

The Senate Discusses the Past and Future of DCAA—Testimony

Written by Administrator
Friday, 02 October 2009 00:00

In July 2008, the Government Accountability Office (GAO) reported significant audit quality and independence issues at the Defense Contract Audit Agency (DCAA)—setting off a firestorm of controversy. That’s not the only set of problems facing DCAA these days. The DOD Inspector General (DOD IG) recently issued a [follow-up report](#), confirming many of GAO’s 2008 findings and asserting that DCAA’s workplace and environment “may have contributed to deficient audit work” even though (in our view) the evidence cited in the report didn’t seem to support such a conclusion. To add fuel to the fire, the GAO issued a separate report [concluding](#)

that the Department of Defense has failed to assure that its contractors have compliant codes of ethics/business conduct and effective internal control systems, because “the new FAR rules are silent with regard to contracting officer review or standards for examining contractor ethics programs during contract administration,” and also because DCAA and the Defense Contract Management Agency (DCMA) can’t agree on who should be responsible for conducting the assessments. (Even though the GAO was concerned that DOD didn’t have its act together, we note that this would seem to be a very low risk area because nearly 100 percent of the contractors surveyed by the GAO already had ethics programs and related internal controls that “include many of the practices consistent with [FAR-required] standards.”) Finally, the GAO also issued its long-expected report expanding on its review of DCAA audit quality, in which it [alleged](#)

“we found audit quality problems at DCAA offices nationwide, as demonstrated by serious quality problems in the 69 audits ... we reviewed, DCAA’s ineffective audit quality assurance program, and DCAA’s rescission of 80 audit reports in response to our work.”

The foregoing establishes background for the September 23, 2009 [hearing](#) by the Senate Committee on Homeland Security and Governmental Affairs (Joe Lieberman-I, Chair, and Susan Collins-R, Ranking Minority Member) called “Defense Contract Audit Agency: Who is Responsible for Reform?” Testifying for the Committee were (1) Gregory Kurtz, representing the GAO, (2) Gordon Heddell, DOD Inspector General, (3) Robert Hale, Undersecretary of Defense (Comptroller), and (4) April Stephenson, Director, DCAA. As expected, DCAA was in for a very rough ride.

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Senator Lieberman opened the hearing, quickly setting the stage: “Good morning and welcome to this hearing where we will examine the potential that billions of taxpayer dollars are at risk of being wasted because of the inadequate auditing procedures at the ... DCAA.” Senator Lieberman continued—

This is the 5th major report sounding the alarm on DCAA. ... all showing that an important watchdog agency, DCAA, is in need of an overhaul. Washington, we’ve got a problem. In my opinion DCAA is in need of a complete cultural transformation. DCAA still seems driven by a culture that emphasizes speed and production of audits over the quality of results. And DCAA appears to be an incredibly insular agency, with little or no infusion of skills from outside the agency. It’s time for us to make sure we change this environment with specific steps, such as improving audit quality control, increasing training opportunities, and developing a strategy to target resources, rather than simply churn out audits to hit numerical goals. ... Certainly, due to DCAA’s unique role, it must have the independence it needs to stand up to pressures from both agencies and contractors. And perhaps that independence should be strengthened. Perhaps it’s time for us to consider separating DCAA from the Department of Defense and making it an independent auditing agency. But what is also needed right now is strong leadership from the top ranks of DOD to help DCAA achieve the necessary transformation and reforms. We do not want to be sitting here a year from now discussing the same old problems. Let’s identify the root causes and get on to the solutions that the taxpayers demand and certainly deserve.

Next, Senator Collins spoke in the same vein as Senator Lieberman, saying, “A well-functioning DCAA is ... vital to our government’s responsibility to be frugal stewards of taxpayer funds. It plays a necessary role in ensuring the accountability and transparency of federal contracts. Unfortunately, the GAO report contains the haunting refrain of disturbing past reports.” She continued—

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The Department of Defense and other federal agencies rely on DCAA to detect waste, fraud, and abuse. It is, therefore, unacceptable for this federal policing agency to continue to have significant performance failures. With more than a little frustration, I note that we are here almost one year to the day since the Committee's last hearing on this very same topic – DCAA's poor performance. During the 2008 hearing, I raised significant concerns about mismanagement at DCAA. And yet, here we are again. ... There are many principled and dedicated auditors at DCAA who endeavor to conduct themselves with the highest possible ethical standards. The management and culture at DCAA should support these efforts, not undermine them. ... I am concerned ... that simply adding resources will not address fundamental failings. Indeed, the consequences of mismanagement may only multiply with these additional resources. Less than a month ago, the [DOD IG] completed an investigation that found evidence of such mismanagement. It cited time pressure, uncompensated overtime, unauthorized changes to audit results, and other unprofessional behavior that had created a work environment not conducive to performing quality audits. What will it take to see progress? DCAA's inability to remedy its mismanagement, despite numerous hearings, investigations, and reports, is truly an epic failure by the agency and the Department. ... To make matters worse, I am told some supervisors responsible for deficient audits were given performance ratings ranging from "exceeds fully successful" to "outstanding." Let me repeat that. For supervising these questionable audits, these managers were given marks of excellence. This is an outrage, plain and simple. We rely on the many honest and dedicated employees at DCAA to be the first line of defense to the abuse of tax dollars. When the audit agency fails, the fallout can cascade through the system, and ultimately shortchange our troops in the field. Congress must carefully consider what reforms are needed at DCAA in light of these disclosures. Reestablishing DCAA as a first-rate audit agency is critical. To date, I have been very disappointed with the lack of leadership from the Office of the Comptroller, which is responsible for overseeing and supporting DCAA.

Next, Mr. Kurtz from the GAO [testified](#) about the findings from the GAO report on DCAA audit quality. Those who read our article focusing on the GAO report will be unsurprised by his words. He testified—

A management environment and agency culture that focused on facilitating the award of contracts and an ineffective audit quality assurance structure are at the root of the agencywide audit failures we identified. DCAA's focus on a production-oriented mission led DCAA

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management to establish policies, procedures, and training that emphasized performing a large quantity of audits to support contracting decisions and gave inadequate attention to performing quality audits. ... In seven audits, independence was compromised because auditors provided material nonaudit services to a contractor they later audited 33 of 37 internal control audits did not include sufficient testing of internal controls to support auditor conclusions and opinions ... for many controls, DCAA did not perform any testing at all. ... DCAA's current approach of performing 30,000 to 35,000 audits and issuing over 22,000 audit reports with 3,600 auditors substantially contributed to the widespread audit quality problems we identified.

Notably, Mr. Kurtz opined that "DCAA's policy to eliminate the 'inadequate-in-part' opinion for contractor internal control systems audits does not recognize different levels of severity of control deficiencies and weaknesses and could unfairly penalize contractors whose systems have less severe deficiencies by giving them all the same opinion—'inadequate'—as contractors having material weaknesses or significant deficiencies that in combination would constitute a material weakness."

Next, [Mr. Heddell](#) testified regarding the DOD IG's efforts to monitor DCAA's audit quality, saying "We recognize, based on our efforts and those of the Government Accountability Office, that significant vulnerabilities continue to exist in DCAA's implementation of auditing standards in terms of guidance and execution." He continued in a similar manner, testifying—

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

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investigation that resulted in a report issued September 11, 2009. The investigation concluded that the individual failed to meet GAGAS standards for independence and objectivity by improperly directing changes to the audit report and that she engaged in conduct that was inconsistent with established leadership standards for senior officials. The report was provided to the Director, DCAA, for review and appropriate action. We also conducted separate investigations into allegations that two other DCAA senior officials abused their authority by improperly directing changes to audit opinions. Those allegations were not substantiated.

Mr. Heddell concluded:

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

Next, Under Secretary [Hale](#) (DOD Comptroller) testified. Mr. Hale is Ms. Stephenson's supervisor in the DOD chain of command. His testimony largely consisted of acknowledging the issues identified by the GAO and DOD IG, and identifying corrective actions that he and DCAA were taking in response. His testimony was notable not for where he agreed with the audit agency detractors, but for where he disagreed. He testified –

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GAO suggested that Congress consider providing DCAA with independence similar to that of the Department's Inspector General (IG). We respectfully disagree. We do not believe that the DCAA Director should be a Senate-confirmed position unless DCAA is independent of DoD. Presidential appointment with Senate confirmation will inject an inappropriate political element into DCAA, and it will inevitably create lengthy periods when there would be no Director. ... While we do not support IG-like independence, we are taking steps to strengthen DCAA's independence internally by assessing improvements to the process used by contracting officials to resolve DCAA audit findings. Under this process, for highly significant issues, DCAA may appeal to the Director of DPAP. If DCAA disagrees with the DPAP decision, further appeal could be made to the Under Secretary (Acquisition, Technology, and Logistics) and to the Under Secretary of Defense (Comptroller), who would act together as a team. We expect that appeals to the Under Secretary level would involve only the most important issues.

Mr. Hale concluded with a bit of a plea to the Senators weighing DCAA's future role as defense acquisition watchdogs: "as we go forward it is also essential that we keep in mind the value of the services DCAA provides to DoD and other organizations. I have spoken personally to the Director of DPAP – one of DCAA's key customers – and he informed me that DCAA products are necessary and critical to the acquisition process. The Wartime Commission on Contracting has made similar comments. As we strive to resolve issues raised by GAO, we must be careful not to undermine the unique value of DCAA."

Finally, DCAA Director [Stephenson](#) spoke on behalf of her agency. We would characterize her testimony as straight-forward and to the point; and perhaps a bit resigned to the beating she was about to take. She started with a simple statement: "Please be assured that we have taken the GAO's findings very seriously. We have worked diligently since late 2008 to accomplish a number of actions to improve the quality of the audit services and to improve the working environment for our employees." She then addressed the GAO report findings, discussing four distinct problems: (1) insufficient testing of contractor internal controls, (2) ineffective [DCAA] quality assurance program, (3) lack of independence, and (4) management abuses of employees/impediments to the 2008 GAO investigations. Following are selected quotes from Ms. Stephenson's testimony.

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- Although the auditing standards do not require that DCAA express an opinion on the adequacy of the contractors' internal control systems, we did so to provide contracting officials meaningful information to approve or disapprove a contractor's system as stipulated under the Federal Acquisition Regulations. We are currently assessing the type of systems DCAA will need to audit and the type of opinion to be provided. We will continue to seek advice from the GAO and the DOD Inspector General. We anticipate our revised processes will be tested in early FY 2010 starting with the contractor's system for preparing interim and final billings to the Government. We envision the revised processes will consolidate testing of contractor billings currently performed in three different types of audits into a single audit.

- In August 2008, we centralized the quality assurance function by moving it to Headquarters and reassigned all quality assurance employees to the new Headquarters directorate. However, centralizing the functions was not enough. We also changed the manner in which we performed the quality assurance reviews. We more than doubled the number of assignments reviewed for each office.

- In its recent review, the GAO concluded that DCAA's independence was impaired primarily due to auditors providing input on draft corrections to internal control policies and procedures and then auditing the final policies and procedures. In several instances, the auditors issued a no-exception audit report when the contractor corrected the deficiencies during the audit. It is not uncommon for contractors with system deficiencies to seek input from the auditors while they are developing corrections to the systems. In many instances, providing feedback throughout the processes expedites the correction of the deficiencies. However, the GAO has concluded that this "feedback" impairs the auditors' objectivity as they will audit information that they have provided feedback on prior to implementation. We have corrected both of these issues. Auditors no longer provide feedback to contractors on draft corrections to systems and no longer remove deficiencies from audit reports when the deficiencies are corrected during the audit.

- We were approved to hire 300 new auditor trainees in FY 2009, and 200 in FY 2010. We have tentative approval for 200 in 2011 depending on budget priorities, for a total of 700 new trainees by the end of FY 2011. We have met our hiring goal in FY 2009 and anticipate easily meeting the hiring goals in FY 2010 and 2011.

- Based on the audits required under laws and regulations and an estimate of the audits required to meet contracting officials' demand requests, the field audit offices developed the hours necessary to accomplish the workload, taking into consideration the risk of the various contractors, the skill level of the audit staff and an estimate of the additional hours required to comply with the auditing standards. Based on the hours, we developed Agency-wide priorities. Since ***our funding provides for only about 65% of the audits that are required to be completed***, we based the FY 2010 priorities on the audits of highest risk.
[Emphasis added.]

- The Administration is considering whether it would make sense legislatively to expand the DCAA subpoena authority to be similar to the subpoena authority provided to the DoD IG. Under the proposal, DCAA would be provided access to the contractor accounting records and

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other information necessary to accomplish the contract audit function.

Ms. Stephenson closed her testimony much as she started it, saying “I want to underscore the seriousness with which DCAA is taking this matter. Inadequate work is unacceptable, and disciplinary and personnel actions will be taken as appropriate.”

The entire hearing, all 106 minutes of it, can be viewed from the Senate Committee website (link above). Below is a five minute snippet of the hearing, where Senator Claire McCaskill asks Ms. Stephenson some pointed questions.

Our next article will address reactions to the testimony.