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GAO vs. DCAA—And the Winner Is? ... Contractors!

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In July 2008, the Government Accountability Office issued the results of an investigation of hotline complaints of Defense Contract Audit Agency management inappropriately removing audit findings from audit reports.² Since that time, the relationship between DCAA and contractors has changed. Some would argue for the better, some would argue for the worse. But one thing is clear, DCAA was caught between some in the Senate who wanted DCAA to be tougher on contractors, and some in the Pentagon who may have appeared to agree on the surface, but behind the scenes, may have desired the status quo.

Over the last 18 months, DCAA has endured two GAO reports and a Department of Defense inspector general report that found shortcomings that stemmed from a reduction in staffing and an increased need for audits over the years. The mantra of “more with less” may have led to DCAA taking shortcuts in some instances.

Root Cause of DCAA Issues—Inadequate Working-Paper Documentation

After one gets through all the distracting and obscuring considerations attended by the media and injected by GAO, and even more, by a viewpoint represented on the Senate Committee on Homeland

Security and Governmental Affairs, the primary cause of the inadequate audits, according to GAO, was a lack of working-paper documentation. When an auditor completes an audit, he creates working papers to document the audit steps performed, including records of discussions with contractors and Government officials, supervisory guidance and final review notes by the supervisor. Most, if not all, auditors would prefer to spend budgeted audit hours on actual audit effort rather than on time-consuming working-paper documentation. When DCAA auditors were faced with smaller and tighter audit budgets because of inadequate funding from DOD over the years, one of the first areas cut was working-paper documentation.

A senior DCAA manager informed the author that DCAA walked a tight rope of how much documentation was enough. DCAA had limited funds, and the required number of audits continued to increase, especially after the war in Iraq began in 2003. DCAA senior leadership used evaluations provided by the DOD IG to help gauge the adequacy of working-paper documentation. As long as DCAA received a “clean” opinion during peer reviews performed by the IG, it felt it had not crossed the line concerning lack of working-paper documentation. After all, DCAA had received a clean opinion on peer reviews since the inception of the requirement for peer reviews pursuant to direction from the President’s Council on Integrity and Efficiency.³ The peer reviews covered the same time period as the July 2008 and September 2009 GAO reports covered. Nevertheless, most senior DCAA leadership seems to agree that some DCAA auditors were given insufficient time to document working papers adequately.

However, with the issuance of the GAO reports, the game changed. The bar on working-paper documentation was raised by GAO, and this caught both DCAA and the DOD IG flat-footed.

Insufficient Transaction Testing

In the report issued in September 2009,⁴ GAO stated that nearly all 69 assignments evaluated did not meet auditing standards. Let us put aside that 26⁵ of the 69 assignments were not “audits” under the auditing standards, and consequently were not required to comply with the auditing standards. How can nearly all the reviewed assignments from 2004–2006 have been noncompliant with auditing standards if the peer reviews performed by the DOD IG reported a clean opinion? According to GAO, the primary issue was insufficient transaction testing or, better put, “GAO’s interpretation” of what constitutes adequate transaction testing.

During an audit, auditors select transactions for audit. For example, during an audit of a contractor’s billing system, an auditor selects a sample of bills submitted to the Government to ensure that the bills comply with contract terms and conditions. The number of transactions selected depends on the risk of the billings. For example, auditors considered as whether the contractor previously had issues with billings not complying with contract terms. The auditor determines the number of transactions to audit based on a risk assessment. The sample is modified during the audit depending on audit findings, if any.

The sample of assignments for GAO’s review issued in September 2009 were audits of contractor systems that had no reported deficiencies. It was not a random sample of all DCAA system audits. Needless to say, audit reports on the KBRs of the contracting world were not included in GAO’s sample. Rather, the sample may have been unfairly biased toward lower-risk contractors. GAO found that DCAA did not perform adequate transaction testing. It appears that GAO interprets the auditing standards as requiring a certain level of transaction testing regardless of the audit risk. This may result in wasted audit effort if an auditor does not find deficiencies in the system, but the auditor is still required to test a stated number of transactions. Regardless, GAO’s interpretation of transaction testing requirements caught both DCAA and the DOD IG off-guard.

Most unfortunately, GAO’s approach has a problematic impact on the large part of the contracting community that follows the rules and has lower risk. Previously, DCAA did its best not to use up its re-

sources on those rule-abiding, lower-risk contractors, especially as to the intensity of transaction testing. But GAO’s approach would have DCAA spend more of its resources on the majority of “good” contractors. And so to support this, DCAA would pull more of its resources away from the high-risk contractors currently receiving greater scrutiny. It is as if the Internal Revenue Service were tasked to spend more resources on honest taxpayers, and thus had to reduce audits of taxpayers with more shady records, for example, an all-cash business, or a tax return with many red flags—just so the documentation was better as to why the audits of honest people found them to be honest.

Who Was Right?

Many reading the headlines that resulted from the July 2008 GAO report would assume that DCAA management was wrong for removing audit findings from reports. But on page 4 of the July 2008 GAO report, GAO states that it “did not reperform the audits to independently validate the completeness or accuracy of the findings contained in DCAA working papers.” This means that GAO did not determine whether the auditors’ findings that were dropped from the final reports were actually correct.

This leaves the reader to wonder whether management acted appropriately in removing the findings, but merely did not document its reasoning. As Darrell Oyer noted in the January 2010 issue of *GOVERNMENT CONTRACT COSTS, PRICING & ACCOUNTING REPORT*, based on his experience as a DCAA supervisor and manager, there are times when the auditor is incorrect and management needs to step in to correct the audit report. Such changes are required under auditing standards. It is curious that GAO spent two years performing an investigation, but in the end could not determine who was right. Working-paper documentation was lacking on the part of the auditor and management. Was working-paper documentation so lacking that GAO could not determine who was right?

The issue of working-paper documentation and insufficient transaction testing is not nearly as exciting as two other issues reported by GAO in July 2008—DCAA had an abusive management culture and a lack of independence. When the July 2008 GAO

report was issued, the DCAA director disagreed with GAO's conclusion that DCAA lacked independence in the audits examined by GAO and stated that she could not comment on the abusive management issues because GAO did not provide the details behind the conclusion for fear it would disclose the identity of the whistleblowers. As a result, in July 2008, Sens. Carl Levin (D-Mich.) and John McCain (R-Ariz.) asked the DOD IG⁶ to perform a review of these two issues.

Independence

The primary issue that led to the finding of a lack of independence was DCAA's participation in integrated product teams (IPTs). IPTs were a DOD initiative that was intended to expedite the resolution of issues that arose before contract award or during contract performance. Some would argue that getting all the major players—DCAA, contracting officers and contractors—to the table helped to expedite the resolution of issues. Early resolution resulted in mitigating the risk of overcharges on Government contracts. However, GAO took issue with DCAA providing feedback to contractors during audits. The DOD IG had not previously taken issue with DCAA's participation in IPTs.

Only after a careful reading of the DOD IG's August 2009 report could one determine that the DOD IG continues to disagree with GAO about the finding on DCAA's independence. In Appendix F (page 66) to the August 2009 report, the DOD IG includes the response to Levin and McCain and stated, "contracting officials and the DOD contracting community did not improperly influence the audit scope, conclusions, and opinions." The DOD IG determined that DCAA did not lack independence in two of the three audits cited by GAO. The third issue is the result of the aforementioned whistleblower investigation and is an ongoing personnel issue.

So who is right—GAO or the DOD IG? DCAA was severely criticized for the lack of independence, and now the DOD IG does not agree with GAO in all cases. More precisely, could DCAA at least say that its approach was legitimate, whether open to discussion, because in practice its approach did not dissatisfy its independent peer reviewer, the DOD IG? It is unfortunate, but perhaps not unexpected,

that the DOD IG did not discuss his office's disagreement with GAO during a September 2009 hearing of the Senate Committee on Homeland Security and Governmental Affairs. Although GAO may have raised a legitimate point, no one with technical expertise was called on to challenge GAO's interpretations and conclusions. This is particularly ironic given the former DCAA director's decision to cancel all DCAA involvement in IPTs.

Management Abuse

The issue of management abuse received more headlines and comments from the senators than any other issue reported by GAO—probably because technical auditing issues, such as inadequate working-paper documentation, is not a catchy headline or sound bite. On the issue of management abuse, the July 2008 GAO report (page 61) states that GAO "documented a pattern of frequent management actions that served to intimidate some of the auditors and create an abusive environment at two of the three locations covered by the investigation." The DOD IG reviewed the issue, and in its August 2009 report (page 4) did not go so far as to state that DCAA had an abusive work environment. Rather, the DOD IG reported that some of the actions by DCAA managers could have been considered abusive by employees. The actions included pressure to meet performance metrics based on budgeted audit hours and cycle times for completing audits, uncompensated overtime at one location, and several instances of employees yelling in the office at one location.

Thirteen months after Levin and McCain asked for an evaluation of the GAO's finding of abusive management, the DOD IG issued its report. Of course, one is tempted to inquire, why did it take 13 months to perform an evaluation of GAO's finding? Normal procedures would require that the DOD IG merely review GAO's working papers, and reach the same conclusion as GAO. A source close to the DOD IG investigation confirmed that the DOD IG evaluators reviewed GAO's working papers and discussed the findings at length with GAO evaluators. However, at the conclusion of its assessment of GAO's work, the DOD IG decided it had to initiate its own investigation. Perhaps the DOD IG had problems working with GAO's documentation.

GAO reported one instance of management abuse that was clearly inappropriate. This was referred to as the “gag memo” in the September 2008 Senate Committee on Homeland Security and Governmental Affairs hearing. The memorandum stated that the auditor could not release information to external sources without approval of DCAA management. The memo was not prepared by DCAA management, but was prepared by an attorney for the Defense Legal Services Agency who was assigned to DCAA (and is still assigned to DCAA as of the date of this writing). The memo has since been rescinded. The prior DCAA director agreed that the memo was not appropriate, and a knowledgeable individual confirmed that she was not even aware that the attorney prepared the memo until it became publicly known. It should be noted that DCAA management has no line authority over attorneys from the Defense Legal Services Agency who are assigned to support DCAA. So it makes more sense to say that attorneys for the Defense Legal Services Agency made a mistake, which DCAA management corrected, rather than suggesting that DCAA management is abusive.

The DOD IG’s review of the management practices does not comport with GAO’s conclusion. The DOD IG found that there was pressure to meet performance metrics; however, this could hardly be considered abusive. Use of uncompensated overtime as reported by the IG existed at one location and averaged seven hours per week for some of the employees. However, some employees stated that they worked uncompensated overtime to make up for time socializing with co-workers in the office or performing research. Most organizations incur some type of uncompensated overtime, but again, does this constitute abusive management? After 13 months of effort by the IG, the abusive management issue reported by GAO does not appear to be nearly as abusive as initially portrayed by GAO. Otherwise, nearly all Government, public and private organizations could be considered to have abusive management, considering nearly all organizations have pressure to meet metrics and uncompensated overtime.

No Real Change—Really?

In the September 2009 hearing of the Senate Committee on Homeland Security and Governmen-

tal Affairs, the general theme was that no real change had occurred at DCAA since the July 2008 GAO report. In an opening statement, one senator said, “What will it take to see progress? DCAA’s inability to remedy its mismanagement, despite numerous hearings, investigations, and reports is truly an epic failure by the agency and the Department.”

But what was the gauge used to measure progress since the July 2008 GAO report was issued until the September 2009 hearing? A report issued by GAO in September 2009 that took three years to complete and covered audit reports issued during 2004–2006, several years before the July 2008 GAO report. How could one conclude that there is no change at DCAA if the measure of change was a report covering assignments several years before implementation of many improvements? The DCAA testimony cited over 50 specific improvements in DCAA. Many of the improvements strengthened DCAA’s coverage of contractors, including revamped access to records guidance and more strict guidelines on timeliness of contractor responses to data requests. Why didn’t GAO expand its review to cover assignments completed after the improvements were implemented? In an interview after the hearing,⁷ Gregory Kutz, managing director of forensic audits and special investigations at GAO, stated that “GAO did not assess how effective these changes have been, but it received positive feedback from DCAA auditors that were interviewed.”

Did the senators just miss that GAO did not evaluate the improvements when stating that there had been no changes at DCAA? During the September 2009 hearing, a well-known contractor lobbyist huddled with minority staffers, which is a good example of the back-story. Perhaps in the hearing it was not appreciated fully how DCAA had become more aggressive with contractors and was performing more comprehensive audits—the types of audits it probably should have been performing all along, but which were discouraged as a result of the so-called “acquisition reform” of the 1990s.

CWC

In 2009, DCAA participated in four hearings of the Commission on Wartime Contracting in Iraq and Afghanistan (CWC) and reported numerous audit

findings as well as shortcomings by other Government organizations in resolving DCAA audit findings. These hearings marked the first time that DCAA discussed such issues as specific fraud referrals in a public forum. DCAA's testimony brought to light the severity of the potential fraud and other overcharges on DOD's largest wartime contract—the Logistics Civil Augmentation Program.

In an August 2009 CWC hearing, DCAA reported a number of deficiencies in contractor business systems. However, many of the reported deficiencies went unresolved or were flat-out ignored by COs. DCAA's frustration at being ignored time and again was clear in the hearing. CWC's frustration was clear as well. As a result of the hearing, DOD issued a proposed revision to the Defense Federal Acquisition Regulation Supplement stipulating the requirements for adequate business systems and the implementation of payment withholds until deficiencies are corrected.

DCAA should have been commended for its efforts and report to CWC. DCAA reported findings of questioned and unsupported costs in excess of \$13 billion. These figured prominently both in the hearings and in CWC's interim report. A fraction of the \$13 billion could be used to fund DCAA for many years.

Corrective actions have been taken as a result of DCAA's disclosures, and the taxpayer will be better protected in the future. All of the actions were ones that the Senate committee asked to see from DCAA. Nevertheless, somehow only the negative seemed to come through during the September 2009 hearing. It may be noted that those members of the contracting community who received negative scrutiny were the ones most naturally displeased with DCAA's aggressive new posture.

What Does it Mean?

Were DCAA's audit findings incorrect? No, GAO and the DOD IG did not take issue with audit findings contained in the allegedly inadequate audit reports. Rather, GAO reported that DCAA management removed audit findings from draft reports, but did not go so far as to state whether DCAA management was correct in its actions. GAO concluded that the working-paper documentation was inadequate and

that DCAA should be sampling more transactions in lower-risk situations.

So again, what does it mean? If DCAA's working-paper documentation were better, would there be more findings? Not necessarily. If DCAA sampled more transactions in lower-risk audits, would there be more findings? Not necessarily. So why all the fuss? Perhaps it is due to the desire of GAO and a Senate element to have DCAA removed from DOD to become a separate stand-alone agency. Perhaps some feel that the reduction in DCAA funding over the years and the increased number of audits required have been DOD's way of diminishing DCAA's effectiveness or, said another way, reducing "burdens" on contractors.

The current deputy secretary of defense, William Lynn, knows these trade-offs very well. He was the DOD comptroller (DCAA's boss) from 1997 to 2001, a time frame of funding reductions and increased pressure to do more audits in less time with fewer resources. It was also a time of DCAA's increased participation in IPTs and productivity metrics. More with less was in vogue. The phrases "partnering with industry" and acquisition reform were used over and over.

So what has been the real result of the GAO and IG reports and the Senate hearings on DCAA? DCAA now spends more time on audits, any type of audit. High-risk and low-risk audits alike are taking more time. More transactions are selected for audit, and more time is spent on documenting auditor work and management review. Will greater audit findings result? Time will tell. But the reality is that without adequate funding of DCAA in light of the increased effort, DCAA will be performing fewer audits.

At the September 2009 Senate hearing, DCAA stated that it has funding for only 65 percent of the required audits for fiscal year 2010. As reported to CWC in prior hearings, in FY 2009, DCAA issued 21,276 audits, compared to 30,352 and 33,801 in FYs 2008 and 2007, respectively. Fewer audits mean less coverage of contractors. Less coverage of contractors increases the risk of overcharges on Government contracts. Funding for 65 percent is inadequate. The remaining 35 percent is being deferred to future years—meaning the backlog of required audits will only increase over time. Lack of audit resources may

cause some COs to award or close contracts without audits. Neither situation protects the taxpayer.

In the end, after all the dust settles and GAO is done sparring with DCAA and the DOD IG, the ultimate winner is not the taxpayer, as desired by the Senate committee, but rather, contractors. And that winner is not contractors in general, who mostly get relatively clean audits, but a limited element of contractors—those that receive negative findings. DCAA is not strengthened, it is weakened. Danielle Brian, executive director of the Project On Government Oversight, a well-known organization that critiques Government contracting practices, put it best: “Contractors have been on a rampage fighting new requirements being placed upon them by DCAA for the past year It would be unfortunate and ironic if Congressional inquiries into the independence and strength of DCAA ultimately serves to strengthen the hand of contractors.”⁸

Less DCAA auditing increases the risk of overcharges. Taxpayers should find this result unacceptable. Why doesn't DOD find this unacceptable?

❖ Endnotes

- 1 Richard C. Loeb is Adjunct Professor of Government Contract Law at the University of Baltimore School of Law. From 1991–2005, Loeb served as Executive Secretary and Counsel to the Cost Accounting Standards Board, and from 2001–2003, as Acting Deputy Administrator of the Office of Federal Procurement Policy in the Office of Management and Budget. The views expressed herein are his own and do not necessarily reflect the views of any agency of the U.S. Government.
- 2 GAO report, *DCAA Audits: Allegations that Certain Audits at Three Locations Did Not Meet Professional Standards were Substantiated* (GAO-08-857, July 2008).
- 3 The President's Council on Integrity and Efficiency has changed its name to Council of Inspectors General on Integrity and Efficiency.
- 4 GAO report, *DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform* (GAO-09-468).
- 5 Of the 69 assignments reported in GAO report GAO-09-468, 16 were paid voucher reviews (page 23) and 10 were overpayment assignments (page 25), all of which the GAO recognized were not audits under the auditing standards.
- 6 Appendix E (page 64) of the DOD IG report, *Defense Contract Audit Agency, Audit Work Deficiencies and Abusive Work Environment Identified by the Government Accountability Office* (D-2009-6-009), contains the request letter from the senators to the DOD IG.
- 7 Federal Times article, “Rebuild DCAA ‘From the Ground Up,’ ” (Sept. 28, 2009).
- 8 Federal Times article, “Embattled DCAA Director Reassigned,” (Oct. 27, 2009).