

DEFENSE CONTRACT AUDIT AGENCY
Management Discussion and Analysis
FY 2021



A COMMITMENT TO EXCELLENCE

DEFENSE CONTRACT AUDIT AGENCY
FY 2021 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 2021. 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 2021 DCAA realized a return on investment of \$5.7 to each \$1. The Agency examined \$336.5 billion in contract costs, issued 2,713 audit reports, and identified \$3.7 billion in net savings while primarily working in a full time telework status due to COVID-19 restrictions. DCAA also continued to issue guidance to the contracting community on the CARES Act and the Paycheck Protection Program loan forgiveness. Additionally, the Agency developed innovative methods to work with contractors to ensure the audit mission continued without significant delays or limitations while in a COVID restricted environment.

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 20th consecutive unmodified audit opinion on its financial statements reflecting the importance we place in these areas.

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 "Anita F. Bales". The signature is written in a cursive, flowing style.

Anita F. Bales
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.

The Agency’s primary function is to conduct contract audits and related financial services for the Department of Defense and other federal entities responsible for acquisition and contract administration. Specifically, DCAA helps determine whether costs are allowable, allocable, and reasonable. DCAA provides recommendations to government officials on contractor cost assertions for specific products and services. With these recommendations, contracting officers are better able to negotiate prices and settle contracts for major weapons systems, services, and supplies.

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 Structure

DCAA has the following organizational structure:

Headquarters is located at the Andrew T. McNamara Headquarters Complex, Fort Belvoir, Virginia. Principal elements of the Headquarters are the Director, Deputy Director, General Counsel, Office of Inspector General, and the Assistant Directors for Operations, Policy and Quality, and Human Capital and Resource Management.

Regional offices are located in Smyrna, Georgia; Irving, Texas; and La Palma, California. A Field Detachment that works on classified matters is located in Reston, Virginia. Each region is staffed with 650 employees aligned with 2,000 to 3,000 contractors. The Field Detachment has 500 employees aligned with 700 contractors.

Corporate Audit Directorates (CADs) are located in Lowell, Massachusetts; McLean, Virginia; Fort Worth, Texas; and Chicago, Illinois. Each CAD directs and administers the DCAA mission at select major defense contractors.

Branch offices are strategically located within the regions and are responsible for the majority of contract audit services within their assigned geographical areas. Branch offices often have smaller sub-offices to ensure adequate audit coverage.

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 defense manufacturers.

The Defense Contract Audit Institute (DCAI) 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 2021, DCAA had 4,137 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 93 percent of employees have a bachelor's degree, with 46 percent having a master's or higher level degree. In addition, 32 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 revised guidance on the CARES Act, Paycheck Protection Program loan forgiveness, forward pricing rate proposals, updated guidance on performing incurred cost audits, and continued updating selected areas of cost. Additional training provided to the workforce pertained to the Peer Review, business system audits, and selected areas of cost. DCAA continued implementation of the 2018 National Defense Authorization Act requirement to use Independent Public Accounting Firms to conduct incurred cost audits. In FY 2021, DCAA awarded task orders for 122 such audits to be performed by Independent Public Accounting Firms.

DCAA's aim is to continue to provide 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 focus 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 2021, we completed one initiative developing a process to better synchronize budget, staffing, and workload planning. We also continued work on two other customer focused initiatives.

Goals, Objectives, and Results

During FY 2021, DCAA examined \$335.6 billion in contract costs; issued 2,713 audit reports; identified \$3.7 billion in net savings; and produced a return on investment of about \$5.7 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 essentially 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 established a goal of issuing at least 90% of forward pricing audits by the original due date; 92% were submitted on time.

FINANCIAL

Appropriated Funding

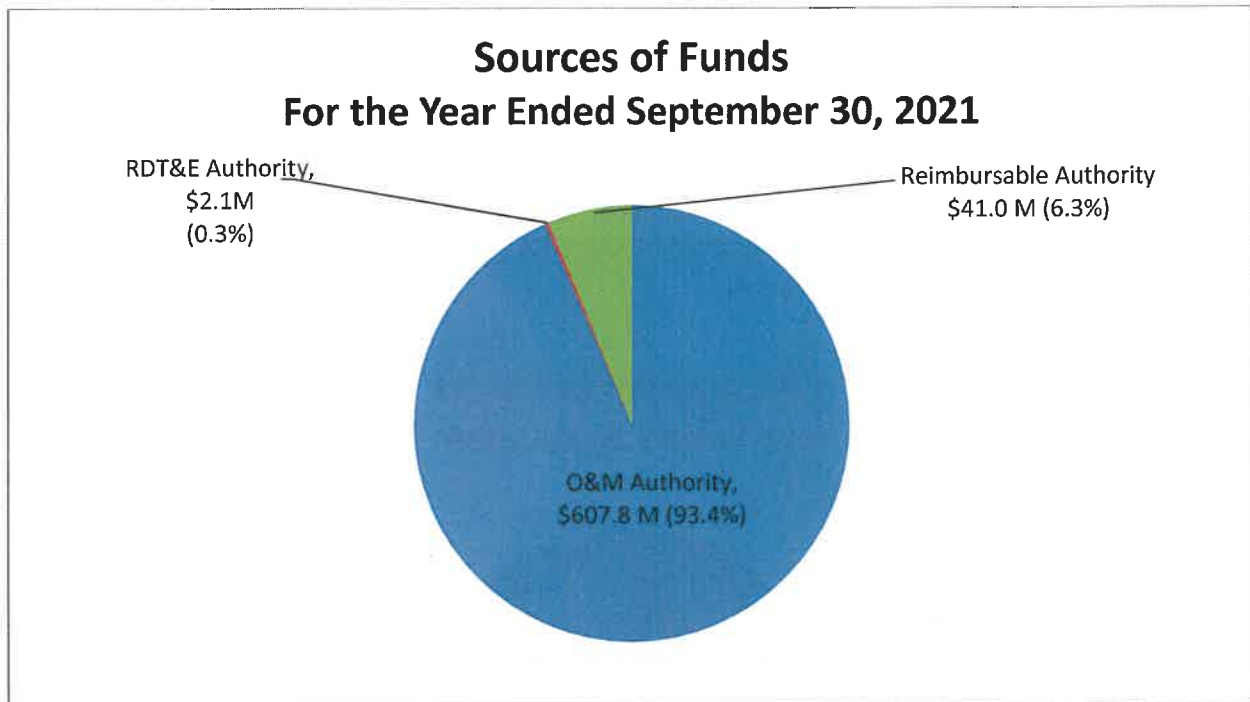
DCAA has four sources of appropriated funding that includes Operation and Maintenance (O&M); Research, Development, Test, and Evaluation (RDT&E); Defense Acquisition Workforce Development Account (DAWDA); and, reimbursable funding authority.

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. The FY 2021 O&M funding of \$607.8 million was \$13.6 million less than the prior year's level.

RDT&E appropriation is a new source of appropriation for FY 2021. The \$2.1 million allocation is required for the development of a prototype software with the capability to streamline the assembly, transmission, routing, processing, and tracking of the large volume of contractor submissions received annually by the Department of Defense.

DAWDA appropriation is used to recruit and train acquisition personnel. The Office of the Under Secretary of Defense for Acquisition and Sustainment [OUSD (A&S)] provided DAWDA funding of \$7.9 million. This appropriation is part of OUSD (A&S)'s financial reporting and 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.

Reimbursable appropriation is paid by non-DoD agencies for DCAA audit services. The Office of Under Secretary of Defense, Comptroller (OUSD(C)) sets reimbursable authority annually. In FY 2021, DCAA received \$41.0 million in reimbursable authority, which was \$2.0 million less than the prior year level.



Analysis of the Financial Statements

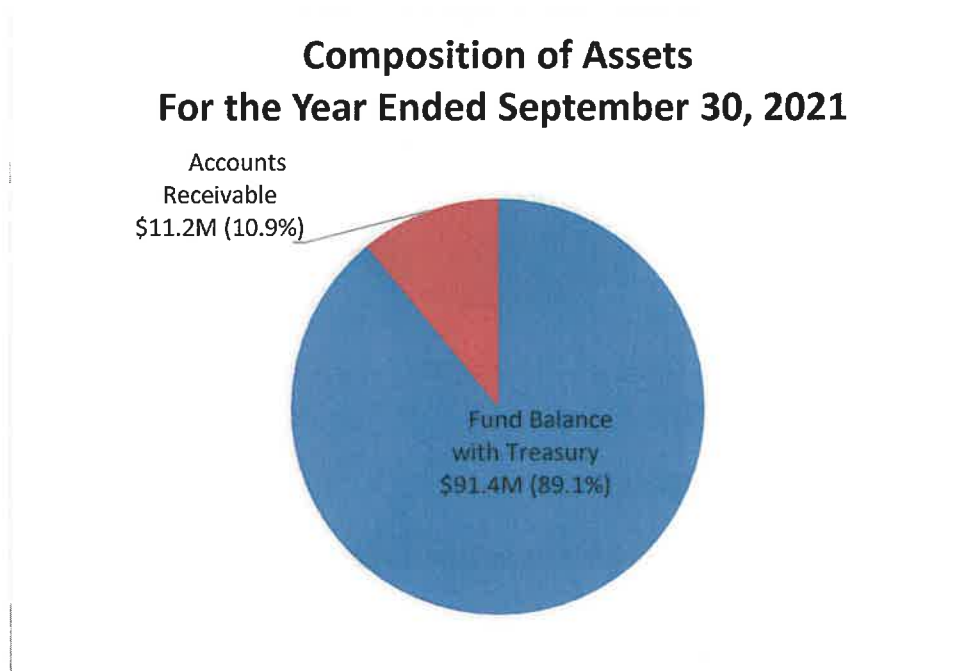
The following tables and graphs summarize information regarding the Agency's financial condition.

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, 2021, September 30, 2020, and a comparison between the two.

	FY 2021	FY 2020	\$ Change
Assets			
Fund Balance with Treasury	\$ 91.4	\$ 96.3	(\$ 4.9)
Accounts Receivable	<u>11.2</u>	<u>12.4</u>	<u>(1.2)</u>
Total Assets	\$102.6	\$108.7	(\$ 6.1)
Liabilities			
Accounts Payable	\$ 0.6	\$ 6.2	(\$ 5.6)
Employment Benefits	20.5	23.8	(3.3)
Accrued Payroll & Leave	16.1	16.1	0.0
Payroll Tax Payable	13.3	12.4	0.9
Unfunded FECA Liability	4.0	5.5	(1.5)
Unfunded Leave	<u>42.4</u>	<u>44.2</u>	<u>(2.0)</u>
Total Liabilities	\$ 96.9	\$108.2	(\$11.3)*

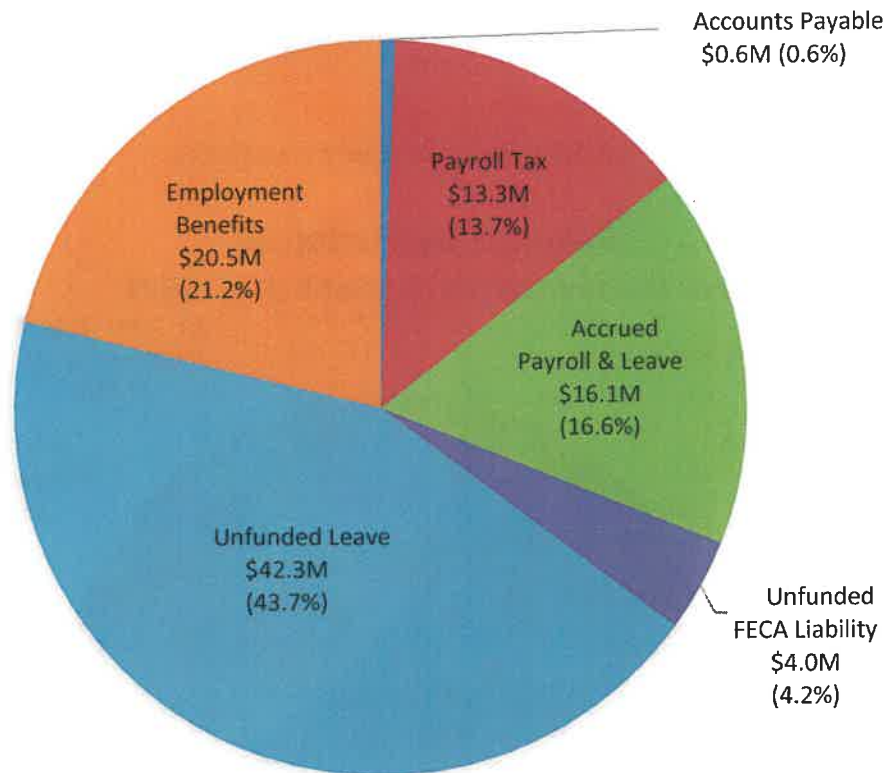
* Numbers may not be exact due to rounding.

DCAA's Assets of \$102.6 million are comprised of the FBwT and Accounts Receivable. This amount is \$6.1 million less than last year's balance. \$4.9 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.



DCAA's Liabilities of \$96.9 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 \$11.3 million.

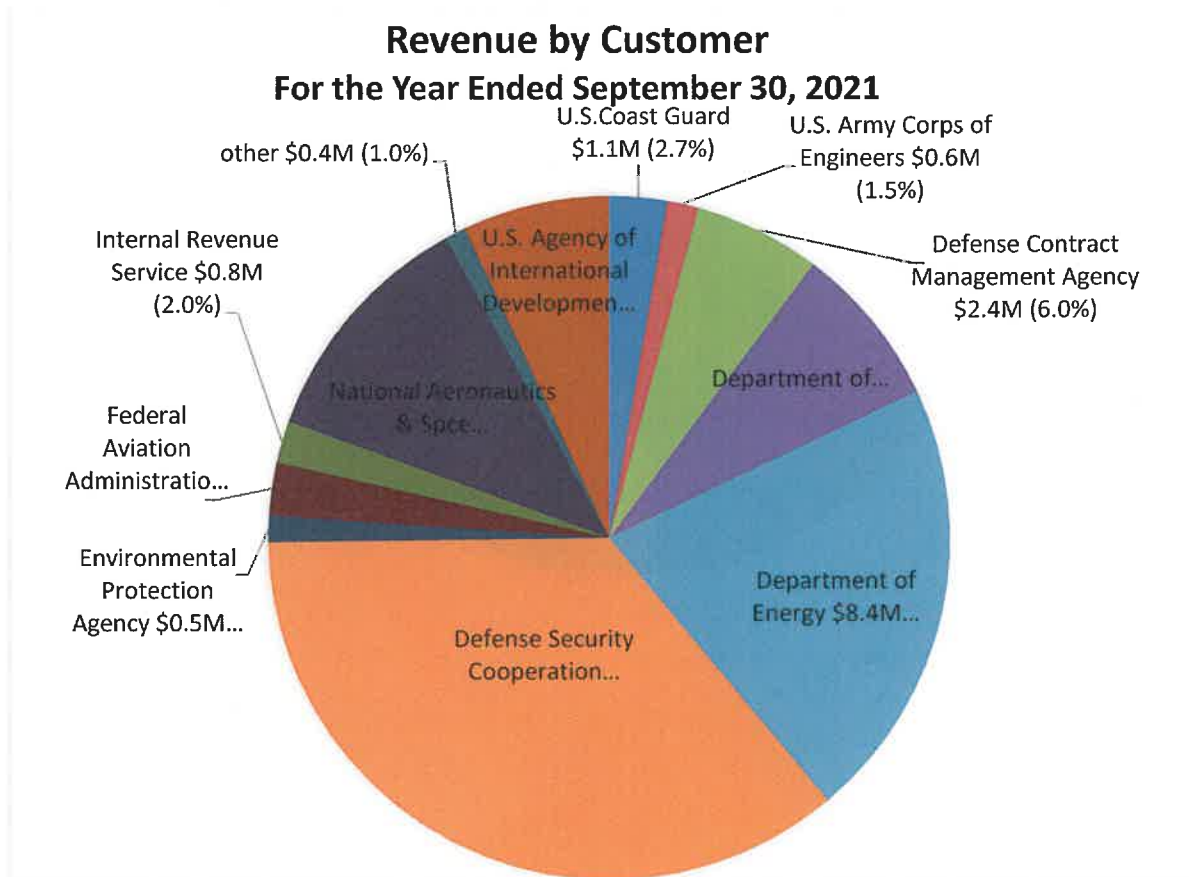
Composition of Liabilities For the Year Ended September 30, 2021



The Consolidated Statement of Net Cost presents the annual costs of operating programs. The net cost of each specific program 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, 2021, and September 30, 2020.

	FY 2021	FY 2020	Dollar Change
Gross Costs			
Personnel Payroll	\$405.9	\$417.6	(\$ 11.7)
Personnel Benefits	150.6	218.2	(67.6)
Purchased Goods & Services	82.4	20.9	61.5
FECA Tax	28.9	29.5	(0.6)
Total Gross Costs	\$667.8	\$686.2	(\$ 18.4)
Less: Earned Revenue	(41.1)	(39.4)	(1.7)
Net Cost of Operations	\$626.7	\$646.8	(\$ 20.1)

The graph below shows DCAA’s FY 2021 revenue by customer.



The following table presents comparative data for the Net Position and Results of Operations as of September 30, 2021, and September 30, 2020.

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

	FY 2021	FY 2020	Change
Unexpended Appropriations	\$ 61.0	\$ 63.1	(\$ 2.1)
Cumulative Results of Operations	<u>(55.3)</u>	<u>(62.5)*</u>	<u>7.2</u>
Net Position:	\$ 5.7	\$ 0.6	\$ 5.1
Operations Beginning Balances	(\$ 62.4)	(\$ 52.6)	\$ 9.8
Financing Sources	633.9	637.0	(3.1)
Net Cost of Operations	626.7	646.8	(20.1)
Net Change	<u>7.2</u>	<u>(9.8)</u>	<u>17.0</u>
Cumulative Results of Operations:	(\$ 55.2)	(\$ 62.4)	\$ 7.2

* Numbers may not be exact due to rounding.

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 \$5.1 million; from \$0.6 million in FY 2020 to \$5.7 million in FY 2021. The increase is attributed to \$2.1 million decrease change in unexpended appropriation and offset by increases of \$7.92 million change in cumulative results of operations when compared to September 30, 2020.

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 \$633.9 million and a Net Cost of Operations totaling \$626.7 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 \$7.2 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, 2021, totaled \$626.7 million. The FY 2021 Net Cost of Operations is \$20.1 million less than the FY 2020 Net Cost of Operations. The majority (83.3 percent) of FY 2021 annual net costs relate to Personnel Compensation (\$380.9 million) and Benefits (\$141.4 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. This system tracks budget execution; the DAI was not designed to capture the information necessary to create financial statements. 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 FY2021, 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

- 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 20 consecutive "unmodified opinions" on our financial statements from independent public auditors. DCAA had no Anti-Deficiency Action (ADA) violations for FY 2021, 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.

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, 2021, 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