quality of the audit service and ultimate utility to the contracting officer. The average length of time for DCAA to complete audits in FY 2011 is depicted in Figure 3.

Figure 3 - Average Length of Time to Complete Audits in FY 2011

Type of Audit Report	Elapsed Days
Forward Pricing (1)	120
Special Audits (2)	184
Incurred Cost (3)	965
Other Audits (4)	283

1. **Forward Pricing.** The time to complete a Forward Pricing audit is generally measured from the date of receipt of the audit request, or in some cases, from the date of receipt of an adequate proposal if received later than the request. In FY 2011, the average time between request and audit report issuance was 120 days.
2. **Special Audits.** The time to complete a Special Audit is generally measured from the date of receipt of the audit request to the date of the audit report issuance. In FY 2011, the average time between request and report issuance was 184 days.
3. **Incurred Cost.** The time to complete an Incurred Cost audit is measured from the time an adequate annual incurred cost submission is received until the date of the audit report issuance. The average time between the receipt of an adequate annual incurred submission and audit report issuance was 965 days. Higher risk audit requirements and resource constraints precluded DCAA from conducting these audits more timely in FY 2011.
4. **Other Audits.** The time to complete Other Audits is generally measured from the time audit work began to the date of the audit report issuance. In FY 2011, the average time between the start of the audit and audit report issuance was 283 days.

Although DCAA does not have a specific time requirement for completing audits, it implemented a new performance measure on Forward Pricing Audits in FY 2012 to be more responsive to contracting officer requests. DCAA will measure and assess whether audits are completed based on initial established due dates with the contracting officer on Forward Pricing audits. The benefits of this new approach include increased communication with the contracting officer on the audit risk assessment, scope of audit, and effective use of milestone planning tools. This approach calls for DCAA auditors to work in close coordination with the buying command to fully explain the audit process and requirements to agree upon a mutually established audit due date.

Assessing whether audits are completed based on agreed upon due dates will help DCAA plan and execute audits by supporting ongoing efforts to resolve audit recommendations, encouraging buying commands to provide sufficient time for the audit function, and ensuring that DCAA's audit services are comprehensive and useful for procurement decision makers. DCAA's increased coordination and communication with the contracting officer should ensure that the contracting officer fully understands the audit issues and supports the auditor's recommendation at contract negotiations. If using agreed upon due dates as a measure of audit timeliness is successful, DCAA will consider expanding the use of this measure to its other audit categories.

4. SIGNIFICANT DEFICIENCIES AND RECOMMENDED ACTIONS TO IMPROVE THE AUDIT PROCESS

Contract auditing is just one critical step in the complex and important acquisition process. DCAA's independent financial opinion directly impacts the value that the Government, taxpayer, and warfighter receive for contracted work. Accordingly, DCAA is consistently working to identify and remove barriers to the contract audit process. In FY 2011, DCAA identified deficiencies that need to be corrected to improve the contract audit process in four key subject areas:

A. Improve Adequacy of Contractor Forward Pricing Proposals. Inadequate contractor proposals are a significant barrier that DCAA faces in performing a timely and quality Forward Pricing audit. Roughly 30 percent of DCAA's workload supports Forward Pricing audits. A key component in a Forward Pricing audit is an adequate proposal from the contractor that outlines the estimated cost of the goods or services that it will provide to the Government. Adequate contractor proposals ensure timely service to the requestor, compliance with FAR and CAS and help support a fair and reasonable negotiated price. Conversely, inadequate contractor proposal submissions lead to extended audit cycle times, create a significant contracting vulnerability for determining fair and reasonable prices, and require the use of significant non-value added audit resources.

FAR Part 15, Contracting by Negotiation, provides general instructions and guidelines for contractors to submit proposals. Prior to beginning a forward pricing audit, DCAA reviews the contractor's proposal for compliance with FAR Part 15.408 Table 15-2. If the proposal is not prepared in accordance with Table 15-2, it is returned to the contracting officer so that the contractor can correct the deficiencies. However, the contracting officer often requests DCAA to audit inadequate proposals due to acquisition timeline requirements—further contributing to extended audit cycle times and less efficient use of audit resources.

DCAA has identified significant deficiencies in contractor proposals that do not comply with Table 15-2. Examples of the deficiencies identified by DCAA where contractors have not complied with Table 15-2 are listed below:

- Variances between proposed amounts and basis of estimate/supporting documentation (proposed amounts not supported)
- Variances between prior buy actual cost data and proposed amounts without supporting justification/explanation
- Lack of consolidated Bill of Materials
- Unsupported additive factors applied to various elements of costs often leading to duplicate costs proposed
- Rates not based on contractor budgetary and/or trend data
- Proposal does not reflect anticipated cost accounting changes
- Subcontract proposal deficiencies including inadequate prime contractor cost or price analysis and inadequate support to demonstrate fair and reasonable commercial pricing

The DCAA Director Co-Chairs the DoD Panel on Contracting Integrity-Adequate Pricing, a working group with representatives from various DoD components, and this panel developed a proposal adequacy checklist to set out clear expectations to contractors on required components for contract proposals. A shared understanding of the required elements that constitute an adequate proposal will facilitate more effective contractor proposal audits and negotiations, mitigate contracting delays, and improve the establishment of fair and reasonable prices. The checklist is based on FAR Part 15.408 Table 15-2 requirements, and it consolidates existing checklists in use by

the U.S. Air Force, U.S. Army, and DCAA to provide a one-government perspective on proposal requirements.

The Panel recommended making the checklist mandatory for all contractors regardless of size and submitted the checklist as a DFARS provision, with an associated solicitation provision. The solicitation provision requires contractors to complete the proposal adequacy checklist where the submission of certified cost or pricing data is required thereby ensuring contractors take responsibility for submitting thorough, accurate, and complete proposals in accordance with the FAR requirements.

B. Continue to Define DoD Contractor Business System Rules. Strong internal controls for contractor business systems are the first line of defense in protecting the government from potential overpayments and overcharges. A contractor's business systems should detect errors and irregularities or prevent them from occurring prior to the contractor submitting proposals, claims, and requests for payment to the Government. In order to support changes that enhance contractor business systems, DCAA participated on the DoD Business System Ad Hoc Committee to establish rules on business systems that clearly delineate the criteria for an acceptable contractor business system.

On February 24, 2012, DoD issued a final rule that clearly defines each business system and the key components that comprise each system. Prior to the issuance of the final rule, the government's expectations to contractors on required business systems and their key components were not always adequately described in the acquisition regulations. The business systems covered by the rule include the contractor's accounting system, estimating system, purchasing system, earned value management system, material management system, and property management system. The rule includes a contract clause that requires the contracting officer to apply a percentage withhold when a contractor's business system contains a significant deficiency. Contract withholds will better incentivize contractors to have adequate business systems and mitigate fraud, waste, abuse, and overpayments.

Under this new rule, DCAA will use the criteria in DFARS to report significant deficiencies identified during the course of an audit. Contracting Officers will use DCAA's report in making an initial determination that significant deficiencies exist and may subsequently invoke a payment withhold.

Additionally, DCAA is currently working with the Defense Contract Management Agency and Director, Defense Procurement and Acquisition Policy, to assess suitable alternatives for ensuring adequate government oversight of the contractor's business system in response to a GAO recommendation.

C. Amend Limitation on DCAA Access to Contractor Records. DCAA is required to perform audits in accordance with GAGAS. To perform GAGAS-compliant audits, DCAA must obtain sufficient evidence to provide a reasonable basis for the conclusions expressed in its audit reports. To address limitations of DCAA's access to contractor records under existing law, DCAA believes it needs statutory authority to access: other than cost and pricing data, management reviews and internal audits related to Government contracts, contract costs, and the contractor's internal control documentation related to compliance with applicable Government regulations.

Currently, under Public Law 99-145, 10 U.S.C. §2313(b), the Director of DCAA has the authority to issue subpoenas when a contractor refuses to grant DCAA access to the records covered by the statute. However, in 1988 the United States Court of Appeals, Fourth Circuit denied enforcement of a

DCAA subpoena related to internal audit material from Newport News Shipbuilding¹. The Court ruled that DCAA's subpoena power provided by 10 U.S.C. §2313(b) is limited to negotiations, pricing, or performance of a particular contract. This ruling denied DCAA access to records of management reviews and internal audits which the Court determined to be beyond the statutory provisions of DCAA's subpoena power. Consequently, government contractors frequently use the Newport News court case as a basis for denying DCAA access to specific records.

Amendments to 10 U.S.C. §2313 would give DCAA access to the types of records needed to accomplish the Agency's mission. The Newport News decisions bring into question the DCAA statutory authority to require contractors to provide other than certified cost and pricing data supporting the reliability of the related internal control systems. It is essential for DCAA to have access to contractor reviews, inquiries, investigations, and internal audits in order to evaluate contractor business systems. DCAA audits contractor accounting systems before and after contract award to assess whether the systems are adequate for accumulating and billing costs that comply with contract requirements. For major contractors, DCAA audits contractor business systems as a basis for relying on those systems during other DCAA audits.

Additionally, DCAA examines contractor compliance with the FAR. The FAR requires contractors to disclose any violations of criminal laws and the Civil False Claims Act, as well as any significant overpayments. The FAR also requires the contractor to establish an internal control system that facilitates timely discovery of improper conduct and the related corrective action taken. This includes periodic reviews such as monitoring and auditing to detect criminal conduct.

Greater access to contractor records means that DCAA would have a more accurate picture of cost and price data. DCAA needs access to contractors' internal documents to determine if contractors are taking appropriate corrective action when irregularities or misappropriations are identified, that the Government is not overcharged, and that appropriate contractor disclosure has been provided to Government officials in compliance with the FAR. Therefore, it is also essential for DCAA to have access to contractor reviews, inquiries, investigations, and internal audits in order to evaluate contractor internal control systems and determine compliance with any applicable contract clauses or Federal or agency acquisition regulations. Greater access by DCAA would lessen the burden on the contractor to identify and isolate specific records that have already been analyzed internally. This increased access would allow DCAA to take a comprehensive look at contractors' internal audits that have already been completed, thus reducing duplication of effort and increasing the cost effectiveness of audit analysis.

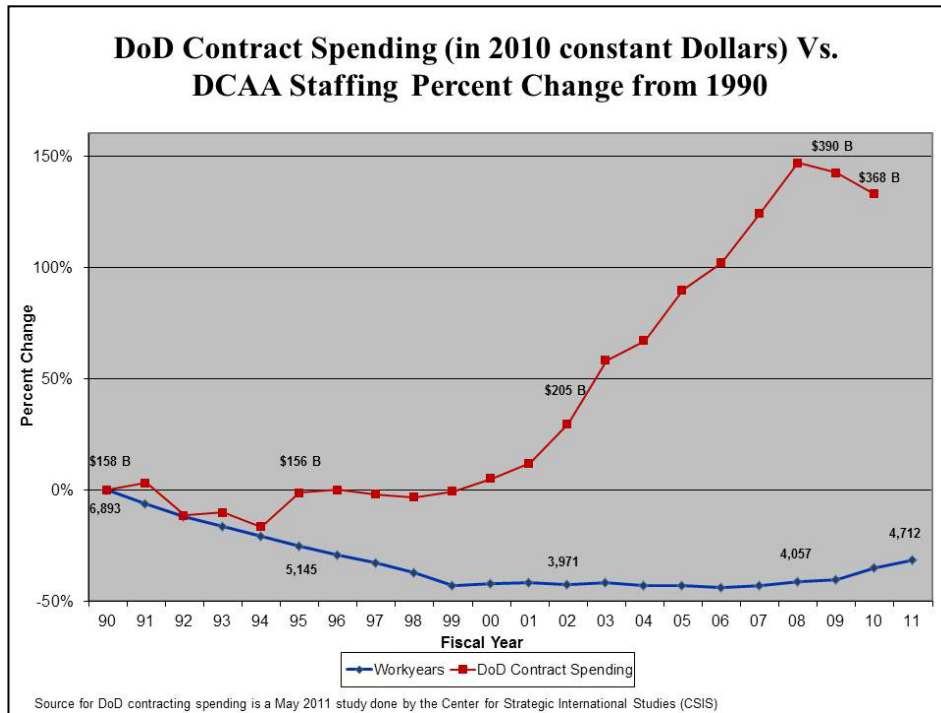
D. Continue to Secure Additional Resources to Reduce Pending Incurred Cost Audits.

DCAA experienced an increase in pending Incurred Cost audits due to significant staffing reductions in conjunction with increased workload requirements. Between 1990 and 2008 DCAA's staffing decreased by more than 40 percent while DoD contract spending increased more than 140 percent. At its peak in 1990, when DoD contract spending was lower in real terms than today, DCAA had a total staff of about 6,900. DCAA's staffing remained relatively stable at around 4,000 between 1999 and 2008. During the same time period DoD contract spending increased dramatically. This growth in DoD spending relates directly to acquisition contracts, which in turn determine DCAA's audit requirements. These factors dramatically increased the workload-to-workforce ratio during each of

¹ 10 U.S.C. §2313(a)(1) and (a)(2), the United States Court of Appeals, Fourth Circuit – U.S. v. Newport News Shipbuilding and Dry Dock Co, 837 F. 2d 162 (4th Cir. 1988) and 862 F. 2d 464 (4th Cir. 1988),

the past 10 years compared to prior years. Figure 4 depicts the gap in DoD contract spending and DCAA Staffing, increasing steadily and peaking in 2008.

Figure 4



One consequence of this prolonged gap is the increase in pending Incurred Cost audits. To address pending Incurred Cost audits, DCAA has developed a specific plan to resolve each outstanding Incurred Cost submission by the end of FY 2016. Part of this plan calls for securing additional audit staff resources to support DCAA’s increasing workload. Since 2008, DCAA has worked closely with DoD leadership on strategies to allocate limited DCAA resources to the highest-risk contracting areas, while targeting high risk pending Incurred Cost audits. With support from DoD, DCAA has increased its audit staff, adding 700 new auditors in the past three years via the Defense Acquisition Workforce Development Fund. As stated above, based on DoD budget guidance to DCAA, staffing will increase from about 4,900 employees in FY 2011 to about 5,600 employees in FY 2016. Additionally, DCAA has dedicated specific audit teams assigned solely to perform pending Incurred Cost audits. As a result, DCAA will be able to effectively apply the audit resources needed to reduce the total amount of pending Incurred Cost audits while continuing to allocate the appropriate audit effort on areas of the greatest payback to DoD.

DCAA is also working to revise its low risk sampling process to reduce pending Incurred Cost audits. Similar to an Internal Revenue Service model, these changes group all low-risk incurred cost proposals into categories by annual auditable dollar value, and then a percentage of the category are selected for detailed audit using sampling techniques. This process allows DCAA to close out low-risk proposals that do not require detailed transaction testing. The revised low risk sampling process reduces pending Incurred Cost audits in an equitable way, across all contractors large and small based on DCAA identified risk factors.

5. CURRENT ACTIVITIES TO SUPPORT QUALITY AUDITS

All of DCAA's activities are designed to support quality, timely, GAGAS compliant audits that are useful to the end user. To better support the acquisition process and protect the needs of the warfighter, DCAA has undertaken new initiatives to ensure quality audits. Some of the key initiatives include the following.

A. Centralizing quality review activities at Headquarters. DCAA created a Directorate of Quality Assurance (QA) to centralize existing quality review activities at Headquarters and ensure audits meet Government quality standards. As a result of QA's new Agency-wide on-the-job training initiative, DCAA has experienced a 20 percent increase in the number of audit assignments reviewed that met or exceeded internal quality standards. This improvement stems from knowledge-sharing of audit practices, training, and QA group interaction with audit staff. For example, QA reviews are followed by specialized training to educate auditors on QA findings. Best practices and policy clarification identified in QA reviews are also shared on DCAA's intranet for training and knowledge dissemination. These findings from QA reviews are growing into a valuable database of information to help auditors address various audit challenges.

B. Conducting more rigorous evaluations of contractor data. Quality audits require a comprehensive understanding of information, which DCAA is achieving through more rigorous transaction testing of contractor data in accordance with GAGAS. This approach includes tracing the contractor's claimed costs back to source documents and actual use. For example, when examining contractor labor costs, DCAA verifies the amount of hours an employee worked, what parts of the contract they worked on, and if they were paid the agreed upon rate to confirm compliance with the government's agreement.

C. Structuring workload to support contractors. DCAA is structuring workload in support of major contractors. Instead of several regional offices doing the work of a major contractor from dispersed locations, DCAA centralized their efforts by contractor. Raytheon was the first pilot case for the restructuring effort, and it was so effective that DCAA permanently restructured offices that work on Raytheon audits to fall under one management jurisdiction within DCAA. This structure aligns all DCAA auditors and professional support staff who work with Raytheon operational segments under one Region. The result is a contract management network that works as one organizational unit to develop and execute a more consistent and comprehensive contract audit approach. The realignment of the Raytheon management network provides several benefits to the contractor, auditor, and buying command. For example, the structure increases consistency and common control in the planning and execution of audits, the contractor has a single point of contact with DCAA, and the contractor receives consistent guidance from DCAA on specific audit matters.

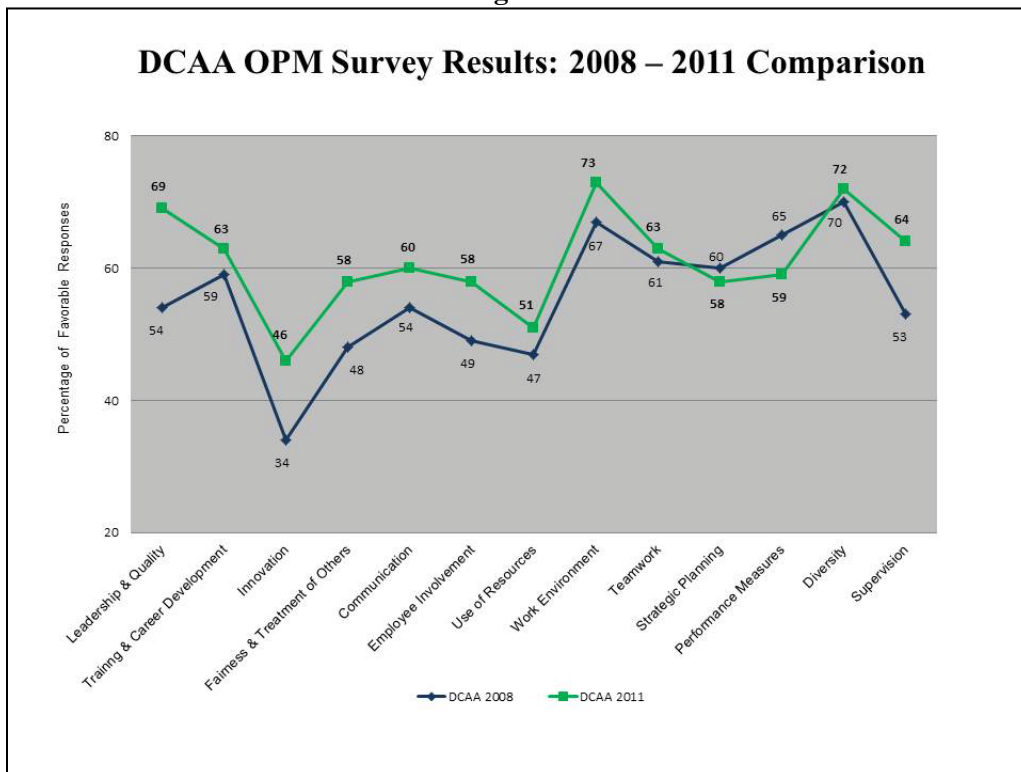
D. Communicating with acquisition community stakeholders during the audit. Effective communication with the contractor and contracting officer throughout the audit process is an essential part of performing a quality audit. DCAA's policy on auditor communications, called "Rules of Engagement," emphasizes the Agency's commitment to open communication for meeting the needs of the contractor and buying commands. This communication allows DCAA to gain a clear understanding of any needs or concerns throughout the process, to deal with issues as they arise, and to ensure understanding of the audit conclusions and rationale after the report is issued. At all phases of the audit engagement, DCAA auditors are consistently communicating with contracting officers and contractors to ensure that audit conclusions are based on a complete understanding of all pertinent facts. Once the report is completed, DCAA actively seeks the contractors' views of the audit conclusions and includes their comments in the audit report.

E. Supporting buying commands at contract negotiations. DCAA supports contracting officers at negotiations where DCAA has issued an audit report on the contractor’s submission, especially for complex audits. At times, contractors provide additional information directly to the contracting officer during negotiations to defend their position. Often, this additional data is in direct response to audit findings. By attending negotiations, DCAA can assist the buying command in understanding how the new data impacts the audit conclusions. Auditors can provide advice, verify data, ensure consistency between reported data and actual contractor records, and provide possible scenarios of Government positions based on their knowledge of the details that support the audit report. When DCAA attends negotiations, there is a greater chance that audit findings will be sustained.

F. Understanding acquisition community challenges by meeting with buying command and industry officials. To best serve the acquisition community, DCAA must understand its challenges and concerns. For the past two years, DCAA executives have made a regular practice of meeting with industry officials, visiting buying commands, and attending conferences to discuss common acquisition challenges. For example, in FY 2011, DCAA co-sponsored the DCAA Government/Industry Summit in conjunction with U.S. Army Aviation and Missile Command and U.S. Army Contracting Command-Redstone, which provided a rich forum for exchanging ideas, clarifying government expectations, and understanding industry perspectives.

G. Surveying the workforce to assess progress. In 2011, the Office of Personnel Management (OPM) conducted an Organizational Assessment Survey (OAS) of DCAA to assess strengths, challenges, and drivers of effectiveness. The survey measured 152 individual indicators of job characteristics and employee attitudes and behaviors. Overall survey results were measured across 12 dimensions associated with OPM’s general standards of high performance. Figure 5 depicts DCAA’s 2011 performance across OPM’s general standards of high performance compared to 2008.

Figure 5



DCAA exceeded the benchmark considered to be an organizational “Strength” in five categories: Employee Support, Strategic Management, Ethics, Supervision, and Teamwork. Of OPM’s High Impact Dimensions considered to be critical drivers of organizational health and performance, DCAA scored high in the Strategic Management and Ethics categories. DCAA also scored above the median in six areas compared to the overall *Performance America* benchmarks: Employee Support, Customer Orientation, Rewards, Strategic Management, Innovation, and Supervision. Additionally, when examining the Best Places to Work Index, DCAA showed large improvement across all items from 2008 to 2011. When compared to the 2008 OAS, DCAA showed improvements in 11 dimensions. The greatest improvements were in the Leadership & Quality, Innovation, Supervision, and Fairness and Treatment of Others categories.

LIST OF ACRONYMS

CAS	Cost Accounting Standards
DCAA	Defense Contract Audit Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DoD	Department of Defense
FAR	Federal Acquisition Regulation
GAGAS	Generally Accepted Government Accounting Standards
OCO	Overseas Contingency Operations
OPM	Office of Personnel Management
OAS	Organizational Assessment Survey
QA	Directorate of Quality Assurance



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