SEN. MCCASKILL: I am told that Senator Brown is on his way so we will begin. And I'm sure that he won't mind that I begin and begin my opening statement. And we'll have plenty of time for his when he get here.

If there is not enough evidence that I am strange, I will add more to the record. And that is that we are going to deal with two of my favorite topics today, auditing and the oversight of contracts. And this committee hearing is all about how those two things need to be merged together so that we are doing the best job we know how to, in fact, manage contracts in the federal government.

This is not a gotcha hearing. This is an informational hearing. This is a hearing so that we understand what contract oversight is ongoing through the very important management tool of contract audits. Last Congress, the subcommittee held a number of hearings that reviewed the fundamentals of contract management and oversight across the federal government. This afternoon's hearing continues that work with an examination of contract audits, one of the most important components of effective and efficient contract oversights.

This is a subject, which may sound dry to almost everyone except those sitting inside this room. And likely some in this room would also agree that it is a very dry subject matter. But this is essential to good contract administration.
Contract audits help ensure that government gets what it pays for and are one of the best weapons that government has to safeguard taxpayer dollars against waste, fraud and abuse.

Last year the subcommittee asked for information from 22 federal agencies about how they use contract audits. My staff has prepared a fact sheet summarizing this information. And I ask the unanimous consent that the fact sheet and the underlying data be admitted into the record.

I think I have unanimous consent. (Laughter.)

The information the subcommittee received show that there is a wide variation in agencies' use of contract audits. The Defense Department, which relies on DCAA, the Defense Department Contract Audit Agency, to perform audits conducted approximately 17,000 contract audits in 2009. All of the civilian agencies combined conducted fewer than 1,800 contract audits, 17,000 in DoD, fewer than 1,800 in the rest of the government.

Let's put it another way. The Defense Department conducted an average of one audit for every 25 million (dollars) it spent on a contract. The rest of government on average conducted one audit for every 511 million (dollars) spent through contracts.

Of course there's a lot of variation among the agencies. The Department of Energy, who will testify today, conducted one audit for every 82 million (dollars) in contracts. Another witness, the Department of Education, conducted one audit for every 1.5 billion (dollars) spent through contracts. I'm very interested to hear from these witnesses about the different approaches their agencies take to contract auditing.

I'm also looking forward to the perspectives of Patrick Fitzgerald, the director of Defense Contract Auditing Agency, and Brian Miller, the inspector general of GSA, who can provide expert testimony regarding the conduct and importance of contract auditing for the federal government.

Let me pause for a moment and congratulate Brian Miller, the inspector general of GSA, because I realize that today we had something that doesn't happen very often. We had very good news about the oversight capacity of the federal government. Oracle had agreed to pay $46 million to settle a kickback complaint that came about in part because of the audit work of the inspector general at GSA.

A number of computer firms were paying government employees to recommend them for IT contracts. And in fact it was the work on contract auditing that exposed some of these problems and ultimately brought about a number of different actions by the Department of Justice and today the announcement that Oracle is going to repay the federal government $46 million or repay $46 million for the problems that they are responsible for. We will also hear testimony on behalf of the Chamber of Commerce as well as from the Project On Government Oversight in the Government Accountability Office who will help us take a broader look at this issue.

Now I am proud, very proud to be a former government auditor. And I'm a passionate defender of the importance of auditing. But that doesn't mean that I think that more audits alone is the answer to good contract management and oversight. If the government is going to be a good steward of taxpayer dollars, we need to have an integrated, comprehensive contract management. And everyone involved in the process, from the line contracting officials to senior leadership and department heads, they need to be involved, engaged and, probably most important, accountable.

Auditing is one part of that continuum. And I hope that today we can have an open conversation about how auditing can and should fit into the overall framework of contract oversight. In a time of scarce government resources and an inadequate contracting workforce the government must evaluate where it's most vulnerable and focus resources where they can most effectively protect taxpayer dollars.

I look forward to the witnesses' testimony and the opportunity to discuss how we can better use contract audits to oversee government contracting. And I encourage all of our witnesses, particularly the witnesses on the second panel this afternoon, to speak frankly and openly about what improvements are necessary.
I was going to compliment Senator Brown right now. And I bet he'd rather wait to be here to hear it. It's a disease that most of us have around here. We love to hear good things about ourselves. So I will wait to compliment Senator Brown for when he gets here.

And now I will introduce the opening panel of witnesses that we will have in the hearing this morning. First we have Thomas Skelly who currently serves as a director of Budget Service to the Department of Education and has been the department's acting CFO since 2008. In that capacity, Mr. Skelly coordinates internal controls and audit follow-up and manages contracts and acquisitions for the department. He is also responsible for the department's 77 billion (dollars) annual budget. Mr. Skelly has served as a federal employee since 1974 and is a member of the Career Senior Executive Service.

Welcome, Mr. Skelly.

Ingrid Kolb has been the director of Office of Management for the Department of Energy since her appointment in 2005. As director, she is responsible for the department's project and acquisition management. Ms. Kolb has served in budget and financial management roles for both the Department of Homeland Security -- that's a tough one -- and the Department of Energy. Prior to joining the Department of Energy, Ms. Kolb was the director of the training and development center at the Department of Education.

Brian Miller has served as the inspector general for the General Services Administration since his confirmation by the Senate in July of 2005. He's also the vice chair of the National Procurement Fraud Taskforce and a member of the Department of Justice's Recovery Act Fraud Working Group. Mr. Miller received the attorney general's Distinguished Service Award in 2008.

Patrick Fitzgerald has served as the director of the Defense Contract Audit Agency since his appointment in November of 2009. As director, Mr. Fitzgerald is responsible for all management and operational decisions at the agency. He previously served as the auditor general for the United States Army.

And before we turn to your testimony, Mr. Skelly, I will tell Senator Brown I finished my opening statement. And the last paragraph of my opening statement was complimenting you. And I said I'm going to hold off on that paragraph because I knew you'd want to be here to hear it.

SENATOR SCOTT BROWN (R-MA): Absolutely.

SEN. MCCASKILL: I would like to take a moment to recognize his contribution to this subcommittee. There aren't a lot of people who wake up in the morning excited about talking about contract oversight and auditing. So I felt very lucky to have the opportunity to work with Senator Brown over these months. I don't think we know yet for sure who's going to be the ranking member on the subcommittee for this Congress, but I'm confident that he and I will continue to work together on important oversight issues, I hope in this committee. But if not, I know that that work will continue. And I turn to you for your opening statement.

SEN. BROWN: Thank you, Madame Chair. I apologize for being a little late. I lost track of time.

First of all, as the ranking member of this subcommittee it's also been my honor and pleasure to work with you in exploring important issues of this subcommittee that go to the core of how government conducts its business. Unfortunately, this may be my last hearing as ranking member, as you're aware of, so I want to just take a brief minute to thank you and your staff for being so cordial and thoughtful and helpful and also welcoming me to the committee and also providing me with the opportunity to kind of spread my wings a little bit and be part of something I think is very important. It's been a great experience and I look forward to continuing to work with you.

As you know in fiscal year 2010, the federal government contracted over 530 billion (dollars) on goods and services. And while I intend to work with my fellow members of Congress to reduce this amount, it also means that we must be incredibly vigilant in ensuring that the effective contract oversight actually occurs. With the $530 billion taxpayer dollars at stake, the government needs strong controls to provide reasonable assurance that these contracts funds are not being lost to waste, fraud, and abuse.
And I want to commend the chairwoman and former Missouri state auditor for calling this hearing to focus on a key part of the contract control system, which is contract audits. Our contract auditing can be an important control mechanism. In our current fiscal environment the reality is we cannot audit everything nor should we.

We must focus our limited resources on examining those activities presenting the greatest risk to the government and which justify the return on the investment. For the auditors -- for the audits that are necessary we must have an efficient system that accomplishes the task in a cost-effective and timely manner. The current system is not working the way it was intended and this is evidenced by the backlog in audits that prevents contracts from being closed on in a timely manner. This delay in closing out contracts increases cost to contractors and to the government.

And while I understand today's hearing will not discuss far-reaching reforms to the federal acquisitions system, we should keep in mind whose money we are spending and try to operate a government more like a business. In today's hearing, I'm interested in finding solutions to the problems in federal contract auditing. I look forward to hearing those witness perspectives on the critical issues. And I thank the witnesses, obviously, for being here today.

And in a more personal note, one of the bills we were able to work in a bipartisan, bicameral manner that really started in this committee would be Arlington National Cemetery. It's something that not only provided great insight to me as to what the process is. But it really served a real need with our nation's heroes. And, you know, you should be commended for that. And it's been an honor to be here in this committee.

But I'm actually going to still be involved on the committee -- and if it in fact works out that it will be, have a contracting arm associated with it and I'm hopeful that I will be able to participate. I still am on this committee if I'm not mistaken. So it's not like you're losing me totally. So thank you.

SEN. MCCASKILL: Thank you. Thank you, Senator Brown.

It is the custom of this subcommittee to swear in all witnesses that appear before us. So if you don't mind, I would ask you all to stand.

(The witnesses are sworn.)

Thank you all.

We will be using a timing system today. We would ask that your oral testimony be no more than five minutes. Obviously, your written testimony will be printed in the record in its entirety and we won't be -- as long as you don't get close to seven, eight, nine, 10 minutes -- we're going to be very tolerant of if you go over slightly. I don't want anyone to feel like they're under the gun, so to speak, in terms of finishing their testimony.

And we will turn to you, Mr. Skelly, for your testimony. Thank you very much for being here.

MR. SKELLY: And thank you, Chairman McCaskill and Ranking Member Brown. Thank you for this opportunity to discuss federal contract auditing and thank you for your leadership on this important issue.

As you know, my name's Tom Skelly. I'm director of Budget Service in the U.S. Department of Education. Since 2008, I've also been delegated to perform the functions and duties of the chief financial officer. In this role, I lead the organization that provides accurate and timely accounting and financial management information, coordinates internal controls and audit follow-up and manages contracts and acquisitions.

I'm proud to report the department's financial statements received a clean opinion for the ninth straight year and we also have achieved recognition for excellence in financial reporting from the Association of Government Accountants.

In the past we've not had many opportunities to benefit from contract audits. In our April 2010 response to you, we identified only one external audit and we expect only one this year. The primary reason for not having many contract audits is that most of our contracts are fixed price and the government's cost risk on that type of contract is relatively low.

The department also has many competing priorities for administrative funding. Therefore, even with cost reimbursement contracts, we limit the use of contract audits to those situations that need a review of incurred cost to help us clos-
percent over the last decade, even though the workload has grown during that period. For example, the enactment of the Ensuring Continued Access to Student Loans Act of 2008 and the more recent Student Aid and Fiscal Responsibility Act of 2010 greatly expanded our student loan work. These loan programs and related increases in Pell Grant applications have been the main drivers of our increased workload, but the department also had a key role in the recovery act implementation through such innovative and competitive kindergarten-through-12 education reform efforts we expanded through such grants as Race to the Top and Investing in Innovation.

In fiscal year 2010, the department had approximately 4,200 employees. This number represents a decrease of about 10 percent over the last decade, even though the workload has grown during that period. For example, the enactment of the Ensuring Continued Access to Student Loans Act of 2008 and the more recent Student Aid and Fiscal Responsibility Act of 2010 greatly expanded our student loan work. These loan programs and related increases in Pell Grant applications have been the main drivers of our increased workload, but the department also had a key role in the recovery act implementation through such innovative and competitive kindergarten-through-12 education reform efforts we expanded through such grants as Race to the Top and Investing in Innovation.

The majority of our funds, though, are really for grants and loans; they're not for contracts. We have used contracts to perform much of the increased work involving delivery of federal student financial aid, and the dollar volume of contracts has increased. For example, we spent approximately $1.5 billion on contracts in 2009 and approximately 1.8 billion (dollars) in 2010. Most of the increase was for our student loan -- student-aid processing and loan-servicing contracts. These contracts tend to require performance of high volumes of routine and similar tasks, like application processing, loan origination and loan servicing and collection. We have continued to contract for these kinds of activities and we've done these kinds of contracts for even three decades, but the work volume has increased dramatically in recent years.

In fiscal year 2010, only 21 percent of the contract dollars and 9 percent of the contract actions awarded by the department were cost-reimbursement, and we are further reducing our reliance on cost-reimbursement contracts each year. In fact, eight of the department's top 10 contracts -- representing 96 percent of the spending on our largest contracts -- are fixed-price. Examples of cost-reimbursement awards that we do have include contracts to analyze student achievement data from the National Assessment of Educational Progress and an ongoing contract with Reading Is Fundamental, which distributes inexpensive books to children and undertakes other activities that promote reading and literacy.

The department's Office of Inspector General conducts independent audits, investigations, inspections and other reviews of programs and operations. Part of this responsibility includes contract audits. In determining what to review, our inspector general's office considers internal risk assessments, department requests, congressional requests and hotline information and other sources that contain allegations of concern.

As noted in last April's response to you about contract audits, in fiscal year 2009, OIG completed an incurred cost audit of a contract that the department had entered into for the administration of part of the National Assessment of Educational Progress. The purpose of the audit was to determine whether the costs incurred in fiscal year 2006 under the contract were, quote, "reasonable, allowable and allocable in accordance with the terms and conditions of the contract and applicable acquisition regulations." The approximate cost to the department to perform this audit was $255,000.

As a direct result of this audit, our inspector general's office recommended that, one, the department recoup unallowable costs paid to the contractor, and two, to then conduct a follow-up review of the costs not included in the inspector general's sample.

The department recouped $229,700 from the contractor for the FY 2006 costs identified by the inspector general. In addition, the contractor disclosed during the audit that it had inappropriately billed the department for post-retirement medical benefits during the period September 2002 through December 2007. The contractor returned to the department $2.7 million in April 2009 for these improper billings. I point this out because it shows we did get some additional benefits from the contract audit in addition to the amounts we recovered through our negotiations with the vendor. So there's obviously some deterrent effect from doing audits. It encourages vendors to keep good records, revise their procedures and maybe return things to us before we actually get into the audit.

We considered several options for a follow-up audit. The IG itself decided not to devote limited resources to a broader audit. And then the department initiated a request to the Defense Contract Audit Agency for audit support to review the incurred costs not included in OIG's sample. To obtain this support, department representatives worked with DCAA in
As a result, since the IG didn't want to do it, the DCA didn't want to do it, we contracted on our own for audit support services. The contract we obtained includes performing incurred-cost audits of this and other kinds of activities and it will be providing services this fiscal year.

The department faces challenges regarding contract audits in deciding whether they take priority over other demands for limited administrative funds. The department's inspector general has multiple priorities and DCAA cannot always accommodate non-DOD requests for audit support. Obtaining audit support from a nongovernmental firm can be costly and time consuming.

In conclusion, we support efforts to maximize the performance of contractors in delivering department services. We rely on many contractors to get our work done. We believe that fixed-price contracts are the preferred options over cost-reimbursement contracts as they provide a better value to the taxpayer.

Thank you, Madame Chairman for your attention to this important issue. I'd be happy to answer any questions.

SEN. MCCASKILL: Thank you very much.

Ms. Kolb.

MS. KOLB: Thank you. Thank you, Chairman McCaskill and Senator Brown. And I too appreciate your leadership on this very important topic.

My name is Ingrid Kolb and I am the director of the Office of Management at the U.S. Department of Energy. And I'm pleased to be here today to discuss with you how the department uses audit services to detect and prevent waste, fraud and abuse in government contracts; to provide contracting officers with reasonable assurance whether contractor submissions are free of material misstatement; and also to provide contracting officers with assistance and advice in the establishment of fair and reasonable prices for products and services.

In fiscal year 2010, the department spent approximately $26 billion on contracts. The bulk of those dollars, about 80 percent, was spent on the department's unique management and operating contracts. These contracts are used primarily to manage the department's laboratories -- its national laboratories -- as well as other government-owned or controlled facilities.

The department's Office of Inspector General is the auditor for the management and operating contracts. And in FY 2010, the department spend approximately 1.1 million (dollars) for 17 of these IG audits.

The Defense Contract Audit Agency has traditionally been the primary auditor for our other contracts.

The Defense Contract Audit Agency has traditionally been the primary auditor for our other contracts. And in FY 2010 the department spent approximately $9.4 million for 273 audits of varying types performed by DCAA. The majority of these are for incurred cost audits. DCAA has provided us with excellent service in the past and remains our primary source of audit services for those non-MNO contracts.

However, over the past few years, as DCAA has experienced challenges with an increasing workload and fewer resources, which have caused some concern for the Department of Energy, our ability to obtain cost-incurred audits in a timely manner has diminished and in some instances at some procurement sites this has caused a backlog of closeouts for our contracts.

In response to the increased workload associated with the American Recovery and Reinvestment and Recovery Act and the corresponding demand for DCAA audit services around the government, the Department of Energy conducted a competitive procurement to obtain supplemental audit services. In coordination with DCAA, a private accounting firm was awarded a contract in May of 2010 to provide audit services primarily for financial assistance awards.

The contract also provides for full contract audit services. And to date the contractors' performance has been timely and we have been satisfied with the quality of their work. Last month, senior officials from the department along with three
And I'm glad to report that the meeting was very productive. And there are future discussions that we have planned to help streamline the process. I believe that this ongoing dialogue with DCAA will strengthen our audit function at the Department of Energy. Again, thank you for this opportunity to testify before the subcommittee. This completes my oral statement. And I'm happy to answer any questions the subcommittee may have.

SEN. MCCASKILL: Thank you very much. Mr. Miller.

MR. MILLER: Madame Chair, Ranking Member Brown, ladies and gentlemen, thank you for the opportunity to testify on the importance of contract audit in detecting and preventing fraud, waste and abuse in government contracts. And thank you for your continued support of inspectors general and for the subcommittee's strong commitment to oversight. This hearing is especially important as the president and the Congress look to aggressively pursue fraud, waste and abuse in federal spending.

Contracting auditing plays a vital role in fighting fraud. A key component of the president's plan to reduce the national debt is rooting out fraud, waste and abuse from federal programs such as health care programs. This is no less true in the procurement area. Across the government contract audits result in saving billions of taxpayer dollars and ensuring that when federal dollars are spent they are spent wisely.

My office has a great deal of experience with contract audits. In my view, they provide a critical oversight mechanism for GSA's handling of billions of taxpayer dollars. Over the last two years, my office has identified about $1.1 billion in potential cost avoidances and $33 million in questioned costs. We have also worked very closely with the Department of Justice in obtaining over $400 million in False Claims Act recoveries.

And thank you, Madame Chair, for mentioning the recovery of -- yesterday from Oracle and from Sun Microsystems of $46 million.

Overall, GAO's 2008 report recognized that for every dollar budgeted our office had a return on investment of 19 (dollars). I am proud of the work our office does in saving taxpayer dollars. I agree with the president and the Congress that we need to restore fiscal discipline to the federal government and to find ways to make the government more effective. Contract auditing is one way to do so. Unlike other government programs, contract auditing saves federal dollars.

It identifies wasteful spending and ensures that taxpayer dollars are spent wisely. Most other federal programs, however useful and good, do not return dollars to the Treasury or prevent federal dollars from being spent. At a time when the acquisition workforce is stretched then, overworked and under-trained, contract audits are crucial to protecting taxpayer dollars. Contract audits are the taxpayers' last line of defense against losing money to fraud, waste and abuse.

To prevent overcharging, our office reviews the pricing the contractors give to GSA. Too often the prices given to GSA are not fair and reasonable. As the largest volume buyer, the federal government deserves the best prices. Yet our auditors often find the contractors have given better prices to other customers.

Our success hinges on both our autonomy from the agency and on our contract expertise. However, we do face perennial oversight challenges. Contractor lawyers and consultants have sometimes delayed responses to information requests for months, and, yes, at times even for years. These kinds of delays should not be tolerated.

Thank you for calling attention to the need for more contract audits and for more effective contract audits. In these times of tight budgets and calls for smaller government, we need to continue to be serious about rooting out fraud, waste and abuse. I am proud of the record of the GSA Office of Inspector General and hope that we can do more in the coming years to save federal money. Thank you for your attention. I ask that my statement and written materials be made a part of the public record. And I would be pleased to respond to any questions. Thank you.

SEN. MCCASKILL: Thank you.

Mr. Fitzgerald.
MR. FITZGERALD: Good afternoon, Chairman McCaskill, Ranking Member Senator Brown. Thank you for the opportunity to appear before you today. I am pleased to provide you with an overview of the role that the Defense Contract Audit Agency plays in performing contract audits for agencies other than the Department of Defense. I became the director of the Defense Contract Audit Agency 15 months ago. And prior to that I was the auditor general of the Army and headed up the Army Audit Agency.

I'm a certified public accountant and have over 30 years of government auditing experience. The Defense Contract Audits Commission supports efforts to obtain the best value for dollars spent on government contracts. To carry out this mission we have about 4,700 dedicated employees and 114 field offices around the world. We have added roughly 500 auditors in the last two years.

And currently 99 percent of our auditors have a four-year college degree. And in addition 29 percent hold advanced degrees and 28 percent are certified public accountants. I consider the work we do for civilian agencies an important part of our contract audit mission. The Defense Contract Audit Agency has performed contract audits for civilian agencies since its creation in 1965.

The type and scope of our efforts at civilian agencies are very similar to the audits we perform for the Department of Defense. Since 2000, the percent of our total budget devoted to reimbursable work has ranged from 9 (percent) to 13 percent. And the total reimbursable funding has ranged from about 45 million (dollars) to 58 million (dollars). In an average year, we provide audit services to more than 30 civilian agencies.

However, our reimbursable work is heavily weighted toward just a few civilian agencies. For example, just two civilian agencies, NASA and the Department of Energy, make up more than 50 percent of the reimbursable work that we do. As a result of our DOD work, we have already established a presence at many of the civilian agency contractors. In 2010, over 90 percent of the contractors we audited were engaged in some type of DOD work.

Using DCAA for contract audit at these locations is a cost-effective use of both government and contractor resources and provides assurance that a comprehensive audit is accomplished. Over the past several months, the Department of Defense has taken initiatives that have improved contract processes. I would like to highlight three that in my opinion will provide similar benefits throughout the federal government.

These are, one, establishing a formal adjudication policy that ensures that contract audit findings and recommendations receive timely and adequate consideration; two, developing new business system rules that will strengthen contractor systems to prevent fraud, waste and abuse by improving the transparency and oversight of these systems; and, finally, creating a risk-based approach to ensure that the limited audit resources are focused on the areas with the greatest risk and largest payback to the taxpayer.

Let me assure you we are committed to providing civilian agencies with high-quality audits that protect the interests of the American taxpayer. Over the past year, we have implemented many initiatives to improve the quality of our audits and improve the work environment of our talented workforce.

To assist in developing our workforce, we are overhauling our training programs as well as making changes to our hiring and promotion policies.

We have also issued extensive audit policy and process changes to improve the quality of our audit services and audits. These changes have resulted in auditors performing additional tests of contractors' controls and transactions. We are reaching out to our stakeholders to better inform them of our process improvements while working with them to revisit the contracting time frames to allow sufficient time to perform thorough audits that are necessary to protect the taxpayers' interests.

In summary, we have changed the way the Defense Contract Audit Agency does audits by using a more collaborative and comprehensive approach to contracting audit. We have institutionalized these initiatives in our recently issued strategic plan that provides a clear roadmap for executing these changes.

We believe we have made significant strides but recognize there is more work to be done. And I know our workforce is committed to performing high-quality audits that serve the American taxpayer.
SEN. MCCASKILL: Thank you, Mr. Fitzgerald.

Let me start by -- I'm trying to get a handle on -- I know that the work you're doing, the majority of it, is in a few agencies. And I know the majority of it are with agencies that some have connection to the Department of Defense.

And the writ-large policy issue that I want this hearing to talk about is, are there sufficient contract auditing resources in the federal government? Do agencies have the ability to be aggressive about contract audits? And how is that process working now?

It's not clear to me -- and if you can help -- is there an overall risk assessment that is being done across all of the agencies that anybody has responsibility to look at and say, you know, we've got a cost-plus contract over here at Interior that no one's ever looked at, and there's never been a question asked about it, and it's, you know, has grown and it's a fairly large contract now.

Is that someplace that there should be -- I mean, are we doing this in stovepipes and you're just being called in on a piecemeal basis? Reassure me that there is some overall strategy here as to where these audit resources are going.

MR. FITZGERALD: Well, Senator McCaskill, from Defense Contract Audit point of view, we have worked over the last year with the Department of Defense and all the stakeholders involved with that to make sure that our auditors are being allocated to the highest-risk, highest-priority work.

We are now starting to work with each individual civilian agency to do that, realizing that one, you know, a risk-based approach for DOD may not be the same thing for DOE or someone like that. So we are working civilian agency by civilian agency to make sure that we are providing the service and allocating our resources, you know, where we believe and they believe are the highest-risk areas.

SEN. MCCASKILL: And so is there some document that's being prepared in each civilian agency about a risk assessment in terms of contract audit work? Is there some --

MR. FITZGERALD: Senator McCaskill, I'm not sure. But what I'd like to do is -- because I can -- I think I can meet the needs of the civilian agencies if I know what that workload is for the future so I can build the workforce capacity to do that because --

SEN. MCCASKILL: Well, it looks like you, by default, are it. Is that a fair assessment? I mean, I don't mean that you -- that you're the only game in town, therefore, we've got to use it. I mean, obviously, you're a strong audit agency with a lot of professionals.

Let me ask. I mean, do you sense, Ms. Kolb, is there a risk assessment that your agency is doing that prioritizes contract audit work within your agency?

MS. KOLB: Yes, we definitely prioritize contract audit work within our agency. We have certain dollar thresholds that trigger an audit, trigger a contracting officer to request an audit. And so that is how we go about determining the risk level.

SEN. MCCASKILL: And Education, same thing?

MR. SKELLY: Pretty much. Our biggest audit -- our biggest contracts are fixed price, so we don't see as much need for that. But if we're closing out one of our cost-plus contracts, then we do see a need to --

SEN. MCCASKILL: Well, there's actually been some waste in fixed-price contracts, too. I know they're not as risky as cost-plus, but --

MR. SKELLY: Just overall, I think our strategy is to try to maximize fixed-price contracts. That's the biggest contract reform we're trying to implement, and we've got direction from the White House and the Office of Management and Budget on doing that.
SEN. MCCASKILL: Now, if I could just make sure that Defense Department had as many fixed-price contracts as you have, I'd be a happy camper. There's certainly not the level of cost-plus going on in your agency that there is in Defense.

So I guess what I'm getting at here is that it appears to me that we have never really had across the government anyone going, okay, are we doing the right audit work. You know, your priority has to be Defense because you're the Defense Contracting Audit Agency. And the other agencies -- and what is the comparison of price?

When you get reimbursed for your cost, Mr. Fitzgerald, how does that compare with contracting with private-sector auditors to do contract work? Give me an apples-to-apples comparison here.

MS. KOLB: Well, I can give you a comparison with the experience we've had with our independent auditor. The price that we pay for DCAA is about $114 an hour. The comparison with our independent private-sector auditor is $150 an hour. However, I will say that one of the big issues for us is timeliness. And DCAA is stretched fairly thin and, sometimes, it's very difficult for them to free up auditors to perform high-priority work. So we have had to go to our independent auditor.

But for us, it is worthwhile because we need the audit work in order to make timely business decisions. So we had to pay that extra amount in order to get that service.

SEN. MCCASKILL: Right. Okay.

Mr. Brown? Senator Brown, I should say.

SEN. BROWN: Either-or is fine.

I guess my biggest concern when we do all these hearings is are we getting the most bang for our buck. Is there something we can do better or you can do better or we can give you guidance to do better?

So why don't I just start with Mr. Fitzgerald if that's okay. Is there something we are not doing correctly to get the maximum bang for our buck?

MR. FITZGERALD: Well, Senator, I think having this hearing is helpful to bring some light on contracting auditing. But, you know, our agency didn't grow through the boom that happened in DOD, and as a result of some external reports, we have gotten the support from the department to grow our workforce. And we are making sure that we are doing a quality product for not only DOD but our civilian agencies.

And it's awful early to tell. We've made some changes over the last year, but we believe we are seeing, as a result of doing a better quality product and service, that the amount of dollars that we're questioning, that has significantly went up over the last two years as we have done in what we believe a more comprehensive and thorough approach to our audits.

SEN. BROWN: But at some point, doesn't it lose its cost-effectiveness? Are there some audits that just, you know, it's like, gosh, I can't believe we're auditing these people? Do you ever, like, have that moment in your office?

MR. FITZGERALD: Well, you know, I think one of the first things we did was to look at a risk-based approach. And we have made some adjustments where we have decided, based on the risk, that we would reallocate our auditors to contracts above a certain dollar threshold and only do below that threshold if there was additional risk or we do believe we might kind of use the IRS model where we'd do some work in that area just on a random basis.

But, clearly, our focus will be on the higher-dollar value, higher-risk contracts because we will never have -- nor would we be purporting to have auditors to be able to audit every contract. So we're looking to make sure that our limited audit capability is applied and allocated to the highest-risk areas.

SEN. BROWN: So you're doing that now?

MR. FITZGERALD: Yes, sir.
SEN. BROWN: And are you -- is it true that you're about 10 percent over in terms of the actual closeouts that, you know, there's some that have been going on for, as I think has been discussed already, for a while. Is it about 10 percent? Or do you have that number?

MR. FITZGERALD: Well, Senator Brown, to be very upfront with you, our cost-incurred audits, which are the audits that we do at the end of the contract and many times they're needed to do to close out the contract, that workload -- that backlog has quadrupled over the last 10 years. So, again, that's why we're using a --

SEN. BROWN: Quadrupled from what to what just in rough numbers so everyone knows? Approximately. You don't need an exact number. I mean, has it come from like one to, you know four?

MR. FITZGERALD: No, no. It's been -- it's a significant backlog that we have to work. I could give you the --

SEN. BROWN: The reason I -- the reason I'm kind of zeroing in on this particular area because, you know, we have a lot of Massachusetts companies that deal in this type of work and not only are they waiting for (cause of it ?) it's costing them real money -- real dollars. So in addition to the -- you know, the health care bill and the taxes they're paying and the regulations that they're dealing with and now they have audits. So it's like, what's next? You know, they need closure and they need certainty and they need closure, and is there a way -- is there something that we can provide you or is there -- is there something that we can -- you know that you need that we're not giving you to get these things done? They've been going on, some of them, for years.

MR. FITZGERALD: Senator, we have to get after that backlog. Hiring 500 new auditors over the -- over the last two years will be helpful in that and I would add -- not to mitigate that at all but we do work closely with the contracting officers to make sure that their billing rates are appropriate so that there's no overages or shortages so that the contractors get the money that they need to be paid as we monitor the billing throughout the contract before we do a final cost-incurred audit.

SEN. BROWN: You know --

MR. FITZGERALD: We work closely to try to make sure that's a minimum amount.

SEN. BROWN: Sure. You know, it's interesting. You're saying you're hiring 500 new auditors. Can you believe it, folks? We're doing 500 new auditors in addition to the thousands of other new auditors in various agencies, and I mean, at what point do we actually just like hire new workers like new construction folks, new -- you know, just a regular, you know, private sector employee? The fact that we're hiring 500 new auditors just smacks to me as saying wow, something's broken somewhere. We -- there's a disconnect somewhere. So we're hiring 500 new auditors to deal with a backlog that's been quadrupled -- quadrupled, sorry -- after, you know, a period of time. Some of these audits have gone on for years. So I guess at what point do we -- do we say my gosh, there's -- something's broken. We're -- are we auditing the proper folks that need to be audited -- the entities that need to be audited? Where's the breakdown? It's just -- it's not kind of working for me really.

MR. FITZGERALD: Senator, just to try to put it a little in perspective, you know, the DOD procurement budget just exploded from 2000 to 2010. DCAA's workload was flat throughout that period. In the early 90s, the Defense Contract Audit Agency was about 7,000 folks. So steadily went down and then stayed flat. We're working to get -- to both adjust to workload requirements and build the workforce capacity to get a good balance there so that we can effectively provide a quality product which is, in my opinion, a timely product -- is a quality product.

SEN. BROWN: Any --

SEN. MCCASKILL: Well, and I wanted to point out that Senator Brown was not yet a senator when all hell broke loose at DCAA. To say that Mr. Fitzgerald had a challenge is an understatement. Then it was determined that DCAA was not meeting Yellow Book standards for government auditing. There was some real management challenges. Not that there aren't -- and I want to say this on the record -- thousands of wonderful auditors at DCAA. I don't mean to disparage the wonderful people that work at DCAA because literally we wouldn't have known about the problems if
somebody at DCAA hadn't come forward. But they had some real management issues and Mr. Fitzgerald was drafted to take over an agency which had -- traditionally only had people move up in the organization to head the organization. I think it may have been -- I don't know, was it the first time, Mr. Fitzgerald, that somebody came from outside the organization to head it?

MR. FITZGERALD: Yes. Yes, Senator.

SEN. MCCASKILL: Yeah. So they never had anybody come from outside in a management capacity. So I don't mean to -- I'm usually not the one making -- and I don't mean to sound like I'm making excuses but I know the challenges that he faced and while I don't think they're there yet they have made significant progress in, I think, turning around the management capacity at DCAA since his arrival. So for what's that worth --

SEN. BROWN: May I just make a note on that?

SEN. MCCASKILL: Sure.

SEN. BROWN: And listen, I don't disagree and I'm aware. I've obviously done my homework and aware of your challenges. I just want to make sure that we're auditing the right entities and that we're not wasting our money and that the audits that are -- you know, that we're participating in, you know, it affects real people, real jobs, real companies, not only in my state but in yours and, you know, that's why I asked is there something that we can do to --

SEN. MCCASKILL: Right.

SEN. BROWN: -- that we're missing to -- that -- to help you to get that closure so people can move on and just start creating real jobs.

SEN. MCCASKILL: I think -- I think that I certainly agree. I think that this is one of those areas where we've got to be careful because there are areas of government where the investment that we make comes back. And that segues into the question I wanted to ask you all, and that is pre-award and post-award auditing, and I would like any of your all's take on that. I just think there is -- I know that you've done a lot of it at GSA but it appears to me, Mr. Miller, that you all could do a lot more of it and -- because every time you've done it we've found real money, haven't we?

MR. MILLER: We have, Madame Chair, and we could do a lot more of it and I think it would save federal money. It's ironic -- that may sound ironic because it's saving all this money -- it's saving money in the -- if we -- if we invest the money there. And I would like to say briefly that we don't currently use DCAA. We have used DCAA in the past a few times in relatively limited capacities, but currently we do the auditing at GSA and that has worked out very well. And one of the areas that you point out is the pre-award and post-award audits. The Sun Microsystems settlement of $46 million that you mentioned earlier started off as an audit in our office that we worked up, developed and referred over to the Department of Justice. It was later on combined with the qui tam action and settled. But we do save lots of money. As I pointed out in my testimony, at one point $1 billion in cost avoidance for the last two years -- 1.1 billion (dollars). So thank you for asking that.

SEN. MCCASKILL: Well, and I think many times those pre-award audits have what I would call a deterrent effect because everyone who's out there competing for federal contracts, they -- it gives them a heads up that somebody's going to be paying attention to their numbers before all the documentation is signed and before the contract is executed, and I think that kind of has everyone on better behavior as it relates to federal contracting. Let me -- let me address Mr. Skelly and Ms. Kolb. As we begin what I'm going to call the lean era in the federal government, which I believe the next decade will be, I don't think you're going to see much expansion of either one of your departments. I think in fact you'll see some contraction at both the Department of Education and Department of Energy. I'm not saying that we're talking about massive layoffs. I'm just thinking that the whole footprint, I believe, will shrink to some extent just because we're going to have a real obligation to begin to cut back on all kinds of spending including discretionary. Be honest with me. What kind of pressure is that going to put on you to squeeze the resources you spend on contract auditing because there'll be so much pressure to keep the money in programming at your agencies?

MR. SKELLY: I think it's going to be a real significant pressure. We've been squeezed already. I think I mentioned that we've declined about 10 percent in the last decade in staff already. We have tried to make investments in key areas
such as contract officers, contract officers’ representatives so they can do a better job at monitoring our contracts. I think that’s a priority since we are going to rely on contracts to get a lot of our student loan and student aid work done, in particular.

I think it's a good investment, though. I'd encourage you not to reduce our footprint at Department of Education, particularly our administrative funds. We do need money to make sure that we award these contracts and deliver our aid and indeed in our direct loan program, which we went to 100 percent of last year as a result of the -- (inaudible) -- legislation -- we believe we'll actually save about $5 billion a year. It'll be a savings of $5 billion per year or more in the mandatory area but we're going to have to spend a couple hundred million dollars more, as I've noted, in contracts in our discretionary budget. I think there will be pressure on things like contract audits and anything else that's not directly related to some of our -- providing our services and doing them very well.

SEN. MCCASKILL: Who's doing the audits now? The people -- you're contracting with people in terms of the application process. Who are -- who's doing the checking on whether or not the people that are getting this money actually even exist on the Pells, and who is -- who is the check on -- you know, I -- you know, there's always a different thing. I think the current cable TV ads are that you can be a -- become a culinary chef online, which I think is tricky. But that's the latest profit center for some of these institutions is, you know, stay in your kitchen and become a world class chef if you just sign up and make sure we get your Pell Grant money.

Who's doing that audit work?

MR. SKELLY: Inspector general. It's independent of Department of Education and can decide which areas to look into and looks into areas that have the highest risk. And there might be abuses on the part of some parties in our programs. We also have -- in looking at the contracts that provide our services, we're relying primarily on our first line of defense, which are contract officers and our contract officers' representatives. Those are the employees in the Department of Education who work with the contracts and make sure they're doing what they're supposed to do.

If the work statement is clear, if the expectations are clear, if there are performance measures in the contracts, then it's easier for those employees to check up on whether the contractor is performing it. These contracts are just providing the mechanical operation in getting the aid to the students and colleges. We have other people who are assigned the job of making sure that colleges are complying with rules. They have certain reports they have to file, we are reviewing those. Both our program officers are doing that, but also our Office of Inspector General is looking into that.

SEN. MCCASKILL: Give them a heads up. I don't think we need a hotline to figure out that there may be a little bit of over-marketing in the area of become a world-class culinary chef from the comfort of your own home.

MR. SKELLY: Also, I should -- I think it's one of the other committees here in the Senate got a report from the General Accounting Office recently where they also looked into the situation.

SEN. MCCASKILL: Right. Ms. Kolb, the question about whether or not your auditing resources are going to get squeezed as the top line budget may get squeezed.

MS. KOLB: Actually, I think that we do a very efficient job of ensuring that we have the audits available that we need to make business decisions. Last year, for example, we spent a total of about $10 million for $32 billion worth of contracts and financial assistance awards that were made. That is a very small percentage, and I would envision us staying committed to providing that level of audit work. So I don't think that a consolidation will impact our commitment to putting forward those dollars. We will stay with that.

Just to pick up on a few points that Pat Fitzgerald was making. First of all, he was talking about moving to a more risk-based approach. We completely support that and we're doing a few things at the department to try and move in that direction, and that is, first of all we don't always need a comprehensive audit. And DCAA does a very thorough job and their preference is to conduct a thorough audit, a thorough comprehensive audit.

We want to work with DCAA to make sure that where a targeted audit is all that's needed that that's what we end up doing. So we believe that's very important and will ensure that there's a more efficient use of resources. So that's something that we can do. And then also I had mentioned earlier that we have thresholds that trigger an audit. We're in the
process of raising those thresholds to make sure that we are really targeting those contracts where we need the audit work completed.

SEN. MCCASKILL: That's great. That's great.

Senator Brown?

SEN. BROWN: Thank you. Ms. Kolb, also you speak of a decline in the DCAA audit support for reviews of contractors' price proposals, which has impacted the department's ability to negotiate fair and reasonable prices. And we've heard from other agencies, business groups in POGO (ph) that DCAA's common practice of submitting these audits to GAGAS standards is both unnecessary and may contribute to these reviews taking more time and is then costly. That's -- is that your opinion of what they're saying about this whole process?

MS. KOLB: Well, the concern that we've had with the services provided by DCAA -- and Pat Fitzgerald and I have talked about this -- really is one of timeliness. We think that DCAA does a very good job. Again, we would like to see more targeted audits as opposed to comprehensive audits, unless they're absolutely needed. But the timeliness issue has to be addressed and DCAA is committed to making those improvements.

SEN. BROWN: Should proposal reviews of cost and pricing then be considered financial advisory services, which are not subject to all of GAGAS requirements?

MS. KOLB: In the pre-award area we depend heavily on DCAA to examine the prices, and we would want to continue to have them look at the proposed prices above a certain threshold.

SEN. BROWN: Mr. Skelly, you've been awfully lucky tonight, so I figure I'll just get you --

MR. SKELLY: My whole life, I think, Senator.

SEN. BROWN: I know the feeling. According to your testimony, the Department of Education spent approximately $1.5 billion on contracts in the fiscal year 2009, and $1.8 billion in fiscal year 2010. The key concept in contract auditing is that the cost of control activities should not outweigh the benefit. With $1 billion at stake, what contract controls does the Department of Education have in place to ensure that the taxpayers' money is spent wisely, in accordance with applicable regulation, and the department is receiving the best value possible for its money? Kind of an extension of what I asked Mr. Fitzgerald.

MR. SKELLY: Our main strategy is to use fixed-price contracts. Approximately 71 percent of our contract dollars are awarded through fixed-price contracts, at least where the unit price is fixed in a contract. We found that that's the best solution. One ounce of prevention is worth a pound of cure. We're better off doing that at the start, stipulating what's expected to be delivered under the contract, having good performance measures, following up that work through the work of our contract officers and our contract officers' representatives.

We think it's -- we've got to do that to make sure that we're spending our money well. When we do use contract audits, it's for the incurred cost. It's sort of after the fact, after the contract's finished and we're trying to close it out. But because we have relatively few cost reimbursement contracts, there's not as much for the auditors to find.

SEN. BROWN: So based on your experience, for somebody who's listening or watching, if somebody is not adhering to the terms of their contract, what do you actually do? What's the typical scenario?

MR. SKELLY: It's notifying them that they're not living up to the standard. A report has come in, we're monitoring the activity. We get management information reports, for example, on how many people are applying, how many people are using the pre-application for federal student assistance, the FAFSA form. About 20 million people use that form to apply. Many of them are doing it over the Web so it's easy to monitor how many are coming in and going out.

We check those management information reports to see are they coming in timely. There's actually an incentive built into the contract for the contractor to process those quickly. We have incentives in our default -- in our servicing contracts, where the contractors are given additional funds if they make sure that people don't go into delinquencies or de-
faults. So we try to build those incentives into the contract up front as opposed -- and we try to monitor that as closely as we can.

SEN. BROWN: Have there ever been any instances that you're aware of where there's just been a total breach of the contract? Or not adherence to the terms of the contract?

MR. SKELLY: I'm sure. We have lots of humans involved in this and we're probably making mistakes, but I don't recall.

SEN. BROWN: I have nothing further.

SEN. MCCASKILL: Thank you, Senator Brown. I want to thank the panel very much for your work, and I appreciate the time and effort you've put into appearing at this hearing today.

And we will take the second panel.

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