



September 10, 2009

Honorable Robert F. Hale
Under Secretary of Defense (Comptroller/Chief Financial Officer)
1100 Defense Pentagon, Rm. 3E770
Washington, DC 20301-1100

Dear Secretary Hale:

The Aerospace Industries Association (AIA) wishes to apprise you of the status of Defense Contract Audit Agency (DCAA) disapprovals of contractor business systems that are causing delays in billings, the need for manual approvals of billings, and an intensive allocation of DCAA and contractor resources.

DCAA reviews contractors' systems of internal controls to assure that the systems provide accurate and reasonable accumulating and reporting of costs charged to Government contracts. Formerly, DCAA based the extent of its transaction testing on the assessed level of risk. Recently issued DCAA policy has resulted in the wholesale disapproval of contractor systems, some of which have been in place for several years without question. This new DCAA policy is disruptive, costly, and appears to be an inefficient use of resources. It also results in contracting officers having to make award decisions in the face of DCAA system inadequacy determinations and delays of program audits while DCAA resources are deployed doing manual approvals of billings.

The attachment includes some of the DCAA issues encountered by AIA members of late. We do not believe that some of the recently implemented DCAA policies and practices are in the overall best interest of Government procurement.

Regards,

A handwritten signature in black ink that reads 'Marion C. Blakey'. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Marion C. Blakey

MCB:rks

cc: Mr. Shay Assad
Director, Defense Procurement and Acquisition Policy

Attachment

ATTACHMENT

Communication

DCAA has virtually eliminated dialog with contractors that facilitated resolution of concerns. DCAA auditors are prohibited from participation in integrated product teams. The longstanding process for resolving audit findings with DCAA in a timely manner no longer exists, yet timely resolution is critical because lack of approval of some systems imposes significant administrative burdens on contracting officers, additional costs for contractors that are passed on to the Government, and may even preclude award of contracts.

- Instead of engaging in a dialog, some auditors are asking for irrelevant records, such as manufacturing controls on a services contract, and when such records do not exist, requiring contractor explanations of why their absence is not a system inadequacy.
- Contractors that respond to audit findings with corrective action plans (CAPs) have experienced DCAA refusals to discuss if the CAPs address the stated inadequacies.
- DCAA will no longer participate in contractor meetings on accounting system implementation when participation would facilitate DCAA's understanding of the new system. This leads to the need for costly rework after such systems are implemented to accommodate DCAA findings.

The underpinning of the DCAA's disengagement from open communication with the acquisition community appears to be in reaction to GAO criticism of the agency's independence under Generally Accepted Government Auditing Standards (GAGAS) for isolated audit instances. DCAA's narrow view of independence is unsupported by the actual standards which state that auditors providing technical advice based on their technical knowledge and expertise does not impair auditor independence. We also believe DCAA's disengagement from open communication is inconsistent with the practices of other independent auditors including those which are also employed by the public accounting profession.

Access to Records

DCAA appears to be focusing more on contractor responses to DCAA requests than to assuring the proper recording of contract costs. "Denial of access" proceedings have been initiated for records contractors do not maintain and system disapprovals have been threatened when access is denied to sensitive contractor internal IT systems or when records are not produced within 5 days.

- During an incurred cost claim audit, DCAA requested detailed vendor cost records to support amounts paid to the vendor. The prime contractor worked with the "commercial" vendor, but the vendor did not maintain cost records in sufficient detail to satisfy the DCAA request. Instead of discussing what records were available and deriving an assessment of appropriate vendor costs, DCAA issued a denial of access letter to the contractor's Vice President and Chief Financial Officer.
- Several contractors have received demands for user privileges on contractor computer applications to retrieve unspecified records. Some requests have included statements indicating access is necessary to ensure the contractor is not manipulating records

provided to DCAA. There are already laws against dishonest practices in Government contracting. While DCAA is the audit advisor to the Government contracting officer, DCAA auditors are not contractor employees who warrant unfettered access to contractor IT systems. Often a contractor's system security precludes granting user access to non-employees. Not even all employees have access to all systems. Contractors have explained these constraints and have offered to provide specific records needed by DCAA. DCAA has responded by deeming the contractors' accounting systems inadequate. At one contractor, DCAA asserted, "There is no excuse for a [contractor's] system to not be designed for Government access." Unrestricted Government access to a corporation's internal accounting system data has never been a basis for determining the adequacy of any system, yet DCAA may be precluding new contract awards to contractors who do not grant such access.

- DCAA has requested access to contractor ethics hotline databases which include unsupported allegations and details of investigations in process that would violate privacy rights if released to individuals without a clear need for access. Some contractor refusals to provide access have resulted in inappropriate DCAA threats to find the contractor's accounting system inadequate.
- DCAA has mandated that records be provided within 5 days of their request. Contractors have received DCAA "denial of access" notifications because they have been unable to respond within 5 days. "Denial of access" is refusal to provide reasonable access to records at the location where the records are maintained, not inability to provide all records requested within an arbitrarily established 5 day period. Records located offsite may not be immediately available.

Internal Control Systems

Before recent DCAA policy changes, the DCAA Audit Manual (Section 3-305.3, revision dated December 31, 2008) stated, "The determination as to whether the overall system is adequate, inadequate, or inadequate in part should be based on the significance of the deficiencies and the extent of reliance, if any, that can be placed on information coming out of the system." DCAA Audit Guidance (08-PAS-043(R), issued December 19, 2008) declares "...[T]he contractor's failure to accomplish any control objective tested for in DCAA's internal control audits will or could ultimately result in unallowable costs charged to Government contracts, even when the control objective does not have a direct relationship to charging costs to Government contracts." Achievement of such perfection would be cost prohibitive. Defense Federal Acquisition Regulation Supplement (DFARS) 209.104-1, General Standards for responsible contractors requires, for example, that a "contractor's accounting system and related internal controls must provide for reasonable assurance that—(i) Applicable laws and regulations are complied with; (ii) The accounting system and cost data are reliable; (iii) Risk of misallocations and mischarges are minimized; and (iv) Contract allocations and charges are consistent with invoice procedures." DCAA's revised standard results in virtually every contractor system being inadequate. Contractors have implemented corrective action plans to resolve system inadequacies, but DCAA is painfully slow in performing the follow-up audits of those plans, while continuing to state the systems are "inadequate."

Accounting Systems: Some of accounting systems were found to be inadequate for seemingly immaterial reasons. For example:

- the contractor has insufficient refresher training for running reports from the software application;
- internal controls are inadequate because a transaction immaterial in amount was recorded in a different cost accounting period;
- a Chief Financial Officer policy manual was not available online;
- meeting notes and phone logs to support a decision to approve an Independent Research and Development project were lacking; and
- DCAA was refused online access to the contractor's Ethics Hotline database.

Billing Systems: If a contractor billing system is adequate, contractors may bill on cost reimbursable and progress payment contracts without manual approval of each invoice. This is a streamlined process with mutual efficiency benefits. DCAA has not conducted billing system audits at many contractor locations in recent years and as a result, has rescinded direct billing authority at scores of contractor locations. These rescissions are not necessarily based on changes or deficiencies, but because DCAA has not audited the system within DCAA's preferred three year cycle. The rescission of direct billing authority causes the expenditure of hundreds of DCAA audit hours to approve invoices manually, yet DCAA has stated repeatedly it is understaffed and, hence, is unable to complete timely audits.