



DEFENSE BUSINESS BOARD

Report to the Secretary of Defense

Independent Review Panel Report on the Defense Contract Audit Agency

Report FY09-1

Recommendations for improving DCAA
mission, strategic planning, culture, structure,
and business practices

October 2008

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Independent Review Panel Report on the Defense Contract Audit Agency

TASK

On August 19, 2008 the Deputy Secretary of Defense established an Independent Review Panel under the Defense Business Board (DBB) to review Defense Contract Audit Agency (DCAA) operations and make actionable recommendations for improvement. The establishment of the Independent Review Panel followed a Government Accountability Office (GAO) investigation of selected DCAA audits that identified serious failures to comply with Generally Accepted Government Auditing Standards (GAGAS), a lack of independence and objectivity, and management actions that intimidated auditors, impaired some audits, and created a generally abusive environment.

The Terms of Reference established by the Deputy Secretary of Defense tasked the Independent Review Panel with delivering actionable recommendations to help the Department of Defense:

1. Enhance a culture of improving performance and accountability within DCAA, particularly regarding independence and standards of auditing;
2. Better align the DCAA organizational structure to provide excellence in management and oversight; and
3. Adopt best business practices in DCAA.

Appendix A contains the Terms of Reference.

Appendix B contains pertinent background information and detailed observations that support the recommendations approved by the DBB on October 23, 2008.

Appendix C contains the recommendations as approved by the DBB in their October 2008 quarterly meeting.

Mr. Jeffrey Steinhoff chaired the Independent Review Panel. Other panel members included The Honorable Joseph Wright (a member of the

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DBB), and LTG Claude “Mick” Kicklighter (USA Ret.). Mr. Zack Gaddy served as the Executive Secretary and BrigGen Sandra Gregory (USAF Ret.), Office of the Under Secretary of Defense (OUSD) Comptroller, served as DoD’s liaison to the panel. A team of senior auditors from each of the Military Service audit agencies and the Defense Finance & Accounting Service Internal Review supported the panel.

PROCESS

The Panel reviewed the following DCAA practices and other related information:

- DCAA mission, strategic plans, organizational structure, workload statistics, performance measures, training and quality assurance documents, and audit reports
- Reports on DCAA issued by the DoD Inspector General (DoD IG) and GAO, as well as other DoD oversight documents
- DCAA intranet and internet site information

The panel interviewed the following DCAA personnel, Defense officials, industry representatives, and public oversight officials:

- DCAA Director, assistant directors, and other DCAA headquarters executives
- Regional directors, deputy directors, audit managers and support personnel at four of the five DCAA regions (Northeastern, Eastern, Mid-Atlantic and Central)
- DCAA regional audit managers, branch managers, supervisors, and staff auditors at 12 field audit offices, sub-offices, and resident offices
- Directors and deputy directors from the Defense Contract Management Agency and the Defense Procurement and Acquisition Policy Office
- Procurement representatives from the Army, Air Force and Defense Logistics Agency
- Industry experts and a representative from the Project on Government Oversight

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The Independent Review Panel also considered best business practices used by government audit organizations, such as the Inspectors General and GAO, and Generally Accepted Government Auditing Standards (GAGAS) in conducting audit work and formulating recommendations.

OBSERVATIONS

The Independent Review Panel observed:

- **DCAA's Mission Needs to be Refocused to Protecting the Taxpayer's Interests.** DCAA had five versions of a mission statement. Each focused primarily on supporting the procurement community with no mention of protecting the taxpayer's interest. The mission fostered the culture of supporting contracting officials, and the value system was one of quantity (number, cost, and timeliness of audits) over quality (results and adherence with GAGAS) which was further reinforced by the performance metrics that drove the organization. To address this situation, the DCAA mission needs to be redefined to clearly establish the taxpayer as the ultimate customer and establish a core value of performing high quality, independent and objective contract audits that adhere to GAGAS and ensure that taxpayer dollars are spent on fair and reasonable contract prices.

The current mission statement also provided for audit advisory services that led to participation in Integrated Product Teams (IPTs), Source Selection Evaluation Boards (SSEBs), and placement of Financial Liaison Advisors (FLAs) at major buying commands. The Panel noted that involvement in these types of advisory services raised serious questions about DCAA's independence and objectivity under GAGAS and should be discontinued in the case of IPTs and SSEBs and reevaluated in the case of FLAs.

- **DCAA Would Greatly Benefit from Adequate Strategic Planning.** DCAA's strategic plan did not address essential elements mandated by the Government Performance Results Act of 1993; rather it resembled a short-term process improvement checklist. The plan lacked long-term goals and objectives (at least 5 years out) for major functions and operations; it contained expired dates; and it did not address enterprise

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risk, external factors or emerging issues that could affect mission accomplishment. Also, DCAA had not prepared:

1. A human capital strategic plan to facilitate workforce development and address recruiting, retention, and succession planning despite spending over 80% of its budget on personnel.
 2. An annual performance (operating) plan that describes the performance measures, expected results, accountability processes, and establishes targets and goals for the current year.
 3. An annual performance report and balanced scorecard that compares actual results against goals established in the annual performance plan.
- **Changes in DCAA's Organizational Structure Would Help Promote Greater Audit Quality and Consistency.** DCAA's decentralized organizational structure dilutes the effectiveness of managerial oversight, affecting audit quality and compliance with GAGAS. DCAA's structure includes a headquarters and five seemingly autonomous geographical regions with five different operating plans supported by 352 offices.

The potential benefits of reorganizing the structure using a deputy responsible for audit operations (Chief Operating Officer) and a deputy responsible for product lines and quality (Chief Planning and Quality Officer) include greater audit quality, consistency, and adherence with GAGAS. The Chief Operating Officer would be responsible for ensuring that audits across DCAA offices were properly and consistently managed, directed at the right issues, and conducted in accordance with GAGAS. The Chief Planning and Quality Officer would provide continuous oversight of audit quality to better ensure independence, objectivity and compliance with GAGAS, and would promote consistent audit quality and strategic planning across the organization.

The Independent Review Panel also observed that the DCAA would benefit from the establishment of a Chief of Internal Review to perform critical inspector general functions, such as performing periodic evaluations and reviews, serving as an ombudsman between staff and DCAA management, addressing hotline complaints, and serving an oversight role for the DCAA Director and OUSD Comptroller.

- **A Reevaluation of the Adequacy of DCAA's Resources Is Needed.** DCAA staffing levels have stayed relatively stable since Fiscal Year 2000 at around 4,000 employees. DoD contract actions increased by 328 percent from 304,500 in Fiscal Year 2000 to over 1.3 million in Fiscal Year 2006. Contract dollars rose from \$132 billion to \$296 billion during the same period, a 124 percent increase. Despite these major increases in work load, DCAA did not have an independent assessment of its resource needs to ensure the organization was properly staffed to provide audit coverage fully compliant with GAGAS and consistent with its mission and strategic plan.
- **Workforce Surveys Would Assist in Changing the Culture.** DCAA has not regularly sought the views of its staff through annual workforce surveys. Section 1128 of the FY2004 National Defense Authorization Act requires each agency to conduct an annual workforce survey to assess satisfaction with the following: leadership and management practices, leadership policy and practices, work environment, rewards and recognition, opportunity for professional development and growth, and the opportunity to contribute to achieving organizational mission. It has been three years since DCAA conducted its last workforce assessment, and that assessment only addressed employee morale and communication. Thus, DCAA employees have had limited avenues for expressing overall job satisfaction, workforce concerns, and opportunities for improvement. An annual survey, if properly structured and used, would be an important tool for ensuring openness and trust between the staff and management, improving operations, and changing the culture of the organization.
- **Following Best Business Practices Would Improve Audit Quality.** DCAA did not always follow best business practices used by the federal government audit profession to ensure that auditors performed quality audits. DCAA could improve audit quality by implementing the following widely used business practices.
 1. **Risk-Based Planning.** DCAA does not have an established procedure to plan self-initiated audits based on its own risk assessments. DCAA's interpretation of the Federal Acquisition Regulation is that it cannot initiate numerous types of high-risk audits, such as audits of competitive contracts, without a specific

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audit request. Competitive contract spending has increased from \$78 billion in 2000 to \$180 billion in 2006, or 62 percent of DoD contract dollars. Expanding DCAA's ability to self-initiate high-risk audits based on its own risk assessment could increase the potential for achieving higher rates of return to the taxpayer.

2. **Adjudication Procedures.** DoD does not have adequate processes and procedures for adjudicating contracting officer disagreements with DCAA audit findings because the contracting officer is currently the final decision authority. DCAA historical sustention rates of questioned costs have been relatively low: 56% for Fiscal Year 2005 and 63% for both Fiscal Years 2006 and 2007. In addition, the DoD IG has issued several contract audit follow-up reports and hotline reports that criticized contracting officers for not sustaining DCAA audit results because some costs were expressly unallowable.

RECOMMENDATIONS

The Independent Review Panel briefed the DBB on its preliminary recommendations on October 23, 2008, at which time the DBB approved the elevation of all 14 recommendations to the Secretary of Defense. A synopsis of the recommendations follows:

- Secretary of Defense revise DCAA's mission statement to identify the taxpayer as the primary customer and focus on core audit services that ensure taxpayer dollars are spent on fair and reasonable contract prices.
- DCAA develop a strategic plan that cascades from the revised mission statement; and concurrently develop (1) an annual performance (operating) plan and a balanced scorecard tied to the strategic plan, and (2) a human capital strategic plan.
- DCAA obtain an independent assessment of resource needs and engage an external professional organization to assist in a cultural transformation.

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- DCAA align performance standards and reward programs to the revised DCAA strategic plan and balanced scorecard in a manner that is transparent, understood, and accepted by the workforce.
- DCAA establish an organizational structure designed to provide consistent governance, control, and quality assurance across DCAA to include enterprise-wide management positions such as Chief Operating Officer, Chief Planning and Quality Officer, and Chief of Internal Review.
- OUSD Comptroller increase oversight by (1) periodically evaluating progress towards development of DCAA's revised mission, strategic and performance plans, (2) requiring DCAA to prepare an annual performance report tied to the strategic plan, and (3) establishing an audit advisory board to support DCAA oversight.
- DoD IG through the Deputy Inspector General for Policy and Oversight perform annual oversight reviews of DCAA.
- DCAA Director establish a risk-based planning process that expands DCAA self-initiated contract audits resulting from risk assessments and increases the potential for identifying fraud, waste and abuse, and higher rates of return to the taxpayer.
- DCAA Director (1) discontinue participation on Integrated Product Teams and Source Selection Evaluation Boards, (2) reevaluate the role and number of Financial Liaison Advisors, and (3) work with the DoD acquisition leadership to explore alternatives for providing technical advice and support to the contract management community while adhering to the auditor independence standards in GAGAS.
- OUSD Comptroller, in coordination with OUSD Acquisition, Technology & Logistics, establish an adjudication process to elevate and resolve significant disagreements between contracting officers and DCAA prior to approving contract actions.

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- OUSD Comptroller provide for independent evaluations of the effectiveness of the corrective actions undertaken in response to the recommendations of the Independent Review Panel.

CONCLUSION

The Defense Business Board, in concert with the OUSD Comptroller, advises the Secretary and Deputy Secretary of Defense to approve the recommended actions for improving DCAA mission, strategic planning, culture, structure, and business practices.

Respectfully submitted,


Jeffrey Steinhoff
Independent Review Panel
Chair


Joseph Wright
Independent Review Panel
and Defense Business
Board Member


LTG Claude "Mick" Kicklighter
(USA Ret.), Independent
Review Panel Member

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APPENDIX A
(TASK GROUP TERMS OF REFERENCE)

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DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

AUG 19 2008

MEMORANDUM FOR CHAIRMAN, DEFENSE BUSINESS BOARD (DBB)

SUBJECT: Terms of Reference – DBB Independent Review Panel on Defense Contract Audit Agency (DCAA)

Due to the recent findings highlighted by the Government Accountability Office (GAO), the Defense Business Board is requested to form an independent panel to review DCAA. Specifically, the Independent Review Panel should deliver actionable recommendations to help the Department (1) enhance a culture of improving performance and accountability within DCAA, particularly with respect to independence and standards of auditing; (2) better align the DCAA organizational structure to provide excellence in management and oversight; and (3) adopt best business practices in DCAA.

The Under Secretary of Defense (Comptroller) will be the DoD Liaison. Mr. Jeffrey Steinhoff will serve as the Independent Review Panel Chairman, and Mr. Zack Gaddy, Director of Defense Finance and Accounting Service, will serve as the Executive Secretary. The Independent Review Panel will plan its actions to present recommendations no later than the October 2008 DBB quarterly meeting.

The Independent Review Panel, as a subcommittee of the Defense Business Board and pursuant to the Federal Advisory Committee Act of 1972, the Government in the Sunshine Act of 1976 and other appropriate federal regulations, shall not work independently of the chartered Defense Business Board, and shall report its recommendations and advice to the Defense Business Board for full deliberation and discussion. Neither the subcommittee nor any workgroups that may be established has the authority to make decisions on behalf of the DBB, nor can any subcommittee or workgroup report directly to the Department or any federal officer or employee who is not also a Board member.

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APPENDIX B

**(TASK GROUP BACKGROUND INFORMATION
AND OBSERVATIONS – OCTOBER 23, 2008)**

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APPENDIX B – BACKGROUND INFORMATION AND OBSERVATIONS

This appendix contains pertinent background information and detailed observations that support the recommendations approved by the Defense Business Board (DBB) at the October 23, 2008 quarterly meeting. The appendix provides background on the Government Accountability Office (GAO) report that led to the creation of the Panel and also describes the process the Panel and staff followed. The observations are grouped in the categories of Strategic Planning, Workforce, Organizational Structure, Oversight, Audit Independence, Business Practices, and Independent Evaluation.

BACKGROUND: GAO INVESTIGATION

A July 2008 GAO investigative report (GAO-08-857) on the DCAA identified:

- Serious failures on behalf of DCAA leadership and staff to comply with Generally Accepted Government Auditing Standards (GAGAS)
- A lack of independence and objectivity
- Management actions that intimidated auditors, impaired some audits, and created a generally abusive environment

The DCAA Director acknowledged the seriousness of the problems and pledged commitment to addressing the problems and restoring confidence in DCAA during testimony before the Senate Committee on Homeland Security and Government Affairs on September 10, 2008.

PROCESS

The Panel reviewed the Terms of Reference as signed by the Deputy Secretary and set objectives by:

- Interviewing the DCAA Director, assistant directors, and other DCAA headquarters officials
- Reviewing strategic, workload, performance, training, and quality assurance documents at DCAA headquarters and regional offices

- Reviewing related GAO and DoD Inspector General (IG) reports
- Interviewing regional directors, deputy directors, audit managers, and support personnel at 4 of the 5 DCAA regions: Northeastern, Eastern, Mid-Atlantic, and Central. The GAO investigation focused heavily on the fifth DCAA region, the Western region
- Interviewing regional audit managers, field audit managers, supervisors, and staff auditors at 12 field audit offices, sub offices, or resident offices
- Interviewing the Defense Contract Management Agency Director and Deputy Director, and Defense Procurement & Acquisition Policy Director and Deputy Director
- Interviewing major procurement officials, industry experts, and public oversight officials

STRATEGIC PLANNING OBSERVATIONS

The Panel's strategic planning observations cover the mission statement, strategic plan, annual performance plan, and human capital strategic plan.

Mission Statement: DCAA had five versions of a mission statement but none were taxpayer focused. The mission statement also included provisions for advisory services that could impair independence and reduce objectivity in fact and appearance. The mission sets the direction and tone of the organization from the top-down for employees, customers, and stakeholders. It drives what the organization does and how it perceives its role. It is also the first step needed for the development of an organizational strategic plan. DCAA's five versions of a mission statement explained what DCAA will do, but none of the versions:

- Clearly defined the ultimate customer as the taxpayer [Note: During the September 10, 2008, Senate hearing, several Senators suggested that the taxpayer be the primary DCAA customer.]
- Explained how DCAA was going to accomplish its mission
- Addressed guiding core values, such as independence, integrity, and objectivity that should drive the mission
- Identified success measures for sustained savings to protect taxpayer dollars

The five versions of DCAA's mission statement were all focused on support to the contracting community as exemplified by the following two mission statement examples:

“Perform all necessary contract audits for the Department of Defense and provide accounting and financial advisory services regarding contracts and subcontracts to all Department of Defense components responsible for procurement and contract administration. These services will be provided in connection with negotiation, administration, and settlement of contracts and subcontracts.”

“Provide contract audit service to other Government agencies, as appropriate.”

Strategic Plan: DCAA had not developed an adequate strategic plan to guide the organization using key factors required by the Government Performance and Results Act of 1993. The DCAA strategic plan resembled a short-term process improvement checklist that did not:

- Have a comprehensive mission statement covering major DCAA functions and operations
- Include long-term goals and objectives (at least five years out) for major functions and operations – most dates in the plan were already expired
- Address enterprise risk and external factors, both immediate and emerging, that could affect mission accomplishment
- Define qualitative and quantitative success measures aligned to the goals, objectives, functions and operations
- Link to supporting strategic documents, such as a strategic operations plan, human capital strategic plan, annual performance report, and a balanced scorecard

Annual Performance Plan: DCAA's annual performance (operating) plan and balanced scorecard were not tied to the strategic plan and were not effective tools for managing the organization. Among other things, an annual performance (operating) plan describes performance measures, expected results, and accountability processes. It also establishes targets and goals for the current year

in support of the strategic plan, and those targets and goals are captured through a balanced scorecard.

Human Capital Strategic Plan: DCAA's workforce is its greatest asset. With over 80 percent of DCAA's annual budget spent on employee salaries and benefits, sound human capital management is paramount to workforce effectiveness. DCAA had not established a human capital strategic plan as a key tool to facilitate human capital management and workforce development in support of DCAA's mission and implementation of its strategic plan.

Human capital strategic plans are a staple of high performing audit organizations and are required by:

- Government Performance and Results Act of 1993
- President's Management Agenda, dated 2002
- Chief Human Capital Officers Act of 2002
- Office of Personnel Management Human Capital Assessment and Accountability Framework – Systems, Standards and Metrics, dated March 2006
- Office of Management and Budget Circular A-11, "Preparation, Submission and Execution of the Budget," dated 2008

Human capital strategic plans help organizations:

- Set workforce development strategies
- Assess workforce characteristics and future needs
- Determine workforce needs
- Align human capital policies and programs with missions, strategic goals, and performance outcomes
- Develop and advocate a culture of continuous learning to attract and retain employees with superior abilities
- Identify best business practices and benchmarking studies
- Apply methods to measure and identify intellectual capital and link the capital to organizational performance and growth
- Address retention and succession planning challenges

These Strategic Planning observations supported recommendations number one through four of the 14 total recommendations presented to the DBB:

“1. **Secretary of Defense**: Revise the DCAA mission to expressly identify the taxpayer as the primary customer and focus on core audit services that ensure taxpayer dollars are spent on fair and reasonable contract prices. (December 2008)”

“2. **DCAA Director**: Establish a strategic plan that:

- a. Cascades from the mission
- b. Extends five years out
- c. Considers enterprise risks and external factors
- d. Includes clearly defined qualitative and quantitative success measures
- e. Links to human capital and operational plans.
- f. Is transparent to the DCAA workforce, customers and stakeholders

(March 2009)”

“3. **DCAA Director**: Develop an annual performance plan and a balanced scorecard tied to the strategic plan. (March 2009)”

“4. **DCAA Director**: Establish a Human Capital Strategic Plan that:

- a. Aligns to the DCAA strategic plan
- b. Provides for recruitment, retention, succession planning, and human capital tools common to leading organizations
- c. Addresses supervisory responsibilities related to independence, core values, ethics, objectivity, and adherence to GAGAS
- d. Meets all Office of Personnel Management requirements.

(March 2009)”

WORKFORCE OBSERVATIONS

Staffing Assessment: DCAA staffing levels have stayed relatively stable since Fiscal Year 2000 at around 4,000 employees. However, this was the same timeframe when DoD contract actions increased by 328 percent from 304,500 in Fiscal Year 2000 to over 1.3 million in Fiscal Year 2006, and contract dollars rose from \$132 billion to \$296 billion during the same period, a 124 percent increase. Despite these major increases in workload, DCAA did not have an independent assessment of its resource needs. An independent assessment

would have helped to ensure the organization was properly staffed to provide audit coverage in line with its mission and strategic plan and to fully comply with GAGAS.

Workforce Surveys: Taking the pulse of the workforce is a very important tool for any organization. DCAA did not regularly obtain and assess the views and climate of its workforce through periodic employee surveys. It has been three years since DCAA conducted its last workforce survey, and that survey only addressed employee morale and communication. DCAA employees have had limited avenues for expressing overall job satisfaction, workforce concerns, and opportunities for improvement. By contrast, other government audit organizations perform broad-based annual employee surveys and use the results, which are shared with their employees and stakeholders, in managing their organizations.

Section 1128 of the National Defense Authorization Act for FY 2004 requires an annual workforce survey to assess:

- Leadership and management practices that contribute to agency performance
- Workforce satisfaction with:
 - Leadership policies and practices
 - Work environment
 - Rewards and recognition for professional accomplishment and personal contributions to achieving organization’s mission
 - Opportunity for professional development and growth
 - Opportunity to contribute to achieving organizational mission

The Panel was informed by DCAA during the review that DCAA plans to conduct a climate assessment (workforce survey) in Fiscal Year 2009 followed by annual workforce surveys to develop corrective action plans that address workforce issues.

Performance Standards: DCAA did not have properly aligned performance measures, standards, and reward programs. DCAA’s performance measures focused heavily on achieving cycle-time targets and dollars audited per hour rather than audit quality. In

addition, there was no direct link between the performance measures and the current strategic plan.

DCAA headquarters established goals for and monitored 24 different performance measures:

- None of the 24 addressed audit quality, such as conformance to GAGAS
- Only eight could be tied to the current strategic plan
- Only four were reported to the OUSD Comptroller

In addition, most employees interviewed felt more pressure to complete jobs within a predetermined time period versus providing a high-quality audit product.

Although DCAA has a rewards program similar to other DoD agencies (e.g., performance, special act, and on-the-spot awards), the perception of the workforce is that awards are given for meeting productivity measures. DCAA performance standards, from senior leadership down to the staff, emphasized productivity over quality.

For example:

- SES performance standards focus on cost per direct auditor hour
- Regional Audit Manager standards state that “Program plan objectives are achieved despite unplanned workload or deficient staffing”
- Auditor standards state, “Almost always able to complete assignments within the approved hours, even when the individual experiences highly complex or unanticipated issues”

Although DCAA performance standards mentioned the word “quality,” there was no clear definition of quality.

Cultural Transformation: The performance issues discussed above are all part of a DCAA culture that over time has resulted in the organization becoming identified primarily as part of the procurement community. While DCAA needs to support the contracting officer, the focus should be on providing quality audit services that meet GAGAS. Audit quality, ethics, objectivity, and independence need to be viewed as the primary drivers of DCAA’s work, with protecting taxpayer interests as the number one priority.

DCAA faces the need for cultural transformation to change its value system and build trust among its staff. Such transformation is not easily attained and will not result entirely from issuing a new mission statement or strategic plan or from the statements of management. It must be ingrained in the fiber of the organization, and it is common for transformation to take hold over years, not weeks or months. It takes hard work to change an organizational culture. Organizations that undergo such cultural transformation find it valuable to obtain the services of outside experts to assist in the transformation process.

These Workforce observations supported recommendations number five through seven of the 14 total recommendations presented to the DBB:

“5. **DCAA Director**: Obtain an independent assessment of DCAA’s resource needs to ensure that DCAA is properly staffed to provide audit coverage in line with its mission and strategic plan and to fully comply with GAGAS. (April 2009)”

“6. **DCAA Director**: Engage an external professional organization to assist in a cultural transformation that includes emphasizing core values such as quality, independence, ethics, and objectivity rather than a mindset focused on quantity and productivity. (February 2009)”

“7. **DCAA Director**: Align performance standards and reward programs to the revised DCAA strategic plan and balanced scorecard in a manner that is transparent, understood, and accepted by DCAA staff. (March 2009)”

ORGANIZATIONAL STRUCTURE OBSERVATIONS

Decentralized Structure: DCAA’s decentralized organizational structure does not fully provide for effective management and oversight to ensure DCAA delivered audit services in accordance with GAGAS. The decentralized structure diluted the effectiveness of managerial oversight and affected the quality of audit work and compliance with auditing standards. DCAA had five seemingly autonomous regions executing five largely independent operational plans:

- DCAA's current structure includes a headquarters and five geographical regions supported by 352 offices: five regional headquarters offices, 79 field audit offices, 266 sub offices, a field detachment, and a training site. Each region has a Director, Deputy Director, quality assurance staff, technical specialists, an Equal Employment Opportunity official, administrative staff, and audit offices. Senior audit managers report traveling as much as 70 percent of the time in order to provide what they termed limited oversight. For example, 27 of the 43 offices in the Philadelphia-based Mid-Atlantic Region are located in the Washington and Baltimore metropolitan areas.
- Of DCAA's total base audit hours, 35 percent were spent auditing the "top 10 contractors" by resident office auditors who report to five different Regional Directors.

Headquarters Positions and Functions: An organizational structure with a Deputy Director responsible for audit operations and a Deputy Director responsible for product lines and quality can provide:

- Horizontal and vertical management involvement in decision-making
- More consistent governance, control, and quality assurance
- Specialized, functional knowledge available to all projects across the organization
- Greater audit consistency and communication between managers

These Organizational Structure observations supported recommendation number eight of the 14 total recommendations presented to the DBB:

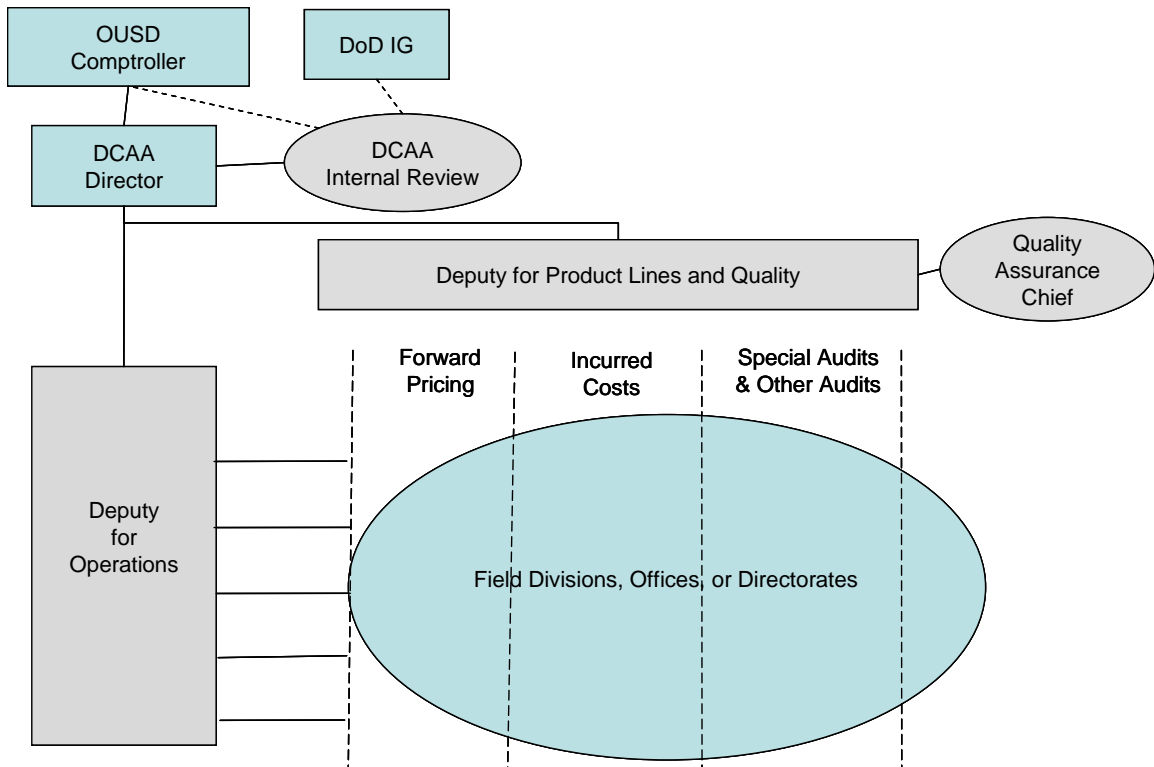
"8. **DCAA Director:** Establish an organizational structure designed to provide consistent governance, control, and quality assurance across DCAA to include the following enterprise-wide management positions at DCAA headquarters:

- a. Deputy Director responsible for audit operations (i.e., Chief Operating Officer)
- b. Deputy Director responsible for product lines and quality (i.e., Chief Planning and Quality Officer)

- c. Chief of Internal Review, reporting to DCAA Director, to perform inspector general functions internal to DCAA and serve as an ombudsman (March 2009)”

The Panel was informed by DCAA that it is expanding and centralizing the existing quality assurance inspection program to enable increased oversight over audit quality and to prepare an annual inspection report.

NOTIONAL ORGANIZATIONAL STRUCTURE



OVERSIGHT OBSERVATIONS

Office of the Under Secretary of Defense (OUSD)

(Comptroller)/CFO Oversight: OUSD Comptroller oversight has primarily focused on just a few DCAA reported metrics and has been minimal, especially with regard to audit quality. OUSD Comptroller oversight can be increased by:

- Periodically evaluating actions taken by DCAA in response to the Independent Review Panel's recommendations and the GAO investigation
- Requiring an annual performance report and balanced scorecard that ties to the enterprise strategic plan and compares actual results against goals established in the annual performance plan
- Creating an audit advisory board to establish accountability and ensure DCAA resources are leveraged into the most critical areas while maintaining audit quality

DoD IG Oversight: Recent GAO, DoD IG, and DCAA quality assurance (internal) reviews have identified serious failures of DCAA to comply with GAGAS. Increased oversight, such as annual oversight reviews by DoD IG, which already has oversight responsibility for DCAA, is needed to help ensure DCAA complies with GAGAS.

These Oversight observations supported recommendations number nine and ten of the 14 total recommendations presented to the DBB:

"9. Office of the Under Secretary of Defense (OUSD)

Comptroller: Increase management oversight of DCAA by:

- a. Periodically evaluating progress toward development of its revised mission and strategic and performance plans (Quarterly progress reviews beginning January 2009)
- b. Requiring DCAA to prepare an annual performance report tied to the strategic plan that compares actual results against targets and goals established in the annual performance plan (First report would cover FY2009 and be due November 2009)
- c. Establishing an audit advisory board to support DCAA oversight (March 2009)"

“10. DOD Inspector General through the Deputy Inspector General for Policy and Oversight: Perform annual oversight reviews of DCAA. (Beginning with FY 2009 audits)”

AUDIT INDEPENDENCE OBSERVATIONS

Advisory Services: Independence is the foundation of auditing and at the heart of GAGAS. Under GAGAS, auditors are not permitted to carry out a management function or audit their own work and need to be concerned with any non-audit service that could impact independence in fact or appearance. The current DCAA mission statement provides for “advisory services” that could adversely impact DCAA’s independence. DCAA performed three types of advisory services that typically represent management functions and could, in fact impair independence:

- **Integrated Product Team Participation.** DCAA auditors have been providing audit input on contractor “draft” proposals as members of Integrated Product Teams. Providing input on proposals that have not been “approved” would be considered a management function under GAGAS and therefore, at a minimum, gives the appearance that DCAA is helping the contractor prepare the proposal, which would impair audit independence.
- **Source Selection Evaluation Board Participation.** DCAA auditors have been participating on Source Selection Evaluation Boards, which are involved in contractor selection. Again, this would be considered a management function under GAGAS and therefore, at a minimum, gives the appearance that DCAA is part of the source selection decision process in awarding the contract, which would impair audit independence.
- **Financial Liaison Advisors.** The DCAA has placed over 100 auditors at major buying commands to improve “customer service” provided to procurement officials. There has been congressional testimony that indicated at least one Field Liaison Advisor tried to influence audit results in favor of a contractor.

These Audit Independence observations supported recommendation number 11 of the 14 total recommendations presented to the DBB:

- “11. **DCAA Director**: Address advisory-type services:
- a. Discontinue participation on Integrated Product Teams and Source Selection Evaluation Boards, both of which impair auditor independence in fact and appearance under GAGAS. (November 2008)
 - b. Reevaluate the role and number of Financial Liaison Advisors to ensure independence and objectivity in both fact and appearance. (January 2009)
 - c. Work with the DoD acquisition leadership to explore alternatives for providing technical advice and support to the contract management community while adhering to the auditor independence standards in GAGAS. (January 2009)”

BUSINESS PRACTICE OBSERVATIONS

Independent Referencing: DCAA had not established an independent referencing process, which is a key quality control and a best business practice used by the federal government audit profession.

- The independent referencing process requires an experienced auditor, who is independent of the audit, to review that the statement of facts, figures, and dates are accurately reported; the findings are adequately supported by the work papers; and the audit conclusions and recommendations flow logically from the evidence.
- Most audit organizations (including GAO, DoD IG, and the Military Service Audit Agencies) have established the independent referencing process.
- The independent referencing process should occur before the draft audit report is released.
- The independent referencing process should help identify and correct the type of work paper deficiencies identified in the recent GAO investigation and DoD IG reviews.

The Panel was informed by DCAA of DCAA’s plan to implement an independent referencing process for all audit reports.

Report Signature Authority: DCAA had not established a key quality control process requiring the second-level supervisor to review and sign audit reports.

- DCAA inappropriately delegated review and signature authority for “clean” (no finding) reports to the immediate supervisor.
- A key quality control procedure requires having an official above the immediate supervisor review the accuracy and completeness of all audit reports.

The Panel was informed by DCAA during the review that audit report signature authority from immediate supervisors has been removed.

Risk-Based Planning: DCAA does not have an established procedure to plan self-initiated audits based on its own risk assessments.

- DCAA audit planning focused on mandated and requested audits.
- DoD contract management has been on the GAO High-Risk List since 1992. DCAA’s interpretation of the Federal Acquisition Regulation is that it cannot initiate numerous types of high-risk audits; for example, audits of competitive contracts, without a specific audit request.
- DoD full and open competition contract spending has increased from \$78 billion in 2000 to \$180 billion in 2006. Since DCAA does not normally audit competitive contracts, 62 percent of DoD contract dollars are typically not subject to DCAA audit.
- DoD awarded over \$15 billion in Fiscal Year 2006 on competitive contracts where only one offer was ultimately received. These contracts are also not subject to DCAA audit.
- DCAA recently completed two requested audits that otherwise would not have been planned or performed by DCAA because the contracts were competitively awarded: *General Dynamics C4 Systems, Inc.’s Joint Network Node* and *General Dynamics-IT’s Equipment & Enhancements*. The reviews identified very high profit margins on both contracts. DCAA made recommendations that could result in savings of \$155.8 million to the taxpayer.

Expanding DCAA’s ability to self-initiate high-risk audits based on its own risk assessment could increase the potential for identifying fraud and achieving higher rates of return to the taxpayer.

Adjudication Procedures: DCAA does not have an adjudication process to elevate significant disagreements above the contracting officer level. The contracting officer is currently the final decision authority.

- DCAA overall sustention rates have been relatively low: 56 percent for Fiscal Year 2005 and 63 percent for both Fiscal Years 2006 and 2007.
- DoD IG has issued several contract audit follow-up reports and hotline reports that criticized contracting officers for not sustaining DCAA audit results. The DoD IG reported that some costs questioned by DCAA but allowed by contracting officers were expressly unallowable.
- DCAA did not know the disposition of audit results until after contract award and receipt of the Post-Negotiation Memorandum (PNM) from the contracting officer. In addition, DCAA officials stated the PNMs often did not specifically address how the audit results were resolved, and they did not always receive PNMs in a timely manner.

These business practice observations supported recommendations number 12 and 13 of the 14 total recommendations presented to the DBB:

“12. **DCAA Director:** Establish a risk-based planning process that expands DCAA self-initiated contract audits resulting from risk assessments, and that increases the potential for identifying fraud, waste and abuse, and higher rates of return to the taxpayer. (April 2009)”

“13. **OUSD Comptroller:** In coordination with OUSD Acquisition, Technology & Logistics, establish an adjudication process to elevate and resolve significant disagreements between contracting officers and DCAA prior to approving contract actions. (April 2009)”

INDEPENDENT EVALUATION

Follow-up Review: GAGAS calls for follow-up to determine if appropriate corrective actions have been taken. This same premise applies to the actions DCAA has been and will be taking to address problems with audit quality. DCAA has been implementing corrective actions suggested by the GAO and DoD IG reports. This report by the Independent Review Panel contains numerous additional recommendations requiring action by DCAA. Future follow-up Independent Reviews could assess the effectiveness of DCAA corrective actions and determine whether additional actions are needed to ensure audit quality. Also, as part of their continuing oversight, the USD (Comptroller) would come back after 18 months and see if the actions that DCAA have taken in fact been effective.

This Independent Evaluation observation supported recommendation number 14 of the 14 total recommendations presented to the DBB:

“14. **OUSD Comptroller:** Provide for independent evaluations of the effectiveness of the corrective actions undertaken in response to the recommendations of the Independent Review Panel. (March 2010).”

Defense Business Board

APPENDIX C

(TASK GROUP FINAL REPORT– OCTOBER 23, 2008)

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DEFENSE BUSINESS BOARD

Defense Contract Audit Agency Review Panel

October 2008



BACKGROUND: GAO INVESTIGATION

GAO's July 2008 investigative report found serious problems with the work of the Defense Contract Audit Agency (DCAA):

- Serious failures to comply with generally accepted government auditing standards (GAGAS)
- The lack of independence and objectivity
- Management actions that intimidated auditors, impaired some audits, and created a generally abusive environment

DCAA acknowledged the seriousness of the problems, and the Director pledged her commitment to addressing the problems and restoring confidence in DCAA in testimony before the Senate Committee on Homeland Security and Government Affairs on September 10, 2008.



TERMS OF REFERENCE

The Deputy Secretary of Defense established an Independent Review Panel under the Defense Business Board to deliver actionable recommendations to help the Department—

- Better align the DCAA **organizational structure** to provide excellence in management and oversight
- Change the **culture** to improve performance and accountability within DCAA, particularly with respect to independence and compliance with GAGAS
- Adopt best **business practices** in DCAA



STRATEGIC PLANNING

1. **SECDEF**: Revise the DCAA mission to expressly identify the *taxpayer* as the primary *customer* and focus on core audit services that ensure taxpayer dollars are spent on fair and reasonable contract prices.
(December 2008)

2. **DCAA Director**: Establish a strategic plan that—
 - a. Cascades from the mission
 - b. Extends 5 years out
 - c. Considers enterprise risk and external factors
 - d. Includes clearly defined qualitative and quantitative success measures
 - e. Links to human capital and operational plans
 - f. Is transparent to the DCAA workforce, customers, and stakeholders
(March 2009)



STRATEGIC PLANNING (Cont'd)

3. **DCAA Director**: Develop an annual performance plan and balanced scorecard tied to the strategic plan. (March 2009)
4. **DCAA Director**: Establish a Human Capital Strategic Plan that—
 - a. Aligns to the DCAA strategic plan
 - b. Provides for recruitment, retention, succession planning, and human capital tools common to leading organizations
 - c. Addresses supervisory responsibilities related to independence, core values, ethics, objectivity, and adherence to GAGAS
 - d. Meets all Office of Personnel Management requirements(March 2009)



WORKFORCE

5. **DCAA Director**: Obtain an independent assessment of DCAA's **resource needs** to ensure that DCAA is **properly staffed** to provide audit coverage in line with its mission and strategic plan and to fully comply with GAGAS. (April 2009)
6. **DCAA Director**: Engage an external professional organization to assist in a cultural transformation that includes **emphasizing core values** such as quality, independence, ethics, and objectivity rather than a mindset focused on quantity and productivity. (February 2009)
7. **DCAA Director**: Align performance standards and reward programs to the revised DCAA strategic plan and balanced scorecard in a manner that is transparent, understood, and accepted by DCAA staff. (March 2009)



ORGANIZATIONAL STRUCTURE

8. **DCAA Director**: Establish an organizational structure designed to provide consistent governance, control, and quality assurance across DCAA to include the following enterprise-wide management positions at DCAA headquarters:
 - a. Deputy Director responsible for audit operations (i.e., Chief Operating Officer)
 - b. Deputy Director responsible for product lines and quality (i.e., Chief Planning and Quality Officer)
 - c. Chief of Internal Review, reporting to DCAA Director, to perform inspector general functions internal to DCAA and serve as an ombudsman

(March 2009)



OVERSIGHT

9. **OUSD Comptroller**: Increase management oversight of DCAA by—
 - a. Periodically evaluating progress toward development of its revised mission and strategic and performance plans. (Quarterly progress reviews beginning January 2009)
 - b. Requiring DCAA to prepare an annual performance report tied to the strategic plan that compares actual results against targets and goals established in the annual performance plan. (First report would cover FY2009 and be due November 2009)
 - c. Establishing an audit advisory board to support DCAA oversight. (March 2009)

10. **DOD Inspector General through the Deputy Inspector General for Policy and Oversight**: Perform annual oversight reviews of DCAA. (Beginning with FY 2009 audits)



AUDIT INDEPENDENCE

11. **DCAA Director**: Address advisory-type services:
 - a. Discontinue participation on Integrated Product Teams and Source Selection Evaluation Boards, both of which impair auditor independence in fact and appearance under GAGAS. (November 2008)
 - b. Reevaluate the role and number of Financial Liaison Advisors to ensure independence and objectivity in both fact and appearance. (January 2009)
 - c. Work with the DoD acquisition leadership to explore alternatives for providing technical advice and support to the contract management community while adhering to the auditor independence standards in GAGAS. (January 2009)



BUSINESS PRACTICES

12. **DCAA Director**: Establish a risk-based planning process that expands DCAA self-initiated contract audits resulting from risk assessments and increases the potential for identifying fraud, waste and abuse, and higher rates of return to the taxpayer. (April 2009)

13. **OUSD Comptroller**: In coordination with OUSD Acquisition, Technology & Logistics, establish an adjudication process to elevate and resolve significant disagreements between contracting officers and DCAA prior to approving contract actions. (April 2009)



INDEPENDENT EVALUATION

14. **OUSD Comptroller**: Provide for independent evaluations of the effectiveness of the corrective actions undertaken in response to the recommendations of the Independent Review Panel. (March 2010)

Defense Business Board

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DEFENSE BUSINESS BOARD

Defense Contract Audit Agency Review Panel

Backup Slides

23 October 2008



STRATEGIC PLANNING: OBSERVATIONS

- **Mission Statement.** DCAA had 5 versions of a mission statement but none were taxpayer focused. The mission statement also included provisions for advisory services that could reduce independence and objectivity.
- **Strategic Plan.** The DCAA strategic plan did not address Government Performance Results Act requirements; at best it was a short-term process- improvement checklist. The plan lacked long-term goals and objectives (at least 5 years out) for major functions and operations. Most dates in the plan had expired. The plan also did not address enterprise risk or external factors that could affect mission accomplishment.
- **Human Capital Strategic Plan.** DCAA did not establish a Human Capital Strategic Plan as required by the Office of Personnel Management to facilitate workforce development (including recruitment, retention, and succession planning) in support of the overall strategic plan.



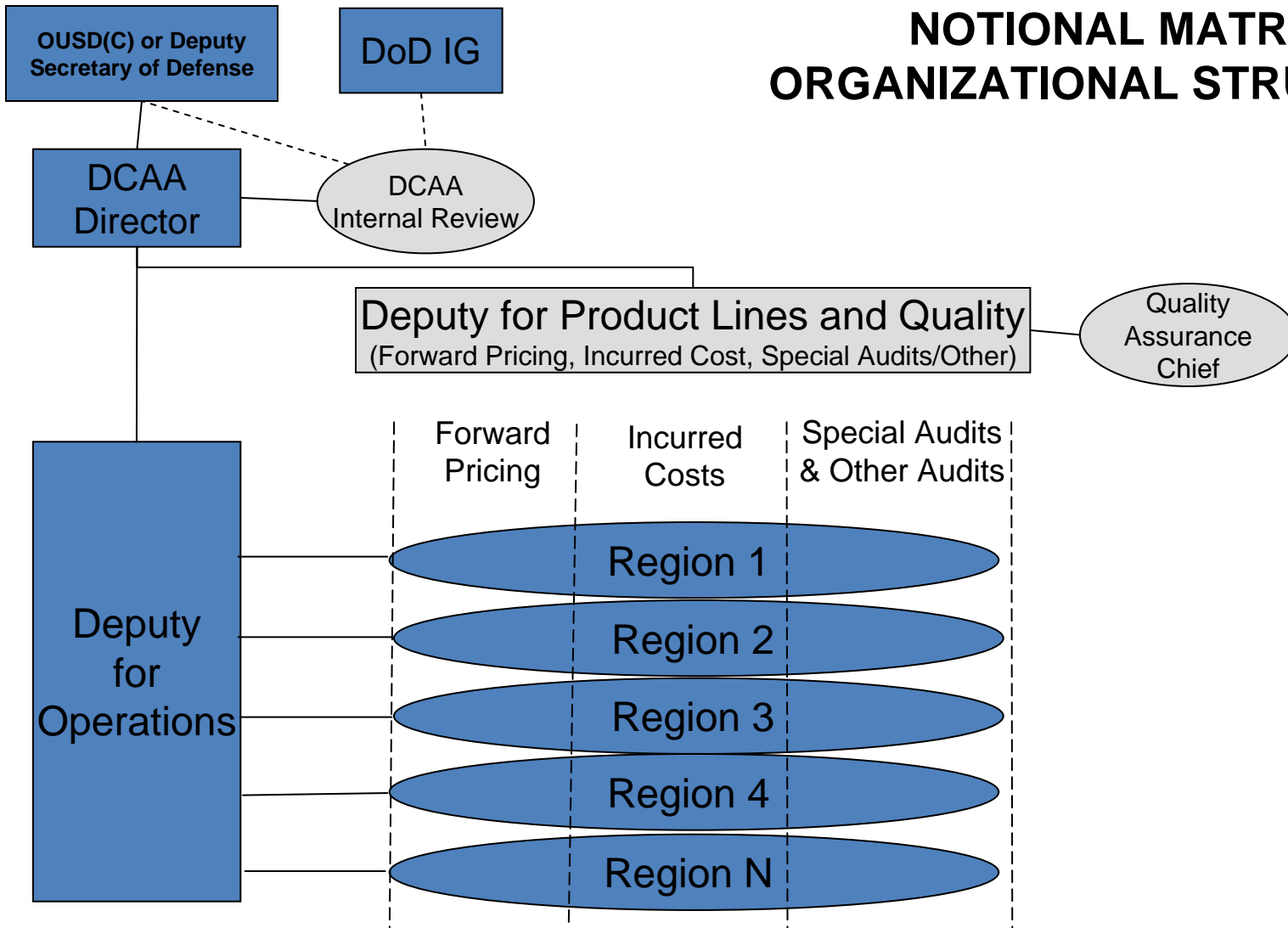
ORGANIZATIONAL STRUCTURE: OBSERVATIONS

Structure. The DCAA organizational structure did not fully provide for effective management and oversight to ensure DCAA delivered audit services according to generally accepted government auditing standards (GAGAS):

- **Decentralized structure.** DCAA decentralized organizational structure diluted the effectiveness of managerial oversight and affected the quality of audit work and compliance with auditing standards. DCAA had 5 seemingly autonomous regions with about 350 offices executing 5 independent operational plans.
- **Quality Assurance.** Regional-level Quality Assurance positions prevented agency-wide identification of failures to comply with GAGAS. Quality Assurance results were provided directly to the Regional Director and were not always shared with other regions nor provided to auditors as lessons learned.



NOTIONAL MATRIX ORGANIZATIONAL STRUCTURE





AUDIT INDEPENDENCE: OBSERVATIONS

Advisory Services. DCAA provided advisory-type services that could impair auditor independence in fact or appearance:

- **Integrated Product Team (IPT) Participation.** DCAA auditors have been providing audit input on contractor “draft” proposals. Providing input on proposals that have not been “approved” gives the potential appearance that DCAA is helping the contractor prepare the proposal.
- **Source Selection Evaluation Board (SSEB) Participation.** DCAA auditors have been participating on SSEBs, which gives the potential appearance that auditors are part of the source selection decision process, such as helping decide which contractor should be awarded the contract.
- **Financial Liaison Advisors (FLAs).** The DCAA has placed over 100 auditors at major buying commands to improve “customer service” provided to procurement officials. There has been congressional testimony that at least one FLA tried to influence the audits results in favor of the contractor.



BUSINESS PRACTICES: OBSERVATIONS

The DCAA **business practices** did not result in the performance of quality audits:

- **Risk-based planning.** DCAA current audit planning focused on mandated and requested audits rather than risk. Although DoD contract management has been on the GAO High-Risk List since 1992, DCAA's interpretation of Federal Acquisition Regulation (FAR) precludes high-risk audits such as competitive contracts without a specific audit request. DoD competitive contract spending was \$180 billion in 2006 and not subject to DCAA audit.



BUSINESS PRACTICES: OBSERVATIONS (CONT'D)

- **Adjudication procedures.** DCAA did not have an adjudication process to elevate significant disagreements above the contracting officer level—the contracting officer is currently the final decision authority. The DCAA sustention rates have been extremely low: 56% for FY05, 63% for FY06, and 63% for FY07. DoD IG has issued several Contract Audit Follow-Up reports criticizing contracting officers for not sustaining DCAA audit results—some costs were expressly unallowable.
- **Appropriate signature authorities.** The DCAA inappropriately delegated review and signature authority for “clean” (no finding) reports to the immediate supervisor.
- **Independent referencing process.** The DCAA did not establish an independent referencing process, which is a key quality control and a best business practice used by the federal government audit profession.



WORKFORCE: OBSERVATIONS

The DCAA workforce had a culture and work environment that was more focused on productivity than audit quality:

- **Staffing Assessment.** While DCAA staffing levels have stayed relatively stable from FY2000 to current (around 4,000 employees), DoD contract actions increased by about 1 million from FY2000 to FY2007, (a 328% increase) and DoD contract dollars have increased by from \$132 billion to \$337 billion (a 155% increase). Government-wide contract spending increased from \$219 billion to \$466 billion during same period.
- **Performance Measures.** DCAA did not have properly aligned performance measures, standards, and reward programs. DCAA focused heavily on achieving cycle-time targets and dollars audited per hour rather than audit quality. In addition, there was no direct link from performance measures to the current strategic plan.



WORKFORCE: OBSERVATIONS (CONT'D)

- **Workforce Assessment.** DCAA did not have adequate workforce **assessment and communication** tools. DCAA did not conduct annual workforce assessments as required by 2004 National Defense Authorization Act. The last assessment was performed three years ago. Therefore, employees had limited avenues for expressing overall job satisfaction, workforce concerns, or opportunities for improvement.



DCAA ACTIONS TAKEN OR PLANNED

The Independent Review Panel endorses the following DCAA planned actions:

1. Expand and centralize the existing quality assurance inspection program to enable increased oversight over audit quality and prepare an annual inspection report.
2. Conduct a climate assessment (workforce survey) in FY2009 followed by annual workforce surveys to develop corrective action plans that address workforce issues.
3. Implement an independent referencing process for all audit reports.
4. Remove audit report signature authority from immediate supervisors.