

DEFENSE CONTRACT AUDIT AGENCY
Management Discussion and Analysis
FY 2014



A COMMITMENT TO EXCELLENCE

DEFENSE CONTRACT AUDIT AGENCY
FY 2014 MANAGEMENT DISCUSSION AND ANALYSIS

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MESSAGE FROM THE DIRECTOR

I am pleased to present the Defense Contract Audit Agency's (DCAA) Management Discussion and Analysis for the fiscal year (FY) 2014. DCAA's mission is to provide audit and financial advisory services to Department of Defense (DoD) and other federal entities responsible for acquisition and contract administration. DCAA operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller)/Chief Financial Officer.

The Management Discussion and Analysis provides executive-level information on Agency's mission and vision, organization and structure, performance results, financial highlights, system control and legal compliance. We accomplish these in an effective and efficient manner through continuous process improvement.

The DCAA team is committed to organizational excellence and sound financial management. I am pleased to report that DCAA received its 14th consecutive unqualified audit opinion from an independent audit of its financial statements. DCAA complies with the requirements of the Federal Managers' Financial Integrity Act (FMFIA) and Federal Financial Management Improvement Act (FFMIA). In the last six years, DCAA has been the subject of two Government Accountability Office (GAO) reviews and a follow-up review conducted by Department of Defense Inspector General (DoD IG); all have implications on the implementation of DCAA audit policy. In September 2009, a GAO quality assurance review found systemic noncompliance resulting in the conclusion that DCAA audits lacked sufficient professional judgment. We took the GAO and DoD IG findings very seriously and implemented comprehensive actions to address GAO and DoD IG recommendations. Because of DCAA workforce's persistence and commitment, we made significant progress in resolving the issues highlighted by these reviews. On August 21, 2014, DCAA received a peer review rating of Pass with Deficiency, which was conducted by the DoD IG. We have implemented several actions to address the DoD IG's latest recommendations. DCAA issued additional guidance on documenting significant judgments, disclaiming an opinion, independent reference reviews, and the audit review process; and we revised our planning and performance system to require a statement of Sufficiency of Evidence and the Basis of the Audit Opinion.

DCAA employs an all-civilian workforce comprised of professional contract auditors and administrative support personnel. The workforce is comprised of highly educated employees with 95 percent of the staff having bachelor's degrees and 39 percent having advanced degrees. As an agency, we focus on continuous education and professional certifications. Our employees hold professional certifications in a variety of functional areas including audit, fraud examination, information technology, financial management, human resources, and others. We are committed to the core values of teamwork, excellence, accountability, mutual respect, integrity, and trust. None of our accomplishments would be possible without the dedication and commitment of our employees.

In 2015, DCAA will celebrate 50 years of providing quality audit services that support the warfighter and protect taxpayers' interests.

/Signed/
Anita F. Bales
Director

ABOUT DCAA

Prior to 1965, each branch of military had separate contract audit functions and regulations. Contractor and government personnel recognized the need for consistency, and Secretary of Defense, Robert S. McNamara instituted “Project 60” in May 1962, to examine whether it was feasible to centrally manage contract administration and audit activities. An outcome of this study was the decision to establish a single contract audit capability – the “Defense Contract Audit Agency.” DCAA began providing audit and financial advisory services to government contract officials on July 1, 1965. DCAA operates under the authority, direction, and control under the Under Secretary of Defense (Comptroller)/Chief Financial Officer. A member of the Senior Executive Service, the Secretary of Defense appoints the Director of DCAA.

OVERVIEW

Mission

DCAA’s primary function is to conduct contract audits, accounting system audits, and to provide financial advisory services regarding contracts and subcontracts to all Department of Defense (DoD) components. We provide these services in connection with the negotiations, administration, and settlement of contracts and subcontracts to ensure fair and reasonable contract prices when the DoD spends taxpayer dollars. Contract audits are independent, professional reviews of financial representations made by defense contractors. DCAA audits only contractors; it has no internal audit responsibilities within DoD. DCAA provides contract audit services to other Federal agencies on a reimbursable basis when appropriate. The scope of DCAA’s influence is significant. DCAA provides definitive recommendations to contracting officers that directly influence negotiations with contractors. Because of these recommendations, contracting officers are better able to negotiate prices and settle contracts for major weapons systems, services, and supplies.

Organization and Structure

At the end of FY 2014, DCAA had 388 Field Audit Offices (FAOs) throughout the United States, Europe, the Middle East, Asia, and the Pacific. To manage the geographically dispersed and complex work, seven major components comprise DCAA: a Headquarters and six regions—five with geographic boundaries plus a Field Detachment that handles classified work.

Headquarters is located at the Andrew T. McNamara Headquarters Complex, Fort Belvoir, Virginia. Principal elements of Headquarters are the Director, Deputy Director, General Counsel, and the Assistant Directors for Operations, Policy and Plans, Integrity and Quality Assurance, and Resources.

Regional offices are located in Lowell, Massachusetts; Philadelphia, Pennsylvania; Smyrna, Georgia; Irving, Texas; and La Palma, California. Each regional office directs and administers the accomplishment of DCAA audit mission for assigned geographical areas. They manage personnel and resources assigned to their region and direct the operation of Field Audit

Offices (FAOs) within their region. Principal elements of regional offices are the Regional Director, Deputy Regional Director, Special Assistant to the Regional Director, Regional Audit Managers, Regional Special Programs Manager, and Regional Resources Manager. DCAA identifies FAOs as either branch or resident.

Branch Offices, strategically situated within the regions, perform the majority of contract audit services within the assigned geographical area. Branch offices often have smaller sub-offices to ensure adequate oversight of contractors. Regional Directors establish sub-offices as extensions of FAOs when required to furnish contract audit service more economically. A sub-office is dependent on its parent FAO for release of audit reports and other administrative support.

Resident offices, located at contractor sites, provide audit services when the workload of that contractor justifies the assignment of a permanent staff.

Liaison employees provide assistance to acquisition, contract administration, and contract audit personnel for DoD and non-DoD procurement or contract administration offices. Some auditors provide financial advisory service at select procurement offices. This service improves the quality of audit information for decision-makers by providing confidence about the reliability and relevance of financial information.

DCAA assists acquisition personnel by:

- evaluating contractor submitted forward pricing proposals;
- providing contracting officers with accounting and financial advisory services useful to negotiations;
- verifying the propriety and acceptability of costs charged by contractors to flexibly priced government contracts; and
- deterring inefficient contractor practices through detection and correction, preventing excessive costs and contract prices.

The Defense Contract Audit Institute (DCAI) in Atlanta, Georgia, provides specialized contract audit training for DCAA's audit staff. In addition, DCAI's trained instructors provide leadership and interpersonal skills training to new supervisors and other Agency employees.

DCAA's Professional Workforce is comprised of nearly 5,100 highly qualified employees. Approximately 95 percent of them have a bachelor's degree, and 39 percent have an advanced degree. In addition, about 27 percent are Certified Public Accountants and 5 percent have other professional certifications in a variety of functional areas including financial management, fraud examination, information technology, human resources, property management, security, and logistics management. Nearly 88 percent of DCAA employees are auditors. The remaining 12 percent are professional support staff that work in a variety of occupational fields including administrative support, accounting, budget, human resources, security, information technology, and legal.

Management and Performance Challenge

To help ensure the quality and efficiency of audit operations, DCAA issued additional guidance on documenting significant judgments, disclaiming an opinion, independent reference reviews, and the audit review process, and revised its planning and performance system to require a Statement of Sufficiency of Evidence and the Basis of the Audit Opinion.

DCAA's aim is to continue to provide contracting officers with high quality and timely audit reports, advice, and negotiation support to establish fair and reasonable contract prices. During contract performance, DCAA auditors continue to verify that results and outputs of contractor business systems comply with applicable rules, regulations, and contract terms.

PERFORMANCE

Strategic Plan

DCAA's current strategic plan covers 2011-2015. It is anchored by core values—Teamwork, Excellence, Accountability, Mutual Respect, Integrity, Trust—and a vision statement: “Dedicated employees working together to deliver top-quality audit services to support the Department and the warfighter, and to protect the taxpayer's interest.” DCAA is effectively using the plan to focus on audit quality and workforce issues and to identify operational improvements. During FY 2014, the Agency completed its work on the final 4 of the 16 different initiatives under the current plan. The completed initiatives addressed the subjects of career paths, non-audit services, system reviews at non-major contractors, and the effectiveness/efficiency of managing resources. Additionally, 4 new strategic action teams were designated to review analytic tools available to auditors; consider changes to the agency's audit planning and performance systems; increase the effectiveness of DCAA working relationships with external stakeholders; and to improve the agency's succession planning model.

Goals, Objective, and Results

During FY 2014, DCAA conducted about 15,800 reviews and produced about 5,700 reports equating to approximately \$182.6 billion. We questioned about \$10.7 billion (or 6 percent) of those costs and reported about \$4.5 billion in actual net savings. These savings far exceed the cost of DCAA's operations and represent a return on taxpayers' investments in DCAA of about \$6.90 for each dollar invested. Although there are no specific goals for savings and return on investment, the results do provide indicators of the value of DCAA audit services to the U.S. taxpayer.

FINANCIAL

Appropriated Funding

DCAA has four sources of funding. Appropriated funds are comprised of an Operation and Maintenance (O&M) Fund, Procurement Fund, and Defense Acquisition Workforce Development Fund (DAWDF). Additionally, DCAA has reimbursable funding authority. Reimbursement revenue supplements the O&M Fund.

O&M funds pay for goods and services used during the normal course of business in the fiscal year appropriated. Examples of expenses include civilian salaries and benefits, travel, information technology, leased office space, training and education, recruiting, and business assets. The FY 2014 O&M funding of \$584.5 million was \$45.3 million or 8% above the prior year level.

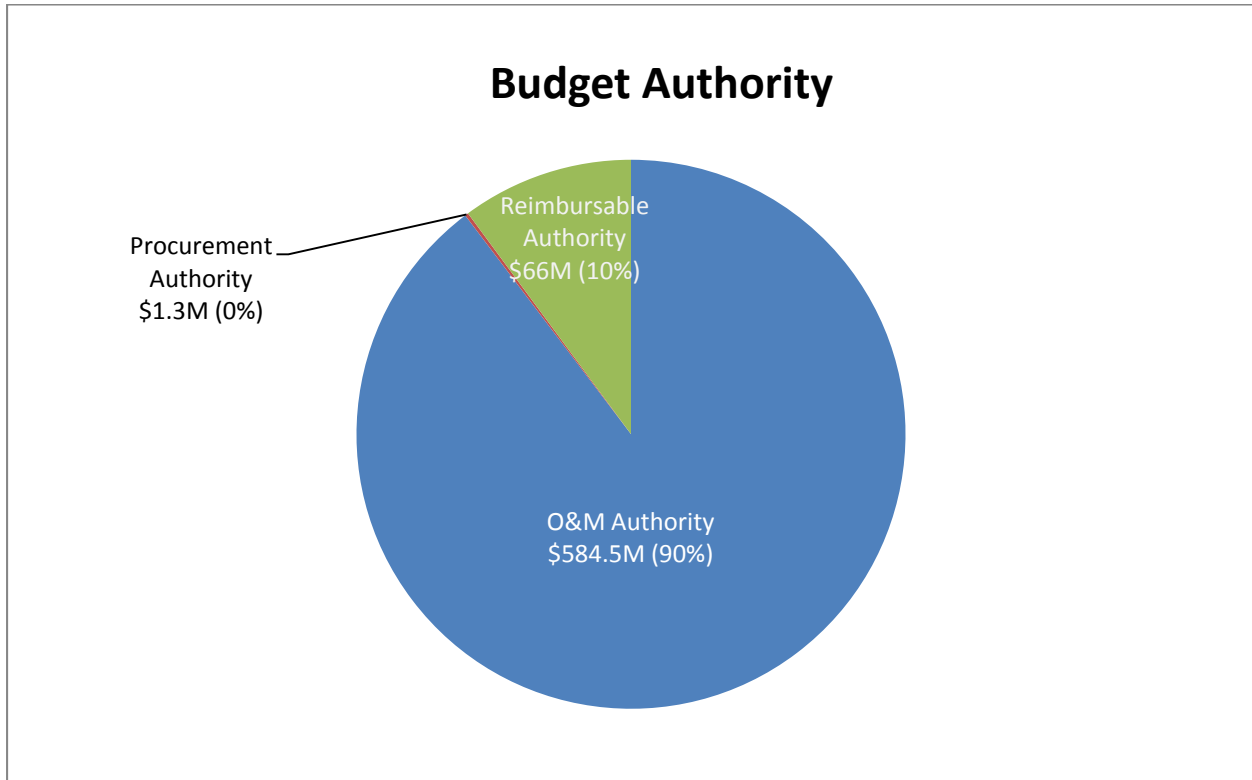
Reimbursable funds are paid by non-DoD agencies for DCAA audit services. The Office of Under Secretary of Defense, Comptroller [OUSD (C)] sets reimbursable authority annually. DCAA executed \$56.4 million in FY 14 reimbursable authority. The execution level is about \$0.3 million or 0.5% below last year.

Procurement funds pay for mission essential and automated data processing equipment. DCAA typically uses procurement funds for high-dollar network and information technology components. In FY 2014, DCAA used \$0.8 million to purchase Wide Area Network (WAN) equipment.

DAWDF funds are used to recruit and train acquisition personnel. The Office of the Under Secretary of Defense for Acquisition, Technology and Logistics [OUSD (AT&L)] provided DAWDF funding of \$11.2 million. These funds are part of OUSD (AT&L)'s financial reporting and not shown on DCAA's financial statements. The DAWDF funding has been a valuable program for DCAA, allowing us to grow, train, and sustain the audit workforce. DCAA has added over 950 new employees over the past five years to meet the demand of the increased workload.

Analysis of the Financial Statements

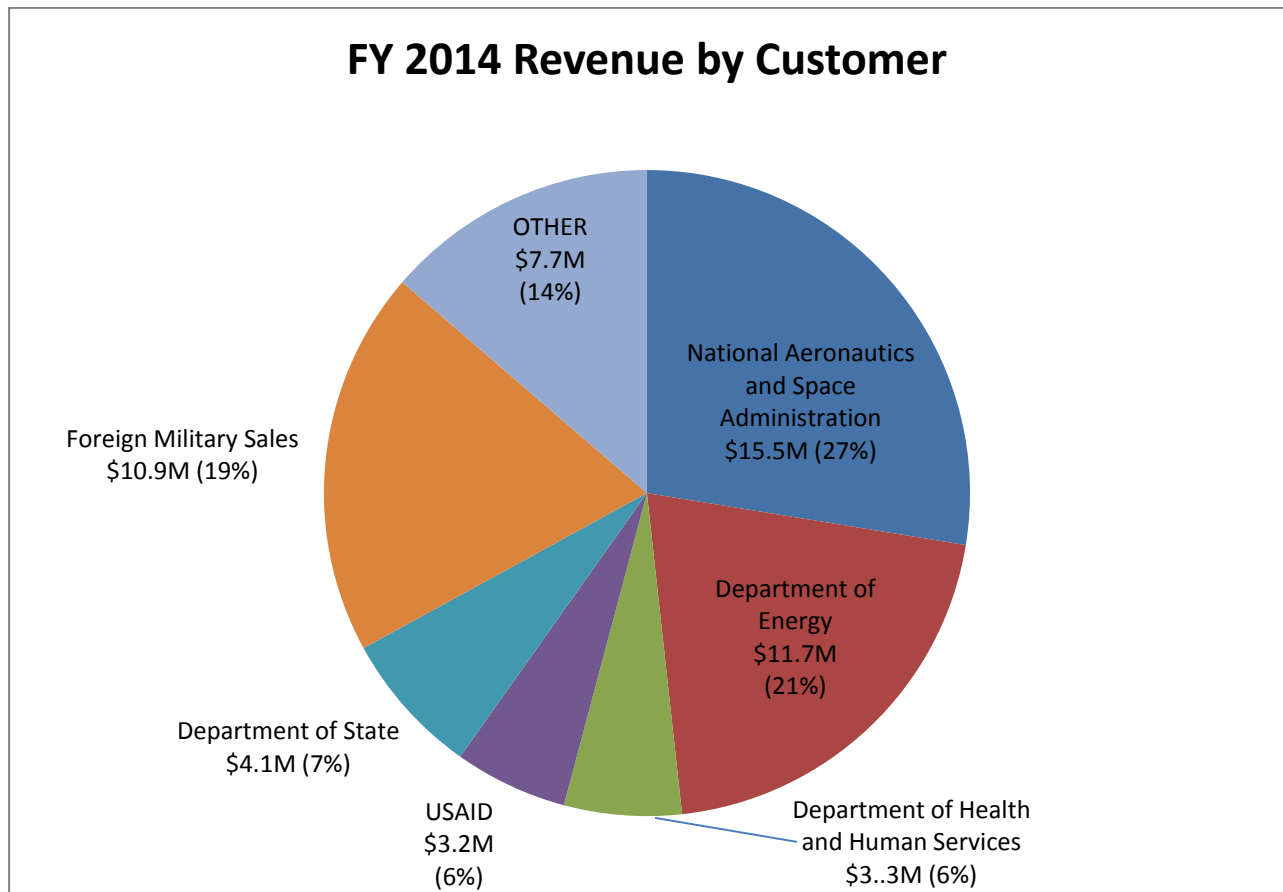
The following tables and graphs of key financial areas summarize information about the Agency's financial condition. The Consolidated Balance Sheet and Cumulative Results of Operations offers a snapshot of the Agency's financial position as of September 30, 2014 as compared to September 30, 2013. The Consolidated Statement of Net Cost summarized key expenditures, less reimbursable revenue earned, incurred for the year ended September 30, 2014 compared to the year ended September 30, 2013.



The Consolidated Statement of Net Cost presents the annual costs of operating programs. The net cost of each specific program operation equals the program’s gross costs less any earned revenue. The following table presents DCAA’s major cost categories for the fiscal years ended September 30, 2013 and September 30, 2014.

Consolidated Statement of Net Cost				
\$ in millions				
	FY 2014	FY 2013	Dollar Change	Percent Change
Gross Costs				
Personnel Payroll	\$409.7	\$394.8	\$14.9	3.8%
Personnel Benefits	\$132.9	\$129.6	\$ 3.3	2.5%
Purchased Goods & Services	\$ 66.9	\$ 74.9	(\$ 8.0)	(10.7%)
FECA Tax	\$ 28.0	\$ 26.5	\$ 1.5	5.6%
Total Gross Costs	\$637.5	\$625.8	\$11.7	1.9%
Less: Earned Revenue	(\$56.3)	(\$56.6)	\$0.3	(0.5%)
Net Cost of Operations	\$581.2	\$569.2	\$12.0	2.1%

The graph below shows DCAA's FY 2014 earnings by major customer.



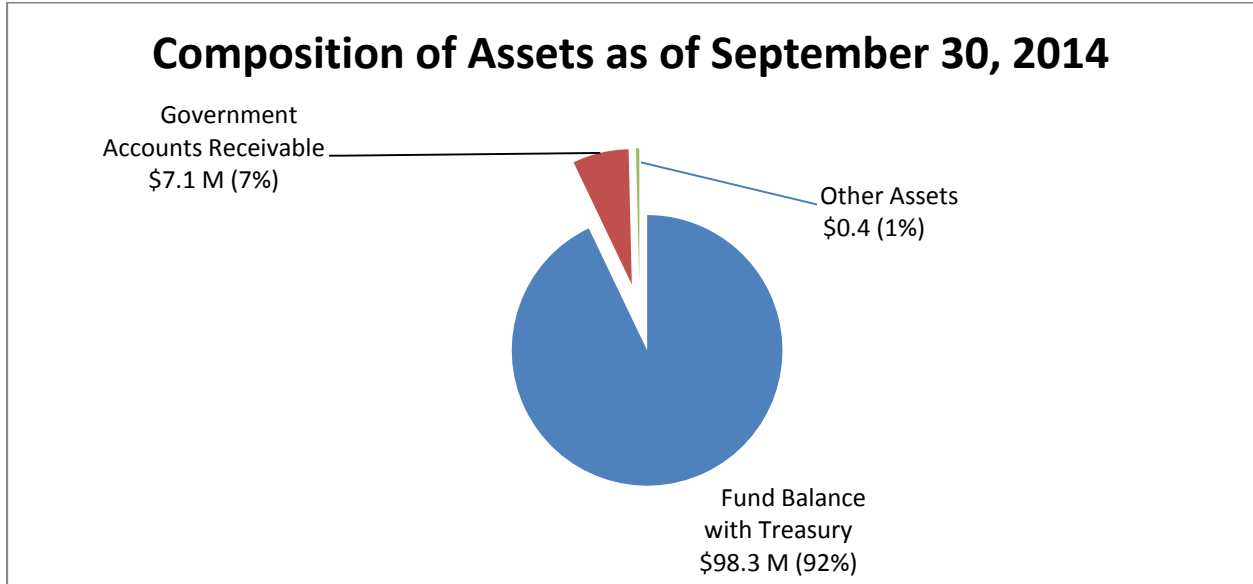
The Consolidated Balance Sheet provides a snapshot in time, descriptions of Agency “assets,” “liabilities,” and the difference, which is known as “net position.” Below is a list of DCAA’s major balance sheet categories as of September 30, 2014, September 30, 2013, and a comparison between the two.

Consolidated Balance Sheet as of September 30, 2014
\$ in millions

	FY 2014	FY 2013	\$ Change	% Change
Assets				
Fund Balance with Treasury	\$98.3	\$57.0	\$41.4	72.6%
Accounts Receivable	\$ 7.0	\$ 8.0	(\$0.9)	(11.7%)
Other Assets	<u>\$ 0.4</u>	<u>\$ 0.3</u>	<u>\$0.1</u>	<u>33.3%</u>
Total Assets	\$105.8	\$65.3	\$40.5	62.0%
Liabilities				
Accounts Payable	\$10.5	\$ 8.4	\$ 2.1	25.0%
Payroll Tax Payable	\$ 2.2	\$ 1.8	\$ 0.4	22.2%
Accrued Payroll & Leave	\$12.0	\$10.1	\$ 1.9	18.8%
Unfunded FECA Liability	\$ 4.3	\$ 4.3	\$ 0.0	0.0%
Unfunded Leave	\$38.7	\$38.9	(\$0.2)	(0.5%)
Employment Benefits	<u>\$19.2</u>	<u>\$20.7</u>	<u>(\$1.5)</u>	<u>(7.2%)</u>
Total Liabilities	\$86.9	\$84.2	\$ 2.7	(3.2%)
Net Position				
Unexpended Appropriations	\$80.8	\$44.8	\$36.0	80.3%
Cumulative Results of Operations	<u>(\$62.1)</u>	<u>(\$63.8)</u>	<u>\$ 1.7</u>	<u>2.6%</u>
Total Net Position	\$18.7	(\$19.0)	\$37.7	198.9%

*Numbers may not be exact due to rounding

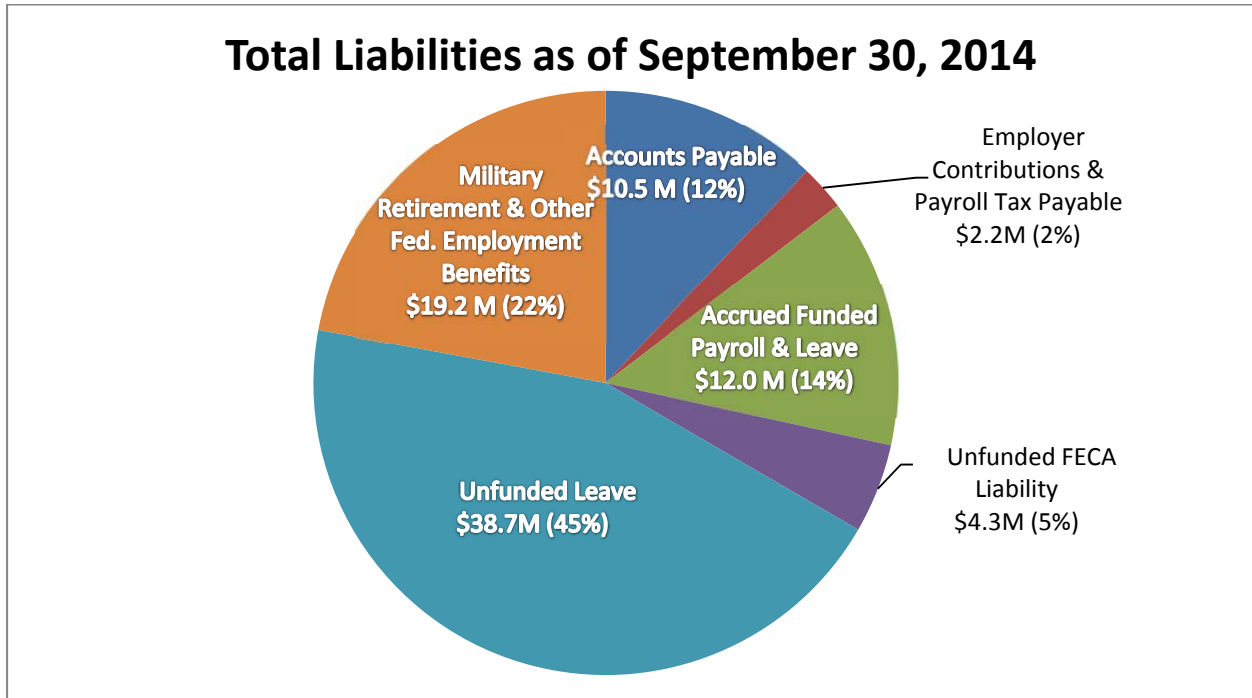
DCAA's Assets of \$105.8 million are comprised of the Fund Balance with Treasury (FBWT), Government Accounts Receivable (AR), and "Other" Assets. This amount represents an increase of \$40.5 million or 62 percent over last year's balance. The increase is primarily attributable to an increase in undelivered orders of \$33.9 and a reduction in AR of \$1.0 million.



*Numbers may not be exact due to rounding

FBWT is comprised of appropriations and collections received, less expenses paid. DCAA continuously reviews reimbursable accounts receivable balances and promptly takes appropriate collection actions for aged accounts. Other assets include employee advances and debts.

DCAA's Liabilities of \$86.9 million are classified as either funded (covered by current budgetary resources) or unfunded (covered by future budgetary resources). Funded liabilities include employer contributions to employee benefits, accounts payable, payroll taxes payable, and current accrued payroll. Unfunded liabilities consist primarily of employment benefits, estimated future Federal Employment Compensation Act (FECA) liabilities, and accrued leave. DCAA's total liabilities increased in \$2.7 million, the majority of this change is related to the increase of \$2.0 million in accounts payable.



Net Position represents the difference between assets and liabilities. Changes in the net position result from changes that occur within the Cumulative Results of Operations and Unexpended Appropriations. Unexpended appropriations represent the amount of undelivered orders and unobligated balances of budgetary authority. Our net position increased by \$37.7 million, from a negative \$19.0 million in FY 2013 to a positive \$18.7 million in FY 2014. The \$37.7 million includes an increase of \$36.0 million of unexpended appropriations and an increase of \$1.7 million in Cumulative Results of Operations. The \$36.0 million increase is attributable to increase in obligation and orders not yet delivered (see table “Change in Net Position and Cumulative Results of Operations”).

The Cumulative Results of Operations are presented in the Consolidated Statements of Changes in Net Position. DCAA had Financing Sources of \$582.8 million and Net Cost of Operations of \$581.1 million. The Net Cost of Operations includes accrued expenses for annual leave liability, personnel benefits liability, and actuarial liability. Future appropriations will fund these liabilities. The Net change of Cumulative Results of Operations were \$1.7 million, which is the difference between the Financing Sources and the Net Cost of Operations.

The following table presents comparative data for the Net Position and Results of Operations as of September 30, 2014 and September 30, 2013.

Change in Net Position and Cumulative Results of Operations
\$ in millions

	FY 2014	FY 2013	% Change
Unexpended Appropriations	\$80.8	\$44.8	80.3%
Cumulative Results of Operations	<u>(62.1)</u>	<u>(63.8)</u>	<u>(2.6%)</u>
Net Position:	\$18.7	(\$19.0)	198.9%
Financing Sources	\$582.8	\$569.1	3.9%
Net Cost of Operations	581.1	569.1	2.8%
Net Change	1.7	0.0	43.1%
Operations Beginning Balances	<u>(63.8)</u>	<u>(63.8)</u>	<u>0.0%</u>
Cumulative Results of Operations:	(\$62.1)	(\$63.8)	(2.6%)

Limitations of the Financial Statements

The Defense Finance and Accounting Service (DFAS), in collaboration with DCAA, prepares DCAA's financial statements. The principal financial statements report the Agency's financial position and results of operations, pursuant to the requirements of 31 U.S.C. 3515 (b). DFAS prepares the statements from the Agency's books and records in accordance with OMB Circular No. A-136, and to the extent possible, generally accepted accounting principles for Federal entities. The statements also are used to monitor and control budgetary resources, which are part of the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government.

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

DFAS prepares DCAA's financial statements based on data entered into the Defense Business Management System (DBMS), a legacy accounting system. The DoD legacy accounting systems track budget execution; they are not designed to capture the information necessary to create financial statements. Departments and agencies under the Executive Office did not produce annual financial statements until required by the Chief Financial Officers (CFO) Act of 1990.

The Federal Financial Management Improvement Act (FMFIA) of 1996 requires, among other things, that audit reports state if Agency financial management systems comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Federal agencies must fully disclose financial data, including the costs of Federal programs and activities. DoD and DFAS have developed long-term strategies to replace the many legacy accounting systems such as DBMS. DCAA is converting to a new enterprise resource planning system, Defense Agencies Initiative (DAI). We anticipate the migration to be completed by FY

2018. DCAA is committed to implementing processes that support the accuracy and auditability of its financial statements.

DCAA's accounting system is adequate to ensure that transactions are executed in accordance with budgetary and financial laws. Reasonable assurance is provided to ensure that assets are properly acquired, used, and safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud.

Management Assurance

In its Annual Statement of Assurance (SOA) for FY 2014, DCAA reported an unqualified statement of reasonable assurance to the Secretary of Defense; internal controls met the objectives of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 (Public Law 104-208). During the period, the DoD Inspector General completed a peer review of DCAA and validated that the quality deficiencies previously identified had been corrected (see *Material Weakness* on page 16).

The Agency has a rigorous system of internal financial and administrative controls to ensure effective management of the Agency's resources. This system provides the reasonable assurance required to certify that the objectives of the FMFIA are achieved. The FMFIA requires federal agencies to assess the effectiveness of internal controls for program, operational, and administrative areas, as well as accounting and financial management.

As an audit organization, DCAA is particularly aware of the importance of management internal controls. As part of its quality control process audit, DCAA made specific reviews and field visits during the past year to evaluate adequacy and consistency in the implementation of audit and procedural guidance. Other objectives of these reviews include identifying areas requiring additional policy coverage and determining the adequacy of existing coverage.

DCAA's Executive Officer champions the Agency's Managers' Internal Control Program (MICP). Individual assurance statements from each Regional Director and Headquarters Assistant Director serve as the primary basis for the Agency's assurance that management controls are adequate. The statements are based on information from various sources such as the managers' knowledge of day-to-day operations and controls, program reviews, management initiated evaluations, and audits, reviews, and investigations performed by the DoDIG and the GAO.

Internal Control Assessment and Results

DCAA continued to evaluate its system of internal accounting and administrative controls in effect during the fiscal year ending September 30, 2014, in accordance with the guidance in OMB Circular No. A-123, Management's Responsibility for Internal Control. The objectives of the system of internal accounting and administrative controls of DCAA are to provide reasonable assurances of:

- Effectiveness and efficiency of operations,

- Reliability of financial reporting,
- Compliance with applicable laws and regulations; and
- Financial information systems are compliant with FFMIA

DCAA and DFAS assessed internal control effectiveness over financial reporting according to the OMB Circular No. A-123, Appendix A, Internal Control over Financial Reporting (ICOFR), for the following:

- Fund Balance With Treasury
- Accounts Receivable
- Accounts Payable
- Financial Statement Compilation
- Federal Employees' Compensation Act Liabilities
- Other Liabilities
- Appropriations Received
- Payroll

Financial reporting is not limited to financial statement reporting. Circular No. A-123, Appendix A, included within the definition of “financial reporting” other significant internal and external financial reports that could materially affect spending, budgetary, or other financial decisions. Appendix A prescribed a process for assessing internal controls over financial reporting. The process included:

- Establishing a high-level governance body, DCAA Senior Assessment Team (SAT).
- Evaluating internal controls by understanding management’s attitude, awareness, and actions to include:
 - Integrity and ethical standards,
 - Commitment to competence,
 - Management philosophy,
 - Organizational structure, and
 - Assignment of authority and responsibility.
- Evaluating internal controls at the process, transaction, and application levels and obtaining knowledge of the organization’s key processes by:
 - Performing process risk assessments with regard to financial assertions of completeness, obligations and rights, valuation, existence and occurrence, reporting and presentation, compliance with laws and regulations, and safeguarding of assets from fraud, waste, and abuse.
 - Identifying existing key controls intended to mitigate identified risk.
- Assessing and testing the design and operation of internal controls over financial reporting.

- Documenting the entire assessment process from the establishment of DCAA's SAT to the identification of deficiencies and development of corrective action plans.
- Issuing an Annual Statement of Assurance (SOA) on Internal Control over Financial Reporting (ICOFR) as a subset of the Annual Federal Managers' Financial Integrity Act Statement of Assurance.

The SAT, established in December 2005, provides oversight, accountability, and an assessment as to whether there is reasonable assurance that DCAA's internal controls are in place, operating effectively, and being used for financial reporting. The SAT, composed of senior leadership-level representatives to indicate DCAA's top down commitment, is maintaining complete records of the assessment documentation to explain significant decisions made in identifying material business processes, results of the assessments, internal control test plans, and in determining if material weaknesses exist.

We conducted separate tests to assess the effectiveness of internal controls. No material weaknesses surfaced in the design or operation of the internal controls. DCAA reported an unqualified statement of assurance on ICOFR in its annual FMFIA SOA.

The concept of reasonable assurance recognizes that (1) the cost of management controls should not exceed the benefits expected to be derived and (2) the benefits consist of reductions in the risks of failing to achieve the stated objectives. The expected benefits and related costs of control procedures should be addressed using estimates and managerial judgment. Moreover, errors or irregularities may occur but remain undetected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, Congressional restrictions, and other factors.

DCAA has implemented internal controls that provide reasonable assurance that performance data and metrics are reliable and relevant. Procedures are in place that control access to DCAA's Management Information System (DMIS). Access to DMIS is through the Common Access Card (CAC). The DMIS login works hand-in-hand with the CAC network login. DMIS checks the user's network profile setting to determine how the user will log in to DMIS. These login procedures control the level of access to the information system. Point-of-data entry edit checks, numerous data accuracy queries run throughout the year, and specific quarterly reviews performed by Headquarters, the Regions, and FAOs assure performance data and metrics are not significantly misstated for the period.

In addition to the point-of-data entry edit checks to reduce risk of data input errors, DCAA executes other rigorous data accuracy queries after entering the data to ensure performance data and metrics are accurate and reliable. These queries focus on data relationships to highlight significant amounts that, if erroneous, could materially affect reported statistics for the period. The Agency maintains consistent oversight of DMIS, from data entry through transaction processing and reporting. The annual review of the Federal Information Security Management Act found DCAA within the compliance standards for all reportable areas.

Material Weakness

In the last 5 years, DCAA has been the subject of two GAO reviews and a follow-up review conducted by the DoD IG. These reviews spurred revisions to DCAA's audit policy. The Agency takes the GAO and DoD IG findings very seriously and has taken comprehensive actions to address GAO and DoD IG recommendations.

GAO issued its first report in July 2008: "DCAA Audits: Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated (GAO-08-857)." They issued their second report in September 2009: "DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform (GAO-09-468)." In September 2009, the DoD IG issued its follow-up to the first GAO report, which substantiated the majority of the findings as reported by the GAO.

The second GAO report found serious quality deficiencies in 65 of the 69 audits they reviewed. The GAO review was originally announced as a review of DCAA audits of internal controls over contractors' significant cost-related systems. However, the review expanded to cover several other areas including:

- Whether DCAA identified and reported overpayments.
- DCAA's organizational environment and quality assurance structure.
- DCAA's actions in response to the July 2008 GAO report.
- DCAA's placement within DoD.

After the September 2009 GAO report, DCAA performed more than 45 quality assurance reviews based on Council of Inspectors General on Integrity and Efficiency guidelines (CIGIE). These reviews confirmed the serious quality issues identified in the GAO report and considered the quality issues to be a material weakness.

Based largely on the issues disclosed during our internal quality assurance reviews in 2010 and 2011, the Agency developed and delivered comprehensive training on commonly found Generally Accepted Government Auditing Standards (GAGAS) deficiencies and solutions. The training was designed to improve audit quality and address the systemic noncompliance disclosed in GAO and DoD IG reports. The training was provided to every auditor in the Agency.

Since this comprehensive training was delivered to our workforce, DCAA has performed an additional 153 quality assurance reviews based on the CIGIE Guide. Although the results of these internal reviews indicated a marked improvement in the quality of our audits, the Agency's corrective action plan required an external peer review to confirm the progress made towards improving audit quality. The successful completion of this external peer review in FY 2014 was the final step in validating that we have corrected our material weakness related to the quality of our audits.

During the performance period, the DoD IG conducted an external peer review of DCAA's system of quality control. The DoD IG review was conducted in accordance with GAGAS and

guidelines established by CIGIE. During their review, the DoD IG interviewed DCAA personnel and obtained an understanding of DCAA's organization and its system of quality control. The DoD IG selected engagements and administrative files to test for conformity with professional standards and compliance with the system of quality control. The engagements selected represented a reasonable cross section of DCAA's audit organization.

On August 21, 2014, the DoD IG issued their formal opinion on the Agency's system of quality control. Federal audit organizations can receive a rating of Pass, Pass with Deficiencies, or Fail. DCAA has received a peer review rating of Pass with Deficiency. The one deficiency identified by the DoD IG related to errors or a lack of sufficient documentation in 11 of the 92 engagements examined that limited the reliability of the audit reports. In the DoD IG's opinion, except for the deficiency described above, the review provided reasonable assurance that DCAA's system of quality control, in effect as of June 30, 2013, is suitably designed and followed, and that DCAA is performing and reporting in conformity with applicable professional standards, in all material respects.

DCAA believes that the DoD IG's rating of Pass with Deficiency confirms the progress the Agency has made in correcting the quality issues identified by the GAO in 2009. The results of the DoD IG's peer review validate that the Agency has corrected our material weakness related to the quality of our audits.