

# Inspector General

United States  
Department of Defense



## **Actions to Align Defense Contract Management Agency and Defense Contract Audit Agency Functions**

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## Acronyms and Abbreviations

DoD	Department of Defense
USD(AT&L)	Under Secretary of Defense for Acquisition, Technology, and Logistics
USD(C)/CFO	Under Secretary of Defense, Comptroller and Chief Financial Officer
DPAP	Office of Defense Procurement and Acquisition Policy
DP	Office of Defense Pricing
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
GAO	Government Accountability Office
DBB	Defense Business Board
FAR	Federal Acquisition Regulation
DFARS	Defense Federal Acquisition Regulation Supplement
PGI	Procedures Guidance and Instructions





**INSPECTOR GENERAL**  
**DEPARTMENT OF DEFENSE**  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

November 13, 2012

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,  
TECHNOLOGY, AND LOGISTICS  
UNDER SECRETARY OF DEFENSE,  
COMPTROLLER/CHIEF FINANCIAL OFFICER  
DIRECTOR, DEFENSE PRICING  
DIRECTOR, DEFENSE PROCUREMENT AND  
ACQUISITION POLICY  
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY  
DIRECTOR, DEFENSE CONTRACT MANAGEMENT  
AGENCY

SUBJECT: Actions to Align Defense Contract Management Agency and Defense  
Contract Audit Agency Functions (Report No. DODIG-2013-015)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report.

DOD Directive 7650.3 requires that recommendations be resolved promptly. Comments provided by the Defense Contract Audit Agency were partially responsive. Please reconsider your response to Recommendation A.1, including your response to Finding A. Comments provided jointly by the Office of Defense Procurement and Acquisition Policy and the Office of Defense Pricing were partially responsive. Please reconsider your responses to Recommendations A.2 and A.3, including your response to Finding A. Therefore, we request additional comments on Recommendations A.1., A.2., and A.3 by December 13, 2012.

If possible, send an Adobe Acrobat pdf file containing your comments to either email address provided below. Copies of your comments must have the actual signature of the authorizing official for your organization. We are unable to accept the /Signed/ symbol in place of the actual signature.

We appreciate the courtesies extended to the staff. Please direct questions to Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877), [Carolyn.Davis@dodig.mil](mailto:Carolyn.Davis@dodig.mil) or Ms. Meredith Long-Morin at (703) 604-8739, [Meredith.Long-Morin@dodig.mil](mailto:Meredith.Long-Morin@dodig.mil).

Randolph R. Stone  
Deputy Inspector General  
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# Results in Brief: Actions to Align Defense Contract Management Agency and Defense Contract Audit Agency Functions

## What We Did

We evaluated actions taken by Department of Defense (DoD) officials to align the Defense Contract Management Agency (DCMA) and the Defense Contract Audit Agency (DCAA) functions by increasing the dollar thresholds a contractor proposal must meet before a contracting officer can request a DCAA audit. We evaluated the factors DoD officials considered in making the decision as well as controls established to ensure the change in dollar thresholds adequately protects the interests of the Department and taxpayer.

## What We Found

The Office of Defense Procurement and Acquisition Policy (DPAP) did not perform a business case analysis to support the decision to revise Defense Federal Acquisition Regulation Supplement (DFARS) Procedures Guidance and Instructions (PGI) 215.404-2(c). The decision will cost the Department and taxpayers \$249.1 million per year in lost potential return on investment from DCAA contract audits. Had DPAP evaluated rates of return across the DCAA audit portfolio, DPAP could have achieved the same results by redirecting DCAA resources from low-risk audits and services to higher risk areas of the portfolio. We found that DCAA had not implemented a risk-based audit planning process as recommended by the Defense Business Board. We found that DCMA is not prepared to perform contract cost analysis in place of a DCAA audit and that DCMA cannot reliably report performance. We found that DPAP did not demonstrate that DCMA has a probable chance to replicate the \$249.1 million in potential return on investment identified by DCAA. We found that DPAP did not demonstrate why they chose to direct

Department and taxpayer resources to DCMA to perform a job DCMA was not prepared to perform when DCAA had existing infrastructure in place to get the job the done.

## What We Recommend

We recommend 1) DCAA implement a risk-based audit planning process based upon achieving higher rates of return to the taxpayer and other high risk factors (Finding A). We recommend 2) DPAP re-instate the pre-September 17, 2010 thresholds for requesting DCAA audit as soon as practical until such time as a business case analysis can support a policy change. (Finding A). We recommend 3) Defense Pricing reassess the decision to revise DoD procurement and acquisition policy and validate that the decision sufficiently considers the potential return to DoD and the taxpayers resulting for DCAA audits and other factors (Finding A). We recommend 4) Defense Contract Management Agency proceed with scheduled corrective actions regarding case file documentation (Finding B) and information system reliability (Finding C).

## Management Comments and Our Responses

DCAA concurred in principle to one recommendation. DPAP and DP provided a joint response and partially concurred to two recommendations. DCMA concurred to all four recommendations. We request that DCAA reconsider their response to Finding A and Recommendation A.1. We request that DPAP and DP reconsider their responses to Finding A and Recommendations A.2 and A.3. We request additional comments by December 13, 2012.

## Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Contract Audit Agency	A.1.	
Director, Defense Procurement and Acquisition Policy	A.2.	
Director, Defense Pricing	A.3.	
Director, Defense Contract Management Agency		B.1, B.2, C.1, and C.2.

**Please provide comments by December 13, 2012.**

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# Introduction

## Objectives

We performed an oversight review of actions taken by DPAP<sup>1</sup>, a directorate reporting to the Under Secretary of Defense, Acquisition, Technology and Logistics (USD(AT&L)), to plan and implement a change to the DoD acquisition policy for evaluating low-dollar contractor cost proposals submitted with cost or pricing data. Our objective was to review factors leading to the functional changes between DCAA and DCMA. We focused on the change in the thresholds for DoD contracting officer requests for DCAA audit assistance when evaluating contractor price proposals to ensure that the interests of the Department were adequately protected.

## Background

On September 17, 2010, DPAP issued revised internal guidance to DoD contracting officers. Paragraph (c) of DFARS PGI 215.404-2 *Information to support proposal analysis* was revised as follows:

(c) *Audit assistance for prime contracts or subcontracts.*

(i) The contracting officer should consider requesting audit assistance from DCAA for—

(A) Fixed-price proposals exceeding \$10 million;

(B) Cost-type proposals exceeding \$100 million.

(ii) The contracting officer should not request DCAA audit assistance for proposed contracts or modifications in an amount less than that specified in paragraph (c)(i) of this subsection unless there are exceptional circumstances explained in the request for audit. (See PGI 215.404-2(a)(i) for requesting field pricing assistance without a DCAA audit.)

In lieu of a DCAA audit, the revised DoD guidance provides at DFARS PGI 215.404-2(a) *Field pricing assistance* that the contracting officer should consider requesting field pricing assistance, including cost analysis. DCMA<sup>2</sup> is tasked by DoD to provide field pricing assistance to DoD contracting officers<sup>3</sup>.

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<sup>1</sup> DPAP is responsible for all contracting and procurement policy matters in DoD. DPAP executes policy through the timely update of the DFARS, PGI, and DoD Directives 5000.1&2. In June of 2011 the Office of Defense Pricing (DP) was established to complement DPAP. The Director of DPAP during the events discussed in this report is now the Director of DP. Both the Director of DPAP and the Director of DP report to the USD(AT&L). DP is responsible for contract pricing policy matters within the Department of Defense (DoD). Additional information is available on the internet at <http://www.acq.osd.mil/dpap/>.

<sup>2</sup> Additional information regarding DCMA is available on the internet at <http://www.dcma.mil/>.

<sup>3</sup> The Director of DCMA reports to the Assistant Secretary of Defense, Acquisition, who reports to the USD(AT&L).

DoD Directive 5105.36, Subject: Defense Contract Audit Agency (DCAA) provides at paragraph 3 Mission that:

The DCAA, while serving the public interest as its primary customer, shall perform all necessary contract audits for the Department of Defense and provide accounting and financial advisory services regarding contracts and subcontracts to all DoD Components responsible for procurement and contract administration. These services shall be provided in connection with negotiation, administration, and settlement of contracts and subcontracts to ensure taxpayer dollars are spent on fair and reasonable contract prices. DCAA shall provide contract audit services to other Federal agencies, as appropriate.

Under paragraph 5, Responsibilities and Functions, DoD Directive 5105.36 provides that:

The Director, DCAA, shall:

- a. Organize, direct, and manage DCAA and all assigned resources.
- b. Assist in achieving the objective of prudent contracting, by providing DoD officials responsible for procurement and contract administration with financial information and advice on proposed or existing contracts and contractors, as appropriate.
- c. Audit, examine, and/or review contractors' and subcontractors' accounts, records, documents, and other evidence; systems of internal control; and accounting, costing, and general business practices and procedures in accordance with Government Auditing Standards, the Federal Acquisition Regulation, the Defense Federal Acquisition Regulation Supplement, and other applicable laws and regulations...
- m. Report incidents of suspected fraud, waste, and abuse to the appropriate authorities.

DCAA audits came under increasing scrutiny after July, 2008 when the United States Government Accountability Office (GAO) issued its report GAO-08-857, *DCAA AUDITS - Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated*. GAO reported finding numerous examples of where DCAA had failed to comply with generally accepted government auditing standards (GAGAS)<sup>4</sup>, including three audits where contractor officials and the DoD contracting

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<sup>4</sup> Government Auditing Standards provide standards for audits of government organizations, programs, activities, and functions, and of government assistance received by contractors, nonprofit organizations, and other nongovernment organizations. These standards, often referred to as generally accepted government auditing standards (GAGAS), are to be followed by auditors and audit organizations when required by law, regulation, agreement, contract, or policy. These standards pertain to auditors' professional



community had improperly influenced the audit scope, conclusions, and opinions – a serious independence issue according to GAO.

In September 2009, the GAO issued report GAO-09-468, *DCAA AUDITS – Widespread Problems with Audit Quality Require Significant Reform*. GAO reported finding DCAA quality problems nationwide, including compromise of auditor independence, insufficient audit testing and inadequate planning and supervision. GAO reported finding that the DCAA management and quality assurance structures were based on a production-oriented mission that put DCAA in a role of facilitating DoD contracting without also protecting the public interest. GAO made 15 recommendations to the Secretary of Defense to improve the quality of DCAA audits and strengthen auditor integrity, objectivity, and independence. The GAO recommendations to DCAA included the following:

Consult with DoD stakeholders and engage outside experts to develop a risk-based audit approach that identifies resource requirements and focuses on performing quality audits that meet generally accepted government auditing standards (GAGAS).

And

In consultation with DOD stakeholders, review DCAA's current portfolio of audit and nonaudit services to determine if any should be transferred or reassigned to another DOD agency or terminated in order for DCAA to comply with GAGAS integrity, objectivity, and independence requirements.

On August 19, 2008, following the first GAO report, the Deputy Secretary of Defense established an Independent Review Panel under the Defense Business Board (DBB) to review DCAA operations and make actionable recommendations for improvement. Among the numerous recommendations to the Secretary of Defense, the Independent Review Panel recommended<sup>5</sup>:

Secretary of Defense revise DCAA's mission statement to identify the taxpayer as the primary customer and focus on core audit services that ensure taxpayer dollars are spent on fair and reasonable contract prices.<sup>6</sup>

And

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qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports. It is DoD policy that DCAA perform contract audits in accordance with GAGAS.

<sup>5</sup> Defense Business Board Report FY09-1, dated October 2008 available on the internet at [http://dbb.defense.gov/pdf/Independent\\_Review\\_Panal\\_Report\\_of\\_the\\_Defense\\_Contract\\_Audit\\_Agency\\_\(Final\\_Report\).pdf](http://dbb.defense.gov/pdf/Independent_Review_Panal_Report_of_the_Defense_Contract_Audit_Agency_(Final_Report).pdf).

<sup>6</sup> DCAA's mission statement was changed to reflect the taxpayer as their primary customer in January 2010.

DCAA Director establish a risk-based planning process that expands DCAA self-initiated contract audits resulting from risk assessments and increases the potential for identifying fraud, waste and abuse, and higher rates of return to the taxpayer.<sup>7</sup>

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<sup>7</sup> The Independent Review Panel recommendations on focusing on core audit services and on establishing a risk-based planning process is open and DCAA considers implementation of these recommendations as an on-going process.

## **Finding A. Lack of a business case analysis results in a potential \$249.1 million loss to the Department and taxpayer**

The Office of Defense Procurement and Acquisition Policy (DPAP) did not perform a business case analysis to support the decision to revise DFARS PGI 215.404-2(c) *Audit assistance for prime contracts and subcontracts*<sup>8</sup>. A business case analysis would have considered total risks to the Department, including the potential rates of return across the DCAA audit portfolio. Such an analysis would have identified that the DCAA proposal to increase the thresholds for requesting a DCAA audit will decrease the potential return on investment to the Department and taxpayer. The DPAP decision to revise DFARS PGI 215.404-2(c) halted DCAA audits of low dollar proposals and may result in a potential loss of \$249.1 million per annum in return on investment from such audits (Table 3). DPAP performing a review could also have identified that DCMA was not prepared to perform cost analysis of low-dollar proposals (Finding B), could not report performance statistics related to their cost analysis (Finding C), and was not positioned to replace the potential return on investment identified by DCAA prior to the revision to DFARS PGI 215.404-2(c).

In early 2010, DCAA proposed that DPAP limit DoD contracting officer access to DCAA proposal audits. DCAA proposed increasing the thresholds for contracting officer requests for audit assistance identified in DFARS PGI 215.404-2(c) *Audit assistance for prime contracts and subcontracts* to cost-type contractor proposals exceeding \$100 million and fixed price contractor proposals exceeding \$10 million. DCAA provided that execution of this action would allow it to redirect 211,191 audit hours from the review of low-dollar proposal audits to “higher-risk audits to the Department/Taxpayer (e.g. higher dollar proposals and incurred cost submissions).”

However, the DCAA proposal did not demonstrate that eliminating low-dollar proposal audits from the DCAA audit portfolio would increase the overall potential for achieving higher rates of return to the Department and taxpayer, a Defense Business Board recommendation. Additionally, in reviewing and approving the revision DPAP did not (i) perform a cost/benefit analysis, (ii) determine a payback period, or (iii) determine a potential return on investment that would result from the proposed change. The former Director, DPAP advised the OIG that no formal business case analysis of the DCAA proposal was performed or needed.

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<sup>8</sup> DFARS PGI 215.404-2(c) provides DoD guidance for contracting officer use in requesting a DCAA audit of a contractor sole-source proposal submitted with cost or pricing data. The revision changed the ‘threshold’ for requesting a DCAA audit on a contractor fixed-price proposal from \$650,000 to \$10 million and on a contractor cost-type proposal from \$10 million to \$100 million. In lieu of a DCAA audit, a DoD contracting officer can request field pricing support, including a DCMA cost analysis. The Background section of this report provides additional information regarding DFARS PGI 215.404-2(c).

The former Director, DPAP advised the OIG that the decision to approve the revision to DFARS PGI 215.404-2(c) was a ‘resources decision’. He reasoned that DCAA does not have unlimited resources and the issue he confronted was how to reduce the number of audits DCAA was performing. In making this decision, he indicated that he was looking for ways to direct DCAA’s limited resources to what he considers DCAA’s most important work: large dollar value contractor proposals, incurred cost audits relating to the backlog of DoD contracts awaiting final close-out, and defective pricing audits. He advised the OIG that senior procurement executives in the Department continue to seek more timely responses from DCAA on contractor high-dollar proposal audits and that contractors have voiced concerns about unpaid contract withholding fees caught up by the DCAA backlog of incurred cost audits.

Table 1 summarizes the impact of the early 2010 DCAA proposal to DPAP:

**Table 1. DCAA estimated reduction in audit activity, early 2010 proposal to revise DFARS PGI 215.404-2(c)**

	<b>Fixed Price Proposal Audits Under \$10 million</b>	<b>Cost-Type Proposal Audits Under \$100 million</b>	<b>Total (Note)</b>
<b>Reports Issued</b>	1,614	553	2,167
<b>Audit Hours</b>	147,374	63,817	211,191
<b>Proposal Dollars Examined</b>	\$4,894,375,000	\$11,619,255,000	\$16,513,630,000
<b>Questioned Cost</b>	\$380,341,000	\$658,739,000	\$1,039,080,000
Note –DCAA fiscal year 2009 activity.			

Subsequent to the September 17, 2010 change to DFARS PGI 215.404-2(c) DCAA made the decision to continue to audit certain below-threshold proposals. DCAA decided to continue performing audits on under-threshold subcontract proposals where the subcontract is included in an over-threshold prime contract proposal that DCAA is also auditing. DCAA explained to the OIG that in order to be responsible for the audit of the complete prime contract proposal, audits of low-dollar subcontract proposals included in the prime contract proposal would continue. As illustrated in Table 2, adjusting the early 2010 DCAA proposal to DPAP for the impact of the DCAA decision to continue auditing low dollar subcontract proposals reduces the estimated savings from 211,191 hours to 132,133 hours.

**Table 2. DCAA early 2010 proposal adjusted for subcontract under-threshold proposal activity subsequently retained by DCAA**

	<b>Fixed Price Proposals Under \$10 million</b>	<b>Cost-Type Proposals Under \$100 million</b>	<b>Total (Note)</b>
<b>Reports Issued</b>	1,001	371	1,372
<b>Audit Hours</b>	86,534	45,599	132,133
<b>Total Proposal Dollars Examined</b>	\$3,072,404,000	\$8,326,515,000	\$11,398,919,000
<b>Questioned Cost</b>	\$217,686,000	\$484,233,000	\$701,919,000
Note – DCAA fiscal year 2009 activity.			

Appendix C identifies DCAA questioned cost<sup>9</sup> per audit hour across the DCAA portfolio in fiscal year 2009; the last full year DCAA performed low-dollar proposal audits. As demonstrated in Appendix C, low-dollar proposal audits returned substantially more questioned cost per audit hour (both fixed price, cost-type and combined) than other areas in the DCAA audit portfolio, including incurred cost audits and defective pricing audits.

DCAA estimates its costs at \$129 per audit hour in fiscal year 2009<sup>10</sup>. The DCAA questioned cost per audit hour on low-dollar proposal audits was \$2,014 (Appendix C). Reducing the questioned cost per audit hour by the estimated cost per audit hour, DCAA was achieving a potential return on investment of \$1,885 per audit hour when performing low-dollar proposal audits.

To explain how DCAA ranked the different audits in its audit portfolio in terms of risk, DCAA advised the OIG that:

*“No comparison or ranking was made to the dollars/audit hour per proposals compared to dollars/audit hour for other areas. We do not believe this comparison would be valid as there was limited audit work performed in these other areas in the recent years. In addition, we do not believe dollars exception to audit hours identifies the total risk to the Department.”*

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<sup>9</sup> DCAA defines questioned cost as those amounts on which audit action has been completed and which are not considered acceptable as a contract cost. This category includes amounts for those items specifically identified as unallowable under the contract terms, statute, public policy, applicable Government regulations, or legal advice. It includes those items which, although not specifically unallowable, are determined to be unreasonable in amount, contrary to generally accepted accounting principles, or not properly allocable to the contract and those items for which the contractor denied access to supporting records/data. DoD contracting officers are responsible for negotiating DCAA questioned costs and adjusting DoD contract prices to reflect the resulting savings.

<sup>10</sup> The estimate considers DCAA payroll, travel, and support costs on readily identifiable audit activities (i.e., proposal audits) as well as an estimate of the costs associated with non-readily identifiable activities, such as certain types of audits, meetings, and planning and programming.



The Defense Business Board in its October 2008 Report FY09-1 *Independent Review Panel Report on the Defense Contract Audit Agency*<sup>11</sup> recommended that DCAA:

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

The DCAA proposals to DPAP did not specifically address the recommendation by the Defense Business Board to expand DCAA self-initiated contract audits and increase the potential for higher rates of return to the taxpayer.

In order for DCAA to direct its resources to the audits that pose the highest risk to the Department and have the potential for achieving higher rates of return to the taxpayer, DCAA needed to identify and rank each audit area in the portfolio by some measure of potential return per unit expended. For our analysis, we used questioned cost per audit hour. Had DCAA performed a similar type of analysis and approach, DCAA could have been in a position to begin implementing the DBB recommendation to achieve higher rates of return for the Department and taxpayer.

Table 3 identifies the loss in potential return on investment to the Department and taxpayer resulting from the decision by DPAP to revise DFARS PGI 215.404-2(c).

**Table 3. Loss in potential return on investment (ROI) caused by raising the thresholds for requesting a DCAA proposal audit, fiscal year 2009 baseline**

	<b>Audit Hours Expended on Low-Dollar audits</b>	<b>Loss in Potential ROI Per Audit Hour</b>	<b>Loss in Potential ROI</b>
<b>DCAA proposal corrected for low-dollar subcontract audits</b>	132,133	\$1,885	\$249,070,705

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<sup>11</sup> Available on the internet at [http://dbb.defense.gov/pdf/Independent Review Panel Report of the Defense Contract Audit Agency \(Final Report\).pdf](http://dbb.defense.gov/pdf/Independent_Review_Panel_Report_of_the_Defense_Contract_Audit_Agency_(Final_Report).pdf)

**DP, DPAP, DCMA, and DCAA Management Comments.** DP and DPAP provide in their response that they have reviewed the responses provided by DCMA and DCAA and concur with their views. Similarly, DCAA provides in its response that DCAA reviewed the draft responses provided by DP, DPAP and DCMA and agree with their views.

**DP and DPAP Management Comments.** In a joint memorandum dated July 10, 2012, DP and DPAP responded that they strongly object to the mischaracterization of the risk based decisions made by DPAP in consultation with the DCAA and DCMA to revise DFARS PGI 215.404-2(c) *Audit assistance for prime contracts and subcontracts*. They state that the decision to raise the thresholds will result in “billions of dollars in savings to the taxpayers” and that the decision recognizes the need to limit the size of the DCAA workforce. DP and DPAP responded that the statement made by the OIG that DPAP did not perform a business case analysis is factually incorrect; they state that a business case analysis was done. DP and DPAP provide that the business case analysis was “so compelling that it was obvious on its face”.

DP and DPAP respond that the OIG statement is inaccurate in relation to the OIG finding that DPAP did not consider that DCMA was (i) not prepared to perform cost analysis, (ii) could not reliably report the results of performance, and (iii) was not positioned to replace the \$249.1 million potential return on investment achieved by DCAA. DP and DPAP provide that since 2008 the Department has carried out a strategy to increase the size and capability of the DCMA pricing workforce, including: reorganizing certain administrative contracting officer positions into one organization; developing an electronic tool to collect contractor business system information; establishing integrated cost analysis teams to assist the DoD procuring contracting officers with evaluating contractor proposals at the top DoD contractors; and, strengthening the pricing capability at each DCMA contract management office. DP and DPAP provide that this capability, though in its early stages, is “poised to assist contracting officers in savings billions of dollars for the taxpayers.”

DP and DPAP question the OIG finding that there is a potential \$249.1 million loss in return on investment to the Department and taxpayer from this action. They state that any “reasonable review of the numbers” presented by the OIG would support their decision. They agree with the OIG calculation of a potential loss of \$2,014 in questioned costs per hour (Appendix C) and calculate a total loss of \$266,109,300 in DCAA questioned cost for all the low-dollar proposal work redirected to DCMA. However, they propose that if only 10 percent of the 132,133 redirected audit hours (13,213 hours) are directed to the audit of high dollar fixed price proposals, the potential cost questioned jumps by \$663,821,120, which is “more than double the entire potential reduction on the low-dollar proposals.” They respond that the OIG report analysis is flawed in that it does not consider the gains from alternate uses of the DCAA audit resources or give any consideration to the results of DCMA reviews.

**DCAA Management Comments.** In a memorandum dated July 3, 2012, DCAA responded that it already has a risk-based audit planning process that directs its limited resources to high risk areas and that this process already addresses the Defense Business Board recommendations. DCAA responded that it disagrees with the substance of the OIG findings for the following reasons:

- The audit resources saved by this change can be put towards higher priority work.
- The OIG model for ranking audit areas based on questioned cost per audit hour is too simplistic and does not consider the total risk to the Department.
- The potential \$249.1 million loss in return on investment calculated by the OIG is overstated and does not consider:
  - The impact of DCMA's cost/pricing efforts.
  - The audit savings resulting from applying the resources that would have been expended on under threshold proposals to higher priority work.

DCAA responded that when moving from under threshold audits to over threshold audits, the rate of return as measured by questioned cost per hour increased by a factor of 8 for cost-type audits and 27 for fixed price audits. DCAA provided that "while it is true that under threshold audits still maintained a relative advantage in terms of cost questioned per hour over other types of audits (e.g. incurred cost), the Agency believes it can make better use of these resources." DCAA provides that redirecting even a small portion of the saved hours to over the threshold forward pricing reviews will provide the Department and taxpayer with a greater return on investment.

**IG Response.** We find that in their responses, DP, DPAP, and DCAA do not directly address the loss experienced by the Department and taxpayer that has resulted from transferring the review of low-dollar contractor proposals from DCAA to DCMA. Instead they emphasize the benefit to be derived through redirecting the audit hours once spent on low-dollar proposal audits to high dollar proposal audits. For instance, DP and DPAP calculate that if only ten percent of the hours once spent auditing low-dollar proposals are redirected to high dollar fixed price proposal audits, the potential cost questioned jumps by over \$663.8 million. DCAA calculates that when moving resources from under-threshold to over threshold audits, the rate of return as measured by questioned cost per hour increased by factor of 8 for cost-type audits and 27 for fixed price audits.

We agree that DCAA auditors make more money for the taxpayer by doing high-dollar, over threshold proposal audits as the table in Appendix C clearly indicates. We also agree that there are benefits achieved from moving auditors from one area of work to another. However, a well-developed business case analysis would have determined the most appropriate audit area(s) to target for redirected work.

We maintain that the low-dollar threshold work was not the best choice for redirected work. In fiscal year 2009 when DCAA made its proposal to limit contracting officer access to low-dollar proposal audits, DCAA performed four other areas of work where questioned cost per audit hour is much lower and in three of the four audit areas, the hours expended were much higher, as follows:

**Table 4. Audit areas in the DCAA portfolio with lower questioned cost per hour than low-dollar proposal audits, fiscal year 2009**

<b>Audit Area</b>	<b>Audit Hours Expended</b>	<b>Questioned Cost</b>	<b>Questioned Cost Per Audit Hour</b>
<b>Special Audits</b>	561,158	\$1,007,259,000	\$1,795
<b>Defective Pricing</b>	58,582	\$37,089,000	\$633
<b>Cost Accounting Standards</b>	238,380	\$89,396,000	\$375
<b>Incurred Cost</b>	1,541,561	\$302,854,000	\$196

With a cost of \$129 per audit hour in fiscal year 2009, DCAA experienced the following potential return on investment per audit hour for each of the four audit areas:

**Table 5. Audit areas in the DCAA portfolio with lower potential return on investment per audit hour than low-dollar proposal audits, fiscal year 2009**

<b>Audit Area</b>	<b>Questioned Cost per Audit Hour</b>	<b>Cost per Audit Hour</b>	<b>Potential Return on Investment per Audit Hour</b>
<b>Special Audits</b>	\$1,795	\$129	\$1,666
<b>Defective Pricing</b>	\$633	\$129	\$504
<b>Cost Accounting Standards</b>	\$375	\$129	\$246
<b>Incurred Cost</b>	\$196	\$129	\$67

These rates are less (in three cases considerably less) than the \$1,885 rate of potential return on investment that DCAA was achieving in the audit area it chose to transfer to DCMA: low-dollar proposal audits. The overall rate of return to the Department and taxpayer could have been increased exponentially by redirecting the 132,133 saved hours from these four audit areas rather than low-dollar proposals. As a simple illustration, taking 132,133 hours proportionally from each of these four audit areas to fund the higher risk work would have reduced the loss in potential return on investment to the Department and taxpayer from \$249.1 million to \$62.0 million, as follows:

**Table 6. Simple illustration demonstrating the reduced loss in potential return on investment, fiscal year 2009**

<b>Audit Area</b>	<b>Audit Hour Reduction</b>	<b>Potential Return on Investment per Audit Hour</b>	<b>Loss in Potential Return on Investment</b>
<b>Special Audits</b>	30,899	\$1,666	\$51,477,558
<b>Defective Pricing</b>	3,226	\$504	\$1,625,745
<b>Cost Accounting Standards</b>	13,126	\$246	\$3,228,960
<b>Incurred Cost</b>	84,883	\$67	\$5,687,132
	132,133		<b>\$62,019,396</b>

**DCAA Management Comments.** DCAA responded that using questioned cost per hour as the sole basis for allocating audit resources ignores areas of risk. DCAA provided that certain audits are required by law or regulation DCAA identified its incurred cost backlog which has quadrupled to \$573 billion in the last 10 years as an important area of risk. DCAA responded that postponing these incurred cost audits any longer puts the Department at risk for canceling funds and may allow any overpayments made to contractors to go undetected. DCAA also responded that it must perform defective pricing audits before the statute of limitations runs out. DCAA identified Overseas Contingency Operations as an area of high risk to the Department, stating that many of these audits result in low payback but that these audits are needed to ensure the contractor is operating efficiently and the U.S. Government is not reimbursing unallowable costs. DCAA provided that it is monitoring the percentage of questioned cost to dollars examined and that this percentage has increased from just over 2 percent in 2001 to more just over 9 percent in fiscal year 2011.

**IG Response.** With respect to the \$573 billion DCAA incurred cost backlog and the risk from canceling funds, we note that DCAA advised the OIG during the review that cancelling funds do not prevent the Department from recovering questioned cost that result from a DCAA incurred cost audit. The impact from cancelled funds is budgetary – where contract costs that are recovered by the Department as a result of a DCAA incurred cost audit have been cancelled, the funds are returned to the U.S. Treasury. We also note that the potential return on investment to the Department and taxpayer from DCAA incurred cost audits is minimal; \$67 per audit hour as demonstrated above. We continue to recommend that DCAA use a risk-based audit planning process in relation to their entire portfolio, including the \$573 billion incurred cost backlog.

**DCAA Management Comments.** Regarding the OIG estimate of \$249.1 million in potential return on investment that may have been lost when DPAP revised the thresholds, DCAA responded that this amount is significantly overstated. According to DCAA, contracting officers do not always sustain DCAA questioned cost and not every proposal that DCAA audits results in a contract award. DCAA provided that the average



net savings rate for audits of fixed price contracts for the fiscal years 2009 through 2011 is approximately 41.8 percent. DCAA responded that “using essentially the same DoDIG methodology, combined with this average net savings rate, yields a much more modest potential loss of \$122.4 million.”

**IG Response.** We find that the alternative measure of ‘net savings’ that DCAA used to calculate a “much more modest” potential loss of \$122.4 million to the taxpayer is as a good measure of contracting officer performance in settling DCAA questioned costs as it is a measure of DCAA performance. DCAA in its response stated that contracting officers have sustained an average of 41.8 percent of DCAA questioned cost during the fiscal period 2009 through 2011, which indicates that in contract negotiations contracting officers are sustaining just over \$4 for every \$10 in DCAA questioned cost. DCAA did not indicate whether it considers a 41.8 percent sustention rate as a good indicator of the viability of its reported questioned cost. This area will be considered for future study.

**DP and DPAP Management Comments.** DP and DPAP conclude their July 10, 2012 joint response by stating that the change in the audit threshold is not the only change in DCAA priorities or the requirements for DCAA audits. They state there will be other changes made to make better use of DCAA resources in support of contractor business system reviews and incurred cost audits.

**DCAA Management Comments.** DCAA responded that “lastly, and most importantly, the DoDIG has completely ignored the audit savings that are generated by applying the resources to higher priority work rather than under threshold proposals.”

**IG Response.** We demonstrated the varying rates of questioned cost per audit hour that DCAA experienced across the audit portfolio in fiscal year 2009 (Appendix C) and identified that low-dollar proposal audits returned substantially more questioned cost per audit hour than other areas in the DCAA audit portfolio.

In their responses, DP, DPAP and DCMA did not address with empirical data the potential rate of return achieved by DCMA since September 17, 2010. Similarly, they did not identify a *timeframe* when they expect DCMA to start achieving the rates of return previously achieved by DCAA. Until DP, DPAP and DCMA can demonstrate that DCMA can achieve a potential rate of return equal to that once achieved by DCAA, we stand by our finding that the decision to revise DFARS PGI 215.404-2(c) may result in a potential loss of \$249.1 million per annum in return on investment to the Department and the taxpayer.

A judicious re-direction of resources, using a risk-based analysis of DCAA's entire portfolio, including nonaudit services, as recommended by the GAO and Defense Business Board Recommendations, would have better supported the rationale for redirecting DCAA resources. A well-documented portfolio risk assessment would have factored in potential for identification of fraud, waste and abuse and higher rates of return to the taxpayer. In addition, it would have allowed for additional considerations, such as preparing the organization receiving the redirected work to properly absorb and train staff

for the additional responsibility and ensuring the receiving organization was in a position to appropriately track the results, comparing their effectiveness in achieving results to those achieved by DCAA (e.g., sustained questioned costs).

Lastly, we find that DP and DPAP did not demonstrate why they chose to direct Department and taxpayer resources to DCMA to perform a job DCMA was not prepared to perform when DCAA had the existing infrastructure in place to get the job the done. A formal business case analysis could have identified that it was advantageous and more economical to direct any increase in DoD resources to the organization that already had the existing infrastructure to adequately perform proposal evaluations and track the questioned costs.

## **Recommendations, Management Comment, and Our Response**

### **Recommendation A**

**We recommend that:**

- 1. The Director, Defense Contract Audit Agency, beginning with the fiscal year 2013 audit planning cycle, implement a risk-based audit planning process that directs limited DCAA audit resources to high risk audit areas based upon:**
  - i. Achieving higher rates of return to the taxpayer,**
  - ii. The potential for identifying fraud, waste and abuse,**
  - iii. The potential for identifying Federal Acquisition Regulation and Cost Accounting Standard violations, and**
  - iv. The need to serve the public interests as the primary DCAA customer.**

**Management Comments.** DCAA concurs in principle. DCAA stated it already has a planning process that addresses the DBB recommendation.

**Our Response.** We did not find that DCAA had implemented a risk-based audit planning process as recommended by the DBB when it proposed revising the PGI to limit DoD contracting officer access to DCAA audits. We continue to recommend that DCAA implement a risk-based audit planning process that directs limited DCAA audit resources to high risk audit areas. We strongly encourage that DCAA use a risk-based audit planning process as recommended by the DBB as its basis for any future proposals to restrict DCAA audits, including DCAA incurred cost audits. Across the board limitations, such as the revision to DFARS PGI 215.404-2(c) that dissuade contracting officers from requesting audits contained in DCAA's risk-based audit portfolio, should be avoided. DCAA should have the flexibility to direct available resources to any high-risk contractor submission (whether a proposal or incurred cost audit) that increases the potential for identifying fraud, waste and abuse and higher rates of return. We request

that DCAA reconsider its response to this recommendation and provide additional comments by December 13, 2012.

- 2. The Director, Defense Procurement and Acquisition Policy reinstate the pre-September 17, 2010 thresholds for requesting DCAA audit identified at DFARS PGI 215.404-2(c) *Audit assistance for prime contracts or subcontracts* until such time as a business case analysis can support that any change to DoD procurement and acquisition policy will protect the interests of the Department and taxpayer.**

**Management Comments.** DP and DPAP partially concur but state that the merit of the change was obvious. They respond that they will continue to monitor the results of the decisions made and, if the facts merit a change in policy, they will modify the present PGI as appropriate. They also respond that the OIG analysis is flawed in that it does not address the alternate uses of the DCAA resources or give any consideration to the results of DCMA pricing reviews.

**Our Response.** We recommend that DPAP re-instate the pre-September 17, 2010 thresholds for requesting DCAA audit identified at DFARS PGI 215.404-2(c) *Audit assistance for prime contracts or subcontracts* as soon as practical. The revision to the PGI has resulted in a \$249.1 million per year potential loss of return on investment to the Department and taxpayer. Once the prior thresholds are re-instated, DPAP should avoid approving any future requests to increase the thresholds at DFARS PGI 215.404-2(c) until such time as it can be demonstrated that any proposed change will increase the overall potential for achieving higher rates of return to the Department and taxpayer.

DP and DPAP have not sufficiently explained the choice to direct Department and taxpayer resources to DCMA to perform a job DCMA was not prepared to perform when DCAA had the existing infrastructure in place to get the job the done. We request that DPAP reconsider its response to this recommendation and provide additional comments by December 13, 2012.

- 3. The Director, Defense Pricing reassess the decision to revise DFARS PGI 215.404-2(c) *Audit assistance for prime contracts or subcontracts* and validate that the decision sufficiently considers:**
  - i. the potential return to the Department and taxpayer resulting from DCAA audits,**
  - ii. DCMA capability to sufficiently perform and adequately document the work, and**
  - iii. DCMA capability to reliably report performance and results.**

**Management Comments.** DPAP and DP partially concur stating they will continue to analyze the use of the Department's scarce resources to find the best utilization for the benefit of the Department and taxpayer. They nonconcur that the Department or taxpayer were exposed to potential losses or that there was not an adequate analysis done to support the decision to increase the thresholds at DFARS PGI 215.404-2(c). They state

that given the resource constraints and the data on similarly sized proposals, the decision made was reasonable.

**Our Response.** DPAP and DP have not provided any additional factual support to demonstrate how the Sept. 17, 2010 decision to revise DFARS PGI 215.404-2(c) sufficiently considered (i) the potential return to the Department and taxpayer resulting from DCAA audits, (ii) DCMA capability to sufficiently perform and document their work, and (iii) DCMA capability to reliably report performance and results. We request that DP reconsider its response to this recommendation and provide additional comments by December 13, 2012.

## Finding B. DCMA cost analysis case file documentation does not demonstrate readiness to assume cost analysis responsibilities

DCMA cost analysis case file documentation does not demonstrate that the DCMA cost analysts performed work sufficient to determine a contractor's proposed cost and fee represent a fair and reasonable price, as required by FAR 15.404-1(a)(3)<sup>12</sup>. Without adequate case file documentation, the Department cannot demonstrate that a DCMA cost analysis protects the taxpayer from paying unreasonable prices on contractor low-dollar sole-source proposals submitted with cost or pricing data. In fiscal year 2009, the last full year DCAA audited these low-dollar proposals, DCAA performed 1,372 audits, examined almost \$11.4 billion in contractor proposed cost and questioned approximately \$702 million<sup>13</sup>.

DPAP did not act to ensure the Defense Contract Management Agency had existing infrastructure in place to adequately document the work that DCMA performed in lieu of a DCAA audit. DPAP had been working with DCMA to create a world-class pricing organization and believed DCMA was in a position to adequately perform the additional contracting officer requests for cost analysis that resulted from the revision to DFARS PGI 215.404-2(c) *Audit assistance for prime contracts and subcontracts*. DPAP expected that DCMA findings in terms of questioned cost and savings would equal that attained by DCAA prior to the change, and exceed it with time. DPAP stated that transferring low dollar contractor proposal evaluations from audit to cost analysis did not create duplicate capabilities or overlap at DCAA and DCMA. Since 2009 DCMA has been building an integrated capability (engineers, quality assurance representatives, price/cost analysts, etc) for evaluating all aspects of a contractor's proposal.

We evaluated the case file documentation supporting the cost analysis<sup>14</sup> performed by DCMA at three of its Contract Management Offices (CMO). We used (i) *DCMA Instruction Folder Number: 22 Pricing and Negotiation –Contract*<sup>15</sup> and (ii) the

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<sup>12</sup> The objective of proposal analysis is to ensure that the final agreed-to price is fair and reasonable. FAR 15.404-1(a)(3) provides that "Cost analysis shall be used to evaluate the reasonableness of individual cost elements when certified cost or pricing data are required. Price analysis should be used to verify that the overall price offered is fair and reasonable."

<sup>13</sup> Amounts exclude low dollar subcontract cost proposals that DCAA announced subsequent to the change in DFARS PGI 215.404-2(c) that it will continue to audit.

<sup>14</sup> FAR 15.404-1(c)(1) provides that "Cost analysis is the review and evaluation of any of the separate cost elements and profit or fee in an offeror's or contractor's proposal as needed to determine a fair and reasonable price or to determine cost realism, and the application of judgment to determine how well the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

<sup>15</sup> DCMA Instruction 22 includes policy on using some of the cost analysis techniques provided at FAR 15.404-1(c)(2), as well as policy directed at case management and reporting. It is available to DCMA cost/price analysts on the DCMA public webpage at <http://guidebook.dema.mil/22/index.cfm>.



procedures included in the Federal Acquisition Regulation System as our criteria. DCMA Instruction Number 22 is the sole DCMA policy that included procedures for performing cost analysis, as conveyed to us by DCMA. In addition to Instruction 22, the DCMA cost/price analysts rely on the criteria provided in the FAR and information obtained from training classes when performing cost analysis of contractor low dollar proposals.

For the period Sept. 17, 2010 through March 31, 2011, the three DCMA CMOs had performed cost analysis on 13 contractor proposals submitted with cost or pricing data. The 13 contractor proposals were valued under the revised DFARS PGI 215.404-2(c)<sup>16</sup> thresholds for requesting audit assistance.

Based upon an objective checklist evaluation (Appendix B), we determined that in 13 of 13 cases the DCMA cost analysis case file documentation did not demonstrate compliance with the Federal Acquisition Regulation or *DCMA Instruction Folder Number: 22 Pricing and Negotiation –Contracts*. DCMA CMO management concurred with our findings in almost all instances, as demonstrated in Table 7.

**Table 7. Results of DCMA case file review**

<b>OIG number of case files reviewed</b>	13
<b>Total number of checklist questions</b>	685
<b>Number of OIG findings, checklist responses where CMO case file documentation did not demonstrate compliance with FAR or DCMA Instruction 22</b>	425
<b>Number of CMO concurs, OIG findings</b>	423
<b>Number of CMO nonconcurs, OIG findings</b>	2
<b>Percentage, CMO concurs</b>	99.5%
<b>Percentage, CMO nonconcurs</b>	0.5%

For the 13 cases at these three DCMA CMOs, the existing cost analysis case file documentation:

- Does not provide evidence that the work was performed.
- Does not demonstrate how the cost analyst applied the various cost analysis techniques provided at FAR 15.404-1(c)(2) to ensure the Government obtained a fair and reasonable price in a sole source noncompetitive acquisition where cost or pricing data was submitted by the contractor.

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<sup>16</sup> Contractor cost proposals submitted with certified cost or pricing data and falling below \$10 million for fixed price proposals and \$100 million for cost-type.

- Does not demonstrate the actions taken by the cost analyst to determine that the offeror submitted all current, accurate and complete cost or pricing data with its certified proposal in accordance with the Truth in Negotiations Act.
- Does not demonstrate the actions taken by the cost analyst to determine that the offeror complied with the cost principles included in FAR Part 31 when pricing contracts, subcontracts and modifications for negotiation.
- Does not demonstrate the actions taken by the cost analyst to determine that the offeror was subject to and/or complied with the rules and regulations issued by the Cost Accounting Standards Board.

Additionally, in 7 of the 13 cases where DCMA performed a technical evaluation in conjunction with the cost analysis, the existing case file documentation did not demonstrate the technical analysis complied with FAR 15.404-1(e)(2) Technical Analysis.

On September 20, 2011, the OIG conveyed to DPAP the results of the OIG work to evaluate DCMA cost analysis case file documentation and the results of the DCMA P&N eTool described in Finding C.

In response to the OIG findings on DCMA case file documentation, on October 3, 2011 DPAP initiated the following actions:

- Perform a 100 percent compliance check of every DCMA office using the OIG developed checklist as the tool to evaluate CMO compliance.
- Establish policies and procedures to ensure all work performed by DCMA in a cost analysis is adequately documented in a case file and demonstrates compliance with the FAR.
- Hold periodic meetings with the OIG to provide real-time assessments and obtain OIG feedback.

On December 14, 2011, the Executive Director, Contracts, DCMA conveyed to the OIG the status of actions taken in response to the OIG findings. DCMA had performed a review of 15 additional CMO sites using the DoDIG checklist and the findings were consistent with those found by the DoDIG. DCMA has initiated corrective action to update the Pricing & Negotiation Instruction, standardize the cost analysis and technical support case file and improve training. DCMA is taking action to develop an organizational structure and mission statement for dedicated pricing and technical support. In addition, DCMA stated that it is revising its internal review mechanism to begin assessing cost analysis performance to ensure pricing across all CMOs is effective, starting September 2012 with completion slated for May 2015.

**Management Comments and Our Response.** See Finding A, Management Comments, and Finding A, Our Response, regarding those aspects of the joint DPAP and DP response related to DCMA performance and any actions taken by DPAP to ensure DCMA was positioned to replace the \$249.1 million in potential return on investment

achieved by DCAA prior to revising DFARS PGI 215.404-2(c) Audit assistance for prime contracts and subcontracts.

## **Recommendations, Management Comments, and Our Response**

### **Recommendation B**

**We recommend that the Director, Defense Contract Management Agency:**

- 1. Evaluate existing case file documentation created by price/cost analysts performing the nine other tasks identified in the DCMA price/cost analyst position description and ensure such documentation demonstrates the actions taken by the analyst demonstrate compliance with FAR, CAS and DCMA internal policies and procedures; and provide semiannual updates to the Assistant Inspector General, Audit Policy & Oversight, DoD, semi-annually until all corrective actions have been completed.**

**Management Comments.** In the June 28, 2012 response, DCMA concurs with the recommendation. DCMA will employ various measures including management reviews to critically examine existing case file documentation and confirm such documentation meets regulations, policies and procedures. DCMA will affirm that, overall, contract price/cost analysts are performing all pertinent duties identified in the standard position description. Additionally, the DCMA Mission Review Team will include the review of case file documentation during its regularly scheduled reviews to ensure such documentation demonstrates performance complied with laws and regulations. DCMA will report the results to the DoDIG on a semiannual basis for the remainder of FY 2012 and FY 2013.

**Our Response.** We consider the DCMA management comments to be responsive to our recommendation and will perform a follow-up review after all DCMA actions have been implemented.

- 2. Proceed with the scheduled implementation of corrective actions relating to cost analysis case file documentation (3 items) identified in the December 14, 2011 Updated DCMA Action Plan, DoD OIG Project No. D2011-DIP0AI-0103; and provide semiannual updates to the Assistant Inspector General, Audit Policy & Oversight, DoD, semi-annually until all corrective actions have been completed.**

**Management Comments.** DCMA concurs with the recommendation and will report semi-annually until the planned actions are complete.

**Our Response.** We consider the DCMA management comments to be responsive to our recommendation and will perform a follow-up review after all DCMA actions have been implemented.

## Finding C. DCMA Pricing & Negotiation eTool information system unreliable for reporting cost analysis performance

Data derived from the P&N eTool, the DCMA information system used to report performance on pricing and negotiation cases, is not sufficiently reliable to report the number of within threshold cost analysis cases completed, the total proposal amount analyzed and the total cost questioned. The data derived from the DCMA P&N eTool is too unreliable for this purpose and would probably lead to an incorrect or unintentional message.

We evaluated and found the following P&N eTool deficiencies. DCMA management is not able to track and report DCMA performance on cost analysis cases performed on low-dollar contractor proposals submitted with cost or pricing data.

- **Field services requested are not tracked at a level of detail identified in the FAR and provided by DCMA.** Without providing P&N eTool definitions on services requested that matches the differing types of pricing assistance identified in the FAR, P&N eTool is unable to track and measure performance by DCMA when providing each specific type of pricing assistance, including cost analysis performed on under threshold proposals submitted with cost or pricing data.
- **Existence of discretionary input fields.** Discretionary input fields are the primary driver behind inconsistency and lack of data within P&N eTool. Over 70 percent of discretionary fields in P&N eTools are blank compared with 3% of mandatory fields. This results in 36 percent of total fields remaining blank. Users are not receiving an accurate view of the performance on cost analysis cases because the application allows the case to be established and closed with missing information.
- **No documented definition for all the input fields.** The reference material available to the P&N eTool user does not provide definitions, descriptions, codes and values for all fields. Without definitions, etc., for the input fields it is left to over 5,000 users to use their best judgment for the type of input expected or to leave the field blank. Not making definitions and/or reference material available to guide a user in populating fields in any log (P&N eTool or External) is a major contributing factor to the inconsistency and lack of data within that log.

- **Limited data integrity control procedures.** P&N eTool documentation does not include control procedures to:
  - ensure data input to the system accurately reflects the underlying information;
  - provide reasonable assurance that erroneous data, errors and irregularities are detected, reported, and corrected;
  - enable users of the data to have a chance to bring attention to incorrect data or data that needs to be updated; or
  - consistently capture all pricing cases and data elements.
- **Reporting strategy not consistent with user's needs.** P&N eTool supports four roles: External Customer role, Cost/Price analyst role, DCMA Headquarters role, and DCMA technical user role. Each user interacts with the P&N eTool differently and expects the reports to meet their needs. Five standard reports available to each user do not include P&N Case Number, contractor, contract type, or any of the text box fields within the P&N eTool. Inability to run a report to meet a user's needs due to missing fields, missing data and lack of consistency are factors that encourage the use of external logs.

Additionally, an alternate estimate of cost analysis activity provided by DCMA management to the OIG was derived from P&N eTools and/or stand-alone computer systems. The alternate estimate suffered from the same deficiencies identified with P&N eTool and was unreliable for use in reporting DCMA activity and performance.

DPAP did not identify that the DCMA information system cannot reliably report the number of cost analysis cases performed, the dollar value of contractor proposals analyzed, and the questioned cost reported since DFARS PGI 215.404-2(c) *Audit assistance for prime contracts and subcontracts* was revised on September 17, 2010. Without reliable information, the Department cannot demonstrate to the taxpayer that the decision to replace DCAA audits with DCMA cost analysis will replicate the potential rates of return previously achieved by DCAA (see Finding A).

DCMA cannot reliably report the number of cost analysis cases performed, the dollar value of contractor proposals analyzed, and the questioned cost reported since DPAP revised DFARS PGI 215.404-2(c) *Audit assistance for prime contracts and subcontracts*. Without reliable information, the Department cannot demonstrate to the taxpayer that the decision by DPAP to replace DCAA audits with DCMA cost analysis had a positive impact on the Department's potential rate of return. In fiscal year 2009, the last full year DCAA audited these low-dollar proposals, DCAA performed 1,372 audits, examined almost \$11.4 billion in contractor proposed cost and questioned approximately \$702 million<sup>17</sup>.

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<sup>17</sup> Figures exclude low dollar subcontract cost proposals that DCAA announced subsequent to the change in DFARS PGI 215.404-2(c) it will continue to audit.

In response to the OIG findings regarding eTools deficiencies, on December 14, 2011, the Executive Director, Contracts, DCMA conveyed to the OIG the status of actions taken in response to the OIG findings. DCMA has initiated corrective action to reassess the P&N eTool, including its manuals, training and reports. In conjunction with that reassessment, the DCMA internal review team will revise its assessment methodology to include an assessment of data integrity of the P&N eTool. Both actions are scheduled for completion by November, 2012.

**Management Comments and Our Response.** See Finding A, Management Comments, and Finding A, Our Response, regarding those aspects of the joint DPAP and DP response related to DCMA performance and any actions taken by DPAP to ensure DCMA was positioned to replace the \$249.1 million in potential return on investment achieved by DCAA prior to revising DFARS PGI 215.404-2(c) Audit assistance for prime contracts and subcontracts.

## **Recommendations, Management Comments, and Our Response**

### **Recommendation C.**

**We recommend that the Director, Defense Contract Management Agency:**

- 1. By Sept. 30, 2012, provide an update on their evaluation of the eTool P&N to determine that the tool can reliably report all activity performed by the DCMA price/cost analyst as identified in the DCMA price/cost analyst position description and take action to correct the tool for identified deficiencies; and provide semiannual updates to the Assistant Inspector General, Audit Policy & Oversight, DoD semi-annually until all corrective actions have been completed.**

**Management Comments.** DCMA concurs with the recommendation and will report semi-annually until the P&N eTool is re-designed.

**Our Response.** We consider the DCMA management comments to be responsive to our recommendation.

- 2. Proceed with the scheduled implementation of corrective actions relating to eTool Price & Negotiation (8 items) identified in the December 14, 2011 Updated DCMA Action Plan, DoD OIG Project No. D2011-DIP0AI-0103; and provide semiannual updates to the Assistant Inspector General, Audit Policy & Oversight, DoD semi-annually until all corrective actions have been completed.**

**Management Comments.** DCMA concurs with the recommendation and will report semi-annually until the P&N eTool is re-designed.



**Our Response.** We consider the DCMA management comments to be responsive to our recommendation.

## Appendix A. Scope and Methodology

We conducted this review from December 3, 2010 through February 21, 2012 in accordance with the Quality Standards for Inspection and Evaluation. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings, conclusions and recommendations based on our review objectives. We believe that the evidence obtained provides a reasonable basis for our findings, conclusions and recommendations based on our review. As part of our review, we:

- Reviewed GAO and DBB findings and recommendations regarding DCAA audit planning practices and compliance with GAGAS.
- Evaluated the DCAA planning process related to its proposal to restrict low-dollar proposal audits.
- Evaluated DCMA cost analysis procedures and case file documentation.
- Evaluated the DCMA computer system to determine if it could be used to reliably report cost analysis activity.
- Interviewed acquisition officials to understand and evaluate any costs and benefits associated with changing DFARS PGI 215.404-2(c).

### Use of Computer-Processed Data

Computer-processed data includes data entered into a computer system or resulting from computer processing. DCMA maintains an electronic tool (eTool) for tracking pricing and negotiation actions. The Pricing and Negotiation eTool is the required method for receiving, tracking, and closing requests for support. We believed that data from this system would have materially supported our findings, conclusions, or recommendations. Specifically being able to reliably report the number of within threshold cost analysis cases created and completed (including associated total proposed cost and total cost savings) by DCMA between September 17, 2010 and March 31, 2011. In accordance with Quality Standards for Inspection and Evaluation we assessed the sufficiency and appropriateness of the computer-processed information. We used GAO-09-680G, "Applied Research and Methods: Assessing the Reliability of Computer-Processed Data," July 2009, as a framework when designing the data reliability assessment.

To determine if we could use data provided by the DCMA P&N eTool to reliably report elements of DCMA cost analysis performance, we performed electronic testing of required data elements, reviewed related documentation, and interviewed agency officials knowledgeable about the data. The results of our electronic testing identified significant errors or incompleteness in some of or all the key data elements and that using the data would probably lead to an incorrect or unintentional message, given the intended use of the data (see Finding D for further details). We determined that the data produced from the DCMA Pricing and Negotiation eTool is not sufficiently reliable. We ultimately determined that an alternate means of estimating would not provide us with reliable data. Therefore, we did not use the data from the Pricing and Negotiation eTool in our analysis or include it in the report.

## **Prior Coverage**

No prior coverage has been conducted during the last 5 years related to the actions taken by DoD officials to restrict DCAA audits of low-dollar contractor proposals, the adequacy of DCMA field pricing support case file documentation and the ability of DCMA to track and report performance on field pricing support performed in lieu of a DCAA audit.

# Appendix B. DoD OIG Checklist Evaluation, DCMA Case File Documentation

## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			
	Yes	No	N/A	Total
<b>1. PCO Request for Cost and Pricing Support</b>				
a. Does the case file demonstrate that the subject of the cost analysis is a contractor proposal submitted with cost or pricing data in accordance with FAR 15.403-4(a)(1)?	13	0	0	13
i. If yes, continue the review.				
ii. If no, discontinue the review and document in the space below the subject of the cost analysis case file.				
b. Does the case file demonstrate that the subject of the cost analysis is a contractor proposal falling below the thresholds for requesting audit assistance from DCAA as specified at PGI 215.404-2(c)? [Less than \$100M for cost type and Less than \$10M for fixed price]	13	0	0	13
i. If yes, continue the review.				
ii. If no, discontinue the review and document in the space below the subject of the cost analysis case file.				
c. Does the case file include the procuring contracting officer's request for cost or pricing analysis submitted by the PCO in accordance with FAR 15.404-2(a)(1).	10	2	1	13
i. If yes, did the procuring contracting officer tailor the type of information and level of detail requested in accordance with the specialized resources available at the buying activity and the magnitude and complexity of the required analysis. [FAR 15.402-2(a)(2)]	10	0	3	13
ii. If no, does the case file identify how the cost price analyst determined the scope of the services provided.	0	2	11	13
<b>2. ACO and Cost Price Analyst Proposal Adequacy</b>				
a. Does the case file demonstrate that the ACO performed a preliminary review of the contractor's proposal and related data to determine its adequacy as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 1.3.	3	10	0	13

## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			Total
	Yes	No	N/A	
b. Does the case file demonstrate the ACO and cost analyst performed a preliminary review of the contractor's proposal for adequacy using FAR 15.408 TABLE 15.2 -- Instructions for Submitting Cost/Price Proposals when Certified Cost or Pricing Data are Required, or other format and instructions as dictated by the PCO (see FAR 15.403-5(b)(1)).	0	13	0	13
c. If the contractor's proposal was determined inadequate, does the case file demonstrate that the ACO complied with DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 1.3.3 and "immediately notified both the contractor and buying command as to all deficiencies. In addition, the buying command shall be notified as to the date when additional data will be submitted by the contractor and whether any difficulty is expected in meeting the cost and pricing analysis report due date. If a delay is anticipated, the ACO shall establish a revised due date with the buying command."	0	0	13	13
i. If determined inadequate, does the case file demonstrate that the ACO complied with FAR 15.404-2(d) and "...[notified] the contracting officer immediately if the data provided for review is so deficient as to preclude review"?	0	0	13	13

### 3. CMO Assignment Coordination and Set-up

a. Does the case file demonstrate that the ACO or cost price analyst acknowledged the PCO request for cost or pricing analysis support within five days of receipt, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 1.2.	4	9	0	13
b. Does the case file demonstrate that the ACO, after having found the proposal to be adequate, established (i) a deadline for completing the cost and pricing analysis and (ii) forwarded the request for support to the cost price analyst in accordance with DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 1.3.1.	1	12	0	13

## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			Total
	Yes	No	N/A	
c. Does the case file demonstrate that the ACO and cost price analyst complied with DCMA policy and ensured the request for cost and pricing analysis support was completed within 45 days or another agreed to date with the buying command in accordance with DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 1.3.1.1.	5	8	0	13
d. Does the case file demonstrate that the cost price analyst, upon receipt of the ACO request for support, entered the request into the Pricing and Negotiation module of eTools, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts,	3	10	0	13
e. Does the case file demonstrate that the cost price analyst accessed the need for, and requested support from, CMO functional specialists (e.g., cost price analysts, engineers and industrial specialists) and audit, if necessary, in compliance with DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 2.2.2.	7	5	1	13
f. Does the case file demonstrate that the cost price analyst requested counsel to provide information as to potential unallowable costs, in compliance with DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 2.2.2.	0	2	11	13

### 4. Compliance with FAR and DCMA Pricing & Negotiation

a. Does the case file demonstrate the cost price analyst complied with FAR 15.404-1(a)(3) and used cost analysis to evaluate the reasonableness of individual cost elements when certified cost or pricing data are required.	6	7	0	13
b. Does the case file demonstrate the cost price analyst considered FAR 15.404-1(a)(3) and used price analysis to verify that the overall price offered is fair and reasonable.	0	11	2	13
c. Does the case file demonstrate the cost price analyst used cost analysis to evaluate the reasonableness of individual cost elements when certified cost or pricing data are required, in accordance with DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 3.2.	6	7	0	13

## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			Total
	Yes	No	N/A	
d. Does the case file demonstrate that the cost price analyst conducted an analysis of the contractor's proposal in accordance with the policy in FAR 15.404-1, DFARS [2]15.404-1 and DFARS PGI 215.404-1, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 3.3.	1	12	0	13
e. (Intentionally left blank.)				
f. Does the case file demonstrate that the cost analysis included verification of cost or pricing data and evaluation of each cost element as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 3.3.2.1.	2	11	0	13
g. Does the case file demonstrate that the cost analysis included verification that proposed cost elements are in accordance with the contract cost principles in FAR Part 31, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 3.3.2.2.	0	12	1	13
h. Does the case file demonstrate that the cost analysis included analysis of the results of any make or buy program , as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 3.3.2.3.	0	0	13	13
i. Does the case file demonstrate that the cost analysis included evaluation of rates and escalation factors, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 3.3.2.4.	10	3	0	13
j. Does the case file demonstrate that the cost analysis included verification that all cost data has been submitted, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 3.3.2.5.	1	12	0	13
k. Does the case file demonstrate that the cost analysis included verification of the contractor's math calculations, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 3.3.2.6.	0	13	0	13

## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			Total
	Yes	No	N/A	
l. Does the case file demonstrate that the cost analyst complied with FAR 15.404-1(c)(2)(v) and performed a review to determine whether any cost data or pricing data, necessary to make the offeror's proposal suitable for negotiation, had not been either submitted or identified in writing by the offeror.	1	12	0	13
m. Does the case file demonstrate the cost price analyst applied judgment to determine how well the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency, as provided at FAR 15.404-1( c)(1).	1	12	0	13
n. Does the case file demonstrate compliance with FAR 15.404-1( c)(2)(iv), i.e., verification that the offeror's cost submissions are in accordance with the contract cost principles and procedures in Part 31 and, when applicable, the requirements and procedures in 48 CFR Chapter 99 (Appendix to the FAR looseleaf edition), Cost Accounting Standards.	0	13	0	13
(i). If not, did the case file include documentation to demonstrate that the circumstances of the acquisition precluded use of this technique and procedure, as provided at FAR 15.404-1(	0	13	0	13
o. Does the case file demonstrate compliance with FAR 15.404-1( c)(2)(iii), i.e., Comparison of costs proposed by the offeror for individual cost elements with—				
(A) Actual costs previously incurred by the same offeror; [FAR 15.404-1( c)(2)(iii)(A)]	4	9	0	13
(B) Previous cost estimates from the offeror or from other offerors for the same or similar items; [FAR 15.404-1( c)(2)(iii)(B)]	1	10	2	13
i. If not, did the case file include documentation to demonstrate that the circumstances of the acquisition precluded use of the technique and procedure, as provided at FAR 15.404-1( c)(2).	0	11	2	13
p. Does the case file demonstrate compliance with FAR 15.404-1( c)(2)(i), verification of cost data and evaluation of cost elements, including				
(A) The necessity for, and reasonableness of, proposed costs, including allowances for contingencies; [FAR 15.404-1( c)(2)(i)(A)]	2	11	0	13



## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			
	Yes	No	N/A	Total
(B) Projection of the offeror's cost trends, on the basis of current and historical cost or pricing data; [FAR 15.404-1( c)(2)(i)(B )]	1	11	1	13
(C) Reasonableness of estimates generated by appropriately calibrated and validated parametric models or cost-estimating relationships; [FAR 15.404-1( c)(2)(i)(C)]	2	8	3	13
(D) The application of audited or negotiated indirect cost rates, labor rates, and cost of money or other factors. [FAR 15.404-1( c)(2)(i)(D)]	10	2	1	13
q. Does the case file demonstrate that the cost analyst complied with FAR 15.404-1(a)(6) and brought to the attention of the contracting officer for appropriate action any discrepancy or mistake of fact (such as duplications, omissions, and errors in computation) contained in the certified cost or pricing data submitted in support of a proposal.	4	4	5	13
<b>5. Compliance with 48 CFR Chapter 99 Cost Accounting</b>				
a. Does the case file demonstrate that the cost price analyst determined that the proposed contract or subcontract is exempt from CAS in accordance with 48 CFR 9903.201-1(b).	0	13	0	13
b. Does the case file demonstrate that, if not exempt, the cost price analyst determined the type of CAS coverage (full, modified or other types of CAS coverage) in accordance with the rules at 48 CFR 9903.201-2.	0	13	0	13
c. Does the case file demonstrate that, if not exempt from CAS, the cost price analyst determined whether, as specified at 48 CFR 9903.202-1(b), a Completed Disclosure Statement from the contractor is required.	0	13	0	13
d. Does the case file demonstrate that, if not exempt from CAS, the cost price analyst determined whether, as specified at 48 CFR 9903.202-6, the CFAO has made a determination of adequacy and that the contractor's Disclosure Statement adequately discloses its practices.	0	13	0	13

## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			Total
	Yes	No	N/A	
e. Does the case file demonstrate that, if not exempt from CAS coverage, the cost price analyst evaluated the contractor's proposed cost for compliance with 48 CFR 9904.401 Cost Accounting Standard - consistency in estimating, accumulating and reporting costs.	0	13	0	13
f. Does the case file demonstrate that, if not exempt from CAS coverage, the cost price analyst evaluated the contractor's proposed cost for compliance with 48 CFR 9904.402 Cost Accounting Standard - consistency in allocating costs incurred for the same purpose..	0	13	0	13

### 6. Cost and Pricing Analysis Report

a. Does the case file demonstrate that the report was prepared and signed by the cost price analyst within 45 days of receipt of the ACO's request, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 4.1.	9	4	0	13
b. Does the case file demonstrate that the cost and pricing analysis report was submitted, reviewed, and approved in accordance with procedures established by CMO management, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 4.1.	0	13	0	13
c. Does the case file demonstrate that the ACO or cost price analyst forwarded the cost and pricing analysis report to the buying command as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 4.4.	3	10	0	13

### 7. Access to Contractor Records

a. FAR 15.404-2( c)(4) provides that general access to the contractor's books and financial records is limited to the auditor. Does the case file demonstrate that the contractor denied, or attempted to deny, general access to the offeror's books and financial records to the cost price analyst.	0	13	0	13
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## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			Total
	Yes	No	N/A	
i. If the contractor denied general access to the cost price analyst, did the contractor make available any data and records necessary to analyze the offeror's proposal (see FAR 15.404-2(c)(4)).	0	0	13	13
ii. If the contractor did not provide or make available any data and records necessary to analyze the offeror's proposal, does the case file demonstrate that the ACO notified the procuring contracting officer immediately that the offeror had denied access to any records considered essential to conduct a satisfactory review, as required by FAR 15.404-2(d).	0	0	13	13
b. Does the case file demonstrate that the cost price analyst accessed the contractor's accounting books and records to examine all records and other evidence sufficient to reflect properly all costs anticipated to be incurred directly or indirectly in performance of this contract. [52.215-2(b)]	0	12	1	13

### 8. Compliance with FAR 15.404-1(e)(2) Technical Analysis

Identify where no Technical Analysis was performed. (Note)			6	6
a. Does the case file documentation demonstrate that the cost price analyst led the CMO functional specialists in the analysis and established the overall approach to use in analyzing the contractor's proposal, as required by DCMA Instruction Folder No. 22, Pricing and Negotiation – Contracts, paragraph 2.2.1.	0	7	0	7
b. Does the case file documentation demonstrate that the technical analysis included an examination of the types and quantities of material proposed and the need for the types and quantities of labor hours and the labor mix. [FAR 15.404-1(e)(2)]	0	7	0	7
c. Does the case file documentation demonstrate that the technical evaluation included the identification of any other data that may have been pertinent to an assessment of the offeror's ability to accomplish the technical requirements. [FAR 15.404-1(e)(2)]	0	7	0	7

## DoD OIG Checklist Evaluation, DCMA Case File Documentation

	SUMMARY RESULTS			Total
	Yes	No	N/A	
d. Does the case file documentation demonstrate that the technical analysis included other data that may have been pertinent to the cost or price analysis of the service or product being proposed. [FAR 15.404-1(e)(2)]	0	7	0	7
e. Does the case file documentation demonstrate that personnel having specialized skills performed a technical analysis of the proposed types and quantities of materials, labor, processes, etc, as set forth in the contractor's proposal and determined the need for and reasonableness of the proposed resources, assuming reasonable economy and efficiency. [FAR 15.404-1(e)(1)]	0	7	0	7

Note - This indicator serves to confirm that no technical analysis work was performed on six cases. The indicator is not included in the question totals.

## Appendix C: DCAA questioned cost per audit hour across the audit portfolio, fiscal year 2009

<b>Audit Area</b>	<b>Audit Hours Expended</b>	<b>Questioned Cost (Note)</b>	<b>Questioned Cost Per Audit Hour</b>
Forward Pricing - All	1,150,756	\$18,821,296,000	\$16,356
Individual Proposal Audits – Over Proposed Thresholds			
Fixed Price Over \$10M	216,178	\$10,860,775,000	\$50,240
Cost-type Over \$100M	50,155	\$279,283,400	\$5,568
<b>Under Proposed Thresholds, Combined</b>	<b>132,133</b>	<b>\$266,109,300</b>	<b>\$2,014</b>
Low Dollar Fixed Price Under \$10M	86,534	\$217,686,000	\$2,516
Low Dollar Cost-type Under \$100M	45,599	\$48,423,300	\$1,062
Other Forward Pricing Audit Activity	752,290	\$7,415,128,300	\$9,857
Other Areas of the Audit Portfolio:			
Operations Audits	40,736	\$157,098,000	\$3,856
Special Audits	561,158	\$1,007,259,000	\$1,795
Defective Pricing	58,582	\$37,089,000	\$633
Cost Accounting Standards	238,380	\$89,396,000	\$375
Incurred Cost	1,541,561	\$302,854,000	\$196
Note. Questioned cost on cost-type individual proposal audits has been factored down to represent the potential impact that DCAA questioned costs may have on the negotiated contract fee (estimated at 10 percent) established by the contracting officer. For example, questioned cost of \$484,233,000 on cost-type proposals under \$100 million (Table 2) factored down to \$48,423,300.			

# Director, Defense Pricing and Director, Defense Procurement and Acquisition Policy Comments



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

JUL 10 2012

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR POLICY AND OVERSIGHT

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS

NS  
7/10/12

SUBJECT: Response to DoDIG Draft Report on Actions to Align Defense Contract Management Agency and Defense Audit Agency Functions (Project No. D2011-DIPOAI-0103.000)

As requested, we are providing responses to the general content and recommendations contained in IG draft audit report D2011-DIPOAI-0103.000, revised June 5, 2012.

The draft report distorts the decisions made by Defense Procurement and Acquisition Policy (DPAP) and suggests, inappropriately and incorrectly, that the decisions made result in a potential loss of \$249.1M.

DPAP and Defense Pricing (DP) have typically been completely aligned with the findings and recommendations made by the DoDIG. While we concur, for the most part, with the recommendations made in the draft report, DPAP and DP strongly object to the mischaracterization of the thoughtful, deliberate, and risk based decisions made by DPAP in consultation with the Directors of the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA) with regard to raising the thresholds for requesting DCAA audits. These decisions will result in billions of dollars in savings to the taxpayers and were respectful of the risk based management decisions that must be made in a fiscal environment that necessitates the recognition that there are and will be limitations on the size of the workforce at DCAA.

Over the past three years, the Department has made a significant investment in increasing the size and capability of the workforces at both DCAA and DCMA. The services of the DCAA are extremely valuable to Contracting Officers. However, they are only one of a number of inputs that are and will continue to be made available to Contracting Officers. There has been a significant investment in DCMA to provide a variety of tools to Contracting Officers in order to assist in achieving fair and reasonable contract prices.

In particular, we wish to respond to the following statements included in the report:

1. *"The Office of Defense Procurement and Acquisition Policy did not perform a business case analysis to evaluate the viability of the DCAA proposal to raise the thresholds for requesting a DCAA proposal audit."*

Response: This statement is factually incorrect. The business case analysis in support of the decision to raise the thresholds for requesting a DCAA proposal audit was so compelling that it was obvious on its face. DCAA's proposal was to cease doing full audits resulting in an audit report on prime contractor proposals less than \$10M for fixed price proposals and less than \$100M for cost type proposals. The Director, DCAA presented an analysis which demonstrated the following:

	# of Reports	Proposal Value	Actual Audit Hours	Total Questioned Costs
Under \$10M (Fixed Price)	1614	\$ 4.89B	147,374	\$ 380.3M
Over \$10M (Fixed Price)	685	\$73.51B	155,338	\$10,697.7M

The above data clearly shows that in performing audits on fixed price proposals less than \$10M DCAA had expended 48.6% of its audit hours to achieve 3.4% of the total potential savings to the Government. In other words, **every hour spent on proposals less than \$10M resulted in potential savings of \$2,580 per audit hour expended. On the other hand, every hour spent on fixed price proposal greater than \$10M resulted in potential savings of \$68,862 per audit hour expended.**

With regard to cost-type proposals less than \$100M:

	# of Reports	Proposal Value	Actual Audit Hours	Total Questioned Costs
Under \$100M (Cost Type)	553	\$ 11.6B	63,817	\$ 658.8M
Over \$100M (Cost Type)	89	\$ 44.6B	31,937	\$ 2,618.3M

The above data clearly shows that in performing audits on cost type proposals less than \$100M DCAA had expended 66.7% of its audit hours to achieve 20.1% of the total potential savings to the Government. In other words, **every hour spent on proposals less than \$100M resulted in potential savings of \$10,323 per audit hour expended. On the other hand, every hour spent on cost type proposal greater than \$100M resulted in potential savings of \$81,983 per audit hour expended. The actual savings for all cost type proposal reviews are generally limited to the negotiated fee percentages applied to the costs questioned that are sustained during negotiations.**

It was clear, on its face, that it made more sense to free up auditors to do the higher priority proposals greater than \$10M fixed price and \$100M cost plus as well as to allow for other important higher priority tasks, such as defective pricing audits, which serve as a very effective deterrent to poorly prepared contractor proposals.

In addition to the above, as discussed by the Director DPAP, the Deputy Director DPAP, and the Directors of both DCAA and DCMA, it was recognized that, under any condition, the

preponderance of cost type contracts less than \$100M were for contracted services which are essentially all labor based. For example, in the sole source cost-type contracts less than \$100M, for FY 2010 and FY2011 the total dollars for services was \$19.9B vs. \$6.9B for supplies.

Three important mitigating factors were considered for cost type proposals: 1) every cost type contract is subject to "another bite at the apple" in that each contract is subject to an after-the-fact incurred cost audit; 2) the contractor is entitled to its full reimbursement of its reasonable, allowable, and allocable costs; and, 3) while there might be an argument that there could be an effect of the fees earned, it was diminutive in relation to the potential benefits gained.

By departmental policy, Contracting Officers are required to rely on DCMA recommended rates for labor and overhead. DCMA, in turn, would utilize DCAA audited rates, whenever available. In other words, while the lifting of proposal thresholds would result in not requiring DCAA auditors to perform audits with reports issued, it had little to no effect on Contracting Officers ability to negotiate fair and reasonable estimated costs and fees. For approximately 80% of the proposed costs there effectively would be no change. From a Contracting Officer perspective there effectively would be no change with regard to how those proposals would be analyzed for cost reasonableness for the preponderance of proposed costs.

***2. The decision by DPAP to revise the Defense Federal Acquisition Regulation Supplement (DFARS) Procedures Guidance and Instructions (PGI) 215-414-2(c) and increase thresholds for requesting DCAA audits of low-dollar contractor proposals did not consider the 249.1M potential return on investments such audits bring to the Department and taxpayer.***

Response: This statement is inaccurate. We did consider the benefit of the decision and, by any measure and in any manner, the decision will result in the savings of billions of dollars to the taxpayers.

***3. DPAP did not consider that DCMA was not prepared to perform cost analysis, could not reliably report the results of performance and was not positioned to replace the potential return on investment previously identified by DCAA of \$249.1million.***

Response: This statement is not accurate. Since 2008 the Department has carried out a strategy to significantly impact the size and capability of the DCMA pricing workforce. That strategic thrust has, and will continue to, result in significant benefit to our Contracting Officers and to the taxpayers. There are four separate but inter-related thrusts to the DCMA pricing strategy:

- The realignment of all Corporate Administrative Contracting Officers (CACOS) and Divisional Administrative Contracting Officers (DACOS) into one integrated organization so that Contracting Officers would receive consistent and detailed contractor rate recommendations.
- The development of the Contractor Business Analysis Repository (CBAR). This force multiplying tool enables Contracting Officers to get real time information on



- rates/cost analysis information and was a factor in enabling the shift from DCAA to DCMA provision of Cost/Price analysis support for the realigned proposal thresholds.
- The establishment of Integrated Cost Analysis Teams (ICATS). These are "super" pricing teams formed and being formed to assist Contracting Officers with the evaluation of all proposals from the top business entities with which the Department does business.
  - Strengthening each of DCMA's Contract Management Office's (CMOS) pricing capability in combination with the utilization of Navy Price Fighter engineers to supplement every aspect of proposal analysis that Contracting Officers might need to analyze proposals.

It is specifically with this capability in mind that the decision was made. While it is recognized that this integrated capability is in its early stages, it is a significant capability and it is poised to assist Contracting Officers in savings billions of dollars for the taxpayers.

**Recommendation 2:**

The Director, Defense Procurement and Acquisition Policy reinstate the pre-September 17, 2010 thresholds for requesting DCAA audit identified at DFARS PGI 215.404-2(c) *Audit assistance for prime contracts or subcontracts* until such time as a business case analysis can support that any change to DoD procurement and acquisition policy will protect the interests of the Department and taxpayer.

**Response:**

Partially Concur. As previously, stated a business case analysis was done. The merit of the change was obvious on its face. We will continue to monitor the results of the decisions made. If the facts merit a change in policy, we will modify our present PGI as appropriate.

We question the DoDIG supposition that there is a potential \$249.1 million loss to the Department and taxpayer from this action. In fact, any reasonable review of the numbers as presented by the DoDIG report would support the decision, even if there were no mitigation planned for the reduction in DCAA questioned costs on low-dollar proposals. The IG asserts that there is a potential loss of \$2,014 in questioned costs per hour, or \$266,109,300 for all the redirected work. While that is true, if only 10% of the 132,133 redirected audit hours (13,213 hours) are used on high dollar fixed price proposals there will be a 149% increase in questioned costs in total, without even considering results from the use of the other 90% of the redirected hours (118,920 hours) or the planned mitigation.

Using the numbers from the draft report's Table 3 that the DoDIG cites as the basis for its calculation of the potential loss, the potential cost questioned per hour for fixed price proposal audits over \$10 million is \$50,240 per hour. If only 13,213 hours of the saved hours are redirected to those audits, the potential costs questioned jumps by \$663,821,120 (more than double the entire potential reduction on the low-dollar proposals). There was never a question if this change would benefit the Department and taxpayer. By a wide and unmistakable margin, this change in threshold for audit is in the best interests of the Department and the taxpayers.

Of course, there will be more analysis as we move forward and if that analysis shows better uses for the DCAA resources or better ways to efficiently support contracting officers, DPAP will make the necessary changes. However, a sufficient business case analysis that supported the action taken was done and that analysis still supports it.

DCAA is still available to address unique problems for the PCO and DCAA is still reviewing forward pricing rates at contractor locations with significant volume. The DoDIG's suggestion that there is potential for a multi-million dollar loss from this decision is erroneous. The DoDIG report analysis is flawed in that it does not consider the gains from alternate uses of the DCAA audit resources or give any consideration to the results of DCMA or PCO pricing reviews. The PGI change was and continues to be the right action to protect the interests of the Department and the taxpayers.

**Recommendation 3:**

The Director, Defense Pricing reassess the decision to revise DFARS PGI 215.404-2(c) *Audit assistance for prime contracts or subcontracts* and validate that the decision sufficiently considers:

- (i) the potential return to the Department and taxpayer resulting from DCAA audits,
- (ii) DCMA capability to sufficiently perform and adequately document the work, and
- (iii) DCMA capability to reliably report performance and results.

**Response:**

Partially Concur. We concur that we will continue to analyze the use of the Department's scarce resources to find the best utilization for the benefit of the Department and the taxpayer. We non-concur with the suggestion that the Department or the taxpayers were exposed to potential losses or that there was not an adequate analysis done to support the decision made to increase the threshold for use of DCAA audit reviews. Given the resource constraints and the data on results of prior audits of similarly sized proposals, the decision made was reasonable.

In response to the specific suggestions in the DoDIG report:

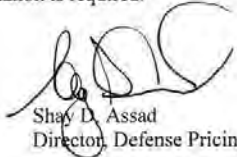
- i. DPAP did consider the potential return to the Department and the taxpayer in its decision to take the action raising the threshold. The required action was manifestly obvious from even a casual review of the numbers provided by DCAA and which are included in the draft DoDIG report Table 3.
- ii. While DPAP worked with DCAA and DCMA to transition the low-dollar proposals from audit by DCAA to pricing reviews by DCMA, that was not the primary basis for the change. The transition was a mitigation technique. If there was no DCMA involvement at all, the decision to raise the thresholds would have been a reasonable one based on the projected return from the reallocation of the DCAA resources. It was a risk DPAP was prepared to take to achieve the use of DCAA audit resources on higher value work. The DCMA involvement is evolving and promises to capture a significant portion of the

potentially questionable costs on the low-dollar proposals as well as provide training opportunities for the newly reestablished DCMA pricing function.

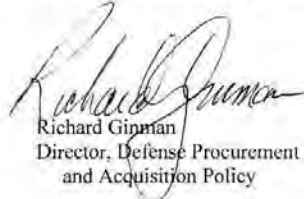
This change in the audit threshold is not the only change in DCAA priorities or in the requirements for DCAA audits to support Department actions. There will be other changes made to make better use of DCAA resources in support of business system reviews and incurred cost examinations. The management of audit requirements in our budget constrained environment will be a continuing process and we will be open to making changes in the thresholds in the future.

We have reviewed the attached responses provided by the Directors of DCAA and DCMA and we concur with their views.

Please contact Mr. Shay Assad, at 703-695-7145 or Shay.Assad@osd.mil, if additional information is required.



Shay D. Assad  
Director, Defense Pricing



Richard Ginman  
Director, Defense Procurement  
and Acquisition Policy

Attachments:  
As stated

# Defense Contract Audit Agency Comments



OFFICE OF THE DIRECTOR

DEFENSE CONTRACT AUDIT AGENCY  
DEPARTMENT OF DEFENSE  
8725 JOHN J. KINGMAN ROAD, SUITE 2135  
FORT BELVOIR, VA 22060-6219

July 3, 2012

MEMORANDUM FOR DEPARTMENT OF DEFENSE, OFFICE OF INSPECTOR  
GENERAL, DEPUTY INSPECTOR GENERAL FOR POLICY  
AND OVERSIGHT

ATTENTION: Mr. Randolph R. Stone

SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft  
Report, *Actions to Align Defense Contract Management Agency and Defense  
Contract Audit Agency*, dated May 29, 2012 (Project No. D2011-DIP0AI-0103.000)

Thank you for the opportunity to respond to the subject draft report, *Actions to Align  
Defense Contract Management Agency and Defense Contract Audit Agency*. Our response to the  
recommendation to DCAA is below.

**Finding A:** Lack of a business case analysis results in a potential \$249.1 million loss to the  
Department and to the taxpayer.

**DoDIG Recommendation A.1:** We recommend that the Director, Defense Contract Audit  
Agency, beginning with the fiscal year 2013 audit planning cycle, implement a risk-based audit  
planning process that directs limited DCAA audit resources to high risk audit areas based upon:

- i. Achieving higher rates of return to the taxpayer,
- ii. The potential for identifying fraud, waste and abuse,
- iii. The potential for identifying Federal Acquisition Regulation and Cost Accounting  
Standard violations and
- iv. The need to serve the public interests as the primary DCAA customer.

**DCAA Response:** Concur in principle.

DCAA concurs in principle with the DoDIG's recommendation. We agree that DCAA's  
audit planning process should be a risk-based process that directs limited DCAA audit resources  
to high risk audit areas. However, we believe that DCAA has such a planning process and that it  
already addresses the Defense Business Board's recommendation. We strongly disagree with the  
DoDIG's assertion that DCAA does not have a risk-based approach because that finding is based  
on incomplete and faulty assumptions. Specifically, we disagree with the substance of the  
DoDIG's finding that led to the recommendation for the following reasons:

- DCAA already employs a risk-based planning approach that directs DCAA audit  
resources to high risk audit areas, which makes this recommendation unneeded.
- Increasing the audit thresholds for forward pricing reviews was only one  
component of DCAA's overall risk-based planning. The Agency believes that the  
audit resources saved by this change can be put towards higher priority work.



SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft Report, *Actions to Align Defense Contract Management Agency and Defense Contract Audit Agency*, dated May 29, 2012 (Project No. D2011-DIP0AI-0103.000)

- The DoDIG's model for ranking audit areas based on questioned cost per audit hour is too simplistic and does not consider the total risk to the Department.
- The potential \$249.1 million loss calculated by the DoDIG is dramatically overstated and does not consider:
  - The impact of DCMA's cost/pricing efforts.
  - The audit savings resulting from applying the resources that would have been expended on under threshold proposals to higher priority work (i.e., the opportunity cost).

#### **Risk-Based Planning Approach**

DCAA already uses a risk-based planning approach that directs its audit resources to high risk audit areas. Since the Defense Business Board recommendations in October 2008, DCAA has worked with its stakeholders to identify low risk work that can be divested or that overlaps with another agency. For example, the review of our portfolio of audit workload disclosed an overlap of coverage in the areas of purchasing system reviews and financial capability reviews. After careful review of the regulations and discussion, DCAA and DCMA jointly determined that this work was best assigned to DCMA, which has the better skill set in these areas. However, DCAA still provides a limited amount of effort in support of DCMA when the underlying concern rests on an accounting issue.

Similarly, a review of our forward pricing effort found that we were spending a considerable amount of time on low dollar audits. Using the thresholds that were eventually established of \$10 million for fixed price audits, and \$100 million for cost-type audits, the proposal data disclosed the following:

**Table 1 - Fiscal Year 2009 Forward Pricing Data**

Description	Percent of Dollars Examined	Percent of Hours	Percent of Cost Questioned
Under Threshold Audits	12 %	53 %	7 %
Over Threshold Audits	88 %	47 %	93 %

As this table shows, we expended over half our audit hours on proposals under the threshold for a negligible return of only 7 percent of the cost questioned. Further analysis showed that when moving from under threshold audits to over threshold audits, the rate of return—as measured by questioned cost per hour—increased exponentially. For cost-type audits, the questioned cost per hour for over threshold audits was 8 times that of under threshold audits; and for fixed price audits, the increase was almost 27 times as much. While it is true that the under threshold audits still maintained a relative advantage in terms of cost questioned per hour over some other types of audits (e.g., incurred cost), the Agency believes it can make better use of these resources. For example, redirecting even a small portion of the saved hours to forward pricing reviews over the threshold will provide the Department and taxpayer with a much greater return on investment.

DCAA's proposal to DPAP was based on the conclusion that increasing the threshold for proposal audits would allow DCAA to spend more time on higher priority work. The under threshold proposal also recognized that there was still a need to review these low dollar

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SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft Report, *Actions to Align Defense Contract Management Agency and Defense Contract Audit Agency*, dated May 29, 2012 (Project No. D2011-DIP0AI-0103.000)

proposals, and the Department empowered DCMA to supplement our limited resources by enabling DCMA cost/price analysts to review low dollar proposals.

**Ranking Audit Areas Based on Questioned Cost Per Audit Hour**

The DoDIG's report recommends that DCAA use some type of measure to rank potential return on investment. The DoDIG's analysis used questioned cost per audit hour as a measure to rank different audit areas. While this is a useful analysis—and one that DCAA is very familiar with—it does not consider the total risk to the Department. In addition, certain audits are required to be done by law or regulation, regardless of the potential return. If DCAA used the model suggested by the DoDIG, DCAA might never perform another incurred cost or Cost Accounting Standards audit. This is obviously not in the best interest of the Department. Overall, using the questioned cost per audit hour as the sole basis for allocating audit resources ignores some important areas of risk that cannot be measured by such an approach.

One key area of risk that DCAA considers is the deterrent effect that DCAA's contract audit presence has on defense contractors. In recent years, with the majority of DCAA audits focused on forward pricing, DCAA has not had the audit resources to provide the deterrent effect brought about by DCAA's continuing audit presence during the performance of incurred cost and defective pricing audits. We believe that the deterrent effect of these audits reduces the likelihood of overpayments and fraudulent activities.

Another area of risk that DCAA has identified is its incurred cost audit backlog. This backlog quadrupled over the past 10 years because DCAA lacked the resources to properly perform this audit work. Postponing these audits any longer puts the Department at great risk for canceling funds and increasing the potential for some overpayments to go undetected. The financial implications are significant: As of the end of FY 2011, there was approximately \$573 billion awaiting DCAA incurred cost audits. In addition, defective pricing audits must be completed to ensure appropriate DoD recovery of any overpricing before the expiration of the statute of limitations. Related to incurred cost audits, an additional area of DCAA focus is reviewing contractor business systems at larger contractors. Adequate business systems represent the first line of defense against fraud, waste, and abuse, as well as overpayments. DCAA business systems audits review the adequacy of contractor systems and identify deficiencies needing correction, which helps ensure the reliability of contractor payments.

A final key area of high risk to the Department is audits of Overseas Contingency Operations (OCO). DCAA identified this as a high risk audit area because the overseas contracting conditions result in vulnerabilities related to proper cost control of DoD contingency operations. Foreign contractors are subject to the same laws and rules as contractors in the U.S. but are not necessarily familiar with these laws and rules. This circumstance requires more scrutiny to ensure that the prices the government pays for contracted work are fair and reasonable. For example, DCAA may encounter situations where contractor and subcontractor proposals are not subject to true competition due to foreign contractor relationships, or U.S.-based contractors may not adequately implement the same level of internal controls in a contingency operation setting. A significant portion of the costs the Government is paying for OCO includes subcontracted work—a historically high-risk area. Importantly, the OCO area is



SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft Report, *Actions to Align Defense Contract Management Agency and Defense Contract Audit Agency*, dated May 29, 2012 (Project No. D2011-DIP0AI-0103.000)

an example where simply applying a return on investment measure might not result in the correct audit decision. Many of the audits we perform in the OCO area have historically resulted in low payback (i.e., floorchecks and material existence reviews); however, in the OCO environment, these reviews become critical to ensure the contractor is operating efficiently and the Government is not reimbursing unallowable costs. In FY 2011, DCAA audited roughly \$9 billion for OCO contracts and recommended nearly \$2 billion in reductions.

DCAA uses a risk-based planning process to ensure audit resources are focused on the highest-payback areas to DoD, the warfighter, and the taxpayer. When prioritizing work within the portfolio, DCAA plans its audits based on the highest-risk areas to the Government. This means that DCAA does not automatically prioritize audits based solely on the type of audit being conducted. Rather, DCAA examines the risk factors involved in each individual audit—whether it is a Forward Pricing, Special Audit, Incurred Cost, or Other Audit—when prioritizing audit work. Some of these factors are easily quantifiable, but some are not and may require professional judgment. Contracts considered “high-risk” typically involve significant costs, poor contractor performance in the past, or circumstances where contractors’ controls are not strong.

DCAA’s risk-based planning approach that directs DCAA audit resources to high risk audit areas has shown a positive result by achieving higher rates of return for the taxpayer. One measure the Agency is monitoring is the percentage of questioned cost to dollars examined. That percentage has steadily grown over the last few years (see Chart 1, below). In FY 2011, the Agency questioned more than 9 cents for every dollar examined. Finally, it is important to note that DCAA’s total savings continues to increase. Over the last 3 fiscal years, DCAA’s net savings went from \$2.6 billion in 2009, to \$2.9 billion in 2010, to \$3.5 billion in 2011—a 35 percent increase over 2009 and the highest net savings amount in more than 10 years.

Chart 1 – Percentage of Question Cost to Dollar Examined by Fiscal Year



SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft Report, *Actions to Align Defense Contract Management Agency and Defense Contract Audit Agency*, dated May 29, 2012 (Project No. D2011-DIP0AI-0103.000)

**Significantly Overstated \$249.1 Million Potential Loss Calculated by the DoDIG**

DCAA believes that the DoDIG's estimate of \$249.1 million "loss in potential return on investment" is significantly overstated. First, the DoDIG's \$249.1 figure was not fully adjusted to reflect that some questioned cost does not result in cost savings to the Government. Not every proposal that DCAA reviews ultimately ends in a contract award. Also, contracting officers do not always sustain DCAA findings. Across FYs 2009, 2010, and 2011, the average net savings rate for audits of fixed price contracts (a combination of both contract not awarded and contracting officer sustained amounts) is approximately 41.8 percent. Using essentially the same DoDIG methodology, combined with this average net savings rate, yields a much more modest "potential loss" of \$122.4 million.

However, even this revised potential loss is misleading because the DoDIG failed to consider that DCMA cost/price analysts will review many of the low dollar proposals. While these reviews are not as comprehensive as full-fledged audits, there is every reason to believe that these reviews will capture some of the questioned cost associated with these proposals.

Lastly, and most importantly, the DoDIG has completely ignored the audit savings that are generated by applying the resources to higher priority work rather than under threshold proposals. These resources can be used on, for example, reviews of OCO contracts or high risk defective pricing reviews, both of which represent a greater potential for considerably more savings for the Department and taxpayer than performing under the threshold proposals.

While preparing this response, we reviewed the draft responses provided by the Directors of Defense Pricing, Defense Procurement and Acquisition Policy and the Defense Contract Management Agency and we agree with their views. Questions regarding this memorandum should be directed to Mr. John Shire, Deputy Assistant Director, Policy and Plans Directorate, at (703) 767-3280.



Anita F. Bales  
Deputy Director



# Defense Contract Management Agency Comments



**DEFENSE CONTRACT MANAGEMENT AGENCY**  
3901 A AVENUE, BUILDING 10500  
FORT LEE, VIRGINIA 23801

JUN 28 2012

## MEMORANDUM FOR DEPUTY INSPECTOR GENERAL POLICY AND OVERSIGHT

**SUBJECT:** DCMA Responses to Recommendations in Draft Report, "Actions to Align Defense Contract Management Agency and Defense Contract Audit Agency Functions"  
(Project No. D2011-DIP0AI-0103.000)

1. As requested, provided below are the DCMA responses to the recommendations contained in the subject draft audit report, as revised June 5, 2012.

(a) Recommendation B.1: Evaluate existing case file documentation created by price/cost analysts performing the nine other tasks identified in the DCMA price/cost analyst position description and ensure such documentation demonstrates the actions taken by the analyst demonstrate compliance with FAR, CAS and DCMA internal policies and procedures; and provide semiannual updates to the Assistant Inspector General, Audit Policy & Oversight, DoD, semi-annually until all corrective actions have been completed.

DCMA RESPONSE TO B.1: DCMA agrees with the recommendation. DCMA will employ various measures to critically examine existing case file documentation and to confirm that such documentation meets regulations, policies and procedures. Overall, DCMA will affirm that pertinent duties are being fully performed. The standard position description (PD) of the GS 1102-12 Contract Price/Cost Analyst specifically outlines 5 major duties that can be performed by an individual with this PD. These items include (1) price and cost analysis; (2) forecasting of future business conditions that would affect pricing proposals; (3) requesting and integrating technical reports into final field pricing reports; (4) determining proposal compliance with law, regulations and the Cost Accounting Standards and; (5) reviewing forward pricing rates, final overhead rates and cost impact proposals. As required in pertinent agency policies, to ensure compliance, DCMA will conduct management review and higher level control reviews of case files involving pricing, forward pricing, final overhead and CAS cost impact settlements. The DCMA Mission Review Team (MRT) will also review the case files of price cost analysts during their regular reviews to ensure that our policies and performance to the policies demonstrates compliance with laws and regulations. We will report results of the MRT reviews in these areas on a semi-annual basis for the remainder of FY 2012 and FY 2013.

(b) Recommendation B.2: Proceed with the scheduled implementation of corrective actions relating to cost analysis case file documentation (3 items) identified in the December 14, 2011 Updated DCMA Action Plan, DoD OIG Project No. D2011-DIP0AI-0103; and provide semiannual updates to the Assistant Inspector General, Audit Policy & Oversight, DoD, semi-annually until all corrective actions have been completed.

DCMA RESPONSE TO B.2: DCMA agrees with the recommendation. DCMA will report results semi-annually until the planned actions are complete. DCMA's updated execution plans, as presented in seven PowerPoint slides, are attached.

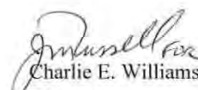
(c) Recommendation C.1: By Sept. 30, 2012, provide an update on their evaluation of the eTool P&N to determine that the tool can reliably report all activity performed by the DCMA price/cost analyst as identified in the DCMA price/cost analyst position description and take action to correct the tool for identified deficiencies; and provide semiannual updates to the Assistant Inspector General, Audit Policy & Oversight, DoD semi-annually until all corrective actions have been completed.

DCMA RESPONSE TO C.1: DCMA agrees with the recommendation. By September 30, 2012, DCMA will provide an update on its evaluation of the P&N eTool and report semi-annually until the tool is re-designed. DCMA's updated execution plans, as presented in seven PowerPoint slides, are attached.

(d) Recommendation C.2: Proceed with the scheduled implementation of corrective actions relating to eTool Price & Negotiation (8 items) identified in the December 14, 2011 Updated DCMA Action Plan, DoD OIG Project No. D2011-DIP0A1-0103; and provide semiannual updates to the Assistant Inspector General, Audit Policy & Oversight, DoD semi-annually until all corrective actions have been completed.

DCMA RESPONSE TO C.2: DCMA agrees with the recommendation. DCMA is in the process of re-designing the tool in accordance with the attached execution plans and will report DCMA's status semi-annually until the tool is completed. DCMA's updated execution plans, as presented in the seven PowerPoint slides, are attached.

2. My point of contact regarding this report and these responses is Timothy Callahan, Executive Director, Contracts. Mr. Callahan can be reached at 804-734-0500 or [timothy.callahan@dcma.mil](mailto:timothy.callahan@dcma.mil).

  
Charlie E. Williams, Jr.  
Director

Attachments:  
As stated



## DoDIG P&N eTool Discussion Items 1- 6

DEFENSE CONTRACT MANAGEMENT AGENCY

**P&N eTool 1:** Revise P&N eTool so that the services requested include the types of field pricing assistance identified in the FAR and provided by DCMA.

**P&N eTool 2 :** Input fields in the P&N eTool should be assessed for their importance, remove unnecessary fields and make the remaining fields mandatory for completion of the pricing case.

**P&N eTool 3:** P&N eTool reference material available to the users should be reviewed and updated where necessary to adequately define all P&N eTool input fields and report fields.

**P&N eTool 4:** Reporting strategy in the P&N eTool should be assessed in order to determine how best to satisfy the different user's expectations.

**P&N eTool 5:** Reports should be evaluated to determine and correct the inconsistencies between the P&N eTool and the reports and amongst the different reports.

**P&N eTool 6:** DCMA instruction should be created to ensure that control procedures are implemented to address the data integrity of the P&N eTool. These control procedures should include but not limited the following:

- data input to the system accurately reflects the underlying information;
- provide reasonable assurance that erroneous data, errors and irregularities are detected, reported, and corrected;
- enable users of the data to have a chance to bring attention to incorrect data or data that needs to be updated; and
- consistently capture all pricing cases and data elements.







## Execution Plan P&N eTool Items 1- 6

DEFENSE CONTRACT MANAGEMENT AGENCY

**Execution Strategy:** We will give consideration to the DoDIG discussion items 1 through 6 during our assessment and revision of the tool, its manuals, training and reports.

**Target Completion Date: April 2013**

**OPR:** DCMA Headquarters Contracts Directorate/ [REDACTED]

Execution Plan Milestones	Original Planned	Revised Planned	Actual
Milestone A Approval – Concept design (new milestone A approval required to update records in new IT system)		June 12, 2012	June 28, 2011
Milestone B Approval – Concept Development	February 20, 2012	August 30, 2012	
Design of Tool, User's Manual, Tutorials and Functional Testing Complete	August 15, 2012	February 15, 2013	
Field/Customer Training Complete	October 15, 2012	February 15, 2013	
Instruct Field/Customers to load pricing cases	November 5, 2012	April 15, 2013	





## DoDIG P&N eTools Discussion Item 7 Execution Plan

DEFENSE CONTRACT MANAGEMENT AGENCY

**P&N eTools 7:** DCMA Internal Review should consider our findings in future reviews and make assessing data integrity of the P&N eTools a priority in their assessment.

**Execution Strategy:** Once the current pricing policy update is completed, DCMA Office of Independent Assessment (DCMA Internal Review), Mission Review Team (MRT) will revise current Mission Review (MR) assessment methodology for future MRs to assess data integrity of the P&N eTools.

**Target Completion Date: FYE 2013**

**OPR:** DCMA Headquarters/Office of Independent Assessment, DM/ [REDACTED]

Execution Plan Milestones	Original Planned	Revised Planned	Actual
Updated Policy signed by Director.	December 20, 2011	July 30, 2012	
Revise MRT Pricing Assessment Guide and Workbook – <b>Add emphasis on review of eTools data</b>	January 5, 2012	August 15, 2012	
Complete MRT review and approval process	January 10, 2012	August 30, 2012	
Conduct MRs to evaluate P&N eTools and policy changes	November 15, 2012	Ongoing – CY 2012-2013	







DEFENSE CONTRACT MANAGEMENT AGENCY

## DoDIG P&N eTool Discussion Item 8 Execution Plan

**P&N eTool 8:** DCMA should ensure that related policies and instructions are updated when implementing recommendations or changes resulting from our findings.

**Execution Strategy:** Our pricing policy is currently being revised to include consideration of the findings of the DoDIG; in addition, we will ensure that it is updated again in coordination with the P&N etool update schedule.

**Target Completion Date: June, 2013**

**OPR:** DCMA Headquarters/Contracts Directorate/ [REDACTED]

Execution Plan Milestones	Original Planned	Revised Planned	Actual
Release Policy for Formal Coordination (re-released due to ICAT changes)	November 15, 2011		April 3, 2012
Director's Signature	December 20, 2011	July 30, 2012	
Next review for accuracy	August 30, 2012	May 30, 2013	
Director's Signature	November 15, 2012	July 30, 2013	





# DoDIG Cost Analysis Discussion Item 1 Execution Plan

DEFENSE CONTRACT MANAGEMENT AGENCY

**Cost Analysis 1:** Using the DoD OIG cost analysis case file checklist, DCMA Internal Review should perform a DCMA-wide independent assessment of cost analysis case file documentation to determine the extent to which the documentation problems identified at Manassas, Baltimore and Northrop Grumman Baltimore exist at other DCMA CMOs.

**Initial Assessment:** A dedicated team performed a review of 15 additional CMO sites using the DoDIG checklist and the findings were consistent with those found by the DoDIG.

**Execution Strategy:** We will incorporate the DoDIG discussion items into our existing Mission Review Pricing Assessment Guide and Workbook. Plan is to continue current review cycle of 22 CMOs per year by Agency Mission Review Team (MRT), DCMA Office of Independent Assessment. In addition, starting with the new integrated cost analysis teams, by Sept. CY12, we will fully assess the policy, processes, tools and training required for a highly functional pricing team. The results of this assessment will be used to ensure pricing across all CMOs is effective.

**Target Completion Date:** October 2012

**OPR:** DCMA Headquarters/Office of Independent Assessment, DM [REDACTED]

Execution Plan Milestones	Original Planned	Revised Planned	Actual
Revise MRT Pricing Assessment Guide and Workbook	January 5, 2012	August, 15, 2012	
Complete MRT review and approval process	January 10, 2012	August 30, 2012	
Utilize revised Assessment Guide to conduct remaining MRT Reviews	May 15, 2012	Sept 2012	
Utilize revised Assessment Guide to conduct reviews DCMA-wide for the new three year (Mission Review) cycle at all field CMOs	May 15, 2015	October 2012	



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DEFENSE CONTRACT MANAGEMENT AGENCY

## DoDIG Cost Analysis Discussion Item 2 Execution Plan

**Cost Analysis 2:** DCMA should establish and implement Agency-wide policies and procedures that will provide reasonable assurance that cost analysis on a contractor proposal submitted with cost or pricing data:

A) Complies with the criteria for cost analysis included in FAR 15.404-1(c) and other pertinent FAR and DFARS criteria.

B) Is adequately documented in a standardized case file.

**Execution Strategy:** We will enhance discussion of cost analysis in the current update of our Pricing and Negotiation Instruction and provide a checklist that will standardize the case file ; however, we will not establish GAGAS standards for the case. We are finalizing a pricing training course to emphasize these areas and will be working with DAU to ensure that their courses also emphasize these areas. The first pilot offering of our training course will be conducted beginning April 23, 2012. The course comprises both business and technical pricing training. We are enhancing our cost analysis capability at 8 contractor locations by forming Integrated Cost Analysis Teams (ICATs) comprised of dedicated business and technical proposal pricing personnel.

**Target Completion Date:** September, 2012

**OPR:** DCMA Headquarters/Contracts Directorate, [REDACTED]

Execution Plan Milestones	Original Planned	Revised Planned	Actual
Release Policy for Formal Coordination (re-coordination due to ICAT update)	November 15, 2011		April 3, 2012
Director's Signature	December 20, 2011-	July 30, 2012	
DCMA Pricing Course Deployment	July 31, 2012		
Engagement with DAU on Pricing Courses	Ongoing		
Initial Operational Capability - ICATs	March 26, 2012	Sept 2012	







# DoDIG Cost Analysis Discussion

## Item 3 Execution Plan

DEFENSE CONTRACT MANAGEMENT AGENCY

**Cost Analysis 3:** DCMA should establish and implement Agency-wide policies and procedures that will provide reasonable assurance that a technical analysis performed in support of a cost analysis on a contractor proposal submitted with cost or pricing data:

1. Complies with the criteria for cost analysis included in FAR 15.404-1(e) and other pertinent FAR and DFARS criteria.
2. Is adequately documented in a standardized case file

**Execution Strategy:** We will enhance discussion of these areas in the current update of our Pricing and Negotiation Instruction and provide a checklist that will standardize the case file ; however, we will not establish GAGAS standards for the case file. In addition, we are developing an organizational structure and mission statement for dedicated pricing and technical support (ICATs). We are enhancing our Pricing Center and HQ Engineering with additional technical personnel dedicated to pricing. The HQ focus will be on training and hub site focus will be on field assistance. Funding is being provided to the Navy Price Fighters for should cost reviews and tech support to pricing.

**Target Completion Date: September 2012**

**OPR:** DCMA Headquarters/Contracts Directorate, [REDACTED]

Execution Plan Milestones	Original Planned	Revised Planned	Actual
Release Policy for Formal Coordination (re-coordination due to ICAT information)	November 15, 2011		April 4, 2012
Director's Signature	December 20, 2011	July 30, 2012	
Initial Operational Capability - Pricing Support Sites	March 26, 2012	Sept 2012	
Explore including Navy Price Fighter function within DCMA	March 26, 2012		Complete





# Inspector General Department of Defense