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on

"Expediency Versus Integrity: Do Assembly Line Audits at the Defense Contract Audit Agency Waste Taxpayer Dollars?"

Chairman Lieberman, Senator Collins, and members of the committee, thank you for the opportunity to appear before you this morning and address our efforts regarding the oversight of audit work performed at the Defense Contract Audit Agency.

I. BACKGROUND

On November 13, 2005, my office received a hotline complaint with allegations that a Defense Contract Audit Agency (DCAA) Branch Manager and subordinate managers were involved in the practice of changing audit findings, or deleting them altogether, in deference to issuing "clean" audit reports. The subject managers were assigned to DCAA's Santa Ana, California, Branch Office and the Huntington Beach, California, Resident Office. The hotline was referred to DCAA for action on February 8, 2006. At the same time it was provided to the Department of Defense Inspector General (DoD IG) Office of Audit Policy and Oversight (APO) for information.

On February 24, 2006, the DoD IG Defense Criminal Investigative Service (DCIS) office in Mission Viejo, California, received information from a senior DCAA auditor who alleged that the Santa Ana Branch Manager changed, or caused to be changed, several auditors' working papers in order to cancel or conceal audit findings that would otherwise have been followed up by DCAA, and could have resulted in significant cost savings to the DoD. It was alleged that the Santa Ana Branch Manager did this to increase the perceived productivity rate of her department. The complainant was concerned about the integrity of DCAA's mission and the potential loss to American taxpayers.

The complainant advised that the DoD IG Hotline was contacted on November 13, 2005, and at that time was provided details concerning the allegations. The complainant then met with a DCIS Special Agent on March 4, 2006, to discuss the Hotline complaint and ensure the allegations were being reviewed.

On February 24, 2006, a DCIS Special Agent contacted the Hotline and obtained the complaint. The agent learned that the Hotline had forwarded the complaint to DCAA. DCIS initiated an investigation on March 6, 2006.

On March 7, 2006, DCIS requested audit assistance from APO. APO was assigned responsibility to review ten DCAA audits brought into question by the Hotline complainant.

The DCIS initial contact with DCAA occurred on March 9, 2006, when DCAA Deputy Director Joseph Garcia (then DCAA Assistant Director of Operations) telephoned the DCIS case agent saying he had received a copy of the complaint from the Hotline, and that he intended to conduct a formal DCAA inquiry with a 60-day estimated time of completion. The DCIS agent informed Mr. Garcia that DCIS had already initiated an investigation.

From March 10 through March 12, 2006, the DCIS agent conducted interviews with several witnesses who corroborated the Hotline allegations. On March 13, 2006, the DCIS agent sent Mr. Garcia an e-mail suggesting that DCIS should conduct its own investigation independent of DCAA and that DCAA should suspend its own inquiry until the DCIS investigation was completed. On March 14, 2006, Mr. Garcia answered this e-mail and concurred with the DCIS agent.

In June 2006, the U.S. Government Accountability Office (GAO) informed DCIS that it was conducting its own investigation of DCAA. GAO indicated that, in addition to receiving the same DoD Hotline complaint, they received reports of DCAA misconduct in other offices and regions located throughout the United States. GAO and DCIS coordinated certain investigative activities regarding DCAA misconduct allegations; however, DCIS concentrated on the allegations contained in the DoD IG Hotline complaint. GAO's investigation focused on the broad implications of the issue, as they relate to DCAA's overall mission, reporting practices, and employee work environment.

II. DCIS INVESTIGATION

DCIS interviewed fourteen DCAA auditors, seven DCAA managers and supervisors, and five contracting officials involved with the ten audits brought into question by the Hotline complaint. Investigative findings disclosed that DCAA managers violated established policy by deleting audit deficiencies from field auditor audit reports without the field auditor's knowledge, and by issuing "clean" audit reports without adequate supporting documentation.

Five DCAA field auditors interviewed confirmed reports that deficiencies noted by them and included in their draft audit reports submitted to management for approval were often minimized by their supervisors. In at least five cases, the field auditors were instructed to delete the deficiencies they noted in favor of issuing "clean" audits wherein the contractor accounting systems were deemed to be "adequate." In at least three other instances, the field auditors said their managers simply deleted the deficiencies from their audit reports without their knowledge, in spite of DCAA's policy (outlined in DCAA's Contract Audit Manual (CAM), Chapter 4, Section 403 (I) (2): page 421 of CAM Volume I) of

giving auditors the opportunity to present their positions to management and to formally document any differences of opinion in the audit working papers.

It was also noted during the interviews with field auditors that DCAA used metrics to evaluate the agency's overall efficiency, such as determining beforehand that certain audits should take a predicted number of hours to complete. This was especially the case with systems audits, which are conducted at major DoD contractor facilities every 3 – 5 years in order to evaluate the adequacy of their accounting, estimating, and billing systems. The investigation identified a correlation between audit reports that were changed by DCAA supervisors and the issuance of those reports on, or just prior to, the end of each fiscal year. The investigation determined that September 30th was often the deadline for completing certain systems audits as determined through metrics, and that audits not closed by that deadline were classified as "languishing audits." DCAA auditors confirmed that the easiest way for DCAA managers to prevent audits from becoming "languishing" was to issue "clean" audit reports that reflected no deficiencies, or to simply characterize noted deficiencies as "suggestions for improvement," wherein the contractor has no obligation to the Government to change their internal control systems.

The DCIS investigation indicated that DCAA' s emphasis upon conducting systems audits within pre-determined milestones and deadlines established through metrics created an environment where the pressure to meet goals affected the outcome of the audit. This constant pressure weighed heavily upon auditors and managers. In contrast, DCAA field auditors advised that in prior years, auditors were routinely praised and rewarded commensurate with the amount of money they questioned, and how much money the Government saved or recovered as a direct result of their audit activities.

From April through July 2006, DCIS interviewed DCAA supervisory auditors involved in the alleged misconduct, to include the Santa Ana Branch Manager. Although the above mentioned trends were questioned during the interviews, the managers involved admitted to no wrongdoing. DCAA regional management acknowledged that certain policies were violated, such as the failure of managers to inform field auditors that their audit findings were being changed or deleted prior to issuing an audit report.

III. AUDIT POLICY AND OVERSIGHT MEMORANDUM

On January 24, 2007, APO issued a memorandum to DCIS detailing the results of its review of one audit assignment completed by the DCAA Boeing Huntington Beach Resident Office and nine audit assignments completed by the Santa Ana Branch Office. These audits were reviewed as part of the DoD IG response to the November 13, 2005, hotline complaint. The memorandum contained the following conclusions:

- On nine assignments, the supervisors either changed or directed to be changed an auditor's draft audit conclusions without adequate documentation.

- The working papers of seven assignments did not adequately support the final audit report opinions. On the three remaining assignments, the supervisory auditor should have directed the auditor to perform additional audit procedures prior to issuing the final report.

- In addition, DCAA should rescind three reports because the reports were not supported by the working papers.

On January 25, 2007, DCIS provided a copy of the APO memorandum to the DCAA regional headquarters office in La Mirada, CA. The Director, DCAA Western Region, in a memorandum dated July 27, 2007, expressed strong disagreement with the overall results of the DoD IG review and refused to rescind any reports, although he acknowledged that "working papers could have been improved."

IV. DoD IG INVESTIGATIVE RESULTS

On June 24, 2008, DCIS presented the results of its investigation to the U.S. Attorney's Office (USAO), Santa Ana, CA, Branch Office. The USAO declined criminal prosecution. At the conclusion of the investigation, DCIS prepared a Fraud Vulnerability Report documenting investigative findings. A Fraud Vulnerability Report is the vehicle used by DCIS to address lack of internal management controls, inadequate compliance with those controls, or a deficiency within the system that may have allowed identified criminal violations to occur or to go undetected. Fraud Vulnerability Reports are not intended to document willful criminal violation of law. On August 25, 2008, the Fraud Vulnerability Report was sent to Ms. Tina W. Jonas, Under Secretary of Defense, Comptroller; Ms. April G. Stephenson, Director, Defense Contract Audit Agency; Mr. Donald Horstman, Deputy Inspector General for Policy and Oversight; and Mr. Vincent Rafferty, Director, Investigations of Senior Officials, DoD IG.

V. REVIEW OF THE DEFENSE CONTRACT AUDIT AGENCY QUALITY CONTROL SYSTEM (2006 PEER REVIEW)

APO issued a peer review, "Review of the Defense Contract Audit Agency Quality Control System," (Report No. D-2007-06-006), on May 1, 2007. In accordance with the purpose of a peer review, we evaluated the DCAA internal

quality control system. We determined that the DCAA internal quality control system was adequate and complied with Generally Accepted Government Auditing Standards (GAGAS) to provide reasonable assurance that applicable auditing standards, policies, and procedures were met. The review, however, did identify some weaknesses and recommended DCAA revise some policies and procedures. The review was conducted from January 2006 through April 2007, and covered the period from October 1, 2005, through September 30, 2006 (the audits reviewed as part of the November 13, 2005 hotline complaint were performed outside of the peer review timeframe). The peer review also reviewed DCAA policies and procedures including a review of supervision, quality assurance procedures, and experience of staff.

We adapted the process outlined in the President's Council on Integrity and Efficiency (PCIE) guidance for selecting offices and reports (audits) for review that included a reasonable cross section of the types of assignments that DCAA performs. We judgmentally selected six field audit offices, one office in each of the five DCAA regions and Field Detachment (classified audits). Five of the six offices had not been reviewed by DCAA during the 3 year cycle for the DCAA internal quality assurance process. Our plan involved a judgmental sample of 141 audits [reviewing from 19 to 28 audits from each of the five regions and Field Detachment (classified audits)] and covered the main audit assignments performed by DCAA. For each office, we selected audits performed by all audit teams or supervisors.

Region (No. of Field Offices)	Office (# of Audits Reviewed)
Western (14)	San Diego Branch Office (28)
Field Detachment (9)	Valley Forge Branch Office (20)
Eastern (12)	Tampa Bay Branch Office (23)
Central (14)	Minneapolis Branch Office (27)
Northeastern (15)	UTC Resident Office (19)
Mid-Atlantic (15)	Mt Laurel Residence Office (24)

The peer review identified deficiencies, including: inadequate documentation of sampling plans; failure to follow GAGAS when performing Agreed-Upon Procedures engagements, desk reviews of incurred cost submissions under $15 million, and contract audit closing statements; and inadequate coverage of internal control system reviews by the DCAA internal quality assurance program.

The PCIE guidance provides that conclusions on what overall opinion to issue should be reached based on the cumulative impact of all findings. Issues may be disclosed that did not affect the opinion singularly or in the aggregate but still warrant reporting because formal corrective action needs to be taken. APO determined that the problems identified were not cumulatively significant enough to indicate that material deficiencies existed in the design or implementation of the DCAA quality control system. The decision to implement the recommendations of any peer review opinion report rests solely with the reviewed audit organization. Follow-up on implemented recommendations occurs during the course of the subsequent peer review. We plan to start the FY 2009 DCAA peer review in January 2009 after we complete the follow-up work on the GAO report findings.

VI. GAO REPORT

On July 22, 2008, GAO issued a report on "DCAA Audits: Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated" (Report number GAO-08-857). GAO found evidence that working papers did not support reported opinions, DCAA supervisors dropped findings and changed audit opinions without adequate evidence for their changes, and sufficient audit work was not performed to support audit opinions and conclusions. The work GAO performed on this investigation was closely coordinated with DoD IG auditors and DCIS investigators. The findings in the GAO report are consistent with the findings contained in the January 24, 2007 APO memorandum.

VII. DOD IG ACTIONS MOVING FORWARD

Additional Investigative Work. After publication of the GAO report, additional DoD Hotline complaints have been received concerning misconduct allegations by senior managers in the same California DCAA offices. These allegations are being assessed and may result in investigations by one or more DoD IG components, such as the Directorate of Investigation of Senior Officials and the Office of Policy and Oversight.

APO Follow-up Review. APO announced a "Follow-up Review on Audit Work Deficiencies and Abusive Work Environment Identified by Government Accountability Office (GAO) Report" on August 4, 2008. As part of this review, we are performing an independent assessment of the completed and planned actions taken by DCAA in response to the GAO report and the allegations concerning supervisor misconduct. We have obtained backup evidence from GAO relating to allegations of an abusive work environment and are interviewing

all professional personnel at the 3 DCAA audit offices. We are also reviewing all available completed audit work that DCAA is performing to mitigate the identified audit deficiencies. Based on the results of our independent assessment, we will make appropriate recommendations.

FY 2009 External Peer Review. In August 2008, the Under Secretary of Defense (Comptroller) requested that we move up our next planned peer review of DCAA. However, we believe that the best approach is to perform the follow-up review on the DCAA corrective actions to the GAO report findings first, and then start the external peer review of the DCAA quality control system as originally planned in January 2009. This approach will allow us to fully concentrate on each review separately thus ensuring the best coverage of pertinent issues and concerns. We will consider the results of the follow-up review, GAO reviews, the prior DCAA peer reviews, and the DCAA internal quality assurance reviews, as well as other information, when performing a risk assessment to determine the scope of the FY 2009 peer review. This review will cover audits performed by all 5 DCAA regions and Field Detachment.

VIII. CONCLUSION

Oversight of Department of Defense contractors is essential in the fight against waste, fraud, and abuse. The Defense Contract Audit Agency ensures early detection of potential contracting issues. We remain committed to supporting DCAA and working with them to ensure that their internal oversight mechanisms are in place and working effectively. I thank you for your time and am ready to answer any questions you might have.