

Exposing Corruption Exploring Solutions
Project On Government Oversight

Testimony of
Nick Schwellenbach, Director of Investigations
Project On Government Oversight (POGO)
before the
Senate Homeland Security and Governmental Affairs Committee,
Subcommittee on Contracting Oversight
on
“Improving Federal Contract Auditing”
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“...the time of the congress is much taken up with a variety of important matters, but the establishing of some office for auditing accounts is a matter of exceeding importance to the public interest. It is the minutia that must be gone into; the propriety of each charge examined, the vouchers looked into.”

-- President George Washington, Commander-in-Chief of the Continental Armies¹

Chairwoman McCaskill and Senator Brown,

Thank you for inviting me to testify today on the importance of contract auditing across the federal government, and on ways to improve contract auditing, including the possible benefits of a proposed independent contract audit agency. I am the Director of Investigations at the Project On Government Oversight, also known as POGO. POGO was founded in 1981 by Pentagon whistleblowers who were concerned about wasteful spending and weapons that didn't work. They needed a safe way of getting that information out to Congress and the public without risking their jobs, and so we were created as the Project on Military Procurement. Over the years POGO has evolved, but we remain devoted to our roots of protecting brave truth-tellers inside the federal government, and to exposing and fixing wasteful spending.

This hearing is an important step. We need a contract audit agency that is not afraid of its own shadow. We need an independent and muscular audit agency that protects the taxpayers' interests.

We believe that there should be an independent Federal Contract Audit Agency (FCAA), as long as it is done right. This isn't a new idea: it is an idea that has been batted around since at least the

¹ Army Audit Agency, “The Evolution of Audit in the Army.” <http://www.hqda.army.mil/aaaweb/history.htm>
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1980s, when DCAA whistleblower George Spanton exposed serious problems at DCAA.²

While Department of Defense (DoD) contracts and contract proposals still represent the bulk of the taxpayer dollars DCAA currently examines, the DCAA has evolved since its inception to become a de facto FCAA for much of the government. There are several reasons this has occurred: both the scale of contracting³ and the type of contracting (cost type contracts and fixed price contracts where the Truth In Negotiations Act applies) that need or can benefit from DCAA's expertise have greatly grown outside of the DoD.⁴ DCAA has also become a de facto FCAA because it has developed a deep institutional knowledge of contractors, and utilizing the DCAA may be cheaper for organizations than hiring and/or training their own cadre of contract auditors.

For some time now, as the amount of contracting has grown outside of DoD, most parts of the federal government have seen DCAA as the place to go for contract auditing.

DCAA provides a critical and useful check on contractors. When it is involved, it helps ensure that we pay reasonable prices for what contractors are billing or propose to bill, and spots attempts by contractors to charge unallowable costs. DCAA estimates that it saves slightly more than \$5 for every \$1 dollar invested in it.⁵ It is, however, horribly understaffed given its workload and deserves to be strengthened and expanded. For example, during the early 1990s, it had over 2,000 more employees than it currently does—and there's a greater amount of contracting now.⁶ There was over \$530 billion in contract spending government-wide in FY 2010, although not all of it is subject to DCAA audits.⁷

In addition to DCAA, some IGs conduct contract audits on a regular basis. But their work in this area is dwarfed by that of DCAA.⁸ Non-DoD agencies can request, via their agency's IG, to utilize DCAA services if they are willing to pay for those services. This is a disincentive to utilize DCAA, as the agency must consider whether it has the funds to pay for contract audit services. In contrast, DCAA does not charge other DoD entities for their services.⁹

² Scott Eyman, "The Man Who Knew Too Much: Pratt & Whitney And The Pentagon Didn't Like What Auditor George Spanton Had To Say, But They Couldn't Shut Him Up. Now He's A Hero In The War Against Military Waste," *Sun-Sentinel*, October 27, 1985. http://articles.sun-sentinel.com/1985-10-27/features/8502170694_1_pratt-whitney-man-contracts (Downloaded January 28, 2011)

³ Defense Contract Audit Agency, "Other DCAA Functions," *DCAA Contract Audit Manual*, Chapter 15, November 30, 2010, p. 13. http://www.dcaa.mil/cam/Chapter_15_-_Other_DCAA_Functions.pdf (Downloaded January 28, 2011) (hereinafter "Other DCAA Functions")

⁴ Over the years, the use of cost-type contracts outside of DoD has grown tremendously, such as in the case of health and education research contracts.

⁵ Defense Contract Audit Agency, "DCAA Products and Services," January 11, 2011. <http://www.dcaa.mil/products.htm> (Downloaded January 28, 2011) (hereinafter "DCAA Products and Services")

⁶ Commission on Wartime Contracting in Iraq and Afghanistan, *Federal Oversight of Billions in Services Contracts*, April 19, 2010, p. 74. http://www.wartimecontracting.gov/docs/hearing2010-04-19_transcript.pdf (Downloaded January 28, 2011) (hereinafter "Wartime Contracting Hearing")

⁷ USASpending.gov. FY 2010 Contracts "Prime Award Spending Data." <http://bit.ly/fRq8Wf> (Downloaded January 28, 2010)

⁸ "DCAA Products and Services"

⁹ "Other DCAA Functions"

If adequately and centrally funded, an FCAA would remove this disincentive for non-DoD agencies to utilize contract auditing.¹⁰

There are other possible benefits to pulling DCAA out from the DoD and transforming it into an FCAA, the most significant being the independence issue. Currently the DCAA reports to the DoD Comptroller, who is the Chief Financial Officer of DoD, and who in turn reports to the Deputy Secretary of Defense. We have grave reservations whether this structure ensures adequate independence for DCAA, particularly as DCAA's work often establishes issues with how DOD works with contractors.

Furthermore, it is apparent to us that the DCAA Office of General Counsel is not independent—its attorneys are evaluated by the Pentagon's Defense Legal Services Agency. It should therefore come as no surprise that some of these attorneys are responsible for the gag letter sent to one of the DCAA whistleblowers.¹¹ A similar independence problem previously existed with the Pentagon Inspector General (IG) and in 2008 the IG Reform Act gave the Pentagon IG its own independent general counsel and severed its tie to the Defense Legal Services Agency.

The FCAA Proposal

In 2009, the GAO laid out its short, medium, and long-term recommendations for congressional consideration. Those included granting IG Act-style protection to DCAA, then moving it out from under the Comptroller to report to the Deputy Secretary of Defense, and in the long-term, possibly creating an FCAA.¹²

Some knowledgeable insiders tell us that the location of the agency is not the key issue, and that the most important factor is whether this agency has reasonable professional independence and can do its job and be independent of the procurement chain of command.

Still POGO has advocated for the creation of an independent and muscular Federal Contract Audit Agency, because of the scale of contracting and because of what is being contracted out.

There have been many different proposals for an FCAA – most of which do not make sense to us or that have serious flaws. One possibility is to create an FCAA for civilian agencies, leaving DCAA for the DoD. Another idea would place an FCAA in the legislative branch or put the contract audit function back in GAO, as it was for some time. Another possibility is to give the DOD IG the responsibility for contract auditing.

¹⁰ For IGs with a robust contract audit capability, we should explore the possibility of allowing them to continue to have responsibility for this function within their agency.

¹¹ *Expediency versus Integrity: Do Assembly-Line Audits at the Defense Contract Audit Agency Waste Taxpayer Dollars?* Hearing before the Senate Committee on Homeland Security and Governmental Affairs, 110th Congress, September 10, 2008, p. 108. <http://www.gpo.gov/fdsys/pkg/CHRG-110shrg45573/pdf/CHRG-110shrg45573.pdf> (Downloaded January 28, 2011)

¹² Government Accountability Office, *DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform* (GAO-09-468), September 2009. <http://www.gao.gov/products/GAO-09-468> (Downloaded January 28, 2011)

If DCAA is moved, we believe that a unified FCAA that conducts most contract auditing for the entire federal government (perhaps allowing some agencies to continue to rely on their IGs, such as the GSA IG) and is based in the executive branch makes sense.

Some insiders have privately told POGO that they would perceive a civilian-only FCAA as second rate because of the prominence of DoD contracting. Two major contract audit agencies would also have duplicative administrative costs.

Putting the operational contract audit function in the legislative branch is likely a non-starter. The GAO shed most of its operational contract audit responsibilities in the 1960s and has preferred to do selective, strategic audits in consultation with and by request from the Congress.¹³

Furthermore, contract auditors' existing problems with access to records could get worse if Congress transferred them to GAO or created a separate FCAA in the legislative branch. For instance, GAO lost a case before the Supreme Court called Bowsher v. Merck in 1983 on its access to contractor cost records.¹⁴ The Justice Department's Office of Legal Counsel might also argue that a legislative FCAA is performing an executive branch function – and that executive branch agencies can ignore a legislative branch FCAA.

Scattering the bulk of contract audit work to IGs across the government would mean many IGs would have to build a contract audit workforce or take DCAA's. This approach would have difficulty replicating the depth of expertise that DCAA—a large, specialized agency—has developed. This would be a step backward: for instance, a more centralized approach to contract auditing within DoD was the basis for DCAA's creation.

An executive branch FCAA that covers the entire government would be somewhat like the Office of Special Counsel, a roving agency with a vast jurisdiction whose head would have to be Presidentially appointed and Senate-confirmed.

If an FCAA is well-staffed, well-led, well-trained and independent, it could potentially bring numerous benefits:

- It would have more independence and would not report to the DoD Comptroller. This would eliminate even the appearance of the external impairments that exist today;
- It would likely have more visibility throughout the federal government;
- An FCAA's audit and audit-related work across the federal government could be centrally funded;

¹³ Paul C. Light, *Monitoring Government: Inspectors General and the Search for Accountability*, Washington, DC: The Brookings Institution, 1993, p. 27. For some historical perspective, consider GAO's role in 1947, when, according to NYU Professor Paul Light, it "was a vast accounting operation... reviewing 1.5 million contracts." At the height of World War II, GAO employed nearly 15,000 people. It only has around 3,350 employees today.

¹⁴ *Bowsher v. Merck & Co., Inc.*, 460 U.S. 824 (1983). <http://openjurist.org/460/us/824/bowsher-v-merck-and-co-inc-merck-and-co-inc> (Downloaded January 28, 2011)

- An FCAA would presumably be more attuned to the nuances sometimes unique to each agency in the federal government than the DCAA is now;
- An FCAA would be better positioned than DCAA to help identify common systemic problems across agencies in contracting matters; and
- It could better deploy its resources to agencies where there are greater risks.

As much as creating a government-wide FCAA is a good idea, there are some pitfalls to be avoided. Perhaps the biggest risk would be politicization of the mission of the agency because it would be headed by a political appointee.

Despite Some Positive Changes, Deep Concerns With DCAA's Direction

As Congress weighs the pros and cons of an FCAA, we need to improve DCAA as much as possible. We are concerned about the current direction of DCAA.

I have to mention that many current and former DCAA employees and knowledgeable observers believe that companies have taken advantage of the current turmoil at DCAA.¹⁵ In addition, you only have to read the hundreds of comments posted on the *Government Executive* website by people claiming to work at DCAA to understand that there is at least some part of the DCAA workforce that is deeply angry with the direction of their agency.¹⁶ Many, if not most, of the comments hammer home the belief that the agency has become risk-averse. Of course, contractors want DCAA to be risk-averse, and afraid to issue reports. Congress must make sure that does not happen.

Unfortunately, despite its many good auditors and cases where it defended the taxpayers' interests, there have been signs that the agency is not reaching its full potential. For instance, DCAA has not issued a subpoena to a contractor in over two decades despite long-standing access to records problems they have faced from contractors.¹⁷ That, by definition, is risk-aversion and contractors know this.

I believe the subcommittee needs to learn more about why, in FY 2010, far more assignments were canceled at DCAA than were completed, according to records POGO has obtained through the Freedom of Information Act. This is the first time this has happened for at least the past five years, and possibly ever.¹⁸

¹⁵ Richard C. Loeb, "GAO vs. DCAA – And the Winner Is? ... Contractors!" *Government Contract Costs, Pricing & Accounting Report*, Vol. 5, No. 2, March 2010. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1616299 (Downloaded January 28, 2011)

¹⁶ Readers' comments, Robert Brodsky, "Defense agency raises bar for reviewing contractor cost proposals," *Government Executive*, November 1, 2010. <http://www.govexec.com/mailbagDetails.cfm?aid=46427> (Downloaded January 28, 2011)

¹⁷ Richard Lardner, "Inside Washington: Auditors go easy on contractors," *Associated Press*, November 9, 2008. http://www.usatoday.com/news/washington/2008-11-09-1290924138_x.htm (Downloaded January 28, 2011)

¹⁸ DCAA in FY2010 canceled assignments (including assignments with "no report issued") far more often than it completed assignments with reports: 16,298 assignments were canceled or "no report issued" versus 11,788

We are also concerned with the ten-fold increase in the proposal review threshold (proposal reviews are where DCAA auditors review cost data in contract proposals).¹⁹ Without the help of DCAA auditors, contracting officers may not be armed with the knowledge they need to negotiate better deals for the taxpayer. To get a sense of how some in the contractor community feel about the change, you should look at one contractor consulting firm's blog post that reports on the change in review thresholds: It has a picture of people jumping for joy.²⁰

Many auditors feel that the DCAA may bring less value to the taxpayer with this threshold change. POGO believes the change is significant, could put billions of dollars at risk, and should be reversed. Some of the essential questions are: Why did the ten-fold threshold change occur? What is the impact? Are DCAA auditors helping contracting officer saves more or less money with the threshold change?

We are concerned by the general decline in contract dollars audited and reviewed by DCAA. In particular, there has been a massive decline in the number of Truth In Negotiations Act assignments conducted by DCAA: in FY 2006 they conducted 468, in FY 2007 438, in FY 2008 348, in FY 2009 148, and in FY 2010 only 59.²¹

We understand that the whistleblowers who testified before the full committee in 2008 feel they have not received adequate and public recognition from agency leadership. There is also a belief by some within DCAA that there has not been enough accountability for the deletion of audit findings or for the gagging of a whistleblower.

One bright spot noted in a recent report by Senator Chuck Grassley (R-IA) is that DCAA has begun sending far more referrals of questionable activity to the Defense Criminal Investigative Service: up from 17 in FY 2007 to 142 in FY 2009. DCAA is sending far more than the IG's own auditors, who only passed along 9 referrals in FY 2009.²² A policy change made by the former Director of DCAA in 2009 removed many of the layers of review by DCAA managers

assignments with reports issued in FY2010, according to assignment data in the DCAA Management Information System provided by DCAA through FOIA to POGO. From FY2006 through FY2009, DCAA finished more assignments with reports issued than assignments that were canceled/no report issued, in most of those years it issued far more. For example, in FY2006, DCAA canceled (or had "no report issued") 16,690 assignments and completed 26,698 assignments where reports were issued.

Overall, there has been a massive decline in the number of DCAA reports issued. According to the database, it has gone from 26,698 assignments with reports issued in FY 2006 to 11,788 in FY 2010 with a drop every single year, but especially large decreases in FY 2009 and FY 2010.

¹⁹ Project On Government Oversight, "Pentagon Radically Reducing Oversight of Contracts Worth Tens of Billions," October 29, 2010. <http://www.pogo.org/pogo-files/alerts/contract-oversight/co-ca-20101029.html>

²⁰ Aronson LLC, "Prepare for a Decrease in DCAA Audits Thanks to New DoD Standards," November 1, 2010. <http://www.aronsonblogs.com/gcsg/?p=1528> (Downloaded January 28, 2011)

²¹ Data obtained by POGO through FOIA.

²² Senator Charles Grassley, *Oversight Review of Audit Reporting by the Department of Defense, Office of Inspector General*, September 7, 2010. <http://grassley.senate.gov/about/upload/Defense-09-15-10-Oversight-Review-of-OIG-Audit.pdf> (Downloaded January 28, 2011)

when DCAA auditors detected suspicious or irregular activity that could be indications of criminal behavior.²³

The staffing increase of over 500 auditors is another very positive sign.²⁴

Changes That Could Improve DCAA and the Role of Contract Auditing

Besides creating an FCAA, there are opportunities to improve the effectiveness of contract auditing.

The Congress recognized the need for IG's to have their own counsel, or access to another IG counsel, rather than that of the agency they are overseeing.²⁵ Similarly, the DCAA needs to have its own general counsel, who is rated by the Director or Deputy Director, and thus directly accountable to the needs of the DCAA.

DCAA needs far more auditors. In the early 1990s,²⁶ when the total amount of federal and defense contracting was lower than today, even adjusted for inflation, DCAA was significantly larger with over 7,000 employees compared to the 4,700 it has today.²⁷ DCAA has nowhere near the workforce it needs to do its job, and the backlog is getting bigger and bigger every year as a result.

DCAA needs more transparency. Unlike the GAO or the IGs, almost no audits or even the results of the audits completed by the DCAA are made public. So unlike the IGs and the GAO, you usually don't have the shaming that comes with publicity of hard-hitting audit findings, except in rare cases such as when Representative Henry Waxman (D-CA) obtained some DCAA reports critical of KBR. For the most part, it may not be appropriate for DCAA audit reports to be made public in an unredacted form because of proprietary information concerns or source selection information – but when a Top 100 contractor has inadequate internal control systems, then DCAA should start naming names. A few years ago, the past DCAA Director testified that 69 percent of Top 100 contractors had at least one deficient internal control system.

DCAA and contract auditing is only one piece of the puzzle: We would also like to see more transparency with how contracting officers handle DCAA and other contract auditors' recommendations. Are they ignoring many of the auditors' findings? When serious and significant disputes are raised by DCAA with Form 1s, how are those disputes being handled

²³ Memorandum from Karen K. Cash, Assistant Director of Operations, Defense Contract Audit Agency, to DCAA Regional Directors *et al.*, regarding Audit Alert – Reporting Suspected Contractor Fraud and Other Contractor Irregularities, February 9, 2009. [http://www.publicintegrity.org/assets/pdf/09-OTS-004\(R\).pdf](http://www.publicintegrity.org/assets/pdf/09-OTS-004(R).pdf) (Downloaded January 28, 2011)

²⁴ Robert Brodsky, "Beleaguered Defense audit agency crafts new vision for the future," *Government Executive*, July 8, 2010. <http://www.govexec.com/dailyfed/0710/070810rb1.htm> (Downloaded January 28, 2011)

²⁵ *Inspector General Reform Act of 2008* (Public Law 110-409), October 14, 2008.

<http://www.gpo.gov/fdsys/pkg/PLAW-110publ409/pdf/PLAW-110publ409.pdf> (Downloaded January 28, 2011) and *National Defense Authorization Act for Fiscal Year 2008* (Public Law 110-181), January 28, 2008.

<http://www.gpo.gov/fdsys/pkg/PLAW-110publ181/pdf/PLAW-110publ181.pdf> (Downloaded January 28, 2011)

²⁶ "Wartime Contracting Hearing," p. 74

²⁷ Defense Contract Audit Agency, "Staff - As of December 6, 2010," December 28, 2010. <http://www.dcaa.mil/staff.htm> (Downloaded January 28, 2011)

within DoD? In some cases when DCAA found billions in unsupported and questioned costs, DoD failed to hold the contractors accountable.²⁸

Congress also needs to take a look at how the role of contract auditors, namely the DCAA, has been systematically reduced over the last two decades by changes to the Federal Acquisition Regulation and by law. For instance, in two weeks, a contractor-sponsored workshop will be held to help contractors in war zones “get past the lack of adequate price competition and strategies to getting exemptions from the Truth in Negotiations Act (TINA)” in order to evade DCAA.²⁹ Such a workshop is not unusual and it is not surprising that contractors are looking out for their interests. But what the government has done is make it harder for the government to get the best deal for the taxpayer, while making it much easier for contractors to get the upper hand.

As mentioned earlier, something needs to be done with how proposal reviews are handled. This issue is making DCAA less relevant and less effective in protecting the taxpayer. The ten-fold threshold increase in involving DCAA auditors on proposal reviews means contracting officers are being deprived of the help DCAA auditors can give them in negotiating better prices with contractors on tens of billions of dollars worth of contract decisions.

DCAA has long had problems with access to contractor records. Access to records by DCAA is key to proving or disproving contractor claims that taxpayer dollars were spent properly. According to an Associated Press article in 2008, DCAA had not used its subpoena power in 20 years.³⁰ Congress may have a role in improving DCAA’s access to records.

I would also take a look at the complaint system at DCAA. Is it working? Are lots of complaints coming in? What are the complaints? Have the old problems been solved? What, if anything, is being done to address legitimate complaints?

Contract auditors provide a great return on investment and save far more money than they cost. With tighter budgets, we need the upfront oversight to protect money before it is awarded. We know how hard it is to put the milk back in the bottle, and DCAA’s proposal reviews, pre-award audits, and internal controls audits can protect taxpayer dollars before it is spent. We believe an FCAA makes sense, but even if DCAA remains within DoD, it needs to be as strong as possible.

²⁸ Government Accountability Office, *Iraq Contract Costs: DOD Consideration of Defense Contract Audit Agency’s Findings* (GAO-06-1132), September 2006. <http://www.gao.gov/new.items/d061132.pdf> (Downloaded January 28, 2011)

²⁹ American Conference Institute, “Performing Contracts and Subcontracts under DCAA Audit Rules: How to Satisfy Cost or Pricing Data and CAS Compliance Requirements,” *National Battlespace Contractors’ Summit on Minimizing Legal, Compliance & Security Risks*, February 16-17, 2011. <http://www.americanconference.com/Battlespace/workshop.htm> (Downloaded January 28, 2011)

³⁰ Richard Lardner, “Auditors can be easy on defense contractors,” *Associated Press*, November 10, 2008. http://www.boston.com/news/nation/articles/2008/11/10/auditors_can_be_easy_on_defense_contractors/ (Downloaded January 28, 2011)