Inspector General

United States Department of Defense

Oversight Review April 8, 2009

Defense Contract Management Agency Actions on Audits of Cost Accounting Standards and Internal Control Systems at DoD Contractors Involved in Iraq Reconstruction Activities

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Acronyms

CAFU	Contract Audit Follow-up
CAS	Cost Accounting Standard
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
FAR	Federal Acquisition Regulation
IG	Inspector General
PGI	Procedures, Guidance, and Information

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April 8, 2009

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY

SUBJECT: Report of Defense Contract Management Agency Actions on Audits of Cost Accounting Standards and Internal Control Systems at DoD Contractors Involved in Iraq Reconstruction Activities (Report No. D-2009-6-004)

We are providing this final report for your review and comment. We performed this review in accordance with DoD Directive 7640.2 "Policy for Follow-up on Contract Audit Reports", February 12, 1988 (the Directive was reissued as DoD Instruction 7640.02 under the same title on August 22, 2008). The directive required that we monitor and evaluate systems in the Department of Defense for follow-up on contract audits.

We request that management provide comments that conform to the requirements of DoD Directive 7650.3. Please reconsider your partial concurrence to Recommendation E.1. For us to consider management comments to the final report, we should receive them by May 8, 2009.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to the e-mail address cited in the last paragraph of this memorandum. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. Matters considered to be exempt from public release should be clearly marked for DoD Inspector General consideration.

Management comments should indicate concurrence or nonconcurrence with Recommendation E.1. If management agrees to the recommendation, the management comments should describe actions taken or planned and provide anticipated dates for completing the actions. State specific reasons for any nonconcurrence, and propose alternative actions, if appropriate.

We appreciate the courtesies extended to the staff. Questions should be directed to Ms. Meredith Long-Morin at (703) 604-8739 (DSN 664-8739), meredith.morin@dodig.mil.

Carolyn R. Davis

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Defense Contract Management Agency Actions on Audits of Iraq Reconstruction Activities

Results In Brief

What We Did

We evaluated the actions that Defense Contract Management Agency contracting officers took on audits of cost accounting standards and internal control systems at major defense contractors involved in Iraq reconstruction activities. Our review covered audits of cost accounting standards and internal control systems included in the semiannual reporting periods ending September 30, 2006, through September 30, 2007.

What We Found

DCMA Houston contracting officers did not adequately justify their actions in response to two DCAA audit reports of potential cost accounting standard noncompliances, and the actions cost the Government $1.6 million. A DCMA Pheonix contracting officer also did not adequately justify his decision to maintain his "adequate" opinion of a major DoD contractor's accounting system in light of significant accounting system internal control weaknesses reported by DCAA. In addition, a DCMA Philadelphia contracting officer failed to adequately coordinate with DCAA when she evaluated the contractor's response to DCAA-reported estimating system deficiencies. DCMA Philadelphia and Houston did not timely process DCAA-reported noncompliances in accordance with FAR 30.605, and did not accurately report contract audit follow-up data. DCMA Philadelphia and Houston contracting officers did not timely resolve or disposition several of the audits, and management has not implemented adequate controls for ensuring an effective contract audit follow-up function. Finally, DCMA Houston is not evaluating one of its contracting officers on the contract audit follow-up process as DoD Directive 7640.2 required and DoD Instruction 7640.02 requires.

What We Recommended

We recommended that DCMA develop a program whereby contracting officers seek expert advice on complex noncompliance issues, and implement procedures for ensuring that contracting officers adequately justify their actions. In addition, DCMA Philadelphia must coordinate with DCAA when evaluating contractor responses, and promptly process potential noncompliances in accordance with FAR 30.605. DCMA Philadelphia and Houston also need to immediately reduce the backlog of overage audits, perform periodic reviews of the function, improve data accuracy, and hold contracting officers accountable.

Management Comments

In responding to the September 30, 2008 draft of this report, DCMA concurred to 13 recommendations and partially concurred to 1 recommendation. We request that DCMA reconsider its comments concerning our recommendation that DCMA contracting officers add DCAA Field Detachment audits into the contract audit follow-up system. DCMA should provide its written comments to the final report by May 8, 2009.

United Stated Department of Department of Defense Office of Inspector General
(Project No. D2008-DIP0AI-0086.000)
Report No. D-2009-6-004
April 8, 2009

Introduction

Objective

Our objective was to review the actions that contracting officers took to resolve and disposition audit reports containing internal control system recommendations and cost accounting standard noncompliances at defense contractors involved in Iraq reconstruction activities. Our review covered reports included in the semiannual reporting periods ending September 30, 2006 through September 30, 2007 for the DCMA Houston, Philadelphia, and Virginia offices. See Appendix A for details regarding our scope and methodology and prior coverage. This is the first in a series of reports we plan to issue on the actions that contracting officers took in response to audit reports of DoD contractors involved in Iraq reconstruction activities. Our next report will cover the actions that contracting officers took on audit reports of incurred costs at DoD contractors involved in Iraq reconstruction activities.

Background

Defense Contract Audit Agency. DCAA performs contract audits and provides accounting and financial advisory services to all DoD Components. DCAA issues audit reports resulting from several types of audits, such as audits on contractor compliance with cost accounting standards and the adequacy of internal control systems.

DCAA conducts audits of cost accounting standards to determine if a contractor's policies, procedures, and practices comply with the requirements of the cost accounting standards (CAS) contained in 48 Code of Federal Regulations Chapter 99, *Cost Accounting Standards Board, Office of Federal Procurement Policy, Office of Management and Budget*. The CAS are incorporated in FAR as an appendix, *Cost Accounting Preambles and Regulations*. They establish rules for consistently allocating costs on Government contracts.

DCAA conducts audits of internal control systems at major DoD contractors to evaluate the adequacy of the internal controls over major financial systems, such as the accounting, billing, estimating, and purchasing systems.

Defense Contract Management Agency. DCMA is a DoD Component that works directly with DoD contractors to help ensure that DoD, Federal, and allied government supplies and services are delivered on time at projected cost and meet performance requirements. DCMA, acting through its 47 field offices, is responsible for resolving and dispositioning most DCAA audit reports for the Army, Navy, Air Force, and Defense Logistics Agency. This report focuses on the actions that three DCMA offices – DCMA Houston [1], Philadelphia, and Virginia – took in response to DCAA audits of cost accounting standard noncompliances and internal control system recommendations at major DoD contractors involved in Iraq reconstruction activities.

[1] DCMA Houston is a suboffice of the DCMA Pheonix field office

These three offices administer a significant portion of DoD contracts involving Iraq reconstruction activities.

Effective June 2008, the responsibility for follow-up of DCMA Philadelphia audits covered in this report transferred to DCMA Maryland. We addressed the related recommendations to both the DCMA Philadelphia and Maryland offices since DCMA Maryland will be taking future actions on the audits and DCMA Philadelphia will need to make improvements to its contract audit follow-up system.

OMB Circular Number A-50, "Audit Followup", September 29, 1982 provides the policies and procedures for use by executive agencies (including DCMA) when considering reports issued by the Inspectors General, other executive branch audit organizations, the Government Accountability Office (GAO), and non-Federal auditors where followup is necessary.

DoD Directive 7640.2, "Policy for Follow-up on Contract Audit Reports", February 12, 1988, prescribed the responsibilities, reporting requirements, and follow-up procedures on contract audits conducted by Defense Contract Audit Agency. Paragraph 6.5 of the Directive required the contracting officer to prepare a post-negotiation memorandum covering the disposition of all significant audit report findings, including the underlying rationale for such dispositions. The DoD Inspector General (IG) evaluates the effectiveness of contract audit follow-up (CAFU) systems implemented at each DoD Component for compliance with this directive.

DoD Directive 7640.2 also required DoD Components to submit semiannual status reports on reportable contract audits to the DoD IG. The DoD IG includes a summary of the status reports for all DoD Components in its *Semiannual Report to Congress*. DoD Directive 7640.2 applied to all CAFU actions covered in this review. The DoD Acting Inspector General reissued the Directive as DoD Instruction 7640.02 on August 22, 2008.

Findings

A. Insufficient Rationale for Actions on Reported Cost Accounting Standard Noncompliances

DCMA-Houston contracting officers failed to document sufficient rationale for their actions on two DCAA Cost Accounting Standard (CAS) noncompliance reports. In one of the two actions, the contracting officer arbitrarily negotiated a position halfway between the DCAA and contractor positions in order to settle a self-insurance credit due to the Government. In the other action, the contracting officer determined that a cost accounting change was desirable to the Government and paid the contractor for the costs associated with the change. In both cases, the contracting officers did not adequately explain the basis for their decisions as DoD Directive 7640.2, paragraph 6.1 required. Because of their actions, the Government lost a combined $1.6 million in costs that DCMA contracting officers should not have paid the contractor. We are reviewing a third instance of an inappropriate DCMA-Houston contracting officer determination involving several million dollars in claimed subcontract costs. We will issue our detailed findings on this determination in our subsequent report of contracting officer actions on incurred costs audit reports involving Iraq reconstruction activities. DCMA needs to develop a program whereby contracting officers can obtain expert advice on complex noncompliance issues such as these to ensure that the actions comply with applicable regulations and the Government's interests are protected.

Failure to Collect Full Amount of Self-Insurance Credit Due to the Government

Self-Insurance Credit. A DoD contractor maintains a self-insured health plan whereby employees pay a fixed premium for health coverage and the contractor assumes the responsibility of paying all claims filed under the plan. During the contractor fiscal year, the contractor charges the Government for the estimated costs of the plan and sets aside the estimate in a medical reserve account to pay the claims. Because the plan's actual costs for 1994 through 1998 were significantly lower than the funds set aside in the medical reserve account and charged to the Government, the contractor withdrew $3.2 million from the medical reserve account and reclassified it as income. However, the contractor did not provide a credit to the Government for the $3.2 million withdrawal.

Applicable Criteria. FAR 31.201-5 states, "The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund."

CAS 416 provides criteria for the measurement of insurance costs, the assignment of such costs to cost accounting periods, and their allocation to contracts.

DCAA Audit Report. In Audit Report No. 3311-2004K19200001, August 6, 2004, DCAA reported that the contractor's failure to credit the Government for the $3.2 million self-insurance reserve reclassification as income was in noncompliance with FAR 31.201-5 and CAS 416. In response, the contractor offered to credit the Government for $2.2 million. The $1 million difference represents the amount of credit that the contractor believed should be allocable to the plan's employee contributions[2]. In Audit Report No. 3311-2005K1950000, February 28, 2007, DCAA stated that the contractor should not reduce the credit to the Government for the employee contributions because the contractor did not record the contributions as an expense. Furthermore, DCAA stated that the contractor had not shared any of the $3.2 million credit with its employees.

DCMA Houston Contracting Officer Determination. The contracting officer negotiated a credit of $2.7 million, halfway between the $3.2 million in questioned costs and the $2.2 million contractor offer. The contracting officer's negotiation memorandum does not include any explanation for the $2.7 million negotiation settlement, or any rationale for her decision to agree with the contractor's assertion that a portion of the credit was allocable to the employee contributions.

The contracting officer's negotiation settlement was improper for several reasons. First, the contracting officer did not comply with DoD Directive 7640.2, Paragraph 6.5.1., by failing to include sufficient rationale in the negotiation memorandum to support a settlement that was different from the DCAA position. Second, the contracting officer failed to provide a legal basis for the settlement as required by OMB Circular Number A-50, paragraph 8a.(6). Third, the settlement was arbitrary and capricious and, as such, did not resolve the underlying legal question concerning whether the contractor was entitled to reduce the credit for the employee contributions. Fourth, the contractor arguments were not persuasive based on our review of information available in the contract file. We did not find any compelling reason to reduce the credit to the Government, especially since the employee contributions were fixed and the employees were not entitled to share in any differences between the estimated and actual costs. Finally, the contracting officer's supervisor did not approve the negotiation position until 2 years and five months *after* the contracting officer had issued her final determination to the contractor. The supervisor should have reviewed and approved the determination before the contracting officer issued it to ensure that the determination complied with applicable regulations and the negotiation memorandum included adequate rationale.

The contracting officer's actions in this case cost the Government $500,000, which is the difference between the DCAA calculated credit of $3.2 million and the negotiated settlement of $2.7 million. In addition, the contracting officer's arbitrary and capricious determination has exposed the Government to the risk of additional losses when the contractor makes future withdrawals from its medical reserve account.

[2] The employee contributions made up about 33 percent of the claims paid under the plan.

We noted another case where a DCMA Houston contracting officer made an arbitrary and capricious interim determination and exposed the Government to unnecessary losses. In this case, DCAA had questioned several million in claimed subcontract costs that the contractor did not fully support. The DCMA Houston contracting officer allowed one-half of the questioned costs but did not adequately explain the basis for allowing those costs. Subsequent events have raised serious questions about the allowability of the subcontract costs and the appropriateness of the contracting officer's interim determination in allowing one-half of the costs. We are still reviewing this complex case and will provide our findings in a subsequent report of contracting officer actions on incurred costs audit reports involving Iraq reconstruction activities.

Desirable Cost Accounting Change Determination Not Justified

Contractor's Cost Accounting Change. A DoD contractor changed its method of charging certain procurement costs by establishing two "Procurement Service Center" overhead pools [3], one to accumulate procurement costs associated with employees stationed in the continental United States and another for employees stationed oversees. Prior to the change, the contractor accumulated these procurement costs using a single Procurement Service Center overhead pool. The Government paid approximately $1.1 million in increased costs over a 4-year period as a result of the contractor's cost accounting change.

FAR Criteria. FAR 30.603-2 addresses two types of cost accounting changes, unilateral and desirable changes. Under a unilateral change, contractors may not charge the Government for any increased costs caused by the change. Under a desirable change, the contractor may charge the Government for any increased costs due to the change. According to FAR 30.603-2(b)(3), some of the factors that the contracting officer should consider in determining if a change is desirable include, but are not limited to, whether:

> *"(i) The contractor must change the cost accounting practices it uses for Government contract and subcontract costing purposes to remain in compliance with the provisions of Part 31;*
>
> *(ii) The contractor is initiating management actions directly associated with the change that will result in cost savings for segments with CAS-covered contracts and subcontracts over a period for which forward pricing rates are developed or 5 years, whichever is shorter, and the cost savings are reflected in the forward pricing rates; and*
>
> *(iii) Funds are available if the determination would necessitate an upward adjustment of contract cost or price.*

[3] An overhead pool includes indirect costs (costs that cannot be charged to a contract on an individual basis) that are incurred for or that only benefit an identifiable unit or activity of the contractor internal organization such as an engineering or manufacturing department.

DCAA Audit Report. In Audit Report No. 3311-2004K19500001, March 8, 2005, DCAA reported that the contractor's cost accounting change is a unilateral change and recommended that the contracting officer immediately recover the $1.1 million in increased costs on Government contracts in accordance with FAR 52.230-2(a)(4)(ii).

DCMA Houston Contracting Officer Determination. The contracting officer did not uphold the DCAA findings and recommendations. The contracting officer determined that the cost accounting practice change was desirable and reimbursed the contractor for the $1.1 million in increased costs. However, the contract file does not include adequate rationale in support of the contracting officer determination or any evidence that the contracting officer had considered the factors for determining if a change is desirable under FAR 30.603-2(b)(3). In fact, our review of the contract file did not disclose any evidence that the change met the factors outlined in the FAR. For example, the contract file did not include any evidence that the change was required for the contractor to remain in compliance with FAR Part 31, or that it would result in cost savings to the Government.

In addition, the contracting officer did not comply with DoD Directive 7640.2, Paragraph 6.5.1., which required that contracting officers prepare a memorandum that includes the underlying rationale for such dispositions. As a result, the contracting officer may have improperly reimbursed $1.1 million for a cost accounting change that did not qualify as a desirable change.

In the case of both the self-insurance credit and the cost accounting change, the DCMA Houston contracting officers did not seek expert advice from individuals having the requisite training and experience to properly analyze the facts and provide appropriate recommendations. DCMA has not developed a program whereby contracting officers can obtain advice on complex noncompliance issues such as these to help ensure that the contracting officer's actions are sound. DCMA needs to develop such a program to ensure that the Government's interests are protected when contracting officers do not possess the necessary training and experience.

Recommendations and Management Comments

Recommendation A.1. **We recommend that the Director, Defense Contract Management Agency develop a program whereby contracting officers may seek advice and assistance from qualified personnel within the Agency on potential noncompliances with the Federal Acquisition Regulation or cost accounting standards.**

Management Comments. The DCMA Executive Director concurred. DCMA issued a policy change notice requiring contract management Board of Reviews on specified actions based on dollar thresholds, or high risk, controversial, or precedent setting items. Second, DCMA reorganized to create a separate Contracts Directorate and functionally

align the contracting workforce. According to DCMA, this will result in greater access to functional expertise residing within the management chain of command.

Recommendation A.2. **We recommend that the Commander, Defense Contract Management Agency Phoenix implement a quality assurance procedure which ensures that contracting officers adequately document the rationale and obtain applicable approvals for their actions on audit reports prior to issuing the determination.**

Management Comments. The DCMA Executive Director concurred. DCMA Phoenix stated it would implement an internal review process to address the recommendation by March 31, 2009.

B. Accounting System Determination Not Supported

A DCMA Houston contracting officer did not adequately justify his actions on a DCAA audit report that outlined significant accounting system deficiencies. The contracting officer failed to recognize the significance of some of the DCAA-reported deficiencies and relied on the contractor's new and untested procedures as his basis for resolving them. As a result, the DoD contracting components that conduct business with this contractor are not making informed decisions to account for the existence of these deficiencies.

DoD Regulation on Contractor Accounting Systems. Defense Federal Acquisition Regulation Supplement (DFARS) Subpart 242.75, *Contractor Accounting Systems and Related Internal Controls*, provides policy for contractor accounting systems and procedures for following up on audit reports identifying significant accounting system or related internal control deficiencies.

DCAA Audit Report. In Audit Report No. 3311-2006K11070001, November 1, 2006, DCAA outlined six significant deficiencies with a contractor's accounting system and related internal controls. Three of the major deficiencies involved the following areas:

- *Cost Transfers*. The contractor did not have adequate procedures covering cost transfers between contracts, nor did they maintain sufficient documentation to demonstrate the reason for the transfer. The contractor made 36,000 cost transfers involving $424 million in contract costs during the first 6 months of 2006.

- *Monitoring and Management Oversight*. The contractor did not have procedures requiring periodic management reviews or provide any evidence that the contractor had conducted management reviews of the accounting system and related internal controls. According to DCAA, the lack of such procedures contributed to the mischarging or misallocations of $320 million on Government contracts between 2002 and 2004.

- *Unallowable Costs*. The contractor had not developed acceptable and reliable written policies and procedures for identifying and excluding unallowable costs from the contractor's annual incurred cost claim. For example, the inadequate procedures contributed to the contractor's failure to exclude millions of dollars in unallowable costs, including $10 million in unallowable executive compensation costs for 2000 through 2003.

Based on these and other deficiencies, DCAA reported that the contractor's overall accounting system and related internal controls were "inadequate in part" and recommended several changes to the contractor's procedures and controls.

DCMA Houston Contracting Officer Determination. Despite the significant DCAA-reported deficiencies, the contracting officer maintained his "adequate" opinion of the accounting system. The contracting officer's September 6, 2007 memorandum does not provide sufficient rationale for maintaining the adequacy of the accounting system or for resolving the DCAA-reported deficiencies. Discussed below is a summary of the contracting officer's rationale for resolving the three major reported deficiencies and our review results.

- *Cost transfers*. The contracting officer resolved the deficiency by stating that his primary concern was with the "quality" of the transfer description and supporting documentation, not the volume of transfers (36,000 cost transfers in 6-months involving $424 million). The contracting officer also stated that the contractor revised its procedures to require more detailed transaction descriptions and supporting documentation of transfers.

We disagree with the contracting officer's decision not to consider the volume of transfers as an important factor in his determination. As explained in the DCAA audit report, the volume of transfers in this case (36,000 over a 6-month period) is a strong indicator that the contractor does not have adequate controls to ensure proper recording of Government contract costs. DFARS 242.7501 emphasizes that contractors "shall maintain an accounting system and related internal controls which provide reasonable assurance that-….risk of misallocations and mischarges are *minimized*." (emphasis added) Each of the 36,000 transfers represented the reversal of an error, and the volume clearly demonstrates that the contractor did not have adequate controls to prevent most errors before they occur. In addition, the contracting officer did not wait for DCAA's review and testing of the revised procedures before resolving the deficiency.

- *Monitoring and Management Oversight*. The contracting officer resolved this deficiency (which contributed to mischarging or misallocations of $320 million over a 3-year period) by stating in part "Although (the contractor) has not provided internal audits to the Government, this is not a contractual requirement." The contracting officer also justified his determination based on the contractor's submission of revised procedures and the contractor's assertion that it had subjected the system to external audits in accordance with the Sarbanes-Oxley Act[4].

Defense Federal Acquisition Regulation Supplement 203.7001(a) recognizes the importance of management reviews wherein it states "A contractor's system of management controls should provide for….(4) Internal and/or external audits, as appropriate." In addition, the contracting officer did not obtain evidence to substantiate the contractor's assertion that it had actually performed audits in response to the Sarbanes-Oxley Act. Furthermore, the contracting officer did not take into account that audits performed in response to Sarbanes-Oxley focus on the effectiveness of the

[4] The Sarbanes-Oxley Act of 2002 introduced major changes to the regulation of corporate governance and financial practice. Section 404 of the act requires management and the external auditor to report on the adequacy of the company's internal control over financial reporting.

company's controls over financial reporting, not on those controls which ensure the allowability of claimed Government contract costs. Therefore, these audits may not have provided a sufficient basis for establishing the adequacy of the contractor's accounting controls over Government contracts. Finally, the contracting officer did not obtain a DCAA opinion on the adequacy of the revised procedures before resolving the deficiency.

- *Unallowable Costs*. The contracting officer resolved the deficiency based on the contractor's implementation of new procedures for identifying and excluding unallowable costs. We disagree with the contracting officer's resolution of this deficiency because DCAA had not reviewed or tested the procedures to ensure they were effective in excluding unallowable costs.

Since the contracting officer resolved the deficiencies and rendered the system adequate, the contracting officer did not advise the affected DoD contracting components of these deficiencies. As of August 8, 2008, eight months after the contracting officer resolved the deficiencies, the contractor had still not adequately corrected two of them–cost transfers and monitoring and management oversight–according to DCAA. DCAA anticipated issuing a follow-up report on the accounting system deficiencies by July 31, 2009. The Government remains at risk for these deficiencies until they are fully corrected and tested. The contracting officer should have notified the DoD contracting commands on the status of the deficiencies to ensure that the DoD contracting commands make informed decisions regarding future business with this contractor.

Recommendations and Management Comments

Recommendation B. **Upon receipt of the Defense Contract Audit Agency follow-up report on the accounting system, we recommend that the Commander, DCMA Phoenix, direct the contracting officer to:**

1. **Take action on the report in accordance with Defense Federal Acquisition Regulation Supplement 242.7502 and prepare a determination memorandum that includes adequate rationale for the action.**

   Management Comments. The DCMA Executive Director concurred. In addition, DCMA now requires a Board of Review for any contracting officer rejection of an auditor recommendation to disapprove or withdraw approval of a business system.

2. **Advise DoD contracting components of any significant deficiencies that the contractor has not corrected.**

   Management Comments. The DCMA Executive Director concurred.

3. **Provide a copy of the determination memorandum referred to in Recommendation B.1 to the Defense Contract Audit Agency and the Office of the Assistant Inspector General for Audit Policy and Oversight.**

   Management Comments. The DCMA Executive Director concurred.

C. Need for Better Coordination on Estimating System Reviews at DCMA Philadelphia

The DCMA Philadelphia contracting officer failed to consult with DCAA as DFARS 215.407-5 requires before she took final action on DCAA-reported estimating system deficiencies. By not consulting with DCAA and working as a team, the contracting officer put the Government at risk of misunderstanding the significance of the reported findings and not taking actions necessary to protect the Government's interests.

DoD Procedures for Conducting and Dispositioning Contractor Estimating System Reviews. DFARS Procedures Guidance and Information (PGI) 215.407-5-70, *Disclosure, maintenance, and review requirements,* outlines the responsibilities and procedures for conducting contractor estimating system reviews and dispositioning estimating system reports. It states that the contract auditor (DCAA) and the contract administration activities (DCMA) shall conduct estimating system reviews as a team effort.

DCAA Estimating System Report. In Audit Report No. 6501-2007B24010001, DCAA reported the estimating system as "inadequate in part" based on two deficiencies that DCAA believed were significant. The deficiencies included:

- proposal files not being maintained in accordance with the contractor's estimating manual; and

- complete proposal packages and support not being available for audit.

DCAA had previously reported the same deficiencies in two prior audit reports (Audit Report Numbers 6501-2004B24010001 and 6501-2006B24010001).

DCMA Philadelphia Contracting Officer Determination. The contracting officer did not uphold the DCAA position. In an October 22, 2007 letter to the contractor, the contracting officer determined that the reported deficiencies did not meet the criteria of a significant estimating system deficiency set forth in DFARS 215.407-5-70(a)(4). The contracting officer based her determination on an independent review conducted by a DCMA price analyst who reviewed some of the same proposals that DCAA had tested. Prior to issuing her determination, the contracting officer did not consult with DCAA on her review of the contractor response to the DCAA report, discuss any concerns she had with the significance of the DCAA-reported deficiencies, or coordinate with DCAA on the price analyst's review. DCMA did not even include DCAA on distribution for a copy of the contracting officer determination as DFARS PGI 215.407-5-70(f)(4) requires.

The contracting officer's failure to consult with DCAA prior to making her determination was inconsistent with the DFARS PGI requirement to conduct estimating system reviews

as a team effort. The contracting officer's actions also violated DFARS PGI 215.407-5-70(f)(3) which states:

> "The ACO, *in consultation with the auditor*, will evaluate the contractor's response to determine whether-
>
> (i) The estimating system contains deficiencies that need correction;
> (ii) The deficiencies are significant estimating deficiencies that would result in disapproval of all or a portion of the contractor's estimating system; or
> (iii) The contractor's proposed corrective actions are adequate to eliminate the deficiency." (emphasis added)

The contracting officer's failure to consult with DCAA put the Government at risk of misunderstanding the reported findings and not taking action to protect the Government's interests for potentially significant deficiencies. Consulting with DCAA and working as a team will help to ensure a consensus for identifying significant deficiencies and taking timely action to correct them.

Recommendation and Management Comments

Recommendation C. **We recommend that the Commander, Defense Contract Management Agency Philadelphia implement quality assurance procedures for ensuring that the contracting officer works with the auditor as a team on future estimating system reviews and consults with the auditor in evaluating the contractor response in accordance with DFARS 215.407-5-70.**

Management Comments. The DCMA Executive Director concurred. DCMA Philadelphia established an Internal Review Process requiring pre-negotiation and post negotiation review by a contracting supervisor. The supervisor will ensure that the contracting officer consults with the auditors when evaluating the contractor's response. Additionally, the supervisor will ensure that the contracting officer documents the actions in accordance with DoD Instruction 7640.02. In March 2008, senior DCMA Philadelphia leadership also began holding quarterly meetings with senior DCAA regional leadership to discuss the status of all outstanding reportable audits, including estimating system audits.

D. Failure to Process CAS Noncompliances in Accordance with FAR 30.605

DCMA Philadelphia and Houston contracting officers did not process CAS noncompliance audit reports in accordance with FAR 30.605 *Processing Noncompliances*. As a result, the Government risks paying increased costs on CAS-covered contracts and wastes Government resources by prolonging the noncompliance resolution process.

Requirements for Processing Noncompliances. FAR Subpart 30.605, *Processing Noncompliances*, outlines the required contracting officer actions for evaluating and processing a reported CAS noncompliance. For example, the contracting officer must:

- Issue a notice of potential noncompliance to the contractor (or disagree with the auditor's allegation) within 15 days after receiving the report [FAR 30.605(b)(1)];

- Obtain the contractor's response to the noncompliance report within 60 days after issuing the notice of potential noncompliance [FAR 30.605(b)(2)], and

- Evaluate the contractor's response and make a determination of compliance or noncompliance. (FAR 30.605(b)(3)).

DCMA Noncompliance Processing. Our review of contracting officer actions on 22 CAS noncompliance reports identified 17 reports that disclosed significant contracting officer delays in evaluating and processing DCAA-reported CAS noncompliances. Our review revealed the following (See Appendix B for details):

- In 12 cases, contracting officers failed to issue the notice of potential noncompliance within the 15-day requirement, instead taking an average of 137 days.

- In 13 cases, contracting officers did not obtain contractor responses within the 60-day requirement or take aggressive steps to obtain the responses once they were overdue. Even though contracting officers have taken 406 days (approximately 14 months) on average as of April 30, 2008 to obtain the contractor responses, contracting officers have only obtained 6 of the 13 responses.

- In 8 cases, contracting officers have taken 454 days (approximately 14 months) on average as of April 30, 2008 to decide whether a noncompliance exists in accordance with FAR 30.605(b)(3). In 2 of the 8 cases, contracting officers had as of April 30, 2008 not determined whether a noncompliance existed.

Overall, CAS noncompliance reports assigned to the DCMA Philadelphia and Houston offices have been open an average of 685 days (nearly 2 years) since DCAA issued the report (See Appendix B). The failure of these contracting officers to take timely and effective actions in response to CAS noncompliance reports have caused significant delays in correcting any potentially noncompliant practices and has delayed the recovery of any increased costs due to the Government. In addition, resolution of CAS noncompliance reports becomes more difficult over time since individuals having a detailed understanding of the issues may transfer or retire, or the records may become lost.

Recommendations and Management Comments

Recommendation D.1. **We recommend that the Commanders, Defense Contract Management Agency Maryland and Phoenix direct contracting officers to take immediate action on the overage cost accounting standard noncompliance reports transferred from Defense Contract Management Agency Philadelphia in accordance with Federal Acquisition Regulation 30.605, *Processing Noncompliances*.**

Management Comments. The DCMA Executive Director concurred. As of November 25, 2008, DCMA has completed final action on six of the seventeen overage reports. In addition, DCMA is providing training with specific emphasis on FAR 30.605, assigning resources to address the noncompliances as quickly as possible, holding weekly status meetings, and conducting oversight of the FAR mandated response dates. The Executive Director of Contracts will review the status of overage audits each quarter. By March 31, 2009, DCMA planned to establish an Agency-wide performance objective requiring timely and effective processing of reportable audits.

Recommendation D.2. **We recommend that the Commander, Defense Contract Management Agency Philadelphia establish a quality assurance measure that ensures contracting officer compliance with Federal Acquisition Regulation 30.605, *Processing Noncompliances*.**

Management Comments. The DCMA Executive Director concurred. DCMA Philadelphia has designated a monitor to ensure that CAFU data is accurate, complete, and compliant with the FAR 30.605. The monitor will report all instances where contracting officers are not meeting deadlines to DCMA leadership so appropriate attention can be devoted to the problem. In addition, DCMA Philadelphia will add performance goals and objectives for processing and monitoring noncompliances in accordance with FAR 30.605.

E. Inaccurate Contract Audit Follow-up Data

The DCMA Houston, Philadelphia, and Virginia offices do not maintain accurate records of reportable contract audit reports in the contract audit follow up (CAFU) system. As a result, the CAFU data that these offices reported to the DoD IG during the semiannual periods ending September 30, 2006 through September 30, 2007 were not reliable and DCMA management, the DoD Inspector General, and Congress did not have accurate information on contracting officer actions taken in response to contract audit reports.

Data Accuracy Requirements. DoD Directive 7640.2 included the following requirements:

- Paragraph 6.3 required the maintenance of accurate and complete information regarding the status of reportable audit reports from the time reports are received through final disposition; and
- Paragraph 6.3.4 required that DoD Components submit semiannual reports on the status of reportable contract audits to the DoD IG. It identified the types of audits that are reportable, such as reports on CAS noncompliances and internal control systems with findings and recommendations.

Data Errors. Our review of the CAFU records for CAS noncompliance and internal control systems reports assigned to the DCMA Houston, Philadelphia, and Virginia offices disclosed:

- 7 audits missing from the semiannual reporting of CAFU data, including 6 at DCMA Virginia and 1 at DCMA Houston (see Appendix C);
- 8 records with incorrect resolution dates (see Appendix D);
- 10 records with inaccurate disposition dates (see Appendix E); and
- 3 records with incorrect status of actions taken (see Appendix F).

The 6 missing audits at DCMA Virginia resulted from DCMA's misunderstanding about whether reports issued by the DCAA Field Detachment office had to be included in the semiannual reporting of CAFU data (The DCAA Field Detachment office provides audit services on classified programs). Most of the remaining errors resulted from DCMA contracting officers failing to verify the accuracy of the data that DCAA entered in the CAFU automated system.

Recommendations, Management Comments, and DoD IG Response

Recommendation E.1. **We recommend that the Commander, Defense Contract Management Agency Phoenix and the Director, Defense Contract Management**

Agency Virginia direct the contracting officers to add the seven audits missing from the contract audit data and report the status of the contracting officer's actions in accordance with DoD Instruction 7640.02.

Management Comments. The DCMA Executive Director partially concurred. DCMA did not agree that it should manually enter audit information received from the DCAA Field Detachment into the CAFU automated system. The DCMA Executive Director believes that the manual entry of DCAA Field Detachment reports could lead to compromise of secure information.

DCMA recommends that DCAA Field Detachment enter all unclassified reportable audits into the DCAA Management Information System that feeds the CAFU automated system. DCMA believes that DCAA Field Detachment is in the best position to decide which audit reports are releasable.

DCMA agreed to add any other missing audits not from DCAA Field detachment into the CAFU automated system, including the one missing audit at DCMA Phoenix.

DoD IG Response. We request that the DCMA Executive Director reconsider his position not to add the six reportable DCAA Field Detachment audits in the CAFU system. DoD Instruction 7640.02 requires that DCMA maintain accurate and timely records on the status of reportable audits and report on their status semiannually to the DoD IG.

DCMA has not demonstrated that a valid security concern exists with respect to the manual entry of DCAA Field Detachment reports. Because the six missing audit reports at DCMA Virginia are unclassified, adding them in the CAFU system and reporting their status to the DoD IG would not result in the compromise of secure information. Nevertheless, the DoD Instruction 7640.02 reporting requirements apply to all reportable audits regardless of security classification. DCMA, as well as all other DoD Components, should have the necessary controls in place to prevent the release of classified information as part of the CAFU reporting process. If entering the reportable audits into the automated CAFU system is a concern, DCMA has the option of instead providing the status of DCAA Field Detachment reportable audits directly to the DoD IG in accordance with Enclosure 3, Paragraph 1.b.(1)(d) of DoD Instruction 7640.02. However, DCMA does not have the option of simply excluding them in the DCMA semiannual reporting to the DoD IG.

We disagree with the DCMA recommendation that DCAA Field Detachment enter its reportable audits into the DCAA Management Information System. DoD Instruction 7640.02 does mandate the use of the DCAA Management Information System. Rather than use the DCAA Management Information System, DCAA Field Detachment prepares an Excel workbook listing of reportable audits as an added security measure to ensure that the listing does not contain any classified or sensitive information. This procedure satisfies the requirement in Enclosure 3, Paragraph 1.b.(2)(a) of DoD Instruction 7640.02,

requiring DCAA to provide a listing of reportable audits on a monthly basis. Therefore, we request that the DCMA Acting Director provide revised comments by May 8, 2009.

We verified that DCMA added the one missing audit at DCMA-Phoenix into the CAFU automated system.

Recommendation E.2. We recommend that the Commanders, Defense Contract Management Agency, Phoenix and Philadelphia, and the Director, Defense Contract Management Agency Virginia, establish and implement quality assurance processes to ensure the accuracy of the data reported in the contract audit follow-up system.

Management Comments. The DCMA Executive Director concurred. DCMA Phoenix and Philadelphia appointed a CAFU monitor who performs monthly reviews of CAFU data. DCMA Virginia updated its quality assurance plan in September 2008 and will implement the plan at the other two sites. DCMA anticipates completing the implementation by May 30, 2009. Additionally, the DCMA Mission Review Team will focus on CAFU practices and compliance with DoD Instruction 7640.02 during FY 2009 site reviews.

F. Untimely Resolution and Disposition

Contracting officers did not complete their actions on 8 audits at DCMA Houston and 14 audits at DCMA Philadelphia within the timeframes required by DoD Directive 7640.2. Timely resolution and disposition of DCAA audit reports are critical for ensuring that the Government promptly recoups reported unallowable costs, improves contractor control systems, and corrects cost accounting practices that do not comply with the cost accounting standards.

Timeliness Requirement. DoD Directive 7640.2 required the resolution of contract audit reports within 6 months and the disposition of contract audits within 12 months. Resolution of an audit report takes place when the contracting officer prepares a written action for responding to the reported findings. Disposition generally occurs when the contracting officer reaches a settlement with the contractor on the reported findings or issues a final decision under the Disputes Clause.

Untimely Resolution. At DCMA Houston, contracting officers exceeded the 6-month resolution requirement in 7 of 13 reports we reviewed. At DCMA Philadelphia, contracting officers exceeded the 6-month resolution requirement in 2 of 20 reports we reviewed. None of the contract files for these audits included adequate justification for exceeding the 6-month requirement. (See Appendix G for a listing of audit reports that exceeded the 6-month requirement.)

Untimely Disposition. At DCMA Houston, contracting officers did not complete the disposition of 6 out of 13 audit reports within the required 12 months, including the 5 audit reports that exceeded the 6-month resolution requirement and 1 additional report. At DCMA Philadelphia, contracting officers did not complete the disposition of 14 of 20 audit reports within the required 12 months, including the 2 audit reports that exceeded the 6-month resolution requirement and 12 additional reports. The contract files did not include a valid justification for exceeding the 12-month disposition requirement. Appendix G shows the list of contract audit reports that exceeded the 12-month requirement.

Lack of Management Controls. Management processes and procedures (internal controls) provide reasonable assurance that what needs to happen does happen. In our January 16, 2008 memorandum to the Commander DCMA Philadelphia, we noted that one of the DCMA Philadelphia contracting officers had a backlog of 39 audit reports that were awaiting action and exceeded the resolution and disposition timeframes by an average of 20 months.

The backlog resulted from DCMA Philadelphia management's failure to implement adequate internal controls for monitoring the effectiveness of the CAFU function. Had DCMA Philadelphia management prioritized and adequately monitored its CAFU function, they would have recognized the need to dedicate additional resources for

reducing the backlog. We noted that the DCMA Philadelphia contracting officer had an excessive workload involving multiple major defense contractors and billions of dollars in Government business. In 2007, the DCMA Philadelphia contracting officer position was vacant for two months and had experienced frequent personnel turnover. Since January 2008, DCMA Philadelphia has made some efforts to reduce the backlog which are reflected in this report. In addition, DCMA's decision to transfer some of the workload to DCMA Maryland should help to focus more resources on the CAFU function at DCMA Philadelphia.

DCMA Houston lacks management controls for ensuring an effective CAFU program. In addition to the significant number of overage audits, we found that DCMA Houston does not have quality assurance procedures covering CAFU and has not subjected its CAFU function to any periodic internal/management reviews of the DCMA Phoenix CAFU function since 2001. DoD Directive 7640.2, paragraph 5.2.3, required that the Component perform periodic evaluations of the contract audit follow-up process to ensure that it is working effectively.

OMB Circular No. A-123, "Management's Responsibility for Internal Control", December 21, 2004 also states: "Continuous monitoring and testing should help to identify poorly designed or ineffective controls and should be reported upon periodically." OMB Circular No. A-123 further states:

> *Monitoring the effectiveness of internal control should occur in the normal course of business. In addition, periodic reviews, reconciliations, or comparisons of data should be included as part of the regular assigned duties of personnel. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations.*

The lack of management attention and oversight of the CAFU function at DCMA Philadelphia and DCMA Houston contributed to the untimely resolution and disposition actions and other CAFU weaknesses cited in this report. When management appropriately identifies the CAFU function as a key process, the resolution and disposition of audit issues are more visible, they are trackable, and they receive higher priority.

Recommendations and Management Comments

Recommendation F. **We recommend that the Commanders, Defense Contract Management Agency Philadelphia and Phoenix establish quality assurance procedures requiring contracting officers and their staff to:**

1. **Resolve and complete the disposition of contract audit reports within the required timeframes or include written justification in the contract file for any resolutions or dispositions that occur beyond the specified timeframes.**

Management Comments. The DCMA Executive Director concurred. DCMA will establish a plan for implementing the recommendation by April 30, 2009. In addition, DCMA planned to establish an Agency-wide performance objective by March 31, 2009, which will include an objective requiring timely and effective processing of reportable audits.

2. **Make the contract audit follow-up function a regular part of the Management Control Review program to measure success in improving actions on audit findings and recommendations.**

   Management Comments. The DCMA Executive Director concurred. DCMA Philadelphia and Phoenix will implement the recommendation by June 30, 2009.

3. **Perform a management control review of the contract audit follow-up function in FY 2009.**

   Management Comments. The DCMA Executive Director concurred. DCMA will perform management control reviews at DCMA Philadelphia and Phoenix by September 30, 2009.

G. Contract Audit Follow-Up Not Addressed in Performance Appraisal

DCMA Houston is not evaluating one of its contracting officers on his actions to effectively and timely complete the disposition of contract audit reports. In accordance with DoD Directive 7640.2, DCMA Houston was required to establish employee performance measures related to contract audit follow-up that recognize and emphasize the significance of the actions taken on contract audit findings.

DoD Directive Requirement. DoD Directive 7640.2, paragraph 5.2.4, required DoD Components to "ensure that performance appraisals of appropriate acquisition officials reflect their effectiveness in resolving and dispositioning audit findings and recommendations in a timely manner, while fully protecting the Government's interests."

DCMA Houston Performance Appraisals. We reviewed the performance appraisals of DCMA contracting officials responsible for contract audit follow-up action. The performance appraisal for one of two contracting officials at DCMA Houston did not adequately address the employee's effectiveness in contract audit follow-up as DoD Directive 7640.2 required. DCMA management must hold contracting officers accountable for their actions taken to resolve contract audit reports.

Recommendation and Management Comments

Recommendation G. **We recommend that the Commander, Defense Contract Management Agency Phoenix revise the performance appraisal of the Defense Contract Management Agency Houston contracting officer to measure his performance in resolving and completing the disposition of contract audit reports in accordance with DoD Directive 7640.2, paragraph 5.2.4.**

Management Comments. The DCMA Executive Director concurred. DCMA is developing an agency-wide job objective for CAFU that it planned to implement by March 31, 2009.

Appendix A. Scope and Methodology

We evaluated the actions that the DCMA Houston, Philadelphia, and Virginia offices took on 39 audit reports addressing potential cost accounting standard (CAS) noncompliances and internal control systems inadequacies. The table below depicts the number of audit reports we selected by office and audit report type.

Table: Number of Audit Reports Selected for Review

DCMA Office	Type of Audit Report		Total Reports
	CAS Noncompliances	Internal Control Systems	
Houston	6	7	13
Philadelphia	14	6	20
Virginia	2	4	6
Total	22	17	39

We selected these audits from the semiannual reporting periods September 30, 2006 through September 30, 2007. We reviewed the 39 audits to determine whether:

- contracting officer actions on DCAA-reported CAS noncompliances and internal control system recommendations complied with the FAR, DoD Directive 7640.2, and other applicable statutes, regulations, and DoD policy;
- contracting officials effectively completed the disposition of all significant audit findings and included sound rationale in the contract file for not upholding DCAA-reported CAS noncompliances and internal control system recommendations;
- audit reports were resolved and their disposition completed within the required timeframes (6 months for resolution and 12 months for disposition) and, if not, whether any delays were justified and documented in the contract file;
- CAFU system data were accurate;
- periodic evaluations of the CAFU program were conducted to ascertain CAFU program effectiveness; and
- contracting officials were evaluated on their effectiveness in timely resolving and completing the disposition of audit findings.

We performed this review from November 2007 through September 2008.

Use of Computer-Processed Data. DCMA uses a Web-based CAFU database to maintain and report the status of contract audit reports. We did not rely on the computer-processed data generated by the CAFU database. We traced the semiannual report data from the CAFU database to source documents.

Prior Coverage. In the last 5 years, we issued four other reports related to DCMA actions on DCAA audit reports.

- DoD IG Report No. D-2007-6-010, "Reimbursement of Settlement Costs at Defense Contract Management Agency Melbourne," September 28, 2007

- DoD IG Report No. D-2007-6-009, "Actions on Reportable Contract Audit Reports by the Defense Contract Management Agency's Northrop Grumman El Segundo Office," September 28, 2007

- DoD IG Report No. D-2007-6-004, "Defense Contract Management Agency Virginia's Actions on Incurred Cost Audit Reports," April 20, 2007

- DoD IG Report No. D-2005-6-003, "Defense Contract Management Agency Santa Ana Office's Actions on Incurred Cost Audits," March 17, 2005

Appendix B: Days Taken to Process CAS Noncompliances

Audit Report No.	Audit Report Date	Number of Days Between Audit Report and Issuance of Initial Notice (Note 1)	Number of Days Between Initial Notice and Contractor Response (Note 2)	Number of Days Between Contractor Response and Compliance Determination (Note 3)	Total Number of Days Since Audit Report
		(As of April 30, 2008)			
DCMA Philadelphia					
6501-2003B19200008	9/26/2003	12	61	44	117
6501-2004B19200005	10/8/2004	25	30	739	794
6501-2005B19200001	12/29/2004	5	672	140	817
6501-2005B19200002	6/28/2005	28	1,009*	--	1,037
6501-2005B19200003	6/28/2005	29	1,008*	--	1,037
6501-2005B19200004	6/28/2005	29	1,008*	--	1,037
6501-2006B19200001	8/18/2006	4	258	350	612
6501-2006B19200002	9/26/2006	9	573*	--	582
6501-2006B19200003	9/26/2006	9	573*	--	582
6501-2007B19200001	3/27/2007	66	116	218*	400
6501-2007B19200003	3/27/2007	294	106*	--	400
6501-2007D19200001	8/3/2007	165	106*		271
6501-2007D19200002	8/13/2007	155	106*	--	261
Subtotal Average		64	433	298	611
DCMA Houston					
3311-2004K19200001	8/6/2004	18	--	1,164	1,182
3311-2004K19200003	11/9/2004	265	63	940*	1,268
3311-2006K19200001	4/2/2006	759*	--	--	759
3311-2006K19200003	3/24/2006	458	--	35	493
Subtotal Average		375	63	713	926
Total Average		**137**	**406**	**454**	**685**

*The contracting officer did not complete these actions as of April 30, 2008.
Notes:

1. This column represents the days elapsed between the audit report date and issuance of the notice of potential compliance required by FAR 30.605(b)(1) (or until April 30, 2008 if the contracting officer has not issued the notice). FAR 30.605(b)(1) requires that the contracting officer issue a notice of potential noncompliance to the contractor within 15 days after receiving the audit report. In 12 cases, contracting officers did not issue the notice within the 15-day requirement. Contracting officers took 137 days on average report to issue the notice of potential noncompliance. Regarding Audit Report No. 3311-2006K19200001, the contracting officer had not yet issued the notice of potential noncompliance even though the contracting officer received the audit report 759 days ago (approximately 2 years).

2. This column represents the days elapsed between issuance of the 15-day notice and receipt of the contractor response (or until April 30, 2008 if the contracting officer has not received the response). FAR 30.605(b)(2) requires that the contracting officer obtain the response within 60 days. In 13 cases, contracting officers did not obtain the contractor response within the 60-day requirement. Contracting officers took 406 days on average (over 1 year) after issuing the notice of potential noncompliance to obtain contractor responses to the reported potential noncompliances. However, contracting officers had still not obtained contractor responses for 8 audit reports indicated with an "*" after the number of days in this column.

3. This column represents the days elapsed from receipt of the contractor response until the contracting officer makes a compliance determination in accordance with FAR 30.605(b)(3) (or until April 30, 2008 if the contracting officer has not yet made a determination). In eight cases, contracting officers expended 454 days (over 1 year and 3 months) on average thus far to decide whether a noncompliance exists. In 2 of the 8 cases, contracting officers had still not made a noncompliance determination (audit reports indicated with an “*” after the number of days in this column).

Appendix C. Reportable Audits Not Being Reported

Audit Report Number	Audit Report Date
DCMA Virginia	
97112005E13010002	03/21/2006
97112007E13010001	09/27/07
97112004E14980006	03/15/2007
97112006E19200001	03/26/2007
97112006E19200002	03/26/2007
97112006E24090001	04/30/2007
DCMA Houston	
3311-2006K11010001	12/1/2006

Note: DCMA did not include these reportable audits in the semiannual data reported to the DoD IG. All of the audits assigned to DCMA Virginia involve audits issued by a DCAA Field Detachment office. DCMA mistakenly thought that it was not required to include any audits issued by DCMA Field Detachment in its semiannual reporting to the DoD IG.

Appendix D. Reported Resolution Date Inaccuracies

Audit Report Number	Actual Resolution Date	Resolution Date Reported in CAFU* System	Note
DCMA Houston			
2131-2004F10503001	5/13/2005	4/4/2006	1
3311-2005B24090001	2/15/2008	3/9/2006	1
3311-2005K12030001	10/3/2006	6/16/2008	1
3311-2005B11010001	--	9/28/2007	2
3321-2006K11070001	9/6/2007	9/28/2007	1
6331-2005N13020001	4/10/2007	7/18/2007	3
3321-2005K19500001	11/1/2007	4/10/2007	3
3311-2004K19200003	8/1/2005	7/18/2005	1

Notes:

1. The contracting officer inaccurately reported the resolution date in the CAFU system as evidenced by the date of pre-negotiation memorandum included in the DCMA contract file.

2. The contracting officer should not have reported these audits as resolved since the contracting officer had not completed the resolution action.

3. Although the contracting officers reached resolution on these audits, they failed to enter the resolution date in the CAFU system.

*Contract Audit Follow-up

Appendix E. Reported Disposition Date Inaccuracies

Audit Report Number	Actual Date of Disposition	Date Reported by DCMA in CAFU* System	Note
DCMA Philadelphia			
6501-2004B24010001	5/24/2005	2/15/2006	1
6501-2005B11070001	--	4/04/2006	2
DCMA Houston			
2131-2004F10503001	5/13/2005	4/4/2006	1
3311-2005B24090001	2/19/2008	3/10/2006	1
3311-2005K12030001	10/3/2006	6/16/2008	1
3311-2005B11010001	--	9/28/2007	2
3321-2006K11070001	9/6/2007	--	3
6331-2005N13020001	4/10/2007	--	3
3321-2005K19500001	11/1/2007	5/08/2008	1
3311-2004K19500001	10/3/2007	12/13/2007	1

Notes:

1. The contracting officer inaccurately reported the disposition date in the CAFU system as evidenced by the post-negotiation memorandum date.

2. The DCMA contract file did not include a post-negotiation memorandum that supports the disposition date entered in the CAFU system. Therefore, the contracting officer should not have entered a disposition date for these reports.

3. Although the contracting officers took final action on these reports, they did not enter the disposition dates in the CAFU system.

*Contract Audit Follow-up

Appendix F. Reported Status Inaccuracies

Audit Report Number	Actual Status of Audit	Status Reported in CAFU* System	Note
DCMA Philadelphia			
6501-2005B11070001	Resolved	Dispositioned	1
DCMA Houston			
3311-2005K12030001	Dispositioned	Unresolved	2
3321-2005K19500001	Dispositioned	Resolved	2

Notes:

1. DCMA Philadelphia inaccurately reported the status of the audit as dispositioned. DCMA should report it as resolved because the contracting officer has only communicated his position to the contract and received their response.
2. DCMA Philadelphia inaccurately reported the status of these audits as unresolved or resolved. The contracting officer should have reported them as dispositioned since the contracting officer took final action.

*Contract Audit Follow-up

Appendix G. Untimely Resolution and Disposition

Audit Report Number	Audit Report Date	Number of Months Past 6-Month Resolution Rule	Number of Months Past 12-Month Disposition Rule
		(As of April 30, 2008)	
DCMA Houston			
3311-2005B24090001	9/29/2005	22	16
3321-2006K11070001	11/1/2006	5	--
6331-2005N13020001	8/21/2006	2	--
3311-2004K19200001	8/6/2004	--	27
3311-2004K19200003	11/9/2004	3	29
3311-2004K19500001	3/8/2005	25	19
3311–2006K19200001	4/2/2006	18	12
3311–2006K19200003	3/24/2006	10	4
DCMA Philadelphia			
65012003B19200008	9/26/2003	--	17
65012004B19200005	10/8/2004	--	14
65012005B19200001	12/28/2004	--	15
65012005B19200002	6/28/2005	--	22
65012005B19200003	6/28/2005	--	22
65012005B19200004	6/28/2005	--	22
65012006B19200001	8/18/2006	--	8
65012006B19200002	9/26/2006	--	7
65012006B19200003	9/26/2006	--	7
65012007B19200001	3/27/2007	--	1
65012007B19200003	3/28/2007	4	1
65012005B11070001	9/28/2005	--	19
65012005B13010001	1/9/2006	--	16
65012005B13020001	5/26/2005	1	23

Note: This is a listing of reports that exceeded the 6-month requirement for resolution and/or the 12-month requirement for disposition contained in DoD Directive 7640.2. The negotiation files for these reports did not include adequate justification for exceeding the 6 and 12-month requirements.

Defense Contract Management Agency Comments

DEFENSE CONTRACT MANAGEMENT AGENCY
6350 WALKER LANE, SUITE 300
ALEXANDRIA, VIRGINIA 22310-3226

IN REPLY REFER TO DCMA- AQ

NOV 25 2008

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDIT POLICY AND OVERSIGHT, DEPARTMENT OF DEFENSE

SUBJECT: Response to DODIG Draft Report on Defense Contract Management Agency Actions on Audits of Cost Accounting Standards and Internal Control Systems at DOD Contractors Involved in Iraq Reconstruction Activities (Project No. D2008-DIPOAI-0086.000)

This is our response to your September 30, 2008 memorandum requesting management comments with each finding and recommendation contained in the subject draft report. The following is provided as our comments:

For DoD IG Consideration Only - Redacted

Comments regarding Recommendations:

Recommendation A 1:
We recommend that the Director, Defense Contract Management Agency develop a program whereby contracting officers may seek advice and assistance from qualified personnel within the Agency on potential noncompliances with the FAR or cost accounting standards.

Response:
Concur. DCMA has taken two actions to address this recommendation. First, DCMA issued a policy change notice on November 12, 2008, (Attached) requiring contract management Board of Reviews on specified actions based on dollar thresholds or high risk, controversial, or precedent setting items. Contracting Officers may seek advice or assistance from these Boards of Reviews on issues involving the FAR or cost accounting standards. Second, DCMA has reorganized to create a separate Contracts Directorate throughout the Agency. DCMA Tasking Memorandum 08-137, dated January 2008, (Attached) directed the contracting workforce be aligned functionally, i.e., all contracting personnel will report to, and be directly supervised by, a person in the contracting career field. This will result in greater access to functional expertise residing within the management chain of command.

Recommendation A 2:
We recommend that the Commander, Defense Contract Management Agency Phoenix implement a quality assurance procedure which ensures that contracting officers adequately document the rationale and obtain applicable approvals for their actions on audit reports prior to issuing the determination.

Response:
Concur. DCMA Soldier Systems & CAP – Phoenix will implement an internal CMO Review Process to ensure that contracting officers adequately document the rationale and obtain applicable approvals for their actions on audit reports prior to issuing the determination by March 31, 2009.

Recommendation B 1:
Upon receipt of the Defense Contract Audit Agency follow-up report on the accounting system, we recommend that the Commander, DCMA Phoenix, direct the contracting officer to take action on the report in accordance with Defense Federal Acquisition Regulation Supplement 242.7502 and prepare a determination memorandum that includes adequate rationale for the action.

Response:
Concur. Upon receipt of the follow-up report, the ACO will take appropriate action in accordance with DFARS 242.7502 and prepare any required memorandum in accordance with the regulation. In addition, the new policy requires a Board of Review for any ACO rejection of a recommendation to disapprove or withdraw approval for any Business System.

Recommendation B 2:
Upon receipt of the Defense Contract Audit Agency follow-up report on the accounting system, we recommend that the Commander, DCMA Phoenix, direct the contracting officer to advise DoD contracting components of any significant deficiencies that the contractor has not corrected.

Response:
Concur: Upon receipt of the follow-up report, any accounting system deficiencies will be provided to the DoD contracting components.

Recommendation B 3:
Upon receipt of the Defense Contract Audit Agency follow-up report on the accounting system, we recommend that the Commander, DCMA Phoenix, direct the contracting officer to provide a copy of the determination memorandum referred to in Recommendation B.1 to the Defense Contract Audit Agency and the Office of the Assistant Inspector General for Audit Policy and Oversight.

Response:
Concur. Upon receipt of the follow-up report, the determination memorandum will be provided to DCAA and the Office of the Assistant Inspector General for Audit Policy and Oversight.

Recommendation C:
We recommend that the Commander, Defense Contract Management Agency Philadelphia implement quality assurance procedures for ensuring that the contracting officer works with the auditor as a team on future estimating system reviews and consults with the auditor in evaluating the contractor response in accordance with DFARS 215.407-5-70.

Response:
Concur. DCMA Philadelphia has established an Internal Review Process that requires pre-negotiation and post negotiation review by a contracting supervisor, a level above the contracting officer. The reviewing supervisor will ensure that the auditors are consulted when evaluating the contractor's response. Additionally the reviewer will ensure that the actions are documented and in accordance with DODI 7640.02. Further, beginning in March 2008, senior DCMA Philadelphia leadership (1102 Group Chief, CAFU monitor and Chief Counsel) meet with senior DCAA regional leadership on a quarterly basis to review all outstanding items on CAFU database that include estimating system reviews. These quarterly meeting insure that the two Agencies are working collaboratively on all open audits and provide a forum to discuss improvements in the process.

Recommendation D 1:
We recommend that the Commanders, Defense Contract Management Agency Maryland and Phoenix direct contracting officers to take immediate action on the overage cost accounting standard noncompliance reports transferred from DCMA Philadelphia in accordance with Federal Acquisition Regulation 30.605, Processing Noncompliances.

Response:
Concur. DCMA Maryland and DCMA Soldier Systems & CAP – Phoenix are taking action to resolve and disposition the open CAS noncompliances which were transferred from DCMA Philadelphia. Actions taken include training with specific emphasis on FAR 30.605, assigning resources to address the noncompliances as quickly as possible, weekly status meetings, and oversight regarding the FAR mandated response dates. To date, six of the seventeen reports identified have been closed. In addition, the Executive Director of

Contracts will review the status of overage CAFU items each quarter with each Division. Finally, DCMA is establishing an Agency-wide performance objective for ACOs that require timely and effective processing of any CAFU reportable audits. We plan to implement the update performance objective by March 31, 2009.

Recommendation D 2:
We recommend that the Commander, Defense Contract Management Agency Philadelphia establish a quality assurance measure that ensures compliance with FAR 30.605, Processing Noncompliances.

Response:
Concur. DCMA Philadelphia has designated an experienced 1102 individual as the monitor for the CAFU data base to insure it is current, accurate and complete, and complies with FAR 30.605. The monitor is also responsible for reporting to DCMA leadership all instances where CAFU deadlines are not being met so appropriate attention can be devoted to the problem. In addition, DCMA Philadelphia will add to ACOs' performance goals non-compliance processing objectives per FAR 30.605 to comply with the 15 day and 60 day action times after receipt of the noncompliance. Further, supervisors' objectives will include monthly review of the ACOs' performance.

Recommendation E 1:
We recommend that the Commander, Defense Contract Management Agency Phoenix and the Director, Defense Contract Management Agency Virginia direct the contracting officers to add the seven audits missing from the contract audit database and report the status of the contracting officer's actions in accordance with DoD Directive 7640.2.

Response:
Partially concur. We do not agree that DCMA should manually enter audit information received from DCAA Field Detachment into the DCMA electronic system, CAFU eTools. As a general rule, manual entry decisions by personnel who are not knowledgeable of the security requirements of DCAA Field Detachment reports could lead to compromise of secure information. As a result, we recommend that DCAA ensure that all reportable audits that are not classified are entered into their DMIS system which feeds the CAFU data into DCMA eTools for tracking and reporting. DCAA is in the best position to decide which ones are releasable, which ones would have no impact to security if information was obtained by someone who did not have a need to know. Any missing audits which are not from DCAA Field Detachment will be entered into the CAFU eTools system by 28 November 2008.

Recommendation E 2:
We recommend that the Commanders, Defense Contract Management Agency, Phoenix and Philadelphia, and the Director, Defense Contract Management Agency Virginia, establish and implement quality assurance processes to ensure the accuracy of the data reported in the contract audit follow-up system.

Response:
Concur. DCMA Phoenix, Philadelphia and Virginia will establish and implement quality assurance processes to ensure the accuracy of the data reported in the contract audit follow-up system. First, the DCMA Phoenix and Philadelphia have a CAFU monitor who is performing

monthly reviews of their CAFU data and is apprising their CMO and Division leadership of all instances where CAFU deadlines are not being met and data is not current. DCMA Virginia established a quality assurance plan in September 2006 which was updated September 2008 and submitted to the DoDIG for review. After the DoDIG review of the plan is complete, this plan will be implemented at the other two sites. The estimated date to have the plan implemented is May 30, 2009.

Additionally, the DCMA Mission Review Team will focus on CAFU practices and compliance to DODI 7640.02 during FY 2009 site reviews. Their review will include data reliability, and the results of the review will be provided to DCMA locally and to HQ for action.

Recommendation F 1:
We recommend that the Commanders, DCMA Philadelphia and DCMA Phoenix establish quality assurance procedures requiring contracting officers and their staff to resolve and complete the disposition of contract audit reports within the required timeframes or include written justification in the contract file for any resolutions or dispositions that occur beyond the specified timeframes.

Response:
Concur: A quality assurance plan that promotes timely resolution and disposition, and requires written justification when the due dates are not met, will be established by April 30, 2009. In addition, DCMA is establishing an Agency-wide performance objective for ACOs that require timely and effective processing of any CAFU reportable audits. We plan to implement the revised performance objective by March 31, 2009.

Recommendation F 2:
We recommend that the Commanders, DCMA Philadelphia and DCMA Phoenix establish quality assurance procedures requiring contracting officers and their staff to make the contract audit follow-up function a regular part of the Management Control Review program to measure success in improving actions on audit findings and recommendations.

Response:
Concur. DCMA Philadelphia and Phoenix will establish quality assurance procedures requiring contracting officers and their staff to make the contract audit follow-up function a regular part of the Management Control Review program to measure success in improving actions on audit findings and recommendations by June 30, 2009.

Recommendation F 3:
We recommend that the Commanders, DCMA Philadelphia and DCMA Phoenix establish quality assurance procedures requiring contracting officers and their staff to perform a management control review of the contract audit follow-up function in FY 2009.

Response:
Concur. A management control review of CAFU will be performed at DCMA Philadelphia and Phoenix by September 30, 2009.

Recommendation G:
We recommend that the Commander, Defense Contract Management Agency Phoenix revise the performance appraisal of the Defense Contract Management Agency Houston contracting officer to measure his performance in resolving and completing the disposition of contract audit reports in accordance with DoD Directive 7640.2, paragraph 5.2.4.

Response:
Concur. As discussed in our response to recommendation D 1, DCMA Headquarters is currently developing a job objective for CAFU for use throughout the Agency. We plan for the standard job objective to be implemented by March 31, 2009.

If you have any questions concerning our responses, please contact Mr. Gerry Reichel, Deputy Director of the Cost & Pricing Branch at (703) 428-7607 or gerry.reichel@dcma.mil, or Glen Gulden at (703) 428- 1009 or glenn.gulden@dcma.mil.

DAVID E. RICCI
Executive Director
Contracts

Enclosures as stated

Instruction Change Notice No. 09-051
Subject: Change to DCMA Instruction, Contract Management Boards of Review, Initial issue as an "interim instruction"
Issue/Effective Date: November 12, 2008
Target Audience: Division Contracts Directors, CMO Contracts Directors, ACOs, DACOs, CACOs, TCOs

Summary of Instruction Changes:

- Contract management boards of review shall be required for specified contracting actions. These boards will ensure reasonable exercise of judgment and adequate documentation in support of decisions by our Administrative Contracting Officers (ACOs), Divisional ACOs, Corporate ACOs, and Terminations Contracting Officers.
- The subject instruction establishes:
  - A board of review requirement at the Headquarters and Division levels for specified contracting actions.
  - The contracting actions that require a board of review.
- The policy contained in this instruction is interim direction. Final direction will be issued upon review of field comments and revision as necessary.

Implementation Guidance/Tools/Training:

- Action: Comments on this interim instruction should be submitted to the point of contact listed below by January 7, 2009.
- Immediate issuance and effective date by direction
- Policy change checklist - not used
- Your feedback on this policy change - Policy Change Feedback/Survey

Point of Contact for Further Information:
Elizabeth Moya, DCMA-AQCF, 703-428-3582

Tasking Memorandum No. 08-137
Memorandum For Directors, DCMA Product Divisions; Commander, DCMA International; Director, Special Programs Division; Commanders/Directors, DCMA Contract Management Offices (CMOs)
Subject: Functional Alignment of Contracting Workforce (TASKING)
Date: January 30, 2008
Suspense Date: May 15, 2008
Target Audience Heads-Up: All DCMA

- **Requirement(s):**
  - This tasking requires that the Agency's Contracting workforce be aligned functionally, i.e., all contracting personnel will report to and be directly supervised by a person in the contracting career field (except for the Senior Contracting positions identified below).
  - Senior Contracting positions will be established in accordance with the direction below.
    - Divisional Contracts Director Positions. Each Division (the four Product Divisions, International, and Special Programs) will establish a GS-1102 Contracts Director position reporting directly to the Commander/Director of that Division. In the Product Divisions, the position will be at the GS-15 level.
    - Contract Management Office Contracts Director Positions. Because of different organizational structures among the Divisions, and in some cases, different organizational structures among the Contract Management Offices within a single Division, Divisions are given a fair degree of flexibility in establishing these positions, but must adhere to the requirements below:
      - Each Primary Contract Management Office that is a contract receipt point and has a contract workload will establish a GS-1102-14 Contracts Director position reporting directly to the Commander/Director of that Contract Management Office.
      - Some Product Divisions have established product-oriented organizations. Some of those organizations are called Contract Management Offices, but are not contract receipt points and do not have a contract workload per se (e.g., DCMA Missile Operations, DCMA Aircraft Integrated Maintenance Operations Center). Such organizations are not required to have a Contracts Director position. Instead, they may choose to place the Contracts Director position at the tertiary Contract Management Offices that are administering contracts.
      - Tertiary (or Streamlined) Contract Management Offices vary greatly in terms of size and workload. Some tertiary Contract Management Offices are large organizations that are "tertiary" only because of the establishment of the product-oriented organizations mentioned above. The choice as to whether to place a GS-1102-14 Contracts Director or a GS-1102-13 Contracts Chief at these offices is left to the discretion of the Contract Management Office Commander/Director with the concurrence of the Division Director. If the decision is to go with a GS-1102-13 Contracts Chief, that position will report to either the Contracts Director of the primary Contract Management Office or the head of the tertiary Contract Management Office.
    - Many organizations are already organized in this fashion and in others this requirement can be achieved through reassignment of the current staff. Only individuals possessing a DAWIA Level III Contracting Certification <u>and</u> who

previously held a permanent 1102 position (or a military equivalent position) are eligible for assignment to the Contracts Director and Contracts Chief positions. Developmental or temporary assignments do not constitute sufficient experience for assignment to these positions.

- In the event these positions can't be filled through internal reassignment, or reassignments among other local offices, competitive procedures will be used to fill the positions. If competitive procedures are used:
  - The selecting official for the Division Contracts Director positions will be the Agency Executive Director/Deputy Executive Director, Contracts. The Division Directors/Deputy Directors will be invited to participate on the selection/rating panels.
  - The selecting official for the Contract Management Office Contracts Director positions (and Tertiary Contract Management Offices Contracts Chiefs positions) will be the Division Contracts Director (or Agency Executive Director/Deputy Executive Director, Contracts if the Division Contracts Director position has not been filled). The Contract Management Office Commanders/Directors or their Deputies will be invited to participate on the selection/rating panels.
  - Note that the selection authority above has been approved for all future competitive recruitments.
- DCMA-AQ is developing position descriptions for the Contracts Director and Contracts Chief positions. If any Contract Management Offices have already developed position descriptions for those positions, please send them to DCMA-AQ and we'll make them available for other offices to use.
- Ratings for personnel in the Contracts Directors and Chiefs positions will be done by the cognizant Division or Contract Management Office Commander/Director. The selecting officials for those positions will provide input to the Performance Ratings for those Senior Contracting positions beginning with the next annual rating period.

- The structure of each organization's Contracts group is not prescribed allowing for local flexibility as to the number/type of branches and supervisors.
- An anticipated result of this alignment of the contracting workforce is the elimination of the Operations Group Leader positions (simply by virtue of splitting the current Operations Group into a Contracts group and a "technical" group(s)). While not a requirement under this tasking, it's suggested that the Divisions and Contract Management Offices take this opportunity to functionally align the "technical" professions. We also expect that the contracts functional alignment will eliminate the need for Contracts Subject Matter Experts and other similar positions since the functional expertise will reside within the management chain of command.
- Any requests for extensions must be submitted to DCMA-AQ. Please note that because we are committed to completing an OSD-mandated contracting competency study this spring and the functional alignment is an enabler of that requirement, we will not be inclined to grant any extensions beyond the established due date except in unusual cases.
- This tasking will require a significant amount of organizational realignment across the Agency. Please contact the Resource and Organization Management Team (DCMA-DSEO) to obtain assistance on preparing the General Orders and establishing the effective dates for the individual realignments.
- If there is a question as to whether a deviation is necessary, please contact the points of contact below to avoid the need for rework.
  - Any deviation from the direction above must be approved by DCMA-AQ.

- Closure:
  - Completion of the functional alignment and submission to DCMA-AQ of an organizational chart showing the alignment of all Contracting personnel within the organization. (No specific format is prescribed but, at a minimum, all formal organizational entities (those assigned organizational codes) will be identified to include the names/grades of the people heading up those organizations.)
  - Note that in order to have the realignments completed by the due date your planning and General Orders will need to be completed in February.
- **Background:**
  - The decision to functionally align the Agency's Contracting workforce was made by the Acting Agency Director at the November 16, 2007 Executive Management Board meeting and communicated in the Director's Sight Picture, *Functional Alignment of Contracts Personnel*, November 30, 2007.
  - The Headquarter's realignment was completed December 9, 2007 with the establishment of the Executive Directorate of Contracts (DCMA-AQ).
- **Resource Impact:** Will vary depending upon current organizational structure.
- **Administrative Information:**
  - PLAS Process Code: Charge to PLAS Process 191, Plans and Policy Deployment
  - Your feedback on this tasking - Tasking Memo Survey

Points of Contact for Further Information:
Janet Carlson, DCMA-AQ, (703) 428-0972
David Ricci, DCMA-AQ, (703) 428-1144

Resource and Organization Management Team Points of Contact:
Naval Sea Systems and Aeronautical Systems Divisions: Leo Brehm, DCMA-DSEO, (617)753-3144
Space and Missile Systems and Ground Systems Divisions: Farid Hammad, DCMA-DSEO, (703) 428-0789
International and Special Programs Divisions: Vicki Paskanik, DCMA-DSEO, (703) 428-1467

Signature:
David Ricci, Executive Director, Contracts

Inspector General
Department of Defense