

# Defense Contract Audit Agency

Financial Statements and Independent Auditor's Report

For the Years Ended September 30, 2011, and 2010

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## INDEPENDENT AUDITOR'S REPORT

### TO THE DIRECTOR DEFENSE CONTRACT AUDIT AGENCY

We have audited the accompanying Balance Sheets of the Defense Contract Audit Agency (DCAA) as of September 30, 2011 and 2012, and the related Statements of Net Cost, Changes in Net Position and Combined Statements of Budgetary Resources for the year then ended (hereinafter referred to as financial statements). The objective of our audit was to express an opinion on the fair presentation of these financial statements. In connection with our fiscal year 2011 audit, we also considered DCAA's internal control over financial reporting and tested DCAA's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on these financial statements.

#### Summary

As stated in our opinion on the financial statements, we concluded that DCAA's financial statements as of and for the year ended September 30, 2011 and 2010, present fairly in all material respects, in conformity with U.S. generally accepted accounting principles.

As stated in our opinion on internal control over financial reporting, we concluded that DCAA had effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations.

We found no material conflicts with DCAA's 2011 report on management controls prepared as required by the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

The following sections discuss our opinion on DCAA's financial statements, our consideration of DCAA's internal control over financial reporting, our tests of DCAA's compliance with certain provisions of applicable laws and regulations and management's and our responsibilities.

#### Opinion on the Financial Statements

We have audited the accompanying Balance Sheets of the Defense Contract Audit Agency (DCAA) as of September 30, 2011 and 2010, and the related Statements of Net Cost, Changes in Net Position and Combined Statements of Budgetary Resources for the year then ended.

In our opinion, the Financial Statements referred to above present fairly, in all material respects, the financial position of the Defense Contract Audit Agency as of September 30, 2011 and 2010, and its net costs, changes in net position and budgetary resources for the year then ended, in conformity with U.S. generally accepted accounting principles.

The information in the Management's Discussion and Analysis and Required Supplementary Information is not a required part of the financial statements but is supplementary information required by U.S. generally accepted accounting principles, OMB Circular A-136, *Financial Reporting Requirements*, Volume 6B of the Department of Defense Financial Management Regulation and the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management

regarding the methods of measurement and presentation of this information. However, we did not audit this information, and accordingly, we express no opinion on it.

### **Internal Control over Financial Reporting**

In planning and performing our audit, we considered DCAA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not consider all internal controls relevant to operating objectives as broadly defined in the FMFIA, such as those controls relevant to ensuring efficient operations. Since DCAA's financial recording and reporting, including compilation of its financial statements, are performed by the Defense Finance and Accounting Service (DFAS), our consideration of internal control included those aspects of DFAS' internal controls that were relevant to DCAA.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses or significant deficiencies.

### **Compliance with Laws and Regulations**

DCAA's management is responsible for complying with applicable laws and regulations. As part of obtaining reasonable assurance about whether DCAA's financial statements are free of material misstatements, we performed tests of management's compliance with certain laws and regulations, noncompliance with which could have a direct and material effect in the determination of financial statement amounts, and other particular laws and regulations specified in OMB Bulletin 07-04. Since DCAA's financial recording and reporting, including the issuance of financial statements, are performed by DFAS, we considered DFAS' compliance with laws and regulations relevant to work performed by DFAS on behalf of DCAA.

Our tests of compliance with selected provisions of laws and regulations for fiscal year 2011 disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

### **Responsibilities**

**Management's Responsibilities.** Management is responsible for the financial statements; establishing and maintaining effective internal control; and complying with laws and regulations applicable to DCAA.

**Auditor's Responsibilities.** Our responsibility is to express an opinion on the fiscal year 2011 financial statements of DCAA. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the relevant standards found in OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and presented fairly in accordance with accounting principles generally accepted in the United States of America. We are responsible for obtaining reasonable assurance about whether DCAA's management maintained effective internal control.

An audit also includes:

- Examining on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

In planning and performing our fiscal year 2011 audit, we considered DCAA's internal control over financial reporting by obtaining an understanding of DCAA's internal control, determining whether internal controls had been placed in operation, assessing control risk and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of DCAA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DCAA's internal control over financial reporting. We did not test all controls relevant to operating objectives as broadly defined in the Federal Managers' Financial Integrity Act of 1982.

As part of obtaining reasonable assurance about whether DCAA's fiscal year 2011 financial statements are free of material misstatement, we performed tests of DCAA's compliance with certain provisions of laws and regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DCAA. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of DCAA's management, the Department of Defense, the Department of Defense Office of Inspector General, OMB, the Governmental Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

Davis and Associates  
Alexandria, Virginia  
November 4, 2011

## PRINCIPAL FINANCIAL STATEMENTS

Department of Defense  
 Defense Contract Audit Agency  
 CONSOLIDATED BALANCE SHEET  
 (Amounts in Thousands)  
 As of September 30,

	2011	2010
<b>Assets (Note 2)</b>		
Intragovernmental		
Fund Balance with Treasury (Note 3)	\$ 54,334	\$ 60,220
Accounts Receivable (Note 5)	5,336	5,721
<b>Total Intragovernmental Assets</b>	\$ 59,670	\$ 65,941
Accounts Receivable, net (Note 5)	\$ 257	\$ 203
General Property, Plant and Equipment, net (Note 6)	19	43
Other Assets (Note 2)	300	399
<b>Total Assets</b>	\$ 60,246	\$ 66,586
<b>Liabilities (Note 7)</b>		
Intragovernmental		
Accounts payable (Note 7)	\$ 4,237	\$ 2,401
Other Liabilities (Note 8)	6,215	7,175
<b>Total Intragovernmental Liabilities</b>	\$ 10,452	\$ 9,576
Accounts Payable (Note 7)	\$ 8,247	\$ 6,119
Other Federal Employment Benefits (Note 7)	17,869	16,127
Other Liabilities (Note 8)	43,032	54,401
<b>Total Liabilities</b>	\$ 79,600	\$ 86,223
<b>Net Position:</b>		
Unexpended Appropriations	\$ 38,539	31,985
Cumulative Results of Operations	(57,893)	(51,622)
<b>Total Net Position</b>	\$ (19,354)	\$ (19,637)
<b>Total Liabilities and Net Position</b>	\$ 60,246	\$ 66,586

*The accompanying notes to the financial statements are an integral part of this statement*

Department of Defense  
 Defense Contract Audit Agency  
 CONSOLIDATED STATEMENT OF NET COST  
 (Amounts in Thousands)  
 As of September 30,

	2011	2010
Program Costs:		
Gross Costs	\$ 589,104	\$ 564,090
(Less: Earned Revenue)	(55,675)	(50,117)
Net Program Costs	533,429	513,973
Net Cost of Operations	\$ 533,429	\$ 513,973

*The accompanying notes to the financial statements are an integral part of this statement*

Department of Defense  
Defense Contract Audit Agency  
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION  
(Amounts in Thousands)  
As of September 30,

	2011		2010
<b>Cumulative Results of Operations:</b>			
Beginning Balances	\$ (51,622)	\$	(42,889)
Beginning Balances, as adjusted	(51,622)		(42,889)
<b>Budgetary Financing Sources:</b>			
Appropriations used	472,924		470,966
Transfers-in/out without reimbursement	20,497		-
<b>Other Financing Sources:</b>			
Imputed Financing from costs absorbed by others	33,737		34,274
<b>Total Financing Sources</b>	<b>527,158</b>		<b>505,240</b>
<b>Net Cost of Operations</b>	<b>533,429</b>		<b>513,973</b>
<b>Net Change</b>	<b>(6,271)</b>		<b>(8,733)</b>
<b>Cumulative Results of Operations</b>	<b>\$ (57,893)</b>	\$	<b>(51,622)</b>
 <b>Unexpended Appropriations:</b>			
<b>Beginning Balances</b>	\$ 31,985	\$	23,712
<b>Beginning Balances, as adjusted</b>	31,985		23,712
<b>Budgetary Financing Sources:</b>			
Appropriations received	484,524		482,804
Appropriations transferred – in/out	(2,196)		(541)
Other Adjustments (rescissions, etc.)	(2,850)		(3,024)
Appropriations used	(472,924)		(470,966)
<b>Total Budgetary Financing Sources</b>	<b>6,554</b>		<b>8,273</b>
<b>Unexpended Appropriations</b>	<b>38,539</b>		<b>31,985</b>
<b>Net Position</b>	<b>\$ (19,354)</b>	\$	<b>(19,637)</b>

*The accompanying notes to the financial statements are an integral part of this statement*

Department of Defense  
 Defense Contract Audit Agency  
 COMBINED STATEMENT OF BUDGETARY RESOURCES  
 (Amounts in Thousands)  
 As of September 30,

	2011	2010
<b>Budgetary Resources:</b>		
Unobligated balance, brought forward, October 1	\$ 9,846	\$ 8,632
Recoveries of prior year unpaid obligations	3,479	3,156
Budget authority:		
Appropriation	484,524	482,804
Spending authority from offsetting collections		
Earned		
Collected	56,062	48,883
Change in receivables from Federal sources	(386)	1,234
Change in unfilled customer orders		
Advance received	-	-
Nonexpenditure transfers, net, anticipated and actual	18,301	(541)
Permanently not available	(2,850)	(3,024)
<b>Total Budgetary Resources</b>	<b>\$ 568,976</b>	<b>\$ 541,144</b>
<b>Status of Budgetary Resources:</b>		
Obligations incurred		
Direct	\$ 500,651	\$ 481,015
Reimbursable	55,689	50,283
Unobligated balances, apportioned	2,101	2,505
Unobligated balance not available	10,535	7,341
<b>Total Status of Budgetary Resources:</b>	<b>\$ 568,976</b>	<b>\$ 541,144</b>
<b>Change in Obligated Balance:</b>		
Obligated balance, unpaid obligations, brought forward October 1	\$ 56,094	\$ 45,406
Less: Uncollected customer payments from Federal sources brought forward, October 1	(5,722)	(4,487)
Total unpaid obligated balance	50,372	40,919
Obligations incurred, net	556,340	531,298
Less: Gross outlays	(561,921)	(517,453)
Less: Recoveries of prior year unpaid obligations	(3,479)	(3,156)
Change in uncollected customer payments from Federal sources	386	(1,234)
Obligated balance, net, end of period		
Unpaid obligations	47,034	56,095
Less: Uncollected customer payments from Federal sources	(5,336)	(5,721)
Total, unpaid obligated balance, net, end of period	41,698	50,374
<b>Net Outlays:</b>		
Gross Outlays	561,921	517,453
Less: Offsetting collections	(56,062)	(48,883)
<b>Net Outlays</b>	<b>\$ 505,859</b>	<b>\$ 468,570</b>

*The accompanying notes to the financial statements are an integral part of this statement*

## NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### A. Reporting Entity

The Defense Contract Audit Agency (DCAA) is an agency of the U.S. Department of Defense (DoD). Before the establishment of DCAA, various branches of the U.S. Military had their own audit functions. There was recognition of the need for uniformity. Created in 1965 by the Secretary of Defense Robert S. McNamara, DCAA was established to provide standardized contract audit services as well as accounting and financial advisory services to the Department of Defense contracting officers and other customers. DCAA's primary customers are contracting officers in the Military Services.

#### B. Organization and Structure of DCAA

DCAA is organized into seven major components – Five Regions, a Field Detachment and the Headquarters office:

- Regions:
  - Irving, TX
  - Smyrna, GA
  - Philadelphia, PA
  - Lowell, MA
  - La Mirada, CA
- Field Detachment:
  - Chantilly, VA
- Headquarters:
  - Fort Belvoir, Virginia

The Headquarters houses the Director; Deputy Director; Executive Officer; Special Assistant for Quality; General Counsel; Assistant Director for Operations, Policy and Plans, and Resources. The staff is responsible for the overall management of DCAA's operations, development and implementation of policy and the allocation, management and accounting for the Agency's resources. Each Regional Office houses the Regional Director; Deputy Regional Director; Special Assistant to the Regional Director for Quality; Regional Audit Managers; Regional Special Programs Manager; and Regional Resources Manager. The Regions direct and administer the audit mission for the particular geographic region. The region manages the personnel and other resources assigned there. The Field Detachment houses the Director, Field Detachment; Deputy Director, Field Detachment; Special Assistant to the Director, Field Detachment; and Detachment Audit

Manager. The Field Detachment is responsible for audits of contracts related to sensitive compartmentalized information and special access programs.

#### C. Basis of Accounting and Presentation

The financial statements have been prepared to report the financial position, net cost, changes in net position and budgetary resources as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other applicable legislation. These financial statements have been prepared from the books and records of DCAA in accordance with generally accepted accounting principles (GAAP) and Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. GAAP for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which is the official standard-setting body for the Federal Government. Currently, DCAA is unable to implement fully all elements of GAAP and the OMB Circular A-133, due to limitations of its financial and nonfinancial management processes and systems that support the financial statements. DCAA derives reported values and information for major asset and liability categories, largely from nonfinancial systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with US GAAP. DCAA continues to implement improvements in its processes and systems to address these limitations. DCAA's management makes certain estimates and assumptions in order to prepare the financial statements in accordance with GAAP that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

OMB financial statement reporting guidelines require the presentation of comparative financial statements for all of the principal financial statements. DCAA has presented comparative FY 2011 financial statements for the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position and Statement of Budgetary Resources. Throughout the financial statements and notes, certain assets, liabilities, earned revenue and costs have been classified as intragovernmental.

The accounting structure of Federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred without regard to receipt or payment of cash. The budgetary accounting principles are designed to recognize the obligation of funds according to legal requirements, which in many cases is prior to the occurrence of an accrual based transaction. DCAA's financial management systems are unable to meet all of the requirements for full accrual accounting. Transactions are recorded using financial (accrual) and budgetary bases of accounting. Financial accounting supports accrual accounting and financial reporting by accounting for assets, liabilities, net position, revenues and expenses to show actual financial position and net cost of operations. Until all of the financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DCAA's financial data will be derived from budgetary and proprietary transactions from nonfinancial feeder systems and accruals made for major items such as payroll expenses, accounts payable and Federal Compensation Act Liability.

#### **D. Accounting for Intragovernmental Activities**

Throughout the financial statements and notes, certain assets, liabilities, earned revenue and costs have been classified as intragovernmental, which is defined as exchange transactions made between two reporting entities within the Federal government. The U.S. Treasury's "Federal Management Transactions Accounting Policy Guide" and Treasury Financial Management Manual Part 2 – Chapter 4700 "Agency Reporting Requirements for the Federal Report of the United States Government" – provide guidance for reporting and reconciling intragovernmental balances. While DCAA is unable to fully reconcile intragovernmental transactions with all of its non DoD Federal Agencies, DCAA is able to reconcile balances pertaining to Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

#### **E. Fund Balance with Treasury**

DoD maintains all cash accounts with the U.S. Department of Treasury (hereafter, Treasury). Treasury processes cash receipts and disbursements on behalf of DoD and DoD's accounting records are reconciled with those of Treasury on a monthly basis. DCAA receives its spending authorizations as allotments from DoD appropriations. DoD reconciles

Fund Balance with Treasury at the agency-wide level. As such, what is presented on DCAA's balance sheet is not reconcilable with account balances maintained by Treasury.

#### **F. Accounts Receivable**

Accounts receivable consists of amounts owed to DCAA by other Federal Agencies and the public. As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims and refunds receivable from other federal entities and the public. Federal accounts receivable arise generally from the provision of services to other Federal agencies, and, with the exception of occasional billing disputes, are considered to be fully collectible. DCAA does not recognize an allowance for estimated uncollectible amounts from other Federal agencies. Claims against Federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual. DCAA establishes an allowance for uncollectible accounts due from the public by determining the established percentage of debts based on the age of the receivable.

#### **G. General Property, Plant and Equipment**

General purpose property, plant and equipment (hereafter, PP&E) consists of buildings, structures and facilities used for general operations; capital leases and leasehold improvements. DCAA's PP&E threshold is \$100 thousand except for real property which is \$20,000. DCAA does not have any real property and is using the capitalization threshold of \$100 thousand for all General PP&E. General PP&E assets are capitalized at historical acquisition costs when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the DoD's capitalization threshold. DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the DoD capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. DoD depreciates all General PP&E, other than land, on a straight line basis.

#### **H. Advances and Prepayments**

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of the prepayment, and recognized as expenditures/operating expenses when the related goods and services are delivered/rendered.

## **I. Lease Agreements**

FASAB guidance on leases is covered in SFFAS No. 5, *Accounting for Liabilities of the Federal Government* and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. Capital leases are leases that transfer substantially all of the benefits and risks of ownership to the lessee. If a lease meets one or more of the following criteria – it is classified as a capital lease: 1) the lease transfers ownership of the property to the lessee by the end of the lease term; 2) the lease contains an option to purchase the leased property at a bargain price; 3) the lease term is equal to or greater than 75 percent of the estimated economic life of the leased property; and 4) the present value of rental and other minimum lease payments, excluding the portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property. DCAA does not have any capital leases. Leases that do not meet the criteria for capital leases are classified as operating leases and recorded as expenses as payments are made over the lease term. DCAA has operating leases on office space that expire at various times. The lease terms depend upon the individual contracts and locations.

## **J. Other Assets**

Other assets represent payments of salary and travel advances made to civilian employees to defray anticipated business expenses while on official travel.

## **K. Liabilities**

Liabilities represent the amount of monies or other resources that are likely to be paid by DCAA as the result of a transaction or event that has already occurred. No liability can be paid by DCAA without an appropriation of funds. Liabilities for which an appropriation has not been enacted are therefore disclosed as liabilities not covered by budgetary resources or unfunded liabilities. The liquidation of liabilities not covered by budgetary or other resources is dependent on future appropriations or other funding.

## **Accrued Leave**

Civilian annual leave, compensatory time and credit hours are accrued as earned and the unfunded liability for the accrued amounts is reduced as leave is taken. The balance for these unfunded liabilities on September 30, 2011 reflects current pay rates for the leave that is earned but not taken. Sick and other types of non-vested leave are expensed as taken.

## **Contingent Liabilities**

Contingent Liabilities are liabilities where the existence or amount of the liability cannot be determined with certainty, because they depend on the outcome of future events as defined by SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. The uncertainty will be resolved when one or more future events occur or fail to occur. DCAA recognizes contingent liabilities on an annual basis when the liability is probable and reasonably estimatable. DCAA discloses contingent liabilities in the notes to the financial statements when the conditions for liability recognition are not met and when the outcome of future events is more than remote.

## **L. Net Position**

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include the amount of unobligated allotments which have not been rescinded or withdrawn and amounts obligated but for which liabilities for payments had not been incurred at the end of the year. Cumulative results of operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains)

## **M. Unexpended Obligations**

DCAA obligates funds to provide goods and services for outstanding orders not yet delivered. Unless the title has passed, the financial statements do not reflect a liability for payment for goods and services not delivered. Unexpended obligations includes both obligations for which goods and services have been delivered (title passed) and a liability is recognized, and obligations for which no delivery has occurred and no liability is recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources and is referred to as "Total, unpaid obligated balance, net, end of period".

## **N. Revenues and other Financing Sources**

Congress appropriates the majority of DCAA's operating funds from the general receipts of the Treasury. These funds are made available to DCAA for a specified time period (one or more fiscal years) or until expended. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of services to other Federal agencies on a reimbursable basis. Appropriations are reflected as a financing source entitled "Appropriations Used" on the Statement of Changes in Net Position once goods or services have been received. Appropriations are reported as

apportioned on the Statement of Budgetary Resources when authorized by legislation. DCAA recognizes revenue as a result of costs incurred or services performed on behalf of other Federal agencies and the public. Full cost pricing is DCAA's standard policy for services provided as required by the OMB Circular A-25, Transmittal Memorandum #1 User Charges. Under the reimbursable order process, DCAA recognizes revenue when earned.

**O. Recognition of Expenses**

For financial statement purposes, DoD requires the recognition of operating expenses in the period

incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on a full accrual accounting basis. Accruals are made for major items such as payroll expenses, accounts payable and unbilled revenue.

**P. Management's Use of Estimates**

DCAA, in conformity with GAAP, has made certain estimates and assumptions related to the reporting of assets, liabilities, revenues, expenses and the disclosure of contingent liabilities. Actual results could differ from these estimates.

## NOTE 2 ASSETS

Assets of DCAA include entity assets and nonentity assets. Entity assets are those available for use by DCAA. Nonentity assets are held by DCAA but are not available for use in its operations. Entity assets

include accounts receivable, general PP&E, and other assets and balances with Treasury comprised of appropriated funds and cash collected for reimbursable audit work.

As of September 30, (Amounts in thousands)	2011			2010
	Nonentity	Entity	Total	Total
<b>Intragovernmental Assets:</b>				
Fund Balance with Treasury	\$ -	\$ 54,334	\$ 54,334	\$ 60,220
Accounts Receivable	-	5,336	5,336	5,721
Total Intragovernmental	\$ -	\$ 59,670	\$ 59,670	\$ 65,941
<b>Nonfederal Assets:</b>				
Accounts Receivable, Net	\$ -	\$ 257	\$ 257	\$ 203
General PP&E, Net	-	19	19	43
Other Assets	-	300	300	399
Total Nonfederal Assets	\$ -	\$ 576	\$ 576	\$ 645
<b>Total Assets</b>	<b>\$ -</b>	<b>\$ 60,246</b>	<b>\$ 60,246</b>	<b>\$ 66,586</b>

**NOTE 3 FUND BALANCE WITH TREASURY**

The United States Treasury performs cash management activities for Federal agencies. Treasury maintains and reports fund balances at the Treasury Index appropriation level. DCAA is included at the Treasury Index 97 appropriation level, an aggregate level that does not provide identification of the

separate Defense Agencies. As a result, Treasury does not separately report an amount for DCAA. Instead, the entire DCAA Fund Balance with Treasury amount of \$60.2 million is reflected as a reconciling amount.

<b>As of September 30,</b> (Amounts in thousands)	<u>2011</u>	<u>2010</u>
<b>Fund Balance:</b>		
Appropriation Funds	\$ 54,334	\$ 60,220
Total Fund Balance	\$ 54,334	\$ 60,220
<b>Fund Balance Per Treasury Versus Agency:</b>		
Fund Balance per Treasury	\$ -	\$ -
Fund Balance per DCAA	54,334	60,220
<b>Reconciling Amount</b>	<b>\$ (54,334)</b>	<b>\$ (60,220)</b>

**NOTE 4 STATUS OF FUND BALANCE WITH TREASURY**

The "Status of the Fund Balance with Treasury" may be classified as unobligated available, unobligated unavailable and obligated. Unobligated funds, depending on budget authority, are generally available for new obligations in current operations. The unavailable balance also includes amounts appropriated in prior fiscal years, which are not available to fund new obligations. The obligated but not yet disbursed balance represents amounts designated for payment of goods and services ordered but not yet received; or goods and services received, but for which payment has not yet been made.

Non Fund Balance with Treasury Budgetary Accounts reduce the Status of Fund Balance with Treasury, such as unfilled orders without advance from customers. The amount shown as non Fund Balance with Treasury Budgetary Accounts on the chart below, \$5.3 million, represents reimbursement earned but not collected on September 30, 2011.

<b>As of September 30,</b> (Amounts in thousands)	<u>2011</u>	<u>2010</u>
<b>Unobligated Balance:</b>		
Available	\$ 2,101	\$ 2,505
Unavailable	10,535	7,341
<b>Obligated Balance not yet Disbursed</b>	<b>\$ 47,034</b>	<b>\$ 56,095</b>
<b>Non FBWT Budgetary Accounts</b>	<b>\$ (5,336)</b>	<b>\$ (5,721)</b>
<b>Total</b>	<b>\$ 54,334</b>	<b>\$ 60,220</b>

**NOTE 5 ACCOUNTS RECEIVABLE**

As of September 30, (Amounts in thousands)	2011		2010	
	Gross Amount Due	Allowance for Estimated Uncollectibles	Accounts Receivable Net	Accounts Receivable Net
Intragovernmental Receivables:	\$ 5,336	\$ N/A	\$ 5,336	\$ 5,721
Nonfederal Receivables (From Public)	288	(31)	257	203
<b>Total Accounts Receivable:</b>	<b>\$ 5,624</b>	<b>\$ (31)</b>	<b>\$ 5,593</b>	<b>\$ 5,924</b>

**NOTE 6 GENERAL PROPERTY PLANT AND EQUIPMENT**

As of September 30, (Amounts in thousands)	2011		2010	
	Acquisition Value	Accumulated Depreciation	Net Book Value	Prior FY Net Book Value
General Equipment	\$ 124	\$ (105)	\$ 19	\$ 43
<b>Total General PP&amp;E</b>	<b>\$ 124</b>	<b>\$ (105)</b>	<b>\$ 19</b>	<b>\$ 43</b>

## NOTE 7 LIABILITIES ANALYSIS

Liabilities covered by budgetary resources are funded liabilities to be paid with existing budgetary resources. Liabilities not covered by budgetary

resources represent those unfunded liabilities for which Congressional action is needed before budgetary resources can be provided.

As of September 30, (Amounts in thousands)	2011			2010	
	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total	Total	Total
<b>Intragovernmental Liabilities</b>					
Accounts Payable	\$ 4,237	\$ -	\$ 4,237	\$	2,401
Other	1,256	4,959	6,215		7,175
Total Intragovernmental Liabilities	\$ 5,493	\$ 4,959	\$ 10,452	\$	9,576
<b>Nonfederal Liabilities</b>					
Accounts Payable	\$ 8,247	\$ 3	\$ 8,250	\$	6,119
Other Federal					
Employment Benefits	-	17,869	17,869		16,127
Other Liabilities	7,356	35,676	43,032		54,401
Total Nonfederal Liabilities	15,603	53,548	69,151		76,647
<b>Total Liabilities</b>	<b>\$ 21,096</b>	<b>\$ 58,507</b>	<b>\$ 79,603</b>	<b>\$</b>	<b>86,223</b>

### Federal Employee Compensation Act (FECA)

The Federal Employees' Compensation Act (FECA), 5 USC Chapter 81, provides compensation benefits to Federal employees for work-related injuries or illnesses and to their surviving dependents if a work-related injury or illness results in the employee's death. The FECA is administered by the Department of Labor (DOL), Office of Workers' Compensation Programs (OWCP). The 12 OWCP district offices adjudicate the claims and pay benefits, and the costs of those benefits are charged back to the employing agency. The actuarial liability for workers' compensation benefits is developed by DOL and is provided to DCAA at the end of each fiscal year. The liability includes the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases. The liability is determined by using historical benefit payment patterns to predict future payments. Cost-of Living adjustments and medical inflation factors are also included in the calculation of projected future

benefits. Consistent with past practice and as allowed under U.S. generally accepted accounting principles, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds.

To provide more specifically for the effects of inflation on the liability for future worker's compensation benefits, wage inflation factors (cost of living allowance or COLA) and medical inflation factors (consumer price index-medical or CPI-Med) are applied to the calculation of projected future benefits. These factors are also used to adjust the historical payments to current year constant dollars. The liability is determined assuming an annual payment at mid-year.

The compensation COLA and the CPI-Med used in the model's calculation of estimates were as follows:

FY	COLA	CPI-Med
2011	1.40%	3.29%
2012	1.50%	3.48%
2013	1.80%	3.71%
2014+	2.00%	3.71%

The medical inflation rates presented represent an average of published quarterly rates covering the benefit payment fiscal year. The compensation

factors presented are the blended rates used by the model rather than the published 2011, FECA-COLA factor from which the blended rates are derived.

**NOTE 8 OTHER LIABILITIES**

As of September 30, (Amounts in thousands)	2011			2010
	Current Liability	Noncurrent Liability	Total	Total
<b>Intragovernmental Assets:</b>				
FECA Reimbursement to the Department of Labor	\$ 2,350	\$ 2,608	\$ 4,958	\$ 3,958
Custodial Liabilities	1	-	1	-
Other Liabilities	1,256	-	1,256	3,217
Total Intragovernmental Other Liabilities	3,607	2,608	6,215	7,175
<b>Nonfederal</b>				
Accrued Funded Payroll and Benefits	\$ 7,356	\$ -	\$ 7,356	\$ 20,091
Accrued Unfunded Annual Leave	35,676	-	35,676	34,310
Advances from Others	-	-	-	-
Total Nonfederal Other Liabilities	\$ 43,032	\$ -	\$ 43,032	\$ 54,401
<b>Total Other Liabilities</b>	<b>\$ 46,639</b>	<b>\$ 2,608</b>	<b>\$ 49,247</b>	<b>\$ 61,576</b>

**NOTE 9 STATEMENT OF NET COST**

The Statement of Net Cost reports DCAA’s gross and net costs by its two major service areas – forward pricing and incurred cost audits and other work. The presentation of the two major product lines

correlates to DCAA’s performance standards and stretch goals as set forth in DCAA Director’s Performance Plan with the DoD Comptroller.

**As of September 30,**  
(Amounts in thousands)

	<u>2011</u>		<u>2010</u>
<b>Intragovernmental Costs</b>	<b>\$ 165,367</b>	<b>\$</b>	<b>149,824</b>
Public Costs	423,737		414,266
Total Costs	<u>\$ 589,104</u>	<u>\$</u>	<u>564,090</u>
Intragovernmental Earned Revenue	\$ (55,667)	\$	(50,117)
Public Earned Revenue	(8)		-
Total Earned Revenue	<u>\$ (55,675)</u>	<u>\$</u>	<u>(50,117)</u>
<b>Net Cost of Operations</b>	<b><u>\$ 533,429</u></b>	<b><u>\$</u></b>	<b><u>513,973</u></b>

The intent of the Statement of Net Cost is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. Intragovernmental costs and revenue are related to transactions made between two reporting entities within the Federal Government. Public costs and revenue are exchange transactions made between the reporting entity and a nonfederal entity.

DCAA is able to compare its trading partners within the Department of Defense and disclose any material differences identified. The amounts presented on the Statement of Net Cost are based on budgetary obligations, accruals, and collection and disbursement transactions. The information presented also includes data from non-financial feeder systems to capture payroll expenses.

**NOTE 10 STATEMENT OF BUDGETARY RESOURCES**

The Statement of Budgetary Resources provides information about how budgetary resources were made available as well as their status at the end of the period. It is the only financial statement exclusively derived from the entity’s budgetary general ledger in accordance with budgetary accounting rules that are incorporated into U.S. generally accepted accounting principles for the Federal Government.

DCAA’s apportionment category for direct and reimbursable obligations incurred is category A: Amount required to be apportioned for each quarter in the fiscal year. For 4<sup>th</sup> Quarter FY 2011, DCAA reported \$500.7 million in direct obligations incurred and \$55.7 million in reimbursable obligation incurred. The net amount of budgetary resources obligated for undelivered orders as of September 30, 2011 and 2010 is \$26.2 and \$24.7 million, respectively.

Other disclosures

Intra-entity transactions have not been eliminated because the statements are presented as combined.

**NOTE 11 RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET**

<b>As of September 30,</b> (Amounts in thousands)	<u>2011</u>	<u>2010</u>
<b>Resources Used to Finance Activities</b>		
Budgetary Resources Obligated		
Obligations incurred	\$ 556,340	\$ 531,298
Less: Spending authority from offsetting collections and recoveries	(59,155)	(53,273)
Net Obligations	\$ 497,185	\$ 478,025
Other Resources		
Imputed financing from costs absorbed by others	\$ 33,737	\$ 34,274
Net other resources used to finance activities	\$ 33,737	\$ 34,274
Total Resources used to finance activities	\$ 530,922	\$ 512,299
<b>Resources Used to Finance Items not Part of the Net Cost of Operations</b>		
<b>Cost of Operations</b>		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	\$ (1,576)	\$ (6,150)
Unfilled Customer Orders	-	-
Resources that fund expenses recognized in prior periods	-	-
Resources that finance the acquisition of assets	-	-
Total resources used to finance items not part of the Net Cost of Operations	(1,576)	(6,150)
Total resources used to finance Net Cost of Operations	\$ 529,346	\$ 506,149
<b>Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period</b>		
Increase in annual leave liability	\$ 1,367	\$ 2,773
Depreciation and amortization	25	25
Other	\$ 2,691	\$ 5,026
Total components of the Net Cost of Operations that will not Require or Generate Resources in the current period	\$ 4,083	\$ 7,824
<b>Net Cost of Operations</b>	<b>\$ 533,429</b>	<b>\$ 513,973</b>

Due to DoD financial system limitations, DCAA's budgetary data is not in agreement with proprietary expenses. These differences between budgetary and proprietary data are a previously identified deficiency

for DoD. The schedule lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

## NOTE 12 LEASES

The DCAA leases real property under operating leases. These leases expire in various years. Minimum rental payments under operating leases

having remaining terms in excess of one year as of September 30, 2011 for each of the next 4 years in aggregate are as follows (Amounts in thousands):

<u>Year Ended September 30</u>	<u>Operating Lease Amounts</u>
2012	8,231
2013	6,255
2014	5,521
2015 and thereafter	<u>12,181</u>
Total Minimum Lease Payments	\$ <u>32,188</u>

Amounts reported as of September 30, 2011 for operating lease future payments represent amounts gathered from lease occupancy agreements.