

# Report to Congress on FY 2013 Activities at the Defense Contract Audit Agency

U.S. Department of Defense

March 24, 2014





## DEFENSE CONTRACT AUDIT AGENCY

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OFFICE OF THE DIRECTOR

March 24, 2014

Congressional Defense Committees:

I am pleased to submit the Defense Contract Audit Agency's annual Report to Congress for Fiscal Year 2013 required by 10 U.S.C. §2313a. This report provides an overview of DCAA's critical mission, summarizes the Agency's audit performance in FY 2013, and describes significant deficiencies and recommended actions to improve the audit process.

In spite of the impact of budget constraints and a hiring freeze, FY 2013 was a very successful year for DCAA. We made major strides in tackling the incurred cost backlog—specifically, we completed about 55 percent of the baseline backlog, and I expect the Agency will substantially eliminate the baseline backlog by the end of FY 2014. Overall, we examined over \$160 billion in defense contractor costs and issued over 6,200 audit reports. Our efforts helped contracting officials achieve \$4.4 billion in documented savings to the Government. This was the fourth consecutive year of increased savings, and the current year total was about 75 percent more than the annual average during FYs 2003-2009. For FY 2013, these savings represented a return on taxpayers' investment in DCAA of about \$7.30 for each dollar invested.

I am extremely proud of our employees for their dedication and accomplishments. Throughout FY 2013 they demonstrated their commitment to conducting independent contract audits, identifying potential cost discrepancies, and providing recommendations to support acquisition officials. I am particularly pleased with our increase in employee satisfaction as indicated by the Federal Employee Viewpoint Survey. In a tough year, our employees gave higher responses for the majority of the questions while the average responses for the rest of DOD and the federal government were lower for the majority of the questions. In addition, our ranking for Best Places to Work moved up from 160 to 88, and we were the second highest Defense Agency in the subcomponent category. These positive trends bode well for the future.

Our focus in FY 2013 was to conduct cost-effective, high-quality audits and to support our workforce. With the results we achieved, I am confident that we will continue to provide critical value to the warfighter and taxpayer in FY 2014.

Respectfully,

A handwritten signature in black ink, reading "Patrick J. Fitzgerald".

Patrick J. Fitzgerald

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## **1. DEFENSE CONTRACT AUDIT AGENCY MISSION**

DCAA provides audit and financial advisory services to Department of Defense (DoD) and other federal entities responsible for acquisition and contract administration. 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 operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, and its work benefits our men and women in uniform and the American taxpayer.

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. Specifically, DCAA helps determine whether contract costs are allowable, allocable, and reasonable. DCAA conducts audits in accordance with Generally Accepted Government Auditing Standards (GAGAS), a set of standards that ensures 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 Federal Acquisition Regulation Part 15 (Contracting by Negotiation). DCAA audits only contractors; it has no internal audit responsibilities in DoD.

DCAA auditors examine and review contractor accounts, records, and business systems. DCAA's goal is to evaluate whether contractor business practices and procedures are in compliance with the Federal Acquisition Regulation (FAR), the Defense Federal Acquisition Regulation Supplement (DFARS), Cost Accounting Standards (CAS), and other applicable government laws and regulations. Based on its findings, DCAA provides recommendations and advice to government officials who are responsible for acquisition and government contract administration. These officials select contractors to perform government-funded work and negotiate prices for products and services for our warfighters. DCAA has no direct role in determining which companies are awarded defense contracts; rather, it provides recommendations to government officials on contractor cost assertions regarding specific products and services.

The scope of DCAA's influence is significant. DCAA provides definitive recommendations to contracting officers that directly impact negotiations with contractors. As a result of these recommendations, contracting officers are better able to negotiate prices and settle contracts for major weapons systems, services, and supplies. In a typical year, DCAA engages with about 7,500 contractors and examines over \$150 billion in contract costs.

## 2. ORGANIZATIONAL STRUCTURE AND STAFFING

**A. Organizational Structure.** DCAA assumed contract audit responsibility from individual services for all DoD entities in 1965. At the end of FY 2013, DCAA had over 300 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 six regions—five with geographic boundaries plus a Field Detachment that handles classified work.

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

**Regional offices** are in Lowell, Massachusetts; Philadelphia, Pennsylvania; Smyrna, Georgia; Irving, Texas; La Mirada, California; and Chantilly, Virginia. Each region directs and administers the DCAA audit mission at various locations near the contractor base.

**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 when the amount of audit workload justifies the assignment of a permanent staff of auditors and support staff. These offices allow auditors to work on location with the largest major industrial manufacturers that the Government buys from, including 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 of nearly 5,000 employees. Approximately 90 percent of them have a bachelor’s degree, and 34 percent also have a degree beyond the baccalaureate level. In addition, roughly 27 percent are Certified Public Accountants, and 5 percent have other professional certifications. Nearly 88 percent of DCAA employees are auditors. The remaining 12 percent are professional support staff individuals who work in a variety of occupational fields including administrative support, budget, human resources, information technology, and legal (Table 1 and 2).

**Table 1 – DCAA Workforce at September 30, 2013**

Auditors	4,334	87.9%
Professional Support Staff	599	12.1%
<b>Total</b>	<b>4,933</b>	<b>100.0%</b>

**Table 2 – DCAA Certifications and Advanced Degrees**

Certified Public Accountants	1,324	26.8%
Other Professional Certifications	243	4.9%
Advanced degrees	1,668	33.8%

### 3. FY 2013 AUDIT PERFORMANCE

**A. Overview.** DCAA uses a risk-based approach to tackle its audit workload in a cost-effective manner. Using this approach, DCAA examined \$163.1 billion in contract costs, issued 6,259 audit reports, reduced the incurred cost backlog, identified \$4.4 billion in net savings, and produced a return on investment of about 7.3 to 1. In addition, this risk-based has produced an upward trend of the percentage of questioned costs compared to dollars examined.

**(1) Incurred Cost.** DCAA established incurred cost audit teams in FY 2012. These teams have developed a high level of expertise in conducting these audits and were in full action in FY 2013. As a result, DCAA significantly increased its incurred cost audits in FY 2012 and FY 2013 (Figure 1).

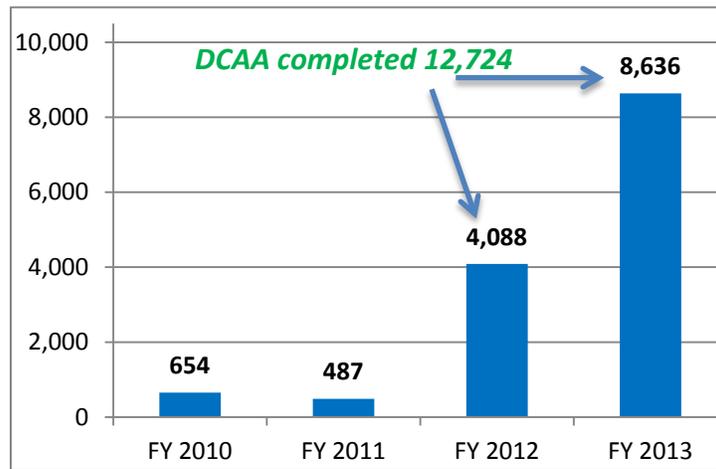


Figure 1 – Incurred Cost Years Completed FY 2010 – FY 2013

**(2) Net Savings.** During FYs 2003-2009, DCAA averaged \$2.5 billion in annual net savings; however, over the last 4 years, DCAA’s net savings has averaged \$3.7 billion, an increase of about 50 percent. In FY 2013, DCAA identified about \$4.4 billion in net savings to the Government. This was roughly 75 percent more than the annual average during FYs 2003-2009 (Figure 2).

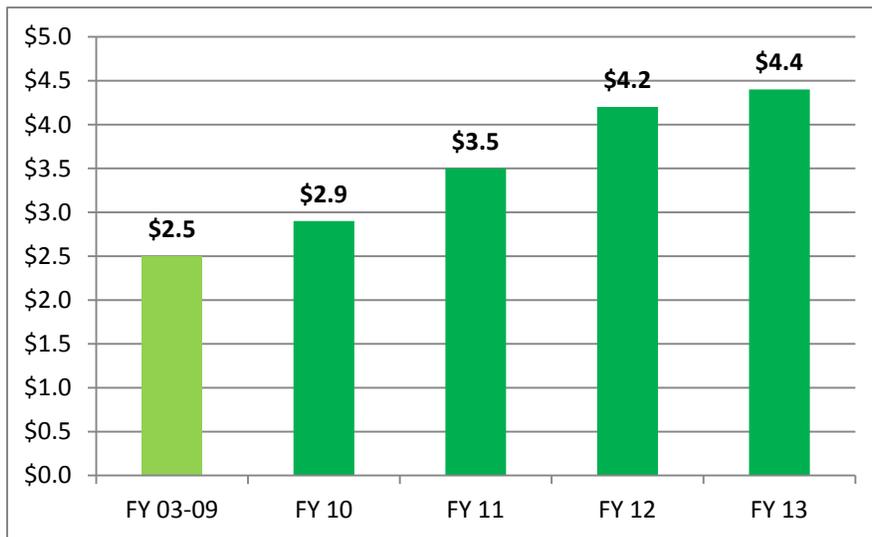
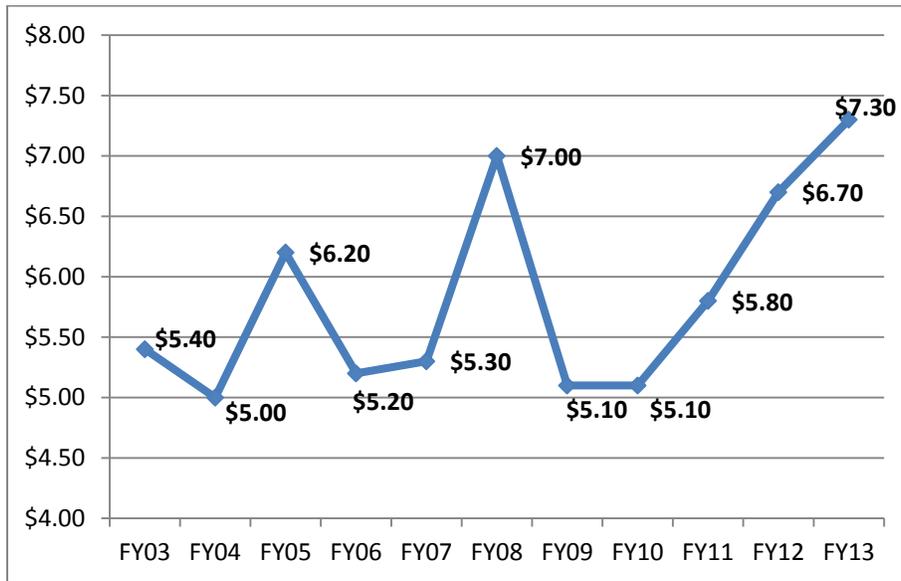


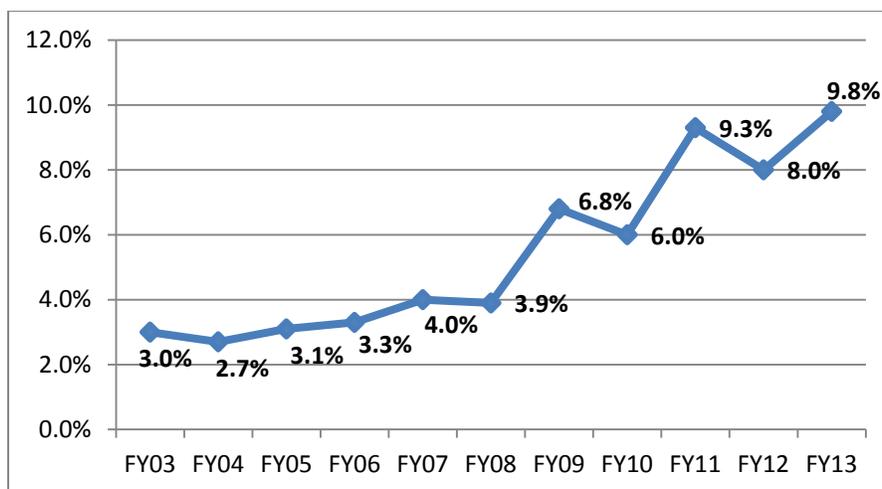
Figure 2 – Comparison of DCAA Net Savings FY 03 – FY 13 (billions)

**(3) Return on Investment.** Based on these net savings, the return on taxpayers' investment in DCAA was about \$7.30 for each dollar invested and represents actual savings that DoD can reinvest in various ways to help the warfighter. DCAA takes a conservative approach to reporting savings and return on investment. DCAA savings do not represent potential savings or possible future savings if DCAA recommendations are implemented. Instead, DCAA only reports savings that have been realized based on actions taken by Government contracting officers. As shown in Figure 3, the \$7.30 is the highest return on investment in the last decade.



**Figure 3 – Comparison of DCAA Return on Investment FY 03 – FY 13**

**(4) Questioned Costs.** DCAA recommended reductions in proposed or claimed contractor costs of \$16.0 billion. An indicator of DCAA's effectiveness in using its risk-based approach is the increasing ratio of DCAA questioned costs to dollars examined during recent years (Figure 4).



**Figure 4 – Comparison of Percentage of Questioned Costs to Dollars Examined**

**B. Audit reports completed in FY 2013.** DCAA conducts a variety of audits that provide the basis for recommendations to the acquisition community. 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. 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.

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 2013 and total dollar value of questioned and unsupported costs are shown in Table 3.

**Table 3 – Audit Reports Completed by DCAA in FY 2013**

Type of Audit Report	Number of Audit Reports	Questioned Cost (Millions)*	Unsupported Cost (Millions)**
(1) Forward Pricing	1,316	\$11,731	\$20,477
(2) Special Audits	1,898	\$791	N/A**
(3) Incurred Cost	1,899	\$3,214	N/A**
(4) Other Audits	1,146	\$299	N/A**
<b>Total</b>	<b>6,259</b>	<b>\$16,035</b>	<b>\$20,477</b>

\* 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.** 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 because subsequent costs are often based on the initial estimated contract costs.

**(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, a circumstance that makes special audits a high priority. Special Audits conducted *after* contract award primarily to 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.

**(3) Incurred Cost.** 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 allocable 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.

**(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 (i.e., verification of current actual cost and price data that cannot be confirmed in the following year) which enables DCAA to immediately notify the contracting officer of any deficiency before the contract is closed out.

**C. 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 a submission in FY 2013 for contract work completed in FY 2010. This submission would then become part of DCAA's FY 2013 pending incurred cost audits.

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 52.216-7(d)(2)(iii). 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 2013, DCAA had about 15,000 adequate annual contractor incurred cost submissions on hand valued at roughly \$390 billion. Additionally, DCAA was either awaiting receipt of, or had not made an adequacy determination for approximately 8,000 incurred cost submissions valued at roughly \$423 billion. This backlog was the result of a conscious decision to defer incurred cost audits. DCAA made this decision in 2010 because of decreased staffing levels. Specifically, between FYs 2000 and 2009 DoD contract spending increased significantly but DCAA staffing levels remained fairly constant; as a result, DCAA did not have the staff to perform the entire workload. Incurred cost audits were one of the few areas that could be deferred without impacting the warfighter. Subsequently, in FY 2011, DCAA developed an action plan to address the backlog that consisted of four strategies:

- Creating dedicated incurred cost audit teams
- Conducting multi-year audits
- Initiating low-risk sampling
- Growing the workforce

This approach was in full operation by the end of FY 2012. Based on prior DoD budget guidance, DCAA planned to increase its staffing during FY 2012 through FY 2016. The primary purpose of these additional employees was to reduce the number of pending incurred cost submissions. However, while the targeted staff increases were on track in FY 2012, the FY 2013 budget constraints negatively impacted DCAA's ability to hire. As a result the total number of employees actually dropped by about 250 during FY 2013.

**D. Prioritization of Audits.** DCAA's risk-based planning process helps ensure that 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. Consequently, instead of prioritizing audits based solely on the type of audit being conducted (i.e., Forward Pricing, Special Audit, Incurred Cost, or Other Audit), DCAA examines the risk factors involved in each individual audit regardless of type. Contracts considered "high-risk" typically involve significant costs, poor contractor performance in the past, or circumstances where there may be less incentive to control costs such as on cost-type contracts. This method has proven to be the best use of existing resources and very effective in returning greater net savings to the Government.

In FY 2013, the highest priority audits were those related to Overseas Contingency Operations (OCO) and to Forward Pricing. In both categories, the audits were time sensitive, carried significant risk factors, and would have significantly impacted the Government and/or the contracting process had they been deferred. Two of the reasons that make OCO higher risk are (1) that a foreign contractor is subject to the same laws and rules as a contractor in the U.S. but might not be fully familiar with them, and (2) that a significant portion of the costs the Government is paying for OCO includes subcontracted work, historically a high-risk area. In FY 2013, DCAA audited roughly \$30.2 billion for OCO contracts and recommended about \$1.4 billion in reductions. In addition to OCO-specific audits, the majority of all Forward Pricing audits were also a high priority for DCAA in FY 2013. These audits are extremely time sensitive because they must be completed before contract negotiations occur to be of value to the contracting officer.

Beyond the two areas of highest priority, DCAA assigns priority to additional audits (Incurred Cost Audits, Special Audits, and Other Audits) based on individual contract and audit risks to the Government. DCAA generally classifies pending (non-backlog) Incurred Cost audits as lower priority because they are performed after contract award. However, audits related to the incurred cost backlog are a high priority because of their age. In addition, 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 a contractor's accounting business system or other specific contract elements before contract work can proceed. Finally, Other Audits are a high priority when DCAA or the contracting officer identifies a high risk area such as inadequate business systems.

**E. Length of time to complete audits.** The timeline for an audit is based on audit type, dollars involved, level of risk, and needs of the requester. Therefore, DCAA does not have specific or mandatory time requirements for completing audits. Instead, DCAA assesses what is necessary to conduct an audit that meets professional audit standards and that will provide value to the contracting officer in negotiating a fair and reasonable price for the Government. DCAA is working closely with Contracting Officers to set reasonable due dates based on the requirements of the audit and the needs of the buying commands.

Based on this coordination, DCAA and Contracting Officers mutually set priorities, milestone plans, and agreed-to dates. Once these agreements are reached, DCAA assesses timeliness based on meeting those targets.

The average length of time to complete each of the four types of audits was less in FY 2013 compared to the prior fiscal year. Details are shown below, followed by additional explanation for each audit type.

**Table 4 – Average Elapsed Days to Complete Audits**

Type of Audit Report	Elapsed Days	
	FY 2012	FY 2013
(1) Forward Pricing	110	97
(2) Special Audits	217	184
(3) Incurred Cost	1,184	1,090
(4) Other Audits	384	309

**(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 2013, the average time between request and audit report issuance was 97 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 2013, 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 1,090 days. This high number is the result of DCAA continuing to work through submissions that had been sitting idle in the incurred cost backlog for years due to the need to perform higher priority, higher risk audits within resource constraints.

**(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 2013, the average time between the start of the audit and audit report issuance was 309 days.

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

Contract auditing is a critical step in the acquisition process, and DCAA's independent audit opinions directly affect the value that the Government, taxpayer, and warfighter receive for contracted work. To ensure DCAA is providing the highest value to its acquisition stakeholders, it has identified deficiencies in the acquisition process, and recommended changes to these ongoing challenges.

**A. Forward Pricing.** While we have seen improvement in this area thanks to the DoD's efforts to implement a proposal adequacy checklist, additional work is still required in the areas of forward pricing rate proposal adequacy and commercial pricing documentation.

- **Proposal Adequacy.** As discussed in the 2012 Report to Congress, inadequate contractor proposals can be a significant barrier that DCAA faces in performing timely, high quality Forward Pricing Audits. Proposal adequacy is critical for a timely response to the requestor, compliance with FAR and CAS, and effective support of fair and reasonable prices. Without an adequate proposal, audits take more time, require non-value added audit resources, and lead to significant contracting vulnerabilities in negotiations. DCAA, together with DoD acquisition stakeholders on the Defense Acquisition Regulation (DAR) Council, were successful in March 2013, when the Department incorporated a proposal adequacy checklist into DFARS 215.408 with an associated solicitation provision at DFARS 252.215-7009 for individual contract proposals. We have seen marked improvement in the proposals of select contractors and believe that as industry and the Department institutionalize the checklist we will see continued improvement in this area.
- **Rate Proposal Adequacy.** Efforts are ongoing to finalize a regulatory change to improve the adequacy of contractor forward pricing rate proposals.

**DFARS Case 2012-D035, Defense Federal Acquisition Regulation Supplement:** The DAR Council established this case to ensure adequacy of forward pricing rate proposals. Specifically, the case calls for contractors to use a Forward Pricing Rate Proposal Adequacy Checklist—jointly established by DCAA and the Panel on Contracting Integrity—that provides instruction and codifies common expectations for auditors, contracting officials, and contractors when obtaining a forward pricing rate proposal pursuant to FAR 42.1701. On May 16, 2013, the Department issued the draft Rule for public comment. The Department is in the process of addressing the comments received and expects issuance of the final Rule this year.

- **Sufficiency of Commercial Pricing Documentation.** The lack of sufficient and adequate documentation (i.e., competition or sales to non-government sources) necessary to establish fair and reasonable prices for commercial subcontracts is another significant barrier that DCAA faces in performing timely, high quality audits. Without sufficient competition or sales to non-government sources, data other than certified cost or pricing information is necessary to ensure excessive prices are not passed along to DoD prime contracts.
  - **Proposed Regulatory Changes.** DCAA assisted in the Department's efforts to make the regulatory changes required by Section 831, "Guidance and training related to evaluating the reasonableness of price" of the 2013 National Defense Authorization Act (NDAA). This assistance focused on ensuring that the training and regulatory

changes helped contracting officers understand the risk and actions they can take related to significant commercial subcontracts not supported by sufficient competition or sales to non-government sources.

**DFARS Case 2013-D034, Defense Federal Acquisition Regulation**

**Supplement:** The DAR council established this case to evaluate price reasonableness procedures for commercial items and to implement the guidance requirements of Section 831 of the FY 2013 NDAA. Specifically, the case establishes standards when contracting officers will require data other than certified cost or pricing data in DFARS 215.403-3(c). The Department expects issuance of the Rule this year.

**Challenges.** Because the scope of Section 831 of the 2013 NDAA did not include responsibilities for prime contractors, DCAA continues to face difficulty in obtaining sufficient commercial pricing documentation from prime contractors for its subcontracts. In addition, the lack of express authority to review “data other than certified cost or pricing data” continues to affect our ability to conduct timely, quality audits.

- **Adequate Documentation of Commercial Prices at the Subcontract Level.** To ensure that the Government is getting fair and reasonable prices, DCAA assists the contracting officer in determining the basis for contractors designating items as “commercial” and therefore exempt from the requirement to provide certified cost and pricing data. DCAA continues to find that prime contractors do not consistently provide sufficient and adequate documentation necessary to support its commercial item determinations or to justify fair and reasonable commercial pricing for subcontracts. Common shortcomings are that prime contractors normally do not obtain and analyze sufficient commercial market sales data to establish price reasonableness, especially when the supplier is a sole-source provider. Prime contractors also do not proactively notify the contracting officer of their inability to obtain sufficient cost or pricing data from its subcontractor when sufficient commercial market sales do not exist. These shortcomings make the acquisition process less efficient and increase the risk that the Department will pay excessive prices at the subcontract level. DCAA remains hopeful that the guidance and training implemented because of Section 831 will address common problems at the prime contract level. However, we believe there needs to be additional clarifications to the regulations, beyond the scope of Section 831, to clearly outline prime contractor management responsibilities related to its subcontracts. Without these changes, the documentation supporting commercial prices at the subcontract level will continue to be inconsistent and, in many cases, insufficient. During the past year, DCAA has engaged AT&L to discuss the proposed rule and available steps to address the significant risk at the subcontract level.
- **Authority to Review and Subpoena “Data Other than Certified Cost or Pricing Data.”** The DCAA subpoena authority contained in 10 U.S.C. §2313 permits DCAA both access to and the authority to subpoena certified cost or pricing data, but it does not specifically provide similar authority for “data other than certified cost or pricing data” as defined in FAR 2.101. When a contracting officer determines that historical data is insufficient to determine the reasonableness of prices in a fixed-price contract for commercial items, FAR 15.403-3 permits the government to obtain “data other than certified cost or pricing data” to assist in making that determination. Contractors have been reluctant to provide this information. While the FAR allows contracting officers to request data, there is currently no authority to compel production of that data. The Department has submitted a legislative proposal for

FY 2015 that would expand the DCAA subpoena authority to “data other than certified cost or pricing data.”

**B. Access to Contractor Records.** To perform audits that meet professional standards, DCAA must obtain an understanding of the contractor’s systems and operation to develop audit procedures to gather sufficient evidence to provide a reasonable basis for the conclusions expressed in its audit reports. A key part of this evidence is pertinent contractor records. Access to records—including access to internal audit reports, online data, and contractor employees—continues to pose significant challenges to DCAA auditors. The auditing standards require auditors to inquire of management and others within the contractor organization that, in the auditor’s professional judgment, have information pertinent to successful planning of their audit. Therefore, DCAA considers access to internal audits and contractor employees a routine and established audit procedure that is necessary to perform our audits.

**Challenges.** Denial of access to contractor internal audit reports, contractor employees, and on-line data in contractor’s systems is a continuing barrier relative to conducting audits.

- **Access to Contractor Internal Audit Reports.** As discussed in the 2012 Report to Congress, DCAA had significant concerns regarding DCAA’s ability to access contractor internal audit reports. The FY 2013 NDAA, Section 832, mandated documentation requirements for DCAA for access to defense contractor internal audit reports. DCAA disseminated the NDAA documentation requirements through Agency formal training, written guidance, and language in its Contract Audit Manual (CAM). As required by the NDAA, in 2014 the Comptroller General will review the documentation DCAA is required to maintain, and issue a report to the congressional defense committees regarding the results of the review.

DCAA must have access to relevant company materials (i.e., relevant internal audits) to effectively accomplish its audit responsibilities. DCAA requires access to contractors’ documents to determine that contractors are taking appropriate corrective action when a contractor identifies irregularities or mischarges, that a contractor is not overcharging the Government, and that a contractor has provided Government officials appropriate contractor disclosures in compliance with the FAR. The contractor has also invested time and resources to support the internal auditors’ development of their understanding of contractor systems and operations. As the cost of this effort is being charged to government contracts it should be leveraged by DCAA to help hold cost down. As part of its audit function, DCAA may require access to contractor reviews, inquiries, investigations, and internal audits in order to determine a contractor’s compliance with the business system criteria, evaluate contractor internal control systems, effectively plan a quality audit that has the least impact on the contractors’ operations, and determine compliance with any applicable contract clauses or Federal or agency acquisition regulations.

DCAA’s implementation of the FY 2013 NDAA, Section 832, mandated documentation requirements has shown a significant change within industry to provide access to internal audit reports. It is too early to determine the overall impact on DCAA audit efficiency and effectiveness.

- **Read-Only Access to Online Data.** As discussed in the 2012 Report to Congress, DCAA continues to have concerns regarding the lack of access to contractor online data. Read-only access to the contractor’s books and records would greatly assist DCAA to effectively plan and perform all of the audit effort at a contractor location. While we have had some limited

success in working directly with contractors to obtain read-only access to online books and records, we believe that clarification to the regulations will ensure DCAA has the necessary access to contractors' online data.

Specificity of the authority for direct and online read-only access to contractor's data would improve both the audit and DCAA's ability to support the Contracting Officer. Furthermore, this access would decrease the amount of costs and personnel resources needed by contractors to support audit requests for data. In addition, online read-only access would advance DCAA audit efforts by allowing real time contract cost monitoring and continuous risk analysis, including the use of advanced data analytics. As a result, DCAA will propose a new FAR case to pursue a clarification to the regulation.

- **Access to Employees.** As discussed in the 2012 Report to Congress, DCAA strongly believes that having access to contractor employees to conduct interviews and observations is critical to ensure the high level of assurance required by professional auditing standards. DCAA continues to find contractors arguing that DCAA's access to records does not include access to employees. FAR 52.215-2(d) specifically gives the GAO rights to interview any officer or employee; however, FAR does not specifically give DCAA this right. DCAA believes that many contractors assert that DCAA does not have such access rights since it is not specifically stated. DCAA submitted a legislative proposal for FY 2015 to support DCAA's right of access to contractor employees and to avoid any future confusion on DCAA's ability to interview employees. This legislative change will ensure DCAA has access to employees, which allows DCAA to conduct audits in accordance with professional standards.

## 5. SIGNIFICANT FY 2013 ACTIVITIES AND THEIR IMPACT

DCAA made significant strides in FY 2013 in workforce support and in audit cost effectiveness.

**A. Workforce Support.** For the past several years, DCAA has emphasized initiatives to better support its workforce. An important part of that effort has been employee involvement. Nearly 250 employee volunteers from all levels across DCAA participated in ad hoc committees to help execute the strategic plan, provide feedback, offer innovative ideas, and help establish best practices that directly impact Agency operations. Many of their recommendations were in place during FY 2013. We remain committed to providing our workforce the necessary support and resources to do its job. One particularly significant action was to hire a Chief Learning Officer to lead our Defense Contract Audit Institute. Our move to Atlanta, combined with new leadership, is an important change to our training strategy. One example of this new strategy is our coaching program. We involved about 100 people in a coaching pilot and saw impressive results; nearly all of our participants said that it benefitted their career development. Consequently, we will be implementing that program across the Agency in FY 2014.

Our focus on supporting the workforce is also having a positive impact on employee satisfaction. A key indicator of our progress is the Federal Employee Viewpoint Survey (FEVS) conducted by the Office of Personnel Management. FEVS covers six major areas—work experience, work unit, the agency as a whole, supervisor/team leader, leadership, and overall satisfaction—and provides a snapshot of employees’ perceptions of whether, and to what extent, conditions characterizing successful organizations are present in their agencies. Our results for FY 2013 were very positive, particularly in light of lower scores across DoD and the federal government. Specifically, DCAA had higher positive responses compared to FY 2012 for 49 of 71 questions. In contrast, DoD was higher for only 2 questions and the federal government was higher for only 5. The FEVS results are also the basis for the Best Places to Work, and DCAA saw significant gains in its rankings there as well. For example, in 2009 DCAA ranked only 202<sup>nd</sup> out of 231 agencies, putting the agency near the bottom of the list. In 2013, however, DCAA ranked 88<sup>th</sup> out of 300, a significant increase (Figure 5).

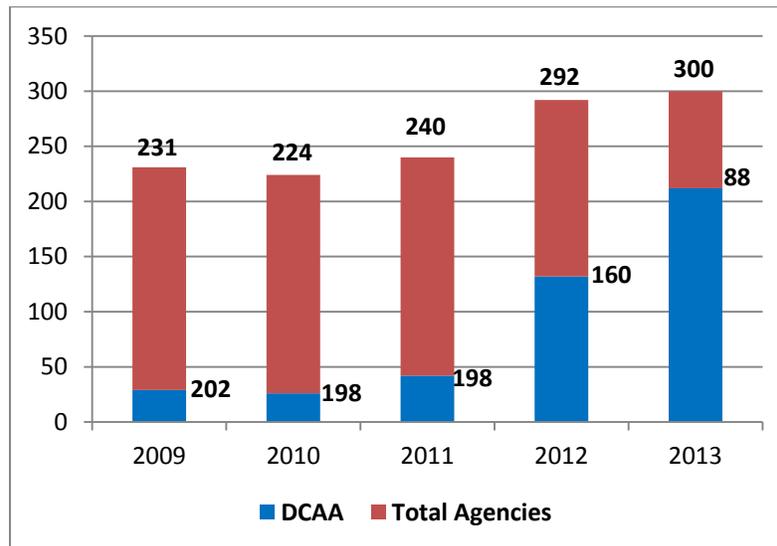


Figure 5 – Improvements in Best Places to Work Rankings, 2009 - 2013

In addition, DCAA was the second highest ranked Defense Agency in the subcomponent category.

**B. Audit Cost Effectiveness.** A key element of cost-effectiveness is DCAA's risk-based approach which enables the most effective utilization of current staffing by focusing on audits that provide the most value in the acquisition process. The value is clearly evident based on historical trends. With net savings of \$4.4 billion, DCAA's FY 2013 results are a clear indication that its risk-based approach and conducting audits in accordance with professional standards provide significant returns for the taxpayer. The importance of quality continued to be a highlighted in our training sessions.

DCAA made additional efforts to increase its cost-effectiveness in the audits of large contractors. In FY 2011, it consolidated the audit management for Raytheon, aligning all auditors and support staff under one region. In FY 2013, DCAA completed a similar consolidation for Northrop Grumman, which represents over \$20 billion in government sales. Some of the benefits of this approach include reduced redundancies in contractor information requests, more comprehensive understanding of contractor business segments, easier access to contractor records, and timelier reporting of audit results.

Applying the high level of quality has provided the basis for the growth in net savings compared to previous years. DCAA's higher quality audits also create an important incentive for contractor compliance and a way to help contractors be better prepared for audits. An important component of DCAA's quality improvements has been the continued focus on communication with stakeholders. DCAA executives visited buying commands, met with industry officials, and attended conferences to discuss common acquisition challenges. Based on these interactions, DCAA helped stakeholders better understand audit requirements, and addressed their specific questions about the audit process.

The Inspector General, DoD, began an external peer review of DCAA in late FY 2013 to provide an independent assessment of the current quality level of DCAA audits. The peer review report is expected in the second half of FY 2014.

## **Looking Ahead**

DCAA's tough and complex mission is an essential component of the acquisition process. As DoD budgets are increasingly constrained, the warfighter and the taxpayer will be even more reliant on DCAA to help get the best value for the critical equipment and services the Department needs to support our national defense. DCAA is dedicated to promoting productive relationships with buying commands and contracting officers through increased communication, a clearer understanding of requirements, and a goal of operating as one government team. Ultimately, DCAA's success depends on the ability to serve its employees. The Agency is fortunate to have an exceptional workforce that is clearly mission-focused. DCAA will continue to seek out workforce feedback—and that of all its stakeholders—to help improve DCAA's service to the warfighter and taxpayer.

## ACRONYMS

CAM	Contract Audit Manual
CAS	Cost Accounting Standards
DAR	Defense Acquisition Regulation
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DoD	Department of Defense
FAR	Federal Acquisition Regulation
GAGAS	Generally Accepted Government Auditing Standards
NDAA	National Defense Authorization Act
OCO	Overseas Contingency Operations



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