

Report to Congress on FY 2019 Activities Defense Contract Audit Agency

U.S. Department of Defense

March 31, 2020





DEFENSE CONTRACT AUDIT AGENCY

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May 26, 2020

Congressional Defense Committees:

I am pleased to submit the Defense Contract Audit Agency's Fiscal Year 2019 annual Report to Congress, as required by 10 U.S.C. §2313a. This report highlights DCAA's audit performance, recommendations to improve the audit process, industry outreach activities, and key accomplishments.

As a result of DCAA audits, contract officials saved \$3.7 billion in defense spending last year—significant savings that can be reinvested in our warfighters or returned to the Treasury. We examined nearly \$365 billion in defense contractor costs, identified over \$11.7 billion of audit exceptions across 2,984 audit reports, and supported Contracting Officers with other valuable products and services to help them ensure fair and reasonable contract prices.

In FY 2019, DCAA returned to performing the full range of audits in its portfolio and focused more effort on other audits such as business systems, Truth in Negotiation Act, Cost Accounting Standards, and labor and material reviews. We also successfully met the congressional requirement to complete incurred cost audits within one year of adequate submission as well as contracted with seven independent public accounting (IPA) firms to perform 101 incurred cost audits. Finally, we continued our outreach to our customers at DCMA and service-buying commands to educate them on the full range of audits and advisory services DCAA provides.

Our vision, *Every audit or service we deliver is on time, on point, and highly valued*, is demonstrated by our workforce every day. I am proud of our workforce and our ability to deliver outstanding audit products and services to the Department in FY 2019.

Respectfully,

A handwritten signature in black ink, appearing to read "Anita F. Bales", is positioned below the word "Respectfully".

Anita F. Bales
Director

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1. DEFENSE CONTRACT AUDIT AGENCY MISSION

DCAA provides audit and financial advisory services to DoD and other federal entities responsible for acquisition and contract administration. DCAA audits only contractors; it has no internal audit responsibilities in DoD. DCAA's role in the financial oversight of government contracts is critical to ensure DoD gets the best value for every dollar spent on defense contracting. DCAA operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. Its work benefits our men and women in uniform and the American taxpayer.

The Agency's mission is to conduct contract audits and related financial advisory services. Contract audits are independent, professional reviews of financial representations made by defense contractors, and 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 audit conclusions are unbiased and 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). The extent of auditing performed is based on risk and materiality considerations.

DCAA provides recommendations to government officials on contractor cost assertions regarding specific products and services. DCAA auditors examine contractor accounts, records, and business systems 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. Its work supports contracting officials as they make procurement decisions. DCAA has no direct role in determining which companies are awarded defense contracts.

Government officials draw on DCAA audit findings throughout the acquisition process. With these recommendations, contracting officers are better able to negotiate prices and settle contracts for major weapons systems, services, and supplies. 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 the contracting officer can officially close out a flexibly priced contract, DCAA assesses whether the contractor's claims for final annual incurred costs during contract performance are allowable and reasonable according to applicable acquisition regulations and contract provisions. This final task in the contract audit process ensures that no excess costs were charged to the government.

2. ORGANIZATIONAL STRUCTURE AND STAFFING

A. Organizational Structure. DCAA's organizational structure consists of four Corporate Audit Directorates organized by major contractors, three geographical regions primarily focused on other large, mid-sized, and small contractors, and a Field Detachment focused on classified work. DCAA has about 300 offices located throughout the United States, Europe, and the Middle East.

Headquarters is located at Fort Belvoir, Virginia. Principal elements are the Director, Deputy Director, General Counsel, Office of Inspector General, and the Assistant Directors for Operations, Policy and Plans, Integrity and Quality Assurance, and Human Capital and Resource Management.

Regional Offices/Field Detachment are located in Smyrna, Georgia; Irving, Texas; La Palma, California; and Reston, Virginia. Each region directs and administers the DCAA audit mission at locations near the contractor base. Each region is staffed with 600 to 800 employees and serves 2000 to 3000 contractors. The Field Detachment has 500 employees to serve 750 contractors.

Corporate Audit Directorates (CAD) are located in Lowell, Massachusetts (Raytheon, General Dynamics, BAE); McLean, Virginia (Northrop Grumman); Chicago, Illinois (Boeing, Honeywell); and Fort Worth, Texas (Lockheed Martin). Each CAD directs and administers the DCAA mission at its major defense contractors.

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

Resident offices are established at specific contractor locations of both regions and CADs where the 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, such as General Atomics, AECOM, and Pratt & Whitney.

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

B. Staffing. DCAA has a professional workforce of about 4,500 employees. Roughly 96 percent of these employees have a bachelor’s degree, 50 percent have a higher level degree, 22 percent are Certified Public Accountants (CPA), and 34 percent have a professional certification such as a Certified Fraud Examiner (CFE), Certified Information System Auditor (CISA) or Certified Defense Financial Manager (CDFM). About 89 percent of DCAA employees are auditors, and 11 percent are professional support staff in various fields including administrative support, human resources, financial management, information technology, and legal (Table 1).

Table 1 – DCAA Workforce and Education

Auditors	3,994	89%
Professional Support Staff	516	11%
Total Employees	4,510	100%
Bachelor’s Degrees	4,347	96%
Advanced Degrees	2,250	50%
Certified Public Accountants	1,009	22%
Other Professional Certifications	1,524	34%

3. TYPES OF AUDITS

- A. 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. Forward pricing includes demand work—proposal audits, forward pricing rates, and high-risk estimating system audits.
- B. Incurred Cost.** Incurred cost audits determine the accuracy of a 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. Audits allow the contracting officer to recover the questioned costs before the contract is officially closed out, which prevents excess payments by the government.
- C. Special Audits.** Special audits are largely conducted after contract award. Most of the reports in this category are issued in response to requests from contracting officers. These audits 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. Special audits are primarily claims and terminations.
- D. Other Audits.** Other audits 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 for misallocation or mischarging of costs. The audit effort in this category focuses on adequacy of the contractor's Cost Accounting Standards (CAS) Disclosure Statement, compliance with cost accounting standards, review of contractor business systems, and contractor compliance with the Truth in Negotiations (TIN) Act.

4. FY 2019 AUDIT PERFORMANCE

A. Overview. DCAA uses a risk-based approach to target its limited resources on the work that provides the most value. Using this approach, DCAA examined \$365 billion in contract costs, identified over \$11.7 billion in audit exceptions, reported \$3.7 billion in net savings, and produced a return on investment of about \$5.50 to \$1. With the elimination of the incurred cost backlog, DCAA resumed performing its full portfolio of audits.

(1) Net Savings. In FY 2019, DCAA reported net savings of \$3.7 billion, marking the ninth consecutive year that the Agency returned over \$3 billion in savings to the government (Figure 1). The average net savings of the past five years is \$3.4 billion, making FY 2019 an above average year.

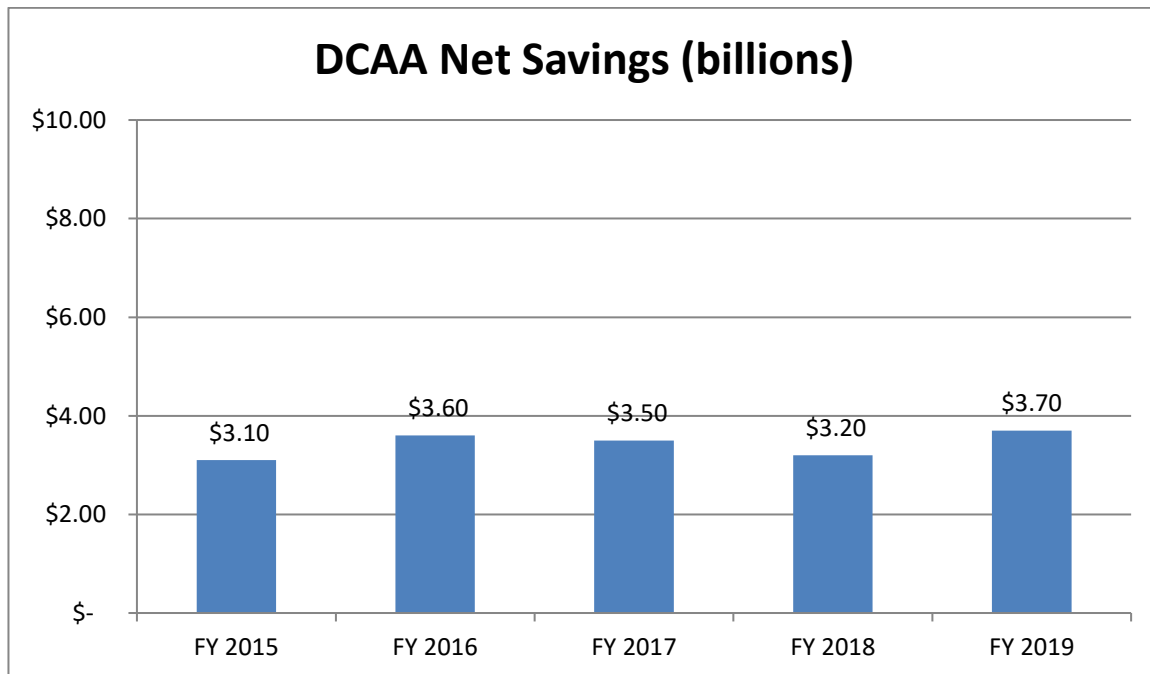


Figure 1 – DCAA Net Savings (in billions)

(2) Return on Investment. DCAA is conservative when reporting savings and return on investment (ROI), foregoing projections of potential or future savings and only reporting actual savings based on contract actions taken by government contracting officers. In FY 2019, the return on taxpayers' investment in DCAA was about \$5.50 for each dollar invested, savings that DoD can reinvest in the warfighter if funds still available for obligation or return to the Treasury (Figure 2).

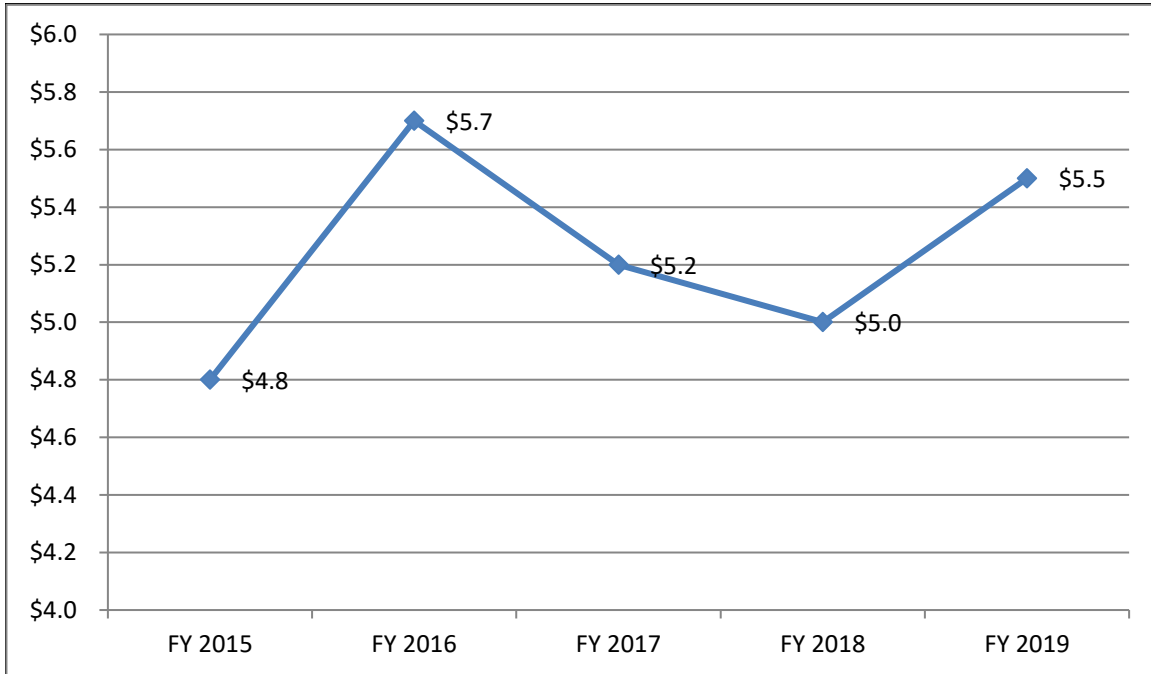


Figure 2 – DCAA Return on Investment

(3) Aggregate cost of performing audits by audit type. DCAA's cost of performing audits was calculated using annual funding and direct audit hours by audit type (Table 2).

Table 2 – Aggregate Cost of Performing Audits by Audit Type

Audit Type	Aggregate Annual Cost
Forward pricing	\$120,051,000
Incurring Cost	\$279,118,000
Special Audits	\$45,505,000
Other Audits	\$224,130,000
Total	\$668,804,000

B. Questioned Cost Sustained. DCAA sustained \$4.4 billion of \$8.6 billion in questioned costs during FY 2019. Table 3 shows audit exceptions and sustention data. This data is calculated based on contracting officer negotiation decisions, not estimates or savings projections. Table 4 shows the return on investment by audit type based on net savings and cost of performing audits. Return on investment for Other Audits is low, as some audits in this category provide long-term value to the government without providing direct savings. For example, CAS and business systems audits determine contractor compliance with regulation, and audit findings result in contractor actions to bring their systems into compliance, thus assuring accuracy of cost data.

Table 3 – Sustention by Amount and Percentage of Audit Exceptions

Audit Type	Audit Exceptions	Exceptions Sustained	Percent Sustained
Forward Pricing	\$5,212,428,000	\$3,257,468,000	62.5%
Incurred Cost	\$2,782,000,000	\$820,984,000	29.5%
Special Audits	\$469,086,000	\$273,695,000	58.3%
Other Audits	\$147,364,000	\$42,894,000	29.1%
Total	\$8,610,878,000	\$4,395,041,000	51.0%

Table 4 – Ratio of Net Savings to the Cost of Audits by Type

	Net Savings	Aggregate Cost of Performing Audits based on Percentage of Direct Audit Hours	Return On Investment (Net Savings /Aggregate Cost)
Forward pricing	\$2,664,558,000	\$120,051,000	\$22.2
Incurred Cost	\$736,485,000	\$279,118,000	\$2.6
Special Audits	\$240,535,000	\$45,505,000	\$5.3
Other Audits	\$84,359,000	\$224,130,000	\$0.40*

* This figure is low as audits in this category provide long term value to the government without providing direct savings, e.g. CAS and business systems.

C. Audit reports completed in FY 2019. DCAA conducts thousands of audits each year that provide the basis for recommendations to the acquisition community. Each audit that DCAA completes, whether 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, and other applicable federal laws and regulations.

In FY 2019, DCAA issued 2,984 audit reports with over \$11.7 billion in audit exceptions from \$365 billion total dollars examined. (Table 5). In addition to issuing audit reports, DCAA reviews and closes thousands of assignments with low risk memos, which contain rate information allowing contracting officers to efficiently close contracts by setting rates. DCAA also supports contracting officers with advisory services that do not result in an audit; for example, DCAA provides negotiation support, independent financial opinion on specific elements of a contract, and assessment of compliance with specific acquisition regulations or contract terms.

Table 5 – FY 2019 Audit Reports Completed and Dollars Examined

Audit Type	Reports	Dollars Examined	Audit Exceptions
Forward Pricing	710	\$118,928,981,000	\$9,344,770,000
Incurred Cost	1,117	\$239,707,515,000	\$1,945,604,000
Special Audits	822	\$6,501,643,000	\$285,922,000
Other Audits	299	\$35,842,000	\$118,673,000
Total	2,948	\$365,173,981,000	\$11,694,969,000

D. Incurred Cost. A contractor is required to submit a certified report of its incurred costs for each year of contract performance under flexibly-priced contracts. After receiving an annual incurred cost submission, DCAA auditors have 60 days to review it to determine if the submission and supporting data are adequate and in accordance with the FAR. If the submission is not adequate, it is returned to the contractor for correction and resubmission. When a submission is adequate, DCAA has 12 months to complete the audit.

In our risk-based approach, we close incurred cost submissions in several ways. We conduct audits on high-risk submissions and a sample of low-risk submissions. For low-risk submissions not audited, we provide valuable assistance to contracting officers by issuing low-risk memos. Because DCAA has the authority to establish final indirect rates, contracting officers can avoid negotiations and go straight to closing out contracts using the rates established in these memos. In FY 2019, DCAA issued 1,117 reports and 4,930 low-risk memos (Table 6).

Table 6 – Incurred Cost Closed by Method and Dollars Examined

Incurred Cost Years Closed	Number	Dollar Value
Reports	1,117	\$239,707,515,000
Memos	4,930	\$45,215,443,000
Total	6,047	\$284,922,958,000

The 2018 NDAA required DCAA to complete all incurred cost audits received after the NDAA enactment date (December 12, 2017) within 12 months of receipt of a contractor’s adequate proposal. In FY 2019, DCAA completed 99% of incurred cost audits within the 12-month requirement (Figure 3).

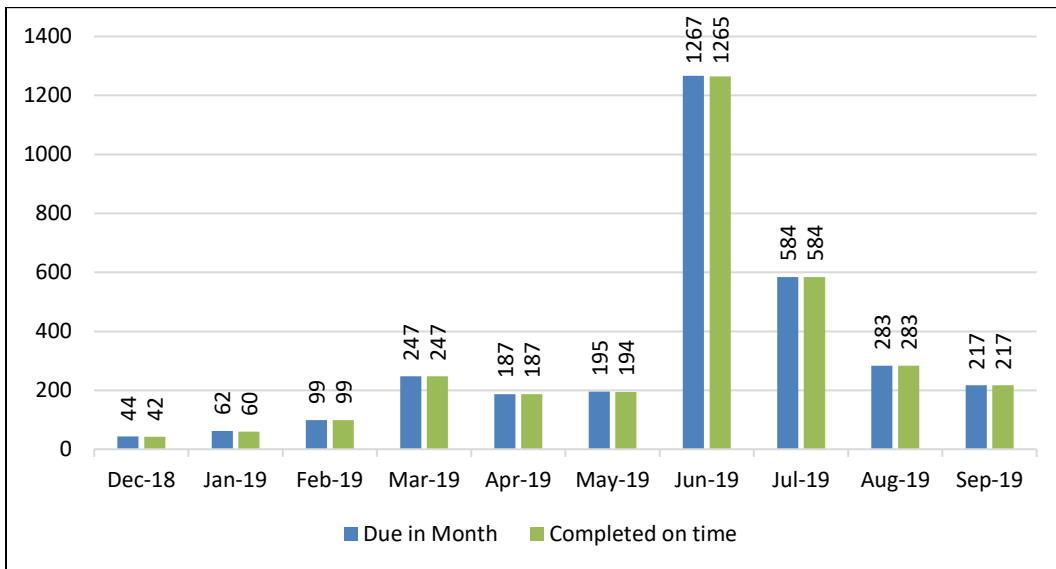


Figure 3 - Incurred Cost Assignments Subject to NDAA Requirements

Incurring cost audits can be delayed for a variety of reasons. Under the 2018 NDAA guidelines, the DoD Comptroller can grant a waiver to the 12-month requirement. During FY 2019, 11 contractors were approved for waivers to the NDAA one-year requirement for a total of 19 qualified incurred cost submissions. Six of the 11 contractors were granted waivers due to cease and desist orders issued by the Department of Justice or the Defense Criminal Investigative Services agencies. The other five contractors requested and were granted waivers for various reasons, including office relocation, corporate merger, or adoption of new accounting system.

The chart below depicts incurred cost assignments pending longer than one year from the date of adequate submission (Table 7). This year, DCAA successfully completed a majority of pending audits, reducing the number from 1,844 in FY 2018 to 48 at the end of FY 2019. Of those currently pending, half are from reimbursable customers delayed due to customer funding and the rest are primarily on hold due to investigations.

Table 7 – Incurred Cost Pending Longer than One Year from Date of Adequate Submission

Year Submission Received	Number of Assignments	Estimated Dollar Value
2012	1	\$ 1,600,000
2013	5	\$ 2,847,068
2014	3	\$ 85,312
2015	1	\$ 125,283
2016	3	\$ 334,979
2017	21	\$ 1,638,456
2018	14	\$3,440,985
Total	48	\$10,072,083

Meeting Forward Pricing Agreed-to Dates. DCAA continues to focus on meeting agreed-to dates. At the beginning of FY 2019, we increased our goal from 80 to 85 percent, which we believe is an attainable number. In FY 2019, 84 percent were completed on time and another 7 percent were completed within one week of the requested due date (Figure 4). These positive results correlate with our customer feedback over the past four fiscal years, which indicates high satisfaction in each of our four measured areas (timeliness, accuracy, communication, and satisfaction).

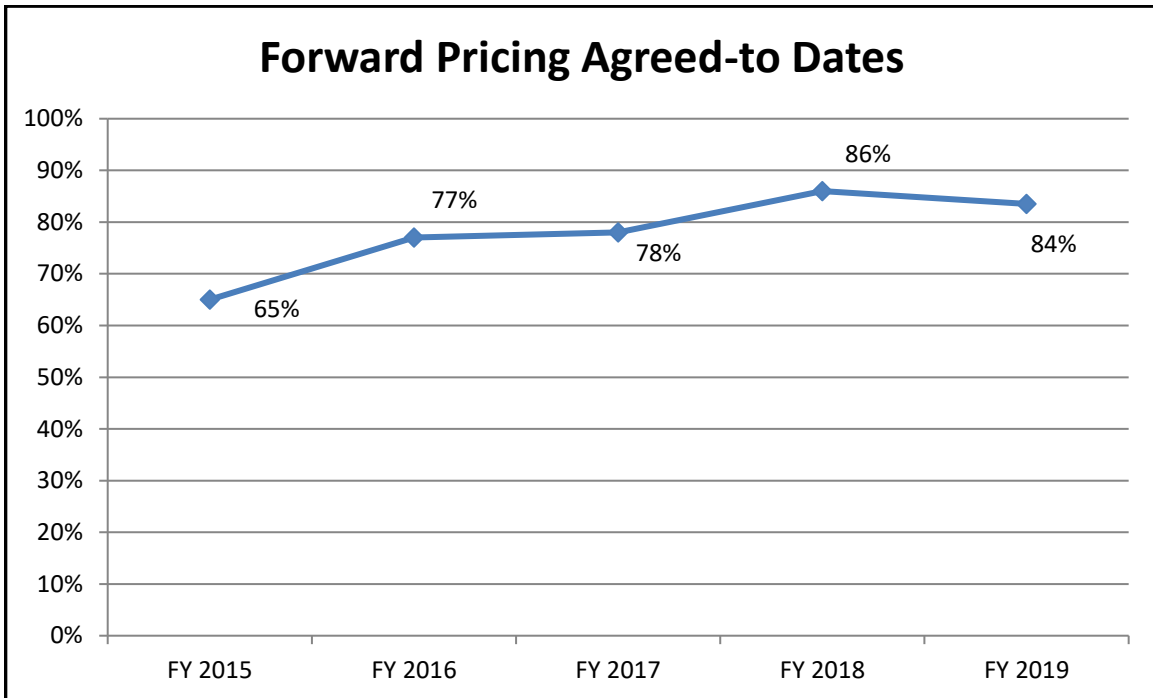


Figure 4 – Forward Pricing Agreed-to Dates Met (percentage)

We know the acquisition community relies on us to meet our agreed-to dates and help them keep the contract award process on track. We meet early with the contracting officer to come to a mutual agreement on a due date for the audit. Once we agree to this date, we do not change it, even when conditions change. If we don't expect to meet the date, we communicate with the command and make sure we provide data throughout the audit to minimize any impact on the acquisition cycle. DCAA's ongoing communication with DCMA, buying commands, and military departments executives has also played a significant role in eliminating duplication of effort, clarifying roles and responsibilities, and establishing realistic timelines. We meet regularly with these acquisition partners to explore root causes of issues and develop system-wide solutions to work effectively as a team.

E. 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. DCAA prioritizes the audits that pose greatest risk to the government, assessing the risk for different types of audit, as well as the risk factors within individual audits, regardless of type. Contracts considered “high-risk” typically involve significant costs, significant audit findings in the past, or circumstances that reduce the incentive to control costs, such as those inherent in cost-type contracts.

- Incurred Cost audits continue to be a priority to meet both the adequacy review (60 days) and completion (12 months) timelines. Working these audits closer to the year costs were incurred improves our ability to retrieve relevant records, ease contractor burden, encourage better compliance, and identify issues that may impact future audits. Additionally, timely completion of incurred cost audits facilitates contract closeout.
- Forward pricing audits net the highest rate of return and are time sensitive because to be of value they must be completed before contract negotiations. We have found that proactive and ongoing engagement with contracting officers, particularly before receiving the contractor’s proposal, enables us to understand audit requirements early, plan for appropriate staffing, and meet contracting needs in a timely manner. Throughout FY 2019, DCAA continued to build on successful initiatives to engage with contracting officials at all levels, confirm that we are focusing on the highest risk contract actions, and ensure that we are providing the right audit services to meet their needs.
- Special audits represent time-sensitive requests for contract terminations or claims. DCAA prioritizes these audits in coordination with contracting officer needs.
- Other audits are a high priority when DCAA or the contracting officer identifies a high-risk area such as inadequate business systems. DCAA assigns priority to additional audits based on individual contract and audit risks to the government. This category includes post-award audits of compliance with the Truth in Negotiations (TIN) Act and CAS Disclosure statement audits. This also includes high-risk, time-sensitive labor and material reviews; contractor billings; provisional billing rates; pre- and post-payment reviews; and high-risk Accounting Systems, Estimating Systems, and Material Management and Accounting Systems (MMAS) audits.

F. 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. As a result, DCAA does not have specific or mandatory time requirements for audit completion; instead, we assess what is necessary to conduct an audit that will meet professional audit standards and provide timely, valuable advice to contracting officials. DCAA works closely with contracting officers to set reasonable due dates based on the requirements of the audit and

the needs of the buying commands. Additionally, DCAA and contracting officers work as a team to set priorities, create milestone plans, and decide on agreed-to dates.

Forward Pricing. The time to complete a forward pricing audit is measured from the date DCAA receives the audit request or adequate proposal. The clock stops on the date we issue the audit report (Figure 5).

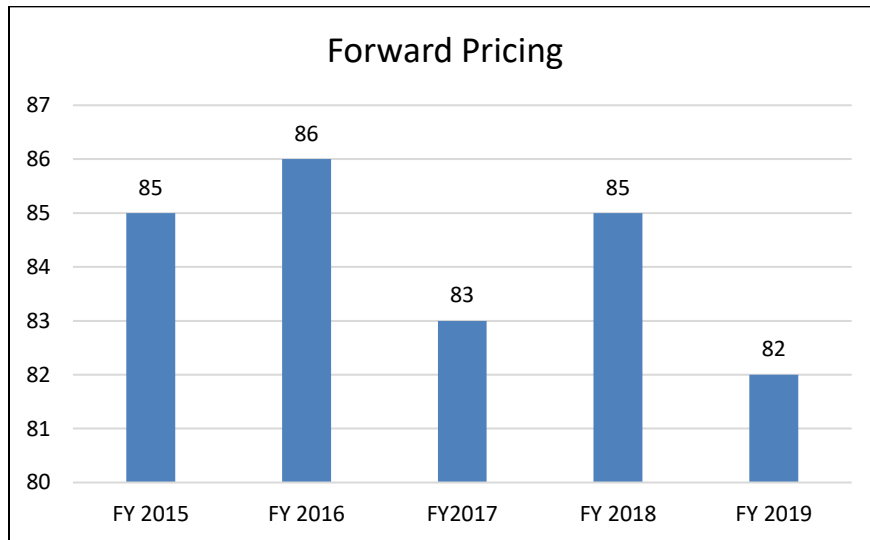


Figure 5 – Forward Pricing average elapsed days

Incurred Cost. The time to complete an incurred cost audit is measured from the date of the entrance conference to report issuance. This year incurred cost audits improved to 88 days (Figure 6).

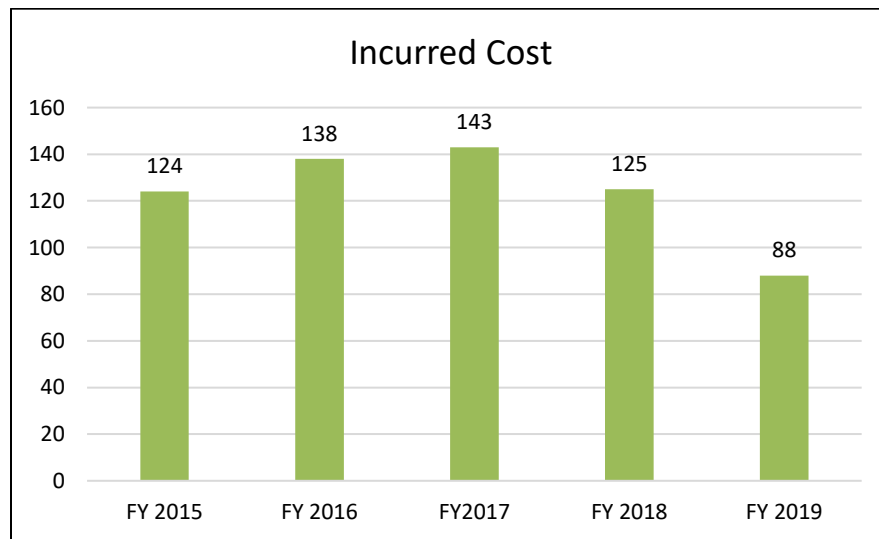


Figure 6 – Incurred Cost average elapsed days

Special Audits. The time to complete a special audit is measured from the date DCAA receives the audit request to the date we issue the audit report (Figure 7).

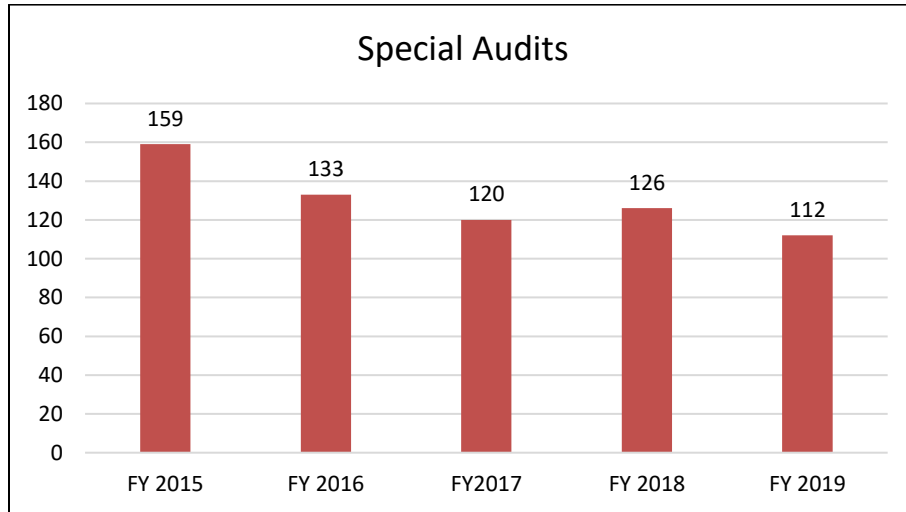


Figure 7 – Special Audits average elapsed days

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 (Figure 8). Audits in this category are generally more complex taking more time to complete.

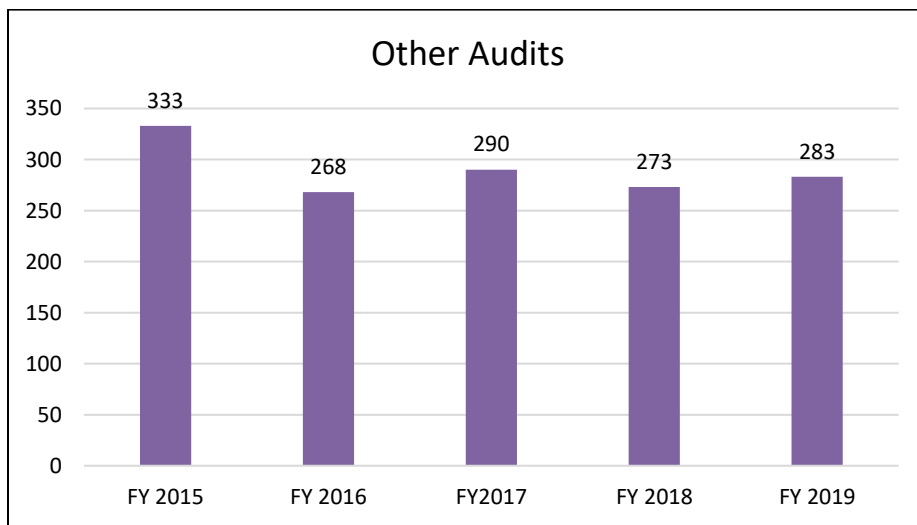


Figure 8 – Other Audits average elapsed days

G. Indirect Costs Incurred for Bid and Proposal and Research and Development. The following table summarizes the amount of incurred contractor Independent Research and Development (IR&D) and Bid and Proposal (B&P) costs computed as a percentage of total contractor indirect costs (Table 8). This data only includes those contractors who detailed their IR&D and B&P costs on their FY 2018 incurred cost submission and does not represent indirect costs for all DoD contractors.

Table 8 – Total Indirect Costs for IR&D and B&P Incurred by Contractors in FY 2018

	Allowable Costs	Allowable Cost as Percentage of Total Indirect Costs
IR&D	\$8,826,000,000	6.2%
B&P	\$4,132,000,000	2.9%
Total IR&D and B&P	\$12,958,000,000	9.1%

5. SUMMARY OF RECOMMENDED ACTIONS OR RESOURCES TO IMPROVE THE AUDIT PROCESS

Contract auditing is a critical part of the acquisition process, and DCAA's independent and objective audit and financial advisory services directly impact the value the government, taxpayer, and warfighter receive for contracted work. To ensure DCAA is providing the highest value to its acquisition stakeholders, we have identified opportunities and implemented improvements in our processes to enhance the value we bring to Defense acquisition.

DCAA has a solid relationship with Congress and looks forward to continuing this relationship. We have found that early engagement provides us the opportunity to assist Congress in its efforts to reform the acquisition process. In support of acquisition reform, this year DCAA continued to implement suggested recommendations of the Section 809 panel by addressing materiality thresholds for incurred cost audits and adjusting the parameters for risk-based sampling for incurred cost audits. The revisions to the materiality thresholds were included in guidance issued during FY 2019 and are applicable to audits started after October 1, 2019. DCAA finalized the revised sampling parameters in 2019 and began implementation on January 1, 2020. In 2019, DCAA addressed two important requirements from the FY 2018 NDAA: contracting with Independent Public Accounting (IPA) firms to conduct select incurred cost audits and completing DCAA incurred cost audits within one year of the receipt of the contractor's submission. DCAA contracted out 101 audits to IPA firms in FY 2019 and plans to do the same in FY 2020. In FY 2019, DCAA also renewed its focus on addressing Truth in Negotiations Act audits in response to renewed emphasis from Congress, and we enhanced our use of data analytics to increase both effectiveness and efficiency in the execution of audits. As further suggestions from the 809 panel and additional acquisition reforms are discussed, we appreciate the opportunity to continue our strong relationship with Congress by contributing our perspective on new initiatives.

In addition to initiatives focused on the effective and efficient execution of our audit mission, DCAA has used a variety of special hiring authorities and funding sources available to us to recruit, develop, and retain a high-performing workforce. We appreciate congressional support in these areas. DCAA relies on its staff to effectively perform its auditing mission. Sufficient staffing levels, along with proper training, are key to effectively and efficiently accomplishing that mission. DCAA has enhanced its recruiting efforts and relies heavily on a variety of special hiring authorities to recruit and bring new auditors on board. We participate in college-sponsored hiring events and collect resumes and transcripts for subsequent job offers using authorities for Direct Hire for Post-Secondary Students and Recent Graduates. At our hiring events, we use direct hire authorities to give qualified candidates on-the-spot job offers, and last year we hired 135 new employees with these authorities. We also take full advantage of the Pathways Internship Program to bring college students into DCAA offices. This internship program allows students who are prospective employees to directly experience the DCAA work environment and determine whether DCAA is a good career fit for them. The program also spreads awareness and knowledge of DCAA as an employer throughout colleges and universities via interns who are in school when they're not participating in their internship. In 2019, seven of our interns transitioned to full-time employees and we currently have 29 active interns in the Agency.

Also, as a service organization, training and development are essential to our workforce. As the largest federal audit organization, we conduct much of our training at our own Defense Contract Audit Institute in Atlanta, Georgia. Last year, we conducted approximately 500 classes in our audit and leadership academies while also graduating the first, and beginning the second, cohort of the Director's Development Program in Leadership. DCAA also uses DOD leadership development programs and OPM's Federal Executive Institute (FEI), as well as other competitive acquisition workforce development opportunities offered through the 4th Estate and Defense Acquisition University, where our auditors build their skills and interact with peers outside the Agency. This training and development is funded through our normal operating funds and Defense Acquisition Workforce Development Funds (DAWDF). Future funds will be critical to ensuring new hires and current employees receive the audit and leadership training to achieve mandated GAGAS, DoD Financial Management, and Defense Acquisition Workforce Improvement Act (DAWIA) certification requirements. DCAA truly values the additional resources available through the DAWDF.

6. OUTREACH ACTIONS TOWARD INDUSTRY

DCAA proactively engages with industry to clarify audit requirements, understand and address contractor concerns, and improve acquisition and audit processes. Following is a summary of those outreach actions.

- A. **Adoption of Materiality Guidelines.** In July 2019, DCAA formally adopted the materiality guidelines set forth in DoD's Professional Practice Guide (PPG), which was jointly developed by DCAA, DCMA, and industry representatives. These guidelines help oversight professionals plan their work and provide the information contracting officers need to make reasonable business decisions. While the materiality standards are based on dollar values, what may be material to a particular business decision will be influenced by a variety of qualitative and quantitative considerations, recognizing that the contracting officer's role is to manage DoD's risk, rather than avoid it. The cost of DoD's oversight, including adverse effects on the timeliness of decision making, must be balanced with expected benefits of that oversight.

DCAA's adoption of a quantified materiality threshold is intended to facilitate a consistent approach that helps an auditor determine the nature, timing, and extent of audit procedures on those cost elements and accounts that are significant, or material, to the audit opinion. To educate the workforce on how to apply the new materiality guidelines, DCAA developed a course for auditors to take prior to beginning an incurred cost audit. These materiality guidelines apply to all incurred cost audits started after July of 2019.

- B. **Engagement with Industry Organizations.** DCAA engages regularly with industry groups to gain a better understanding of their issues and to improve the Agency's ability to address industry concerns. In FY 2018, DCAA established a recurring dialog with the Aerospace Industry Association (AIA). Meeting regularly with this group during FY 2019 has resulted in two tangible results – a joint draft of a FAR change proposal related to incurred cost submissions and a reprioritization of updates to DCAA's Selected Area of Cost Guidebook.

The FAR change proposal addresses industry's concerns regarding documentation and schedules required for incurred cost submissions. Industry's viewpoint was that burdensome requirements were not always necessary for the audit. After gaining an understanding of the specific industry concerns, DCAA conferred with DCMA for additional input. After a series of collaborative meetings, DCAA, in coordination with industry and DCMA representatives, is preparing a FAR change proposal to address industry's concerns. Additionally, DCAA will make improvements to the incurred cost electronic (ICE) model to address those concerns within DCAA's purview.

During these engagements, industry representatives also expressed their views about the DCAA's Selected Area of Cost Guidebook and the need to update specific chapters to increase clarity. DCAA listened to this concern and has reprioritized the order in which the guidebook chapters will be updated.

C. Assisting with Other Transaction Agreements. DCAA is working with the acquisition community to mitigate the risks inherent in the use of Other Transaction Agreements (OTA). As DOD continues efforts to streamline the acquisition process, the use of OTAs instead of traditional contracting vehicles has increased. OTAs allow DOD to access cutting edge commercial technology, leverage the private sector's investment in research and development, and promote the engagement of non-traditional and small business contractors. However, OTAs do carry certain inherent risks because they are exempt from numerous acquisition regulations. DCAA's risk mitigation efforts with the acquisition community are focused on ensuring cost reasonableness without hindering the speed that makes OTAs so valuable. While these efforts are still in their infancy, progress is being made.

For expenditure-based OTAs—those agreements where payments are based on amounts from the awardees' financial or cost records—DCAA worked with DMCA to develop a process to review and approve vouchers. DCAA modified the existing public voucher assessment tool with language applicable for OTA vouchers. This voucher review process has been shared across DCAA and DCMA to standardize the process and accelerate payments to contractors.

DCAA is also collaborating with the acquisition community to develop suggested wording for inclusion in OTAs that introduces important risk reducing concepts without hindering the flexibility and speed of OTAs. Finally, DCAA is continuing its efforts to collaborate with Service Buying Commands on ways DCAA can assist in other aspects of OTAs to reduce risk to the government.

7. SIGNIFICANT FY 2019 ACTIVITIES AND THEIR IMPACT

DCAA had many organizational accomplishments in FY 2019. Some of these are summarized below.

- A. **Independent Public Accountants Contracted for Incurred Cost Audits.** The 2018 National Defense Authorization Act set forth the requirement to “acquire and maintain private sector capacity to meet current and future needs for the performance of incurred cost audits.” To meet this requirement, DCAA contracted with seven different IPAs - small, medium, and large firms located nationwide - who completed 101 incurred cost audits.

In determining which incurred cost submissions were suitable for audit by an IPA, DCAA applied several factors to its pool of submissions. DCAA determined those involving classified information were unsuitable, as were submissions from contractors where DCAA has an on-site presence, typically those from the largest defense contractors. DCAA’s extensive experience with these contractors creates efficiencies based on the variety of ongoing audits. After applying these criteria, DCAA randomly selected 100 of the remaining submissions for audit by IPAs.

During the conduct of the audits, DCAA contracting officer representatives coordinated between the IPAs, contractors, and DCAA’s Field Audit Offices to facilitate communication, monitor status of ongoing audits, and resolve issues. All of the IPAs who performed these audits had some prior experience with incurred cost audits, which helped contractors and contracting officers adjust to working with these companies.

Moving forward, IPAs will perform about the same number of audits in FY 2020 with planned increases for future years. DCAA is also conducting a survey of all parties involved in this initial round of audits to capture feedback to refine the process.

- B. **Truth in Negotiation Act Audits.** DCAA has slowly increased its focus on Truth in Negotiation (TIN) Act audits since 2015 and, in FY 2019, completed 13 audits on \$18 billion examined and found \$88 million in potential defective pricing. TIN audits ensure cost and pricing data submitted by contractors is current, accurate, and complete. The TIN statute provides the government with a price reduction remedy if a contractor fails to comply and includes provisions for interest and penalties.

TIN audits find cases where the contractor did not fully disclose information that impacted contract costs. This information may also impact other contracts with the same contractor and for that reason, DCAA auditors routinely share their findings. This knowledge helps contracting officers ask better questions, receive the best information in their negotiation, and helps other DCAA auditors conduct their audits more effectively and efficiently.

In FY 2019, DCAA and Defense Pricing and Contracting (DPC) began working collaboratively to increase the knowledge of TIN audits across the acquisition team. DPC’s focus is increasing the TIN knowledge of contracting officers as well as

encouraging and supporting them as they negotiate TIN findings, which is essential to returning money to the warfighter and taxpayer. DCAA's focus is on expanding the knowledge on TIN audits in our Field Audit Offices. To do this, DCAA developed a TIN course at our Audit Academy and, starting in FY 2020, our Field Audit Offices will conduct TIN audits along with our headquarters TIN team. These collaborative, proactive efforts are vital as DCAA will double the number of hours dedicated to these audits in FY 2020.

- C. **Leveraging Technology to Improve the Audit Process.** As contractors have more electronic data and increasingly complex accounting systems, auditing continues to evolve. This constant evolution drives DCAA to upgrade its information technology systems and to leverage advances in technology during performance of audits.

In late 2018, DCAA moved from an in-house developed audit software package to a commercial off-the-shelf product. After approximately one year of use, this new software has increased efficiency throughout the audit process. The software operates seamlessly across team members allowing real time collaboration and eliminating previous manual processes required to share the work among the team. DCAA is fielding this software incrementally and is now in the second of four phases. Phase three will introduce one audit type as an "intelligent document" that will roll numbers forward within the working papers to the audit report. Additionally, these "intelligent documents" allow tagging of selected data fields that feed into our audit management system, which improves the accuracy of data used for decision making. Phase four, estimated to begin at the end of 2020, will see "intelligent documents" in all our audits.

DCAA is also capitalizing on advances in technology in performing audit procedures. One example is our expanded use of data analytics as a method of gathering audit evidence. Data analytics allows for the rapid testing of very large sets of data against specific audit criteria. For example, one FAO combined several excel files to create a file of 3.2 million rows representing \$410 million in costs, which enabled analysis of 100 percent of the transactions against specific criteria. The ability to analyze 100 percent of the data provides better audit coverage and detailed transaction-level data when issues are identified. Advances in software technology also allowed DCAA to decommission 100 discrete, in-house-developed Excel and Word power tools. This was possible because Microsoft Excel and Word now include many of these functions right out of the box. Eliminating these 100 tools frees up IT personnel to work on other priority projects.

Our future initiatives include examining our other systems and, contingent on funding, we plan to replace our management software that integrates the data from our audit software packages. We also will continue to expand our use of data analytics as a normal part of the audit process.

8. OUTLOOK

DCAA is an integral member of the acquisition team and continues to deliver high quality audits and services that assist contracting officials negotiate fair and reasonable prices for goods and services.

In FY 2019 we expanded efforts to resume performing our entire audit portfolio and will continue to do so in FY 2020. As we continue this expansion, we will move away from complex, specialized audits performed by dedicated teams, like TIN and business systems, to performing these audits with our FAO staff. To do this, we will prioritize education of the workforce and sharing of lessons learned from the current teams.

It has been almost three years since our corporate realignment and much has changed in the contractor base. Some of the larger defense contractors have acquired or merged with others, which has impacted our workload distribution. This year, we will closely examine our workload, staffing, and office locations to determine if changes are necessary for efficiency and effectiveness.

Finally, we began updating our Agency's Strategic Plan and will finalize it in FY 2020. Agency leaders have worked diligently to assess the Agency and the current environment and I am confident our new goals and objectives will successfully guide us in the future.

I am proud of the DCAA workforce and their demonstrated professionalism. The outlook for the Agency is strong, and I look forward to a very productive FY 2020.

ACRONYMS

CAM	Contract Audit Manual
CAS	Cost Accounting Standards
DCAA	Defense Contract Audit Agency
DCAI	Defense Contract Audit Institute
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DoD	Department of Defense
DoDIG	Department of Defense Inspector General
FAR	Federal Acquisition Regulation
GAO	Government Accountability Office
GAGAS	Generally Accepted Government Auditing Standards
NDAA	National Defense Authorization Act
NDIA	National Defense Industrial Association
OSBP	Office of Small Business Programs
OSD	Office of Secretary of Defense
PTAC	Procurement Technical Assistance Centers
SBA	Small Business Association



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