

DEFENSE CONTRACT AUDIT AGENCY
Management Discussion and Analysis
FY 2022



A COMMITMENT TO EXCELLENCE

DEFENSE CONTRACT AUDIT AGENCY
FY 2022 MANAGEMENT DISCUSSION AND ANALYSIS

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MESSAGE FROM THE DIRECTOR



I am pleased to present the Defense Contract Audit Agency's Management Discussion and Analysis (MD&A) for FY 2022. Our MD&A provides executive-level information on the Agency's mission and vision, organization and structure, performance results, financial highlights, systems, controls and legal compliance.

In FY 2022, DCAA realized a return on investment of \$4.7 for each \$1. The Agency examined \$409.6 billion in contract costs, issued 2,560 audit reports, and identified \$3.0 billion in net savings despite the challenges presented by various COVID-19 variants that prevented a smooth reentry to the workplaces. However, our workforce continued to display extraordinary resiliency and innovation to accomplish our audit mission without significant delays or limitations. In addition, DCAA received a rating of PASS on its peer review.

DCAA's sound financial management and organizational controls underpin all of our mission requirements and enable our success. I am pleased to announce that DCAA received its 21st consecutive unmodified audit opinion on its financial statements.

Our focus on both mission accomplishment and sound financial management have enabled our success and will continue to do so into the future.

A handwritten signature in black ink that reads "Terri L. Dilly". The signature is written in a cursive, flowing style.

Terri L. Dilly
Director

ABOUT DCAA

Prior to 1965, each branch of the military had separate contract audit functions and regulations. Contractor and government personnel recognized the need for consistency, and the Secretary of Defense, Robert S. McNamara, instituted “Project 60” in May 1962 to examine whether it was feasible to centrally manage contract administration and audit activities. An outcome of this study was the decision to establish a single contract audit capability – the “Defense Contract Audit Agency.” DCAA began providing audit and financial advisory services to government contract officials on July 1, 1965.

Today, DCAA operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. The Agency’s primary function is to conduct contract audits and related financial advisory services. Contract audits are independent, professional reviews of financial representations made by defense contractors, and DCAA helps determine whether contract costs are allowable, allocable, and reasonable.

The 2022 National Defense Strategy (NDS) outlines how the Department of Defense will contribute to advancing and safeguarding vital U.S. national interests – protecting the American people, expanding America’s prosperity, and realizing and defending our democratic values. In developing the NDS, the Department conducted its strategic reviews in a fully integrated manner to ensure tight linkages between our strategy and our resources. DCAA’s role in the financial oversight of government contracts is critical to ensuring DoD maximizes the resources required to build a resilient Joint Force and defense ecosystem to support integrated deterrence of potential adversaries.

OVERVIEW

Mission

Together with our acquisition partners, we increase warfighter capabilities by delivering high quality audits and financial services to achieve fair and reasonable prices that protect taxpayer dollars. Our mission statement clarifies our commitment to getting the most value for every dollar spent on defense contracts. We operate as a member of the acquisition community that works together to equip and serve our service members in uniform. As stewards of taxpayers’ interests, we conduct high-quality contract audit services to ensure the government is paying fair prices.

Organization and Staffing

Organizational Structure. DCAA’s organizational structure consists of a Headquarters, four Corporate Audit Directorates organized by major contractors, three geographical Regions primarily focused on other large, mid-sized, and small contractors, and a Field Detachment focused on classified work. DCAA has about 230 offices located throughout the United States, Europe, and the Middle East.

Headquarters is located at Fort Belvoir, Virginia. Principal elements are the Director, Deputy Director, General Counsel, Office of Inspector General, Operations Directorate, Policy and Quality Directorate, and Human Capital and Resource Management Directorate.

Regional Offices/Field Detachment are located in Smyrna, Georgia; Irving, Texas; Lone Tree, Colorado; and Reston, Virginia. Each region directs and administers the DCAA audit mission at locations near the contractor base. Each region is staffed with about 600 employees and serves 2000 to 3000 contractors. Regions are structured with subordinate branch offices strategically located to provide audit coverage within their assigned geographical areas. The Field Detachment has nearly 415 employees to serve 700 contractors.

Corporate Audit Directorates (CAD) are located in Lowell, Massachusetts (General Dynamics/Raytheon Technologies); McLean, Virginia (Northrop Grumman); St. Louis, Missouri (Boeing); and Irving, Texas (Lockheed Martin/BAE). Each CAD is staffed with about 300 employees that audit/review their designated major defense contractors. CADs are structured with subordinate branch offices that are co-located with the associated business lines of their designated major defense contractors.

Resident offices are established at specific contractor locations of both regions and CADs where the audit workload justifies the assignment of a permanent staff of auditors and support staff. These offices allow auditors to work on location with the largest major industrial manufacturers the government buys from.

DCAA liaison activities are conducted at DoD acquisition or contract administration offices to directly communicate and coordinate audit processes.

Defense Contract Audit Institute, located in Atlanta, Georgia, provides specialized contract audit training for DCAA's audit staff, and leadership and interpersonal skills training to new supervisors and other Agency employees.

DCAA's Professional Workforce. For FY 2022, DCAA had 3,968 authorized personnel. About 89 percent of DCAA employees are auditors and 11 percent are professional support staff in various fields, including administrative support, budget, human resources, information technology, and legal support. Roughly 92 percent of employees have a bachelor's degree, with 50 percent having a master's or higher level degree. In addition, 24 percent of the workforce have a professional certification such as Certified Public Accountant (CPA), Certified Fraud Examiner (CFE), Certified Internal Auditor (CIA), or Certified Information System Auditor (CISA).

Management Initiatives

To help ensure the quality and efficiency of audit operations DCAA routinely reviews and updates, as necessary, DCAA issued guidance. In 2022, DCAA updated guidance on Truth in Negotiations, Termination, and Requests for Equitable Adjustment audits. Additionally, we updated guidance related to the CARES Act, Paycheck Protection Program loan forgiveness and

the performance of incurred cost audits and contractor business systems. Notably, DCAA received a rating of PASS on its peer review. In accordance with the 2018 NDAA, DCAA awarded 116 audits to Independent Public Accounting firms.

DCAA also completed several information technology projects to improve our ability to adapt to the evolving environment, engage with our customers, and increase our workforce's capabilities. Among these were infrastructure improvements, the transition to DoD 365, as well as the introduction of the Contractor Submission Portal (CSP). The CSP provides a single place for contractors to submit their incurred cost proposal electronically, which benefits the contractor by providing an easy way to transfer large files, an electronic receipt for their submission, centralized version control, and a simple process to withdraw or update a proposal. Together, these projects have significantly improved our ability to engage and serve our stakeholders.

DCAA's aim is to continue providing contracting officers with high-quality and timely audit reports, advice, and negotiation support to establish fair and reasonable contract prices. During contract performance, DCAA auditors continue to verify that results and outputs of contractor business systems comply with applicable rules, regulations, and contract terms.

PERFORMANCE

Strategic Plan

DCAA's 2021-2025 Strategic Plan has three goals focused on strengthening alliances with our customers and strategic partners; delivering flexible and responsive products and services to our customers; and recruiting, cultivating, and retaining a highly skilled, flexible, and empowered workforce. This plan acknowledges the ever changing budgetary and security landscape that demands we operate at peak efficiency to reduce the cost of acquisition while increasing speed to ensure our warfighters get what they need when they need it. In FY 2022, we completed two customer focused initiatives. The first initiative focused on defining our customer groups and refining our understanding of their expectations and requirements; the second initiative standardized our process to service non-traditional support requests. In the upcoming year, we will build on this work to fully develop DCAA's customer engagement strategy.

Goals, Objectives, and Results

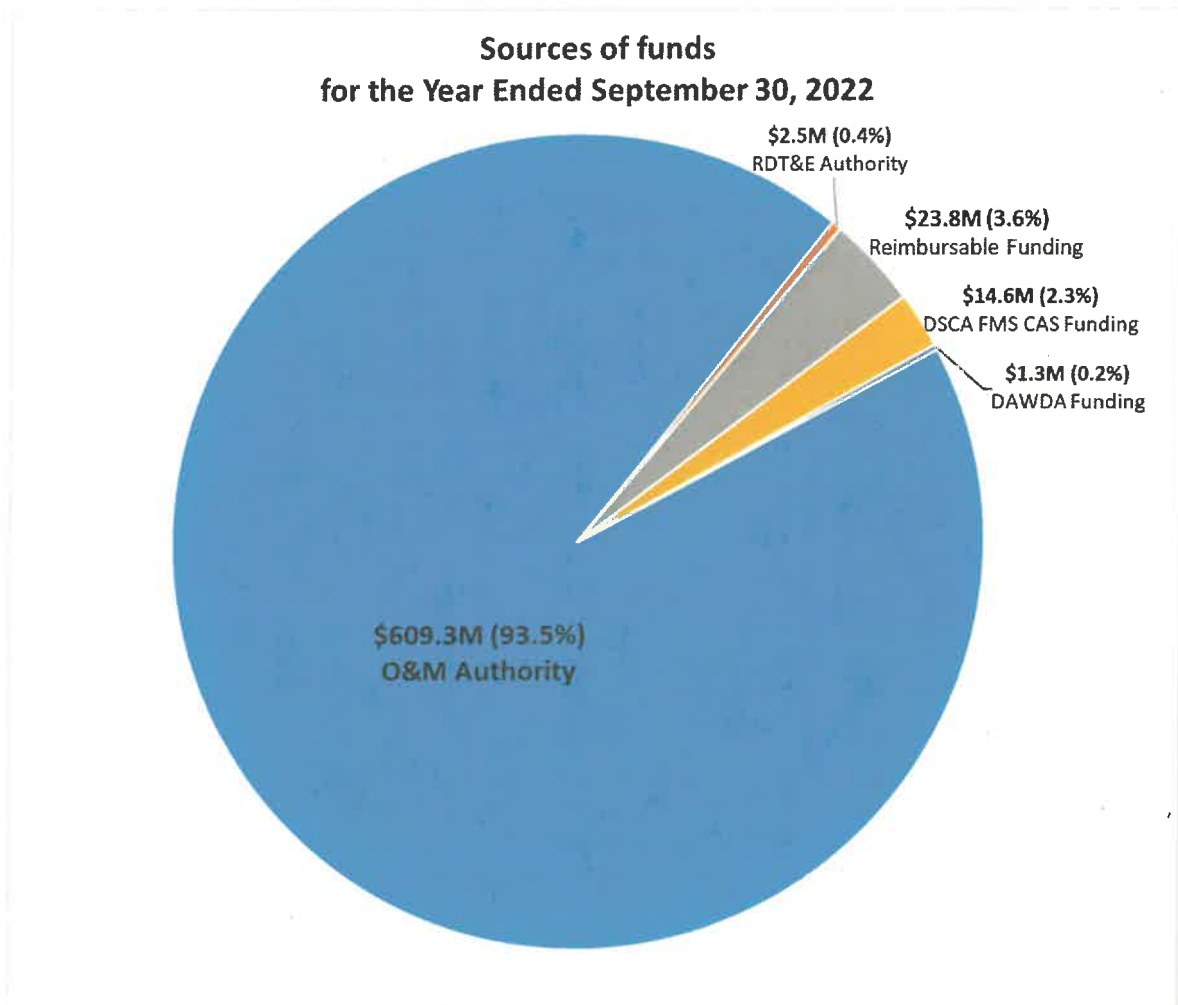
During FY 2022, DCAA examined \$409.6 billion in contract costs; issued 2,560 audit reports; identified \$3.0 billion in net savings; and produced a return on investment of about \$4.7 per \$1 spent. Although there are no specific goals for savings and return on investment, the results provide a significant indication of the value of DCAA's audit services to the U.S. taxpayer.

DCAA met the statutory requirement to complete incurred cost audits within one year of submission, and continues to find ways of being more efficient in executing these audits. The Agency also placed special emphasis in the area of Forward Pricing Audits. Reports were issued prior to the applicable negotiation to meet acquisition timelines.

FINANCIAL

Appropriated Funding

DCAA has five sources of appropriated funding that include Operation and Maintenance (O&M); Research, Development, Test, and Evaluation (RDT&E); Defense Acquisition Workforce Development Account (DAWDA); Defense Security Cooperation Agency (DSCA) direct funding; and reimbursable funding provided by non-defense agencies. The total allocated funding for FY 2022 was \$651.5M .



O&M appropriation pays for goods and services used during the normal course of business in the fiscal year appropriated. Examples of expenses include civilian salaries and benefits, recruiting, training and education, travel, information technology, leased office space, and business assets.

RDT&E appropriation finances research, development, test and evaluation efforts performed by contractors in the development of equipment, material, or computer application software. This includes services, equipment, components, materials, end items and weapons used in such efforts.

DAWDA appropriation is used to recruit and train acquisition personnel. This appropriation is part of the Office of the Under Secretary of Defense for Acquisition and Sustainment [OUSD (A&S)] financial reporting and is not shown on DCAA's financial statements. The DAWDA appropriation has been a valuable program for DCAA, allowing us to grow, train, and sustain the audit workforce.

DSCA's appropriated funds are provided directly to DCAA to pay for Foreign Military Sales (FMS) Contract Audit Support (CAS) work accomplished by the Agency.

Reimbursable work is paid by non-DoD agencies for DCAA's audit services. Customers included the U.S. Agency of International Development, U.S. Army Corps of Engineers, Department of State, Department of Homeland Security, Department of Energy, Department of Transportation, General Service Administration, and NASA.

Analysis of the Financial Statements

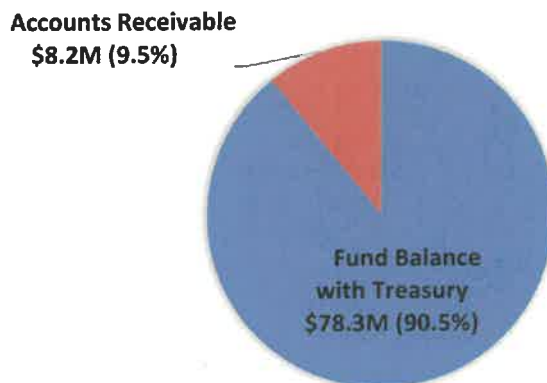
The following tables and graphs summarize information regarding the financial statements.

The Balance Sheet presents the total amounts available for use by DCAA (assets) against the amounts owed (liabilities) and amounts that comprise the difference (net position). DCAA's total assets are largely composed of Fund Balance with Treasury (FBwT) and accounts receivable. Below is a list of DCAA's major balance sheet categories as of September 30, 2022, September 30, 2021, and a comparison between the two.

	FY 2022	FY 2021	\$ Change
Assets			
Fund Balance with Treasury	\$ 78.3	\$ 91.4	(\$ 13.1)
Accounts Receivable	<u>8.2</u>	<u>11.2</u>	<u>(3.0)</u>
Total Assets	\$ 86.5	\$102.6	(\$ 16.1)
Liabilities			
Accounts Payable	\$ 3.0	\$ 0.6	\$ 2.4
Employment Benefits	15.8	20.5	(4.7)
Accrued Payroll & Leave	5.9	16.1	(10.2)
Payroll Tax Payable	4.9	13.3	(8.4)
Unfunded FECA Liability	3.7	4.0	(0.3)
Unfunded Leave	<u>39.5</u>	<u>42.4</u>	<u>(2.9)</u>
Total Liabilities	\$ 72.8	\$ 96.9	(\$24.1)

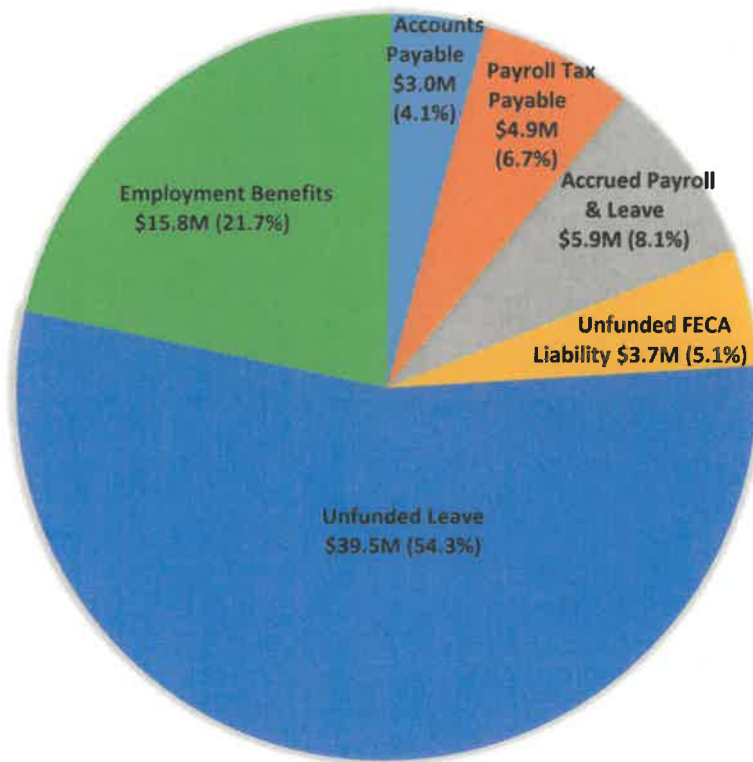
DCAA's Assets of \$86.5 million are comprised of the FBwT and Accounts Receivable. This amount is \$16.1 million less than last year's balance. \$13.1 million of this change is attributed to a decrease in FBwT. It is funding available from which DCAA is authorized to make expenditures and pay amounts through appropriations.

Composition of Assets For the Year Ended of September 30, 2022



DCAA's Liabilities of \$72.8 million are classified as either funded (covered by current budgetary resources) or unfunded (covered by future budgetary resources). Funded liabilities include employer contributions to employee benefits, accounts payable, payroll taxes payable, and current accrued payroll. Unfunded liabilities consist primarily of employment benefits, estimated future Federal Employment Compensation Act (FECA) liabilities, and leave earned but not yet taken. DCAA's total liabilities decreased by \$24.1 million.

**Composition of Liabilities
For the Year Ended of September 30, 2022**

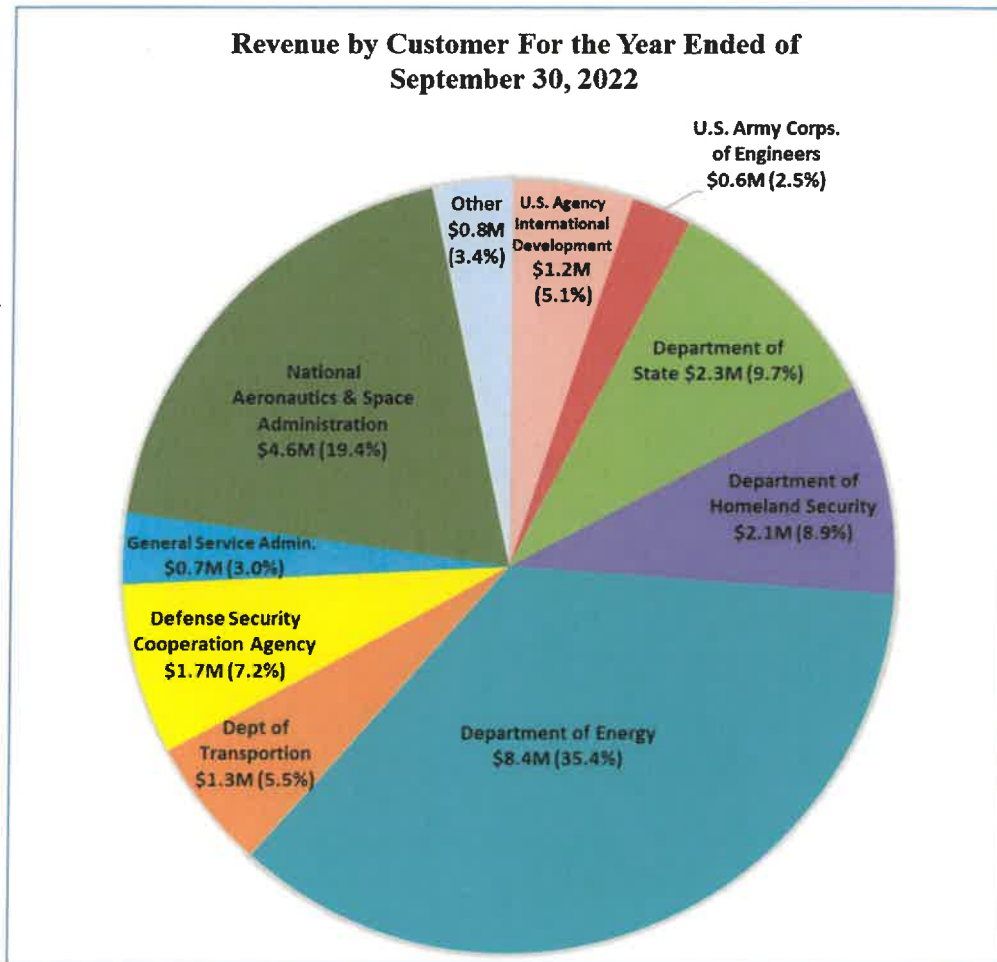


The Consolidated Statement of Net Cost presents the annual costs of operating programs. The net cost of each specific program's operation equals the program's gross costs less any earned revenue. The following table presents DCAA's major cost categories for the fiscal years ended September 30, 2022, and September 30, 2021.

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	FY 2022	FY 2021	Dollar Change
Gross Costs			
Personnel Payroll	\$401.4	\$405.9	(\$ 4.5)
Personnel Benefits	144.8	150.6	(5.8)
Purchased Goods & Services	73.7	82.4	(8.7)
FECA Tax	29.8	28.9	0.9
Total Gross Costs	\$649.7	\$667.8	(\$ 18.1)
Less: Earned Revenue	(23.8)	(41.1)	17.3
Net Cost of Operations	\$625.9	\$626.7	(\$ 0.8)

The graph below shows DCAA's FY 2022 revenue by customer.



The following table presents comparative data for the Net Position and Results of Operations as of September 30, 2022, and September 30, 2021.

Change in Net Position and Cumulative Results of Operations
\$ in millions

	FY 2022	FY 2021	Change
Unexpended Appropriations	\$ 81.1	\$ 61.0	\$ 20.1
Cumulative Results of Operations	<u>(67.4)</u>	<u>(55.3)</u>	<u>12.1</u>
Net Position:	\$ 13.7	\$ 5.7	\$ 8.0
Operations Beginning Balances	(\$ 55.3)	(\$ 62.4)	\$ 7.1
Financing Sources	613.7	633.9	(20.2)
Net Cost of Operations	625.8	626.7	(0.9)
Net Change	<u>(12.1)</u>	<u>7.2</u>	<u>19.3</u>
Cumulative Results of Operations:	(\$ 67.4)	(\$ 55.2)	(\$ 12.2)

Net Position represents the difference between assets and liabilities. Changes in the net position result from changes that occur within the Cumulative Results of Operations and Unexpended Appropriations. Unexpended appropriations represent the amount of undelivered orders and unobligated balances of budgetary authority. Our net position increased by \$8.0 million; from \$5.7 million in FY 2021 to \$13.7 million in FY 2022. The increase is attributed to \$20.1 million increase change in unexpended appropriation and offset by decreases of \$12.1 million change in cumulative results of operations when compared to September 30, 2021.

Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources (including appropriations used, imputed financing, transfer in/out, and other adjustments), since inception. DCAA had Financing Sources of \$613.7 million and a Net Cost of Operations totaling \$625.8 million. The Net Cost of Operations includes accrued expenses for annual leave liability, personnel benefits liability, and actuarial liability; Future appropriations will fund these liabilities. The Net Change was \$12.1 million, which is the difference between the Financing Sources and the Net Cost of Operations.

DCAA's Net Cost of Operations represents the difference between the costs incurred by our programs less associated revenues. We receive our funding through Congressional Appropriations and reimbursement for services provided to other federal agencies. Our Net Cost of Operations for the year ended September 30, 2022, totaled \$625.8 million. The FY 2022 Net Cost of Operations is \$0.9 million less than the FY 2021 Net Cost of Operations. The majority (84.1 percent) of FY 2022 annual net costs relate to Personnel Compensation (\$386.7 million) and Benefits (\$139.5 million).

Limitations of the Financial Statements

The Defense Finance and Accounting Service (DFAS), in collaboration with DCAA, prepares DCAA's financial statements. The principal financial statements report the Agency's financial position and results of operations, pursuant to the requirements of 31 U.S.C. 3515 (b). DFAS prepares the statements from the Agency's financial records in accordance with OMB Circular No. A-136, and uses generally accepted accounting principles for Federal entities. The statements are also used to monitor and control budgetary resources. The statements should be read with the understanding that they are for a component of the U.S. Government.

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

DCAA uses an enterprise resource planning system, Defense Agencies Initiative (DAI), and DFAS prepared DCAA's financial statements based on data entered into the DAI. Departments and agencies under the Executive Branch did not produce annual financial statements until required by the Chief Financial Officers (CFO) Act of 1990.

The Federal Financial Management Improvement Act (FFMIA) of 1996 requires that audit reports state whether Agency financial management systems comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Federal agencies must fully disclose financial data, including the costs of Federal programs and activities. DCAA continues to develop and implement improved business processes that support the accuracy and auditability of its financial statements.

DCAA's accounting system is adequate to ensure transactions are executed in accordance with applicable appropriations statutes. Reasonable assurance is provided to ensure that assets are properly acquired, used, and safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud.

Management Assurance

In its Annual Statement of Assurance (SoA) for FY 2022, DCAA provided reasonable assurance to the Secretary of Defense that the Agency's internal controls met the objectives of the Federal Managers' Financial Integrity Act (FMFIA) of 1982.

The Agency has a rigorous system of internal financial and administrative controls to ensure effective management of the Agency's resources. This system provides the reasonable assurance required to certify that the objectives of the FMFIA are achieved. The FMFIA requires federal agencies to assess the effectiveness of internal controls for program, operational, and administrative areas, as well as accounting and financial management.

As an audit organization, DCAA is aware of the importance of management internal controls. As part of its quality control process, DCAA performed specific reviews during the past year to evaluate the adequacy and consistency in implementing audit and procedural guidance. Other

objectives of these reviews include identifying areas requiring additional policy coverage and determining the adequacy of existing coverage.

Internal Control Assessment and Results

DCAA continued to evaluate its system of internal accounting and administrative controls in effect during the fiscal year ending September 30, 2022, in accordance with the guidance in OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control. The objectives of the system of internal accounting and administrative controls for DCAA are to provide reasonable assurances for:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting,
- Compliance with applicable laws and regulations, and
- Financial information systems compliance with the FMFIA.

DCAA and DFAS assessed internal control effectiveness over financial reporting according to the OMB Circular No. A-123, Appendix A, Internal Control over Financial Reporting (ICOFR), for the following:

- Fund Balance with Treasury
- Accounts Receivable
- Accounts Payable
- Government Purchase Card Program
- Financial Statement Compilation
- Federal Employees' Compensation Act Liabilities
- Government Travel Card Program
- Property Management Procedures
- Other Liabilities
- Appropriations Received
- Payroll

Financial reporting is not limited to financial statement reporting. Circular No. A-123, Appendix A, included within the definition of "financial reporting" other significant internal and external financial reports that could materially affect spending, budgetary, or other financial decisions. Appendix A prescribed a process for assessing internal controls over financial reporting. The process included:

- Evaluating internal controls by understanding management's attitude, awareness, and actions to include:
 - Integrity and ethical standards,
 - Commitment to competence,
 - Management philosophy,
 - Organizational structure, and
 - Assignment of authority and responsibility.

- Evaluating internal controls at the process, transaction, and application levels and obtaining knowledge of the organization’s key processes by:
 - Performing process risk assessments with regard to financial assertions of completeness, obligations and rights, valuation, existence and occurrence, reporting and presentation, compliance with laws and regulations, and safeguarding of assets from fraud, waste, and abuse;
 - Identifying existing key controls intended to mitigate identified risk;
 - Assessing and testing the design and operation of internal controls over financial reporting; and,
 - Issuing an Annual Statement of Assurance on Internal Control over Financial Reporting (ICOFR) as a subset of the Annual Federal Managers’ Financial Integrity Act Statement of Assurance.

We conducted separate tests to assess the effectiveness of internal controls. No material weaknesses surfaced in the design or operation of the internal controls. DCAA reported an unmodified statement of assurance for internal controls over non-financial operations and integrated financial management systems in its annual FMFIA SoA.

The concept of reasonable assurance recognizes that (1) the cost of internal controls should not exceed the benefits expected to be derived and (2) the benefits include reducing the risks associated with failing to achieve the stated objectives. However, errors or irregularities may occur but remain undetected because of inherent limitations in any system of internal accounting and administrative control. These include limitations resulting from resource constraints, Congressional restrictions, and other factors.

Our evaluation of internal control processes relied on several sources, including internal reviews and an audit by an external firm. The best evidence of our success in institutionalizing internal controls comes from the fact that DCAA has earned 21 consecutive “unmodified opinions” on our financial statements from independent public auditors. DCAA had no Anti-Deficiency Action (ADA) violations for FY 2022, and no incomplete corrective actions from a prior year.

As the Department faces decreasing budgets, DCAA will continue to be an essential component for getting the best value for every dollar spent to protect the taxpayer and support our warfighters. Our strategic outlook is solid and our central focus remains on delivering the highest quality products, serving our customers, and supporting our workforce.