

10 of 13 DOCUMENTS

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**PANEL II OF A HEARING OF THE CONTRACTING OVERSIGHT
SUBCOMMITTEE OF THE SENATE HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS COMMITTEE;
SUBJECT: "IMPROVING FEDERAL CONTRACT AUDITING";
CHAIR BY: SENATOR CLAIRE MCCASKILL (D-MO);
WITNESSES: JEANETTE FRANZEL, MANAGING DIRECTOR,
FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT
ACCOUNTABILITY OFFICE (GAO); E. SANDERSON HOE, PARTNER,
MCKENNA LONG & ALDRIDGE; NICK SCHWELLENBACH, DIRECTOR
OF INVESTIGATIONS, PROJECT ON GOVERNMENT OVERSIGHT;
LOCATION: 342 DIRKSEN SENATE OFFICE BUILDING, WASHINGTON,
D.C.**

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SEN. MCCASKILL: I want to thank the witnesses.

The first -- let me introduce this panel. Jeanette Franzel is the managing director of the financial management and assurance team at the Government Accountability Office, GAO. In her role, she heads GAO's oversight of financial management and auditing issues across the federal government, which includes review of internal control, financial management systems, cost management, improper payments and accountability, and corporate-governance issues.

Ms. Franzel is also responsible for overseeing the GAO's development of the government auditing standards, also known to all of us who know and love it as the yellow book, the standards used in the U.S. and as a model for the private sector and other governments around the world as it relates to auditing standards.

Nick Schwellenbach -- is that correct?

MR. SCHWELLENBACH: (Off mic.)

SEN. MCCASKILL: Schwellenbach -- is the director of investigations for the Project on Government Oversight. Mr. Schwellenbach conducts investigations which include examination of the effectiveness of government oversight. He

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Service February 1, 2011 Tuesday

has previously worked as a writer for the Center for Public Integrity and is a reporter and researcher for the Nieman Watchdog, a project of the Nieman Foundation for Journalism at Harvard University.

E. Sanderson Hoe is a partner at the law firm of McKenna Long & Aldridge. He has practiced government contract law for over 36 years. He has expertise in areas including contract formation, the structuring of complex private financing of government contracts, and resolution of post-award contract disputes. He co-chaired the Committee on Privatization Outsourcing and Financing of the Public Contract Law Section of the American Bar Association since 1999 and is currently serving as a pro bono counsel to the government of Liberia in the drafting of a new procurement code.

Thank you all for being here, and we will begin. Oh, I've got to swear you in. It's the custom to swear in the witnesses in the subcommittee. I would ask you to stand.

Do you swear that the testimony you will give before this subcommittee will be the truth, the whole truth and nothing but the truth, so help you God?

(The witnesses were sworn.)

SEN. MCCASKILL: Thank you very much.

Ms. Franzel, we welcome your testimony.

MS. FRANZEL: Good afternoon, Madame Chairman. Thank you for the opportunity to be here today to discuss the role that contract audits can serve in effective contract oversight and internal control in the government. As the government has become increasingly reliant on contractors over recent years, effective contract oversight is key to protecting the taxpayers' interests.

In fiscal year 2010, federal agencies reported obligating approximately \$535 billion for contracted goods and services. The sheer size of federal contract spending poses significant risk if effective oversight and controls are not in place.

Today I will describe the contracting cycle and related internal controls, DCAA's role in performing contract audits, and risks associated with ineffective contract controls and auditing.

In preparing this testimony, we relied on the work we performed during our DCAA engagements, as well as our extensive body of work on federal agency contract management.

The contracting cycle consists of activities throughout the acquisition process, including pre-award and award, contract administration and management, and ultimately the contract closeout. Effective contract oversight includes internal controls throughout the process, and the standards for internal controls cover agencies' control environment, risk assessment, control activities, information and communication, and monitoring.

As we heard in the previous panel, the type of contract used really determines the types of internal control and contract auditing activities needed to help protect the government's interests. Specifically, contract types can be grouped into three broad categories: Fixed-price, cost-reimbursable, and time-and-materials contracts.

For fixed-price contracts, the government agrees to pay a set price for goods or services, regardless of the actual cost to the contractor. So in those cases, the contractor is assuming most of the cost risk.

Under cost-reimbursement contracts, the government agrees to pay contract or costs that are allowable, reasonable and allocable, based on the contract. Consequently, the government assumes most of the cost risk in a cost-reimbursement contract, and (as ?) a similar situation for time-and-materials contracts.

Contract audits are intended to be a key control in the contracting process to help ensure that prices paid by the government for goods and services are fair and reasonable and that contractors are charging the government in accordance with applicable laws, the federal acquisition regulation, which is known as the FAR, cost accounting standards and contract terms.

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Service February 1, 2011 Tuesday

DCAA plays a critical role in contract oversight by providing contract auditing services that DOD and other agencies rely on when making these contract decisions and when providing oversight. The majority of DCAA audits focus on cost-reimbursable and time-and-materials contracts, as these contract types pose the highest risk to the government.

For example, the FAR requires government contracting officers to determine the adequacy of a contractor's accounting system before awarding a cost-reimbursement or other flexibly priced contract. Also billing system audits support decisions to authorize contractors to submit invoices directly to the government for payment without further government review.

Audits of contractor-incurred cost claims and voucher reviews directly support the contract payment process by providing the information necessary to certify payment of claimed costs. And finally, closeout audits include reviews of final vouchers and the cumulative costs and may include adjustments and recoveries, if necessary.

Our work has identified significant contract management weaknesses in federal agencies, problems with agency controls over payments, and weaknesses in contract auditing. And all of these pieces need to fit together in order to have effective contract oversight. These weaknesses increase the risk of improper payments and fraud, waste, abuse and mismanagement.

For example, our work at various agencies has found that contract officers are not performing detailed reviews of invoices prior to paying invoices. In some cases, even if the contract officer had attempted to review the invoices, the invoices provided by the contractor did not provide sufficient detail to facilitate such a review.

There were also instances in which contracting officials decided to rely primarily on DCAA's audits rather than performing normal internal-control procedures. We also discovered cases in which contracting officers did not even use the DCAA audits that were available to them. We also found instances in which agency was not obtaining the required audits of contractors' accounting systems and incurred audits.

Finally, our work has found problems with contract auditing itself. In 2009, we reported on audit-quality problems at DCAA offices nationwide. We found serious quality problems in the 69 audits that we reviewed, including compromise of auditor independence, insufficient audit testing, and inadequate planning and supervision. As a result of our work, DCAA rescinded over 80 audit reports and has been making many changes in its operations.

We concluded that at the root of DCAA's audit problems was DCAA's focus on a production-oriented mission that emphasizes performing a large quantity of audits with inadequate attention to performing quality audits.

In our 2009 report, we made 17 recommendations to DOD and the DOD IG to improve DCAA's management environment, audit quality and oversight. And in response, DOD and DCAA have taken a number of actions.

Our 2009 report also offered some potential actions for strengthening the organizational effectiveness of DCAA and the contract-audit function in the federal government. Those potential actions would require further study, as well as potential congressional action, and include actions intended to strengthen DCAA's independence, including potential organizational changes.

Madame Chairman, this concludes my statement, and I'll be happy to answer any questions that you have.

SEN. MCCASKILL: Thank you very much.

Mr. Hoe.

MR. HOE: Madame Chairwoman, my name is Sandy Hoe. I'm a partner at the law firm of McKenna Long & Aldridge.

Is that on now?

SEN. MCCASKILL: No. Try again.

MR. HOE: All right.

SEN. MCCASKILL: There you go.

PANEL II OF A HEARING OF THE CONTRACTING OVERSIGHT SUBCOMMITTEE OF THE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE; SUBJECT: "IMPROVING FEDERAL CONTRACT AUDITING"; CHAIRED BY: SENATOR CLAIRE MCCASKILL (D-MO); WITNESSES: JEANETTE FRANZEL, MANAGING DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO); E. SANDERSON HOE, PARTNER, MCKENNA LONG & ALDRIDGE; NICK SCHWELLENBACH, DIRECTOR OF INVESTIGATIONS, PROJECT ON GOVERNMENT OVERSIGHT; LOCATION: 342 DIRKSEN SENATE OFFICE BUILDING, WASHINGTON, D.C. Federal News Service February 1, 2011 Tuesday

MR. HOE: The light was on.

SEN. MCCASKILL: Now it's on.

MR. HOE: The light was on. I will begin again.

Madame Chairwoman, my name is Sandy Hoe, and I'm a partner at the law firm of McKenna Long & Aldridge. I am pleased to be here to testify before you today on behalf of the United States Chamber of Commerce.

As you indicated in your opening, I've been practicing government contract law on behalf of the contractor community for more than 36 years.

Today's hearing is very important to the government contractor community. Contractors understand and accept that by providing goods, supplies and services to the federal government in exchange for taxpayer funds, they are agreeing to contract auditing requirements. The need for such audits is not being questioned. How the audits are conducted is something on which the contractor community has definite views.

Of the three auditing organizations who have appeared here today, the Government Accountability Office, the inspector general and the DCAA, government contractors interface most frequently with the DCAA. There are a number of concerns the government contracting community has as it works with DCAA, and you have heard many of these issues before, such as the length of time it takes to complete an audit and the quality of the audits themselves.

There are, however, more recent issues facing the contractor community. The first is the role that the auditor is taking in relation to the contracting officer. Both traditionally and by law, contracting officers have exercised authority to make decisions regarding the implementation and performance of government contracts. Recently, however, there's evidence that the auditing community may be usurping some of that contracting officer's role.

Let me provide you a specific example from the Department of Defense. On January 4 of this year DOD published a memorandum assigning new roles for the Defense Contract Management Agency -- which houses the administrative contracting officers for the Department of Defense -- and the DCAA regarding forward pricing rates for contracts. The memorandum provides that contracting officers shall adopt the DCAA's recommended rates. This is a significant change of policy and conflicts with current law.

Under current law, contracting officers have the authority to administer contracts, taking advice from auditors, lawyers and technical experts. Industry does not see the wisdom of separating this one auditing function from the contracting officer, who otherwise is the final arbiter for the government on all contract matters, and we perceive this change may well cause problems in the future.

Another issue that concerns industry today is DCAA's recent stridency in its application of regulations during the conduct of audits. Some in the industry have noted the sharp upturn in DCAA's reluctance to engage in the discussion of audit issues when they arise through the performance of an audit. The Federal Acquisition Regulation Cost Principles and other cost and price compliance regulations are relatively explicit, but still cannot and do not cover every circumstance that may arise. A judgment often is necessary in applying the regulations to resolve issues.

Unfortunately, since 2008 and 2009, DCAA seems to have lost its appetite for analysis of the intent of a regulation versus its literal interpretation. Once it has applied the literal language, DCAA seems little moved by any argument that the result reached is nonsensical or that it could not have been what the drafters intended. This has confounded some in the contractor community who believe that the goal of the regulations and of government contracting generally is to reach correct and rational results.

I would like to end my statement with an idea of how to improve government contracting. Considering that an audit can have at least perspectives -- and, Madame Chairwoman, you mentioned this in your comments earlier -- an audit can be forward-looking, where the intent is to identify steps needed to assure that a contractor's systems, policies and procedures will comply with government contract requirements. A contract audit also can backward-looking, where its purpose is to test a contractor's actual compliance with the contract and regulatory requirements.

PANEL II OF A HEARING OF THE CONTRACTING OVERSIGHT SUBCOMMITTEE OF THE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE; SUBJECT: "IMPROVING FEDERAL CONTRACT AUDITING"; CHAIRED BY: SENATOR CLAIRE MCCASKILL (D-MO); WITNESSES: JEANETTE FRANZEL, MANAGING DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO); E. SANDERSON HOE, PARTNER, MCKENNA LONG & ALDRIDGE; NICK SCHWELLENBACH, DIRECTOR OF INVESTIGATIONS, PROJECT ON GOVERNMENT OVERSIGHT; LOCATION: 342 DIRKSEN SENATE OFFICE BUILDING, WASHINGTON, D.C. Federal News Service February 1, 2011 Tuesday

The first is affirmative, seeking to assure future compliance. The latter is more investigative and often associated with the concept of rooting out fraud, waste and abuse. Each one is important, but the first could be referred to as the carrot, the affirmative emphasis by the government and the contractor in getting things right up front, and the other is the stick.

Both will incentivize a contractor to be in compliance, as Senator McCaskill, you noted, I believe, earlier. However, we believe the carrot is much more likely to achieve the goal. And by analogy, from the manufacturing sector there is a saying: You cannot inspect your way to a quality product. It's a phrase that's often heard. The lesson from this is that quality needs to be built into a product up front. Inspecting-in quality after the fact is far less effective, and I think that lesson from the manufacturing industry can provide some lessons for the auditing community.

Thank you again for inviting me to testify, and I look forward to any questions you may have.

SEN. MCCASKILL: Thank you, Mr. Hoe.

Mr. Schwellenbach.

MR. SCHWELLENBACH: Chairwoman McCaskill, thank you for inviting me today to testify on ways to improve contract auditing, including the possible benefits of an independent contract audit agency. This hearing is an important step. We need an independent and muscular contract audit agency that protects the taxpayer.

We believe that there should be an independent federal contract audit agency, or FCAA. This isn't a new idea, but it's been around since at least the 1980s when DCAA whistleblower George Stanton exposed serious problems at DCAA. In 2009 the GAO laid out recommendations for congressional consideration. This included, in the long term, possibly creating an FCAA.

While some knowledgeable insiders tell us that the location of the agency is not the key issue, POGO believes an FCAA that conducts most contract auditing for the entire federal government makes sense. And I believe -- the statistics that your staff prepared today, I think, bear that out to some extent.

While DOD contracts and contract proposals still represent the bulk of DCAA's work, the DCAA has evolved since its inception in 1965 to become a de facto FCAA. There are several reasons why this happened.

Contracting has greatly grown outside of the DOD. DCAA has deep institutional knowledge of contractors, and utilizing the DCAA may be cheaper for organizations than hiring or training their own cadre of contract auditors.

DCAA provides a critical check on contractors. It helps ensure that we pay reasonable prices and spots attempts by contractors to charge unallowable costs. DCAA estimates that it saves slightly more than five dollars for every one dollar invested in it. It is, however, horribly understaffed, given its workload. For example, during the early 1990s it had more than 2,000 more employees than it currently does, while there's a greater amount of contracting now.

Non-DOD agencies can request DCAA services if they are willing to pay. This is a disincentive to utilize DCAA. If adequately and centrally funded, an FCAA would remove this disincentive. There are other possible benefits to an FCAA, the most significant being independence. Currently the DCAA reports to the DOD comptroller. Along with the GAO, we have some reservations whether this structure ensures adequate independence.

Furthermore, it is -- it is apparent to us that the DCAA Office of General Counsel is not independent. Its attorneys are evaluated by the Defense Legal Services Agency. A similar independence problem previously existed with the Pentagon IG, and in 2008 the IG Reform Act gave the Pentagon IG its own independent general counsel. We think this has some relationship with the unwillingness of DCAA to issue subpoenas to contractors -- and I can get into that later.

But in the meantime, we need to improve DCAA as much as possible, and we are concerned about its current direction. You only have to read the hundreds of comments posted on the government executive website by people claiming to work at DCAA to understand that some part of its workforce is deeply angry with its direction. As I mentioned, DCAA has not issued a subpoena to a contractor in over two decades, despite long-standing access-to-records problems they have faced from contractors. And we believe this is an indication that it is risk-averse.

PANEL II OF A HEARING OF THE CONTRACTING OVERSIGHT SUBCOMMITTEE OF THE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE; SUBJECT: "IMPROVING FEDERAL CONTRACT AUDITING"; CHAIRED BY: SENATOR CLAIRE MCCASKILL (D-MO); WITNESSES: JEANETTE FRANZEL, MANAGING DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO); E. SANDERSON HOE, PARTNER, MCKENNA LONG & ALDRIDGE; NICK SCHWELLENBACH, DIRECTOR OF INVESTIGATIONS, PROJECT ON GOVERNMENT OVERSIGHT; LOCATION: 342 DIRKSEN SENATE OFFICE BUILDING, WASHINGTON, D.C. Federal News Service February 1, 2011 Tuesday

We're also concerned with the tenfold increase in the proposal review threshold at DOD. You mentioned earlier, Chairwoman, that pre- award audits are highly important, especially in negotiating better deals for the taxpayer. Essentially, DOD has cut out DCAA from performing many of those pre-award audits. An audit, often with the smaller contract proposals, is where they find the biggest amount of questioned costs as a percentage of the proposal.

Without the help of DCAA auditors, contracting officers may not be armed with the knowledge they need to negotiate the best deal for the taxpayer.

We also understand that whistleblowers who testified before the full committee in 2008 feel they have not received adequate and public recognition from agency leadership.

There's also a belief by some within the DCAA that there has not been enough accountability for the deletion of audit findings or the gagging of a whistleblower. Bad managers must be held accountable and DCAA's promotion process needs to emphasize merit.

And I'll quickly conclude here: Besides creating a DCAA, there are opportunities to strengthen contract auditing. DCAA should have its own general counsel. While the staffing increase of 500 auditors is a step in the right direction, they perhaps need a larger workforce. DCAA needs more transparency. Little is known about what it does and we believe some reporting could be made public or to the Congress.

We'd also like to see more transparency with how contracting officers handle DCAA recommendations. Often, DCAA auditors find large amounts of questioned costs or unallowable costs, but at the end of the day it's up to the contracting officer to actually sustain those findings.

Congress also needs to take a look at how the role of contract auditors has been systematically reduced over the last two decades. And I would also take a look at the complaint system at DCAA -- is it working? Contract auditors provide a great return on investment and save far more money than they cost. We believe and FCAA makes sense, but even if DCAA remains within DOD, it needs to be as strong as possible.

And I'm open to questioning.

SEN. MCCASKILL: Thank you very much. I thank all three of you.

And I think legitimate points have been raised by both Mr. Hoe and Mr. Schwellenbach. I see validity in some of the points you've made and as -- in being fairly knowledgeable about the situation at DCAA, I do think that I understand why maybe some of the points that you're bringing up, Mr. Hoe, have surfaced.

Let me talk for a minute about your testimony, Mr. Hoe. And it's very hard for me -- I will expose my bias right now -- I think that the independence of an auditor by definition does not produce warm and fuzzy relationships between auditors and those people who are being audited. You know, the biggest lie that was ever told to me as we went into a state agency to audit was, gosh, we're glad to see you.

MR. HOE: (Chuckles.) I've heard that too.

SEN. MCCASKILL: Yeah. It is not a pleasant experience, because human nature makes one feel very defensive when they are being audited. In fact, a lot of the good work that audits do get -- it gets lost, because the auditee is too busy being defensive and isn't in the right place to get the constructive criticism that comes inevitably with an audit.

And I guess my problem with -- let me talk about two things: The DCMA directive as it relates to DCAA. I mean, isn't it true that the contracting officers have an ongoing relationship with the contractors that sometimes impact their ability to see everything clearly as it relates to some of the behavior of the contractors?

MR. HOE: Senator McCaskill, in my experience -- which goes back a number of decades now -- it has been the rare circumstance, if I was even aware of a single circumstance, where I believe that the contracting officer was co-opted by the contractor with whom he was dealing as a contracting officer.

SEN. MCCASKILL: I don't think you spent much time in Iraq then.

PANEL II OF A HEARING OF THE CONTRACTING OVERSIGHT SUBCOMMITTEE OF THE SENATE
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Service February 1, 2011 Tuesday

MR. HOE: Well, I didn't. I have not spent time in Iraq. But --

SEN. MCCASKILL: Clearly that was -- it's the best example I can think of. LOGCAP, by and large, there was a co-opting of the contracting officers. In fact, the contracting officers on the ground generally were just the low man on the totem pole that were handed a clipboard and had no training, had no capability of even asking a question like, why in the world are we monogramming the towels on a cost-plus contract?

I mean, those are the kinds of things that went on there. You understand that?

MR. HOE: Oh, yes. I do. And I do understand that a large part of the analysis that explains that was the need to get into the country quickly, to set up quickly, to provide contracting services --

SEN. MCCASKILL: I don't think that explains monogramming the towels, Mr. Hoe.

MR. HOE: Excuse me?

SEN. MCCASKILL: I don't think that explains monogramming the towels. That's not consistent with getting in there quickly. That's consistent with running up the price to maximize the amount of money the contractor was being paid, you know? And that's just one -- I mean, I can give you -- we could sit here all day.

I mean, I guess what I'm saying is I don't want businesses to feel like they're being punished for doing business with the federal government. But it's hard for me from where I sit in this committee and the work we've done to think that we have -- that we are being so aggressive with our auditing that they believe that it is no longer a place they want to do business. That's just -- I mean, it's -- I've just got to tell you, it's hard for me to think that.

MR. HOE: Well, I don't think the solution to the problem that you state is necessarily to take the authority that contracting officers had held for decades and decades -- if not centuries -- in handling government contracts.

They are currently by law -- as well as by tradition -- the central clearinghouse, if you will, for all aspects of contracting. And of course, contracting involves not just cost accounting and billing and estimating and so forth. It involves performance and full compliance with many other socioeconomic provisions. All of that currently filters through a single source at the contracting officer and I think there's good reason for that.

There may be with further thought some reason to separate out some portion of the audit function, but it would be a very unique circumstance. And I think it would be an unfortunate assessment of what contracting officers are and what they do.

There are problems, there were problems and probably currently exist problems -- as you say -- in Iraq and Afghanistan and some of those areas. I don't think that that is representative of the entirety and the history of federal government contracting.

SEN. MCCASKILL: And I, you know, I won't belabor the point. I think that there is just a fine line between cooperation and co-opted. And I think independence -- an auditor always has to err on the side of not being co-opted, which means maybe a little less cooperation. And I'm not sure that contracting officers traditionally -- particularly in the Department of Defense -- have taken that -- their independence is not something that is front and center like it is with an auditor.

So if we're talking about pricing information -- I'll look into what you talked about today and make sure I understand what's occurred and make sure it's lawful. But I like the idea that auditors are telling contracting representatives what the prices should be. You know, in my book, that's good news.

MR. HOE: Well, if I may, Madame Chair, that assumes that the questions related to audited costs or prices upfront on the fixed price contract are quite clear. And I don't think that is a true picture of the situation.

There are many areas, as I mentioned in my opening statement, of the regulations that state certain standards or principles for the allow ability of a cost or the accounting for a cost that create a good bit of debate and discussion among the auditors, the contracting officers and the contractors. It goes on every day. And often the outcome is not precisely what one party or the other stated at the beginning. It's the result of an investigation.

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And contracting officers hold the role of the party negotiating on behalf of the government. They certainly do -- and they're commanded by the Federal Acquisition Regulation -- to take input from their advisers, which include the auditors, the lawyers, the technical people. That all ought to come through the contracting officer. But it's the contracting officer that centralizes all those facts, all those considerations and renders a final judgment.

If the view is to take a different tack going forward, I think it deserves some debate.

SEN. MCCASKILL: Some discussion.

MR. HOE: Yes.

SEN. MCCASKILL: Fair enough.

Ms. Franzel, you talked about preventative controls. And I think this is a huge point that needs to be made here. I think that accounting system reviews, invoice reviews, all of those things are incredibly important. Do you think the right balance is being struck now between time being spent on those measures versus the time we spend on auditing?

MS. FRANZEN: Well, I think that we do need to evaluate this both from the contract management side of the house, as well as the auditing side of the house. Because if the contract management or the contracting officers are not doing their job, then a huge preventive mechanism is being lost.

There are also certain types of audits that have great value as a preventive mechanism. And rather than waiting for the detective mechanism -- you know, we've seen examples in agencies where because the final billing rates -- indirect billing rates were never determined -- the contractors were actually booking payables on their financial statements to the government, because they knew they owed the government money and there was a backlog in these audits. But if this could have been handled properly upfront, these types of problems wouldn't be occurring.

But I want to emphasize that this is really on both sides of the house.

Contracting officers need to do their jobs properly and implement the appropriate preventive controls of their responsibilities, and then the audits -- I think there is certainly room for taking a look at the different types of audits that are being conducted. Where do we get the best bang for the buck?

It isn't always going to be a one-size-fits-all though. Some contractors are very risky for unique reasons. And for these contractors, it may be best to go in and do an after-the-fact audit to try to recover certain fraudulent charges.

So everybody needs to be working diligently on this, but there is certainly a benefit for those detective audits.

SEN. MCCASKILL: I believe the number is \$55 billion in improper payments at HHS. Does that sound right?

MS. FRANZEL: I think that's about right, yes. The government wide total is 125 (billion dollars), and I think HHS is a very large chunk of that.

SEN. MCCASKILL: Yeah. And I will make one bold statement here. That would never happen in the private sector, ever, ever, ever happen in the private sector. We would not let that money go out the door as we have without putting more preventative controls in place up front.

And it is very hard to get the government's attention about improper payments because it's not like it impacts anybody's bottom line. It doesn't impact profit margin. It doesn't impact their discussions with the banks. It doesn't impact any of that.

So I think that we need to do more work in this committee about preventative measures as it relates to contracting. Maybe drill down even deeper as to what's being done in the various agencies and what isn't being done, just through the lens of preventative measures before the money goes out the door because I think it's something that we have not focused on to the extent that we need to.

I know GAO has done some great work here, but we've got a lot more we need to be doing.

PANEL II OF A HEARING OF THE CONTRACTING OVERSIGHT SUBCOMMITTEE OF THE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE; SUBJECT: "IMPROVING FEDERAL CONTRACT AUDITING"; CHAIRED BY: SENATOR CLAIRE MCCASKILL (D-MO); WITNESSES: JEANETTE FRANZEL, MANAGING DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO); E. SANDERSON HOE, PARTNER, MCKENNA LONG & ALDRIDGE; NICK SCHWELLENBACH, DIRECTOR OF INVESTIGATIONS, PROJECT ON GOVERNMENT OVERSIGHT; LOCATION: 342 DIRKSEN SENATE OFFICE BUILDING, WASHINGTON, D.C. Federal News Service February 1, 2011 Tuesday

Okay. Mr. Schwellenbach, I understand -- you know, I like to say that, in government, we can grow when somebody has a good idea and gets enough votes. Businesses can't grow unless they've got the revenue stream to pay for it. And if they do grow and their idea about growing doesn't work, they cut it.

So government is very inefficient when it relates to creating programs. And I am beyond reluctant, after looking at what happened when we created Homeland Security, and looking what happens whenever we create a new program. Generally don't check to see if it really duplicative, generally don't check to see if there's any metrics if the program is doing what it's supposed to be doing very well. Job training is a great example. Broadband deployment is another great example. We've got, you know, two different agencies that are both, ostensibly, running broadband deployment programs, both Agriculture and Commerce.

So I guess what -- I'm really not excited about creating a new agency even if it is auditing. If there's ever going to be a subject matter I'd want to create a new agency, it would be auditing.

Why can't we make DCAA -- why can't we just improve DCAA to be the main repository of auditors that agencies can go to when they need audit work done within their agencies?

MR. SCHWELLENBACH: Chairwoman, I think you're absolutely right. And I think, as GAO recognized their 2009 report, it's a -- it's a risky suggestion. You could possibly make things worse if you created a new agency. There could be a lot of upfront costs.

SEN. MCCASKILL: And the wrong kind of competition.

MR. SCHWELLENBACH: Absolutely, absolutely. So we do believe, in a perfect world, you would have an FCAA that's centrally funded, that removes the disincentive for non-DOD agencies to utilize its services. We think that would be, obviously, the best of all worlds.

Now, clearly, we have budget limitations. You know, you yourself mentioned, you know, we're probably entering some lean times. So why not make the system as it exists now work better, which is one thing I tried to address in my testimony.

I think there are a lot of more modest reforms, such as giving the DCAA its own independent general counsel, another issue the GAO pointed out in its 2009 report. I think that could do a lot of good. I think --

SEN. MCCASKILL: Like we did for the IGs?

MR. SCHWELLENBACH: Yeah. As we did for the IGs. And I think that's a common-sense solution. I don't think there would be much cost involved, you know, beyond what we're already paying. There are also ways DCAA uses its workforce that perhaps need to be reviewed.

I'm not entirely convinced that only looking at large contract dollars is a risk-based approach. For example, a lot of the smaller contracts involve, you know, non-traditional government contractors that may not have the internal-control systems that are government compliant in place. So sometimes they are the riskier actors rather than the Boeings and Lockheeds of the world. Not to say, you know, that they have not done anything wrong, which they clearly have in the past.

So I do think there are a lot of modest measures that need to be looked at. The subpoena -- the lack of subpoenas over the last two decades, I think, is a major issue. And, you know, we know DCAA has problems with getting access to records. You know, a few successful uses of the subpoena by DCAA could really shake up the contractor community and make them, you know, open up their books more often and reduce a lot of the issues with, you know, access to records and timeliness that currently exist.

SEN. MCCASKILL: I think you're right about that. I think that we do need to begin to ask the question: Has there never been an occasion that DCAA hasn't gotten the information it needed? And if there has been, then what is the reason? And we will pose that question for the record for Mr. Fitzgerald and his agency.

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 Service February 1, 2011 Tuesday

And I recall vividly that it was, in fact, a lawyer at DOD who wrote the very offensive letter to the whistleblower basically telling the whistleblower that she was not allowed to speak. It was very un-American, the letter that was composed by the counsel at Department of Defense as it related to --

MR. SCHWELLENBACH: And I would submit, because that general counsel is not directly accountable to the director of DCAA, it's more difficult to hold that general counsel accountable.

SEN. MCCASKILL: Yeah. Well, we had a hard time. We had a hard time.

Let me ask, besides the -- is there any other barriers to businesses that you see, Mr. Hoe, that we need to -- that I need to make sure that we keep on the radar as it relates to auditing work? Is there something we could be asking of our contractors that they do on their side of the equation that would prevent some of the less-than-productive interaction with the auditors? Should we be requiring them to do more of the internal audits that then can be sampled and approved by auditors within the IG departments of these various agencies?

MR. HOE: Senator McCaskill, I think that is an excellent suggestion and, in fact, there are in place currently a number of programs that are designed to encourage, if not require, contractors to examine their own operations prior to a government auditor or an investigator coming to the company to assess its systems or its performance.

The voluntary disclosure program that's been in existence for a number of years now replaced or supplemented with a mandatory disclosure requirement that is placed in new contracts that obligates contractors to come forward and disclose, on their own, certain acts that may rise to a certain level of malfeasance. That encourages --

SEN. MCCASKILL: I'm looking at the competitors' fact sheet on the joint tanker competition.

MR. HOE: Yes, very definitely.

SEN. MCCASKILL: That would definitely be one.

MR. HOE: I believe that would be very definitely one, and certainly others. And I can say from my own experience that there are many contractors out there who, since the implementation of that program, have been raising questions with people like myself to understand what the requirements are and what kind of looking they need to do within their company and how extensive and what needs to be disclosed, what doesn't rise to the level.

So it's having a substantial effect. So I think taking into account what's already in place, one would want to consider that before deciding whether there's additional, affirmative steps that would be required by law or otherwise for the contractor to undertake themselves. But there are many incentives currently for contractors to look at their own systems and make them compliant or try to make them as compliant as they can.

SEN. MCCASKILL: I'm sure, Ms. Franzel, you're familiar with the single audit and the way the decisions are made in terms of prioritization of audits that are done under the single audit. And I guess -- and I should have asked Mr. Fitzgerald this when he was testifying.

It seems to me that the way in which states are told they must prioritize audit work for the federal government, that that exercise would be fairly simple to implement within the federal government. In other words, agencies deciding how many of their programs are what -- in the single audit, I can it's A, B and C -- I think, isn't it? A and B -- and we probably did a lot of Cs where I was because I liked doing some of the smaller programs that didn't -- and A, is the size of the program; B is those that are high risk for other reasons. And then if you wanted to do other programs, then it had to be in consultation and cooperation with the federal government signing off on it.

Do we have that kind of risk assessment going on in each agency so that, in a very simple way, DCAA could look at government-wide, where are the big thresholds -- but then, on the other hand, where are these programs? I mean, the example I like to use is weatherization under ARRA. That was a lot of money getting pumped into a program that had, up until that time, had very modest appropriations; a lot of labor involved; a lot of shotgun type approach across the country in how the money was used.

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 Service February 1, 2011 Tuesday

And even though it was not as large as, say, a Medicaid or Medicare program, the opportunity for a lack of internal controls, the opportunity for a lot of money walking away with somebody's nephew in a pick-up truck was real.

And the other part of this question I want to ask: Is anybody using the software programs that are out there right now that allow the integration of data-point sets to really expose risk, similar to what we did on ARRA where we contracted with a company to try to detect fraud by overlays of integrated data sets to show where there might be the most risk?

MS. FRANZEL: Certainly. I do believe that the risk assessment function can be made better and bolstered, and I think it's being done inconsistently across agencies. So I think that's really the next big step in terms of looking at how contract audits are done and to what extent across the federal government.

And let me emphasize across the federal government because, similar to the single audit for contracting, there's the cognizant agency concept. And so one contractor may actually be doing work for multiple agencies, but one agency is the cognizant agency. So what kind of communication and coordination is happening for all of the affected agencies, I think, that's probably something else that could be improved and that can feed back into this risk assessment process.

And, frankly, if the agencies are coordinating, one would hope it would make it a little easier on the affected contractors. So I think risk assessment is something that definitely needs to be looked at and probably improved as well as coordination across --

SEN. MCCASKILL: Is that something we can get the IG counsels to do? To do a better job of a coordination of risk assessment across all agencies that would then be a document that could be a point of reference for DCAA when they got requests?

MS. FRANZEL: Yeah. That would certainly be one place. In fact, we were having this discussion at GAO how would this coordination happen. You know, perhaps it could be under OMB. It would have to be some sort of centralized --

SEN. MCCASKILL: Oh, let's don't go there.

MS. FRANZEL: -- that really -- (chuckles). It could be at IG. It could be the SIGI (ph). So we do need some kind of centralized risk assessment function, I think, in coordination across agencies and, frankly, somebody or an entity to serve as technical expertise in consultation to the agencies because we've seen varying degrees of internal controls over the contracting function and the contracting officer's diligence to the preventive controls and other controls.

So I think there's just huge room for improvement here.

Your final question was about taking the data points that were used for the recovery monies. And I do believe that the recovery board is looking at how to get that out to agencies and use that going forward. But that is something that we need to institutionalize in government going forward.

SEN. MCCASKILL: It really -- I've seen the software demonstrated. In fact, I believe they're using it with CERP. It's very impressive. They're overlaying attacks versus population versus CERP money to make the assessment as to whether or not the CERP funds are truly getting at the cause that we want them to get at in terms of stabilizing different regions of Afghanistan. And I think that's something that we will continue to take a look at because I think that technology that's available now, as long as we don't create a new agency to do this technology, if we could effectively and efficiently access the technology that's out there right now, I think we could save a lot of man-hours just by data that's available and that can be digested, synthesized and fit back out in a way that helps us manage risk.

I want to thank all of you today. I think we've got some things to work on. I think this risk assessment government-wide is important. Getting some consistency, I think, looking at some of the things we've talked about in terms of DCAA and making sure they have the independence they need if they're going to be the go-to contract agency and, importantly, looking at preventative measures going forward and making sure they're getting the emphasis they need so we're not trying to claw back, but rather we're preventing up front.

So most Americans can't even compute over a hundred billion dollars in improper payments. That dog doesn't hunt. And we've got to figure out how we get at that.

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Service February 1, 2011 Tuesday

I appreciate everyone's time today, and we will continue to follow up with you because we will have a few more questions for the record.

Thank you very much. This hearing is adjourned.

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