SEN. LIEBERMAN: The hearing will come to order. Good morning to all who are here. Welcome to this hearing where we're going to examine the potential that billions of taxpayer dollars are at risk of being wasted become of the inadequate auditing procedures at the Defense Contract Agency (sic), DCAA.

DCAA has 300 offices and 3,800 auditors throughout the United States and the world. Just to give you a scope of -- a sense of the scope of their responsibilities, in fiscal year 2008, which is the last one, obviously, for which I have complete data, DCAA did more than 30,000 audits covering $501 billion in proposed or claimed contractor -- contracting,
contracts. So that's a lot of audits, with a lot of money, and therefore what it does or doesn't do well is of great consequence to the taxpayers.

A year ago our committee heard from GAO, the Government Accountability Office, and two auditors, "whistleblowers" if you will, from DCAA about alarming problems in the Western Region of DCAA. We heard that -- then found that there was widespread failure in meeting professional auditing standards in that region. Time after time DCAA had issued clean audits of contractors that were not -- simply not supported by the underlying audit work. In some cases, supervisors had even overturned the audit findings of subordinates without a justification for their decisions.

Because Senator Collins and I were concerned that these problems in the Western Region might be symptoms of a larger systemic breakdown, rather than just a regional one, we, joined by Senator McCaskill, asked Government Accountability Office to do a review across all the regions of DCAA. And today we're going to hear the results of that review.

I'm sorry to say that GAO has found similar problems just about everywhere DCAA operates. I'm just -- highlight some of the findings, because I know Mr. Kutz will speak to them in detail. Each and every audit that GAO reviewed for this report was out of compliance with auditing standards -- most with very serious deficiencies.

SEN. LIEBERMAN: As an example, in one case a supervisor directed audit staff to delete some audit documents, generate others, and copy the signature of a prior supervisor onto the new documents, and then issued a clean audit opinion. This supervisor was later promoted to Western Region quality assurance manager responsible for the quality control of thousands of audits.

One auditor asked supervisors for permission to spend more time on an audit of a contractor known to be under criminal investigation for fraud. The auditor ultimately drafted a negative opinion that was overturned by supervisors, who then, rather than praise the auditor's efforts, lowered his performance appraisal for performing too much testing and exceeding budgeted hours.

In an audit of one of the DOD's largest contractors, the auditor told GAO that he did not perform detailed tests, quote, "because the contractor would not appreciate it," end quote.

When auditors reviewed contractor invoices, in many cases they did not look to see if the contractor could offer supporting documentation for the goods or services they were charging the government for. The auditors simply looked the numbers on the invoices to see if they added up.

To date, GAO's two reviews have led DCAA itself to rescind 80 of its audits, which is, I gather, a rare -- and, of course, embarrassing step for an auditing agency. The rescission of 80 audits is, to me, effectively a self-indictment by DCAA for failure to hold audit quality above all else. Now, this would be bad enough if it was a separate and unique -- a critical audit by GAO, but the fact is that this is the fifth major report sounding the alarm about DCAA.

In addition to the two GAO audits -- reports that I've cited, we have a 2007 Department of Defense inspector general's peer review, a report last fall from the Defense Business Council, and a new DOD IG report -- all showing that an important watchdog agency, DCAA, is badly in need of overhaul. I mean, the fact is when the people we've charged with the responsibility of auditing, themselves receive this many critical audits, "Washington, we've got a problem." And it's a big problem because of the enormous amount of money being audited, (that spent ?) over half a trillion dollars in 2008 through the Defense Department.

In my opinion, DCAA is in need of a complete overhaul. One problem may be, as GAO suggests, that DCAA emphasizes speed and production of audits over the quality of results. DCAA also appears to be very insular, with little or no infusion of skills from outside the agency. I think it's really time for us to make sure that we change this environment with specific steps, such as improving audit quality control, increasing training of the auditors, developing a strategy to target resources, rather than simply churning out audits that are faulty to hit numerical goals.

So we want to have a very frank discussion today because this is very important. A lot of money is on the line. And the discussion really is: Who is responsible, in the end, for the operational reform that is necessary at DCAA?
This auditing agency has a unique role, and because of that role it also needs to have independence. It needs to stand up to pressures from both agencies and contractors. And, as I believe may be suggested here today, perhaps that independence should be strengthened. Perhaps it's time for us to consider separating DCAA from the Department of Defense and, either separately or as part of a larger operation, making it an independent auditing agency.

But what is also needed right now is, clearly, strong leadership from the top ranks of DOD to help DCAA achieve the necessary transformation and reforms. Because this committee -- Senator Collins, and I, and the members don't want to be sitting here a year from now discussing another audit which finds similar problems once again in DCAA. Let's identify the root causes, and implement the solutions that Congress must demand and that the taxpayers surely deserve.

Senator Collins.

SEN. SUSAN COLLINS (R-ME): Thank you, Mr. Chairman.

With the release of today's GAO report we once again focus on the extensive problems with the quality of audits at the Defense Contract Audit Agency and with the management of this watchdog agency. The DCAA is the Department of Defense's principal contract auditor. It completes more than 30,000 reviews and audits per year that cover hundreds of billions of dollars in federal contracts.

A well-functioning DCAA is -- that's vital to our government's responsibility to be careful stewards of taxpayer funds. DCAA plays a necessary role in ensuring the accountability and transparency of federal contracts.

Unfortunately, the GAO report contains a haunting refrain of previous past disturbing reports. It cites, for example -- and perhaps most troubling, a lack of independence from undue influence on audit outcomes by contractors, program managers, and even some senior managers at DCAA. It cites poor or inadequate audit quality and gross mismanagement of government resources, and it cites ineffective audit practices that allow contractors to overbill the government, in some cases for millions of dollars.

The Department of Defense and other federal agencies rely on DCAA to help detect waste, fraud and abuse. It is, therefore, completely unacceptable for this federal policing agency to continue to have such significant performance problems. With more than a little frustration, I note that we are here almost one year to the day since the committee's last hearing on this very same topic -- DCAA's poor performance. During the 2008 hearing I raised significant concerns, as did the chairman, about the mismanagement of DCAA, and yet here we are again.

Three particularly troubling areas still need to be addressed:

First, the GAO report highlights the ongoing lack of rigor and independence of DCAA audits due to coercion by a few errant contractors, program managers and, on occasion, even by DCAA management. Auditors cannot be constrained from doing their jobs. They must be able to work in an environment where they are encouraged to conduct their oversight in a fair, unbiased and principled manner. Indeed, not just encouraged -- required -- to conduct their audits in that manner.

Now, I want to make clear that there are many principled, dedicated and competent auditors at DCAA who endeavor to conduct themselves with the highest possible ethical and professional standards. The management and the culture at DCAA must support their efforts, not undermine them.

Second, I am baffled by the complete lack of a sense of urgency in terms of addressing and resolving these problems. As the chairman as indicated, there have been repeated reports indicating these flaws. Recent reviews of DCAA's reform efforts do not assure me that significant progress has been made over the past year. While DCAA has taken some steps toward improvement, it has been too little.

To date, DCAA, as the chairman has indicated, has rescinded some poor quality audits, and issued guidance to improve the quality. The agency also plans to hire 700 additional auditors to augment its workforce.
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SEN. COLLINS: But if all we do is add more people, that's not going to solve the fundamental failings of this agency. Indeed, the consequences of not requiring high-quality audits and of mismanagement may only multiply with these additional resources. Your throwing more people at the problem is not going to solve it.

Less than a month ago, the DOD Inspector General completed an investigation that found evidence of this kind of mismanagement. It cited time pressure, uncompensated overtime, unauthorized changes to audit results, and other unprofessional behavior that had created a work environment not conducive to performing quality audits.

What will it take to finally see progress? DCAA's inability to remedy its mismanagement despite numerous hearings, investigations and report after report, is truly an epic failure by the agency and the department.

Third, the GAO report raises significant questions regarding the need for structural reform, such as the chairman has mentioned and I brought up last year. How can it be that DCAA auditors spent more than 530 hours auditing a billing system that did not exist?

How can it be that they repeatedly changed audit findings to make the results acceptable to some contractors? To make matters worse, I'm told that some supervisors responsible for deficient audits were given performance ratings ranging from exceeds fully successful to outstanding. Again, how can this be? Where is the accountability?

Now let me end by saying why this is so important. When an audit agency fails, the fallout can cascade throughout the system and ultimately short-change our troops in the field. For this reason alone, Congress must carefully consider whether fundamental restructuring, as well as internal reforms are needed at DCAA in light of these disclosures.

Re-establishing DCAA as a first-rate audit agency is critical, and I will say that to date I've been very disappointed at the lack of leadership at DCAA itself and at the Office of the Comptroller, which is responsible for overseeing and supporting DCAA.

Action must be taken swiftly to help this agency regain its credibility and restore its oversight mission. Once its performance and image have been repaired, it can once again assume its vital role of insuring the best value for the American taxpayer on all defense contracts. Thank you, Mr. Chairman.

SEN. LIEBERMAN: Thank you very much, Senator Collins. Before I call on Mr. Kutz I want to say that I mentioned, Senator McCaskill, that you had joined us in the request for this report by GAO and I appreciate that and it leads me into moving slightly behind you and acknowledging the work of your counsel, Peg Gustafson, who, as you know, has been nominated by the president to be the Inspector General of the Small Business Administration.

I want to thank Peg for the hard work you've done on the matter before us today and so many other issues, and we look forward to working with you as you move on into the IG community. Your nomination is pending before our committee now; we'll give it a rigorous and dispassionate review, of course, and hope to discharge your nomination by unanimous consent as soon as possible. Good luck.

SEN. CLAIRE MCCASKILL (D-MO): Mr. Chairman, can we slow that down any? (Laughter.) I'm having buyer's remorse --

SEN. LIEBERMAN: I got you. (Laughs.)

SEN. MCCASKILL: -- about losing Peg.

SEN. LIEBERMAN: All right. We've got a conflict of interest here, but we'll help you resolve it.

Mr. Kutz, here for the second day in a row. God only knows what may bring us together tomorrow, but I thank you for your continuing high level of work, which really is -- and greatly benefits Congress and ultimately the people of our country. I note that you're here with Gayle Fischer, who's an assistant director at GAO, who will be available to answer questions.
For the record, Mr. Kutz is before us as managing director of the Forensic Audits and Special Investigations Team of GAO. Thanks for your work, and we welcome your testimony now.

MR. KUTZ: Mr. Chairman and members of the committee, thank you for the opportunity to discuss the Defense Contract Audit Agency. Last year I testified that 14 audits at three California locations did not meet professional standards. Today's testimony highlights our broader review of the DCAA quality control system. My testimony has two parts. First I will discuss our findings, and second I will discuss our recommendations.

First, 65 of the 69 engagements that we reviewed did not meet professional standards. Key issues relate to lack of independence, insufficient testing and inadequate planning and supervision.

Examples of these problems include: First, an accounting system report drafted with eight significant deficiencies. One year after contractor objections to this draft report, an adequate or clean opinion was issued with no deficiencies. We found little evidence to support these changes.

Second, inadequate opinion issued on a billing system with insufficient testing. As you mentioned in this case, Mr. Chairman, an auditor told us that testing was limited because the contractor would not appreciate it.

Third, an adequate opinion issued for a billing system based on a test of only four vouchers, all from the same day. And finally, as Senator Collins mentioned, 530 hours spent auditing a billing system that did not exist.

Further evidence of problems at DCAA is the rescission of 80 audit reports. I expect the rescission of 80 audit reports is unprecedented in both the federal government and the private sector. The evidence supporting our conclusion of widespread audit quality problems is irrefutable. So why did these problems happen? Let me give you few of the examples.

First, we found a production-focused culture resulting in part from flawed metrics. These metrics focused on getting audits done on time and within budget. Taking time to find and address issues was discouraged.

This resulted in some audits of accounting and billing systems being issued within two to three weeks of the entrance conference. No wonder we saw opinions of contractor systems being issued based upon a conversation with the contractor and a quick look at a few transactions.

Further evidence of the need to cut corners is the 22,000 reports issued in 2008 by DCAA's 3,600 auditors. That's 60 reports issued every day of the year, including weekends and holidays. There is also evidence of pressure caused by the fear of DCAA being outsourced. In other words, DCAA's metrics were intended to show that they could do their work faster and cheaper than public accounting firms.

Let me move onto human capital. Last year the original whistleblower, Ms. Thi Le, testified before this committee on her experience at DCAA. Ms. Le's testimony is one of the most memorable of my experience.

If this GS-12 auditor and the dozens of others that we have spoken to are representative of DCAA's employees, then the quality of audit staff is not the issue. Instead, what you have are thousands of good auditors trapped in a broken system.

Let me move on to steps that can be taken to improve DCAA's operations. First, let me commend this committee for your oversight on this matter. The hearing you held last year and your consistent oversight have made a difference.

DOD is taking these matters very seriously. Positive steps have been taken and are underway to address most of these issues. My only recommendation to you is to continue your oversight.

We made 15 recommendations to the Secretary of Defense. The intent of these recommendations was to strengthen DCAA's independence and effectiveness. DOD agreed with 13 of these recommendations.

We also provided three matters for the Congress to consider, as you had requested. The first of these relates to providing DCAA with the protections and authorities granted to inspector generals.

Legislation would be needed to implement this matter. This change could strengthen leadership, independence and transparency to external reporting of DCAA results to the Congress.
MR. KUTZ: The other two matters related to organizational placement. Most of the effectiveness issues can be addressed within the current organization placement. However, elevating DCAA to a separate DOD component, or outside of DOD as an independent audit agency, are matters for longer-term consideration. We believe that organizational placement changes should not be considered until current reform efforts are complete.

In conclusion, the 14 audits that we reported on last year were not isolated cases, but in fact proved to be the tip of the iceberg. We commend DOD for their recent actions. However, it is important to remember that if not for a tip from a courageous GS-12 auditor, Congress would still believe that everything at DCAA was fine. We look forward to working with this committee and DOD to help DCAA achieve its full potential.

Mr. Chairman, this ends my statement and I look forward to your questions.

SEN. LIEBERMAN: Well done. Thank you very much. Next we're going to hear from the Honorable Gordon Heddell, who is the Inspector General for the Department of Defense.

MR. HEDDELL: Chairman Lieberman, Ranking Member Collins, and distinguished members of this committee. Thank you for the opportunity to be here today to discuss continuing oversight by my office of audits conducted by the Defense Contract Audit Agency. The Department of Defense office of the Inspector General has a responsibility to verify that audits by all DOD audit agencies, including DCAA, comply with stringent standards.

At the hearing last year before this committee we discussed serious problems with DCAA, to include weaknesses in its quality assurance programs, audits that failed to comply with generally accepted government auditing standards, and allegations of an abusive work environment.

We have been monitoring DCAA's efforts to correct the deficiencies identified in our May 2007 peer review and in a report issued in July of 2008 by the Government Accountability Office. On August 31 of this year we issued a report following up on the deficiencies identified by GAO.

We found that a fraud audit could have allowed a contractor to recover millions of dollars in unallowable costs on a major aerospace program. We found audits performed by trainee auditors at one location that did not comply with standards. We found audit opinions that were not sufficiently supported, and we found audit findings that were dropped without sufficient justification.

Additionally, employee concerns with time pressures, uncompensated overtime, changes to audits, and unprofessional behavior created a work environment not conducive to producing quality audits. We made several recommendations to DCAA, including that it rescind an additional five audit reports and notify contracting officials not to place reliance on the report's conclusions.

Our report also recommended that DCAA take appropriate corrective action regarding the performance of the two supervisors associated with the majority of cases reviewed by my office and GAO. DCAA reported that those individuals will re-take supervisory courses and receive additional training. We expect DCAA to monitor their performance very carefully.

We issued a report on September 11th of this year regarding improper conduct by a DCAA manager. This senior official investigation supported a GAO finding that a former regional audit manager was not free from external impairments to independence. Her direction resulted in a flawed audit that could have allowed a contractor to recover $271 million in unallowable costs.

Additionally, we concluded that the individual failed to adhere to established leadership standards and fell short of the type of leadership skills expected from senior leaders. The report was provided to the director of DCAA for appropriate action.

Based on the most recent GAO review of DCAA, together with the deficiencies identified in our May 2007 peer review, I notified DCAA that our adequate opinion on its system of quality controls would expire as of August 26th of this year.
Further, that DCAA should qualify its audits with a statement noting an exception to compliance with the quality control and assurance standard.

On August 5 of this year we announced the peer review for the period ending September 30, 2009. This review will assess whether DCAA's quality control system provides reasonable assurances of compliance with standards. We will also follow up on DCAA corrective actions in response to prior GAO and DOD IG recommendations, including the findings in our May 2007 and December 2003 peer review reports.

On September 1 of this year DCAA requested GAO approve delaying the announced peer review by at least two years so that it could continue internal improvements. The DOD Inspector General has a statutory responsibility to provide continuous audit oversight and, should the peer review be postponed, we will undertake a number of targeted reviews of DCAA high-risk areas.

Our oversight is essential to helping DCAA identify audit deficiencies and to take corrective actions. However, implementing change and creating a quality workforce requires a commitment by management.

It is essential that DCAA senior management address fundamental issues to include recruiting, training, and cultivating skilled personnel, and most importantly, developing highly skilled and motivated leaders.

Equally important is the engagement, involvement, and support of senior DOD management. Absent any of these factors, DCAA will fail to achieve the cultural transition necessary for success.

This concludes my statement. I welcome your questions.

SEN. LIEBERMAN: Thank you very much. And next we'll hear from the Honorable Robert Hale, Undersecretary of Defense, Comptroller, and Chief Financial Officer of the Department of Defense, to whom, if I've got this straight, the DCAA reports. Correct, Mr. Hale?

ROBERT HALE: Yes.

SEN. LIEBERMAN: Thanks for being here.

MR. HALE: Mr. Chairman, members of the committee, thank you for the opportunity to share some observations about the Defense Contract Audit Agency, the DCAA. I'll focus on the concerns raised by the recent audits of DCAA, particularly by the GAO audit. As members of the committee are aware, the Department has submitted a lengthy response to GAO's recommendations. We acknowledge the seriousness of GAO's findings, as well as those of the IG and others, and concur with their recommendations, with very few exceptions. I'll mention a couple below.

Based on my own review of DCAA and the GAO recommendations, as well as the IG, I believe that DCAA, with assistance from me and others in the Department of Defense, needs to focus on three major issues.

First, maybe foremost, improving the quality of audits, especially the audits of contractor business systems. Second, assessing the number and types of audits performed by DCAA and whether all audits currently required by acquisition laws and regulations are appropriate.

I'm worried about 24,000 audits a year. As the GAO pointed out, we've got to be sure we do all that are needed, but we also need to look at that number. And finally, assessing improvements in the process for resolving DCAA audit results to ensure that audit findings are fully considered during contracting officer deliberations.

DCAA has already begun to focus on these major issues and on others. As GAO said, a number of steps have been taken, and in her testimony the DCAA director, April Stevenson, will describe some of the actions that have already been completed and those that are underway.

It's important to note that the spotted (ph) assignments covered by GAO and the IG were completed three to five years ago on all of the audits that we're talking about, cover items completed three to five years ago, and that a series of corrective actions were undertaken beginning in late 2008, not long after the hearing that you held last year.
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The committee has to understand that it may take several years. It took us years to get into this problem. It may take
several years for the full benefit of these actions to be realized. In addition, I'd like members to know that the office of
the undersecretary of defense comptroller, my office, has taken some steps to improve oversight of DCAA operations.

First, I've assigned a senior member of my staff to assist on oversight efforts. This provides me some personal eyes and
ears to keep track of what's going on.

MR. HALE: Second, last March, I established a DCAA oversight committee to provide my office with advice and rec-
ommendations concerning the oversight of DCAA. The committee is made up of the auditors general of the Army,
Navy, and Air Force -- all three of them personally agreed to participate -- and these individuals provide me with some
heavweight audit experience that's simply not present on my staff, which is focused on financial management and the
budgetary responsibilities.

This senior group will assess DCAA's activities -- they've already begun to do so -- and the actions taken to correct
problems, and they've provided me advice. I've met with them several times personally and will continue to do so.

We have also taken steps in the Department of Defense to increase the resources available to DCAA. Between fiscal
'09 and '10, we'll add 500 new auditors and will consider further adds beyond fiscal '10, and I'll be monitoring the
DCAA budget carefully -- and that's something I can do -- during our fall program and budget review.

We believe that by taking aggressive action, improving oversight, and increasing resources, we can resolve the signifi-
cant issues posed by the GAO report -- and as well as the report by the IG -- and we'll monitor that progress -- and I will
personally -- to determine if further actions need to be taken.

We generally agree with GAO, there are two areas where we take exception or disagree with their findings.

First, GAO suggested that the Congress consider providing DCAA with independence similar to that of the department's
inspector general. There are some aspects of that that may make sense. For example, we're looking at increased sub-
poena authority for DCAA.

But we disagree with a number of the implications of that recommendation. For example, we don't believe the DCAA
should be a Senate-confirmed position, a presidential appointment with Senate confirmation. It will inject, in my view,
an inappropriate element of politics into what should be a technical audit agency and inevitably will create long periods
of delay -- it's just inevitable in our system -- when there would be no director in charge.

Likewise, we oppose fixed terms for the DCAA director and mandatory public reporting, as the IG is required to do. It's
an additional burden on an agency that's already struggling to meet its many mission demands.

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an additional burden on an agency that's already struggling to meet its many mission demands.

While we don't support IG-like independence -- or most aspects of it -- we are taking steps to strengthen DCAA's inde-
pendence internally in a number of ways, but I'll mention one in particular: by assessing improvements to the process
used by contracting officials to resolve DCAA audit findings.

When there's disagreement, we need a process that allows DCAA to elevate that disagreement if it can't be resolved at
the staff level, and we've put that in place with the director of procurement and acquisition policy and appeals to both
the undersecretaries of AT&L and the comptroller if DCAA doesn't feel that first set of appeals has resolved the
issues.

Second, GAO suggested that Congress require DCAA to report to the deputy secretary of defense. DOD strongly dis-
agrees with this recommendation. The deputy secretary is the chief management officer of one of the world's largest
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organizations. He backs up the secretary in the wartime chain of command. Direct oversight of an individual defense
agency would, I believe, add unreasonably to his current responsibilities.

I think DCAA should remain within the department, and at least until these issues resolve, I believe it should continue
to report to my office. I feel personally responsible for helping to fix the problems that have occurred.

In sum, Mr. Chairman, we acknowledge that GAO has raised some serious issues. We believe we've begun taking ap-
propriate steps, and I think that's important. We believe we've begun taking appropriate steps to resolve these issues
and we will monitor -- I will personally monitor -- the situation to determine if additional steps are needed.

Let me close with what I hope -- what I believe is an important and critical context, and I ask the committee's help.
DCAA provides valuable services to the Department of Defense and other government organizations. You've all said
that. I agree.

I've spoken personally to the director of defense procurement and acquisition policy, one of DCAA's key customers. He
informed me that DCAA products are necessary and critical to the acquisition process. The Commission on Wartime
Contracting has made similar comments.

As we strive to resolve the issues raised by GAO and others, I'm worried about morale at the agency. We've got to be
careful not to undermine the unique value of DCAA to DOD and other organizations. Let's be careful not to throw out
the baby with the bathwater here.

Mr. Chairman, thank you again for providing this opportunity for me to comment on GAO's findings. I'm convinced
that working together with this committee and senior leadership of the department and, of course, DCAA, we can ensure
that the work of DCAA will continue to support the department and the security of the United States.

When the other witnesses have completed, I'd be glad to answer your questions.

SEN. LIEBERMAN: Thank you, Mr. Hale.


MS. STEPHENSON: Mr. Chairman, members of the committee, thank you for the opportunity to appear before you
today. I am pleased to be here.

As requested, I will describe the actions taken as a result of the recent oversight reviews of DCAA. Please be assured
we take all findings that have taken place on DCAA from any source very seriously.

We have worked diligently since late 2008 to accomplish a number of actions to improve the quality of the audit ser-
vices and to improve the working environment for our employees. As shown in the appendix of my submitted testi-
mony, we have completed over 50 specific improvement actions. We are not done, and we have various long-term ac-
tions in process.

For the purposes of my testimony today, Mr. Chairman, we have categorized the issues into four general areas: insuffi-
cient testing, ineffective quality assurance program, lack of independence, and management abuses.

The GAO identified non-compliances with the audit standards of nearly all the assignments it's reviewed. This is pri-
marily due to an insufficient number of transactions tested, particularly in assignments of business systems where the
contractor's system was deemed to be adequate.

Contractor internal control systems involve hundreds of control points. Auditors assess the risks of the control points
on government contracts and establish the level of testing on that risk.

At times, auditors assess the risk at low, and sampled few transactions. And at other times, the risk was high and sam-
pled more transactions. In some instances, the number of transactions were reviewed -- we have no defense for. It was
unacceptable. In others, it was a judgment call, and we are in the process of revamping this process.
HEARING OF THE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE; SUBJECT: DEFENSE CONTRACT AUDIT AGENCY: WHO IS RESPONSIBLE FOR REFORM?; CHAIRED BY: SENATOR JOE LIEBERMAN (ID-CT); WITNESSES: GREGORY KUTZ, MANAGING DIRECTOR, FORENSIC AUDITS AND SPECIAL INVESTIGATIONS, GOVERNMENT ACCOUNTABILITY OFFICE; GAYLE FISCHER, ASSISTANT DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, GOVERNMENT ACCOUNTABILITY OFFICE; ROBERT HALE, UNDERSECRETARY/COMPTROLLER AND CHIEF FINANCIAL OFFICER, DEPARTMENT OF DEFENSE; GORDON HEDDELL, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE; APRIL STEPHENSON, DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY, DEPARTMENT OF DEFENSE; LOCATION: 342 DIRKSEN SENATE OFFICE BUILDING Federal News Service September 23, 2009 Wednesday

As I said, we recognize these concerns with the business systems and initiated a project in 2009 to reassess the entire process for performing audits of business systems and the types of opinions to be provided. This will continue into early 2010. We are consulting with the GAO and the IG as we proceed with this project.

The GAO concluded that DCAA's quality assurance program was deficient. We recognize that improvements are required, not only with the structure of the quality assurance organization, but also the manner in which the reviews were performed.

In August 2008, we centralized the quality assurance function to headquarters. We then proceeded with doubling more -- we more than doubled the reviews we performed in the past. We no longer provide a rating of pass-fail depending on the number of deficient assignments.

Offices that are determined to have at least one assignment in non-compliance with the auditing standards are required to provide a meaningful corrective action plan, which is monitored at the headquarters level.

The GAO concluded that DCAA's independence was impaired. This was primarily due to providing input on draft corrections to internal control policies and procedures and then auditing the final policies and procedures. It is not uncommon for contractors with system deficiencies to seek input from the auditors while they are developing corrections to the systems. In many instances, providing feedback throughout the process expedites the correction of the deficiencies.

The GAO has concluded that this feedback impairs the auditors' objectivity as they audit information they have provided feedback for prior to implementation. We have corrected these issues. Auditors no longer provide feedback to contractors on draft corrections to systems, and we will no longer remove deficiencies from reports when the deficiencies are corrected during the audit.

In July 2008, the GAO concluded that DCAA had an abusive work environment. The IG was engaged to investigate this matter, and as Mr. Heddell mentioned, they finished their review in August 2009, and although they did not go as far as to say we had an abusive work environment, it included we had a work environment that was not conducive to producing quality audits.

Auditors felt pressured to work uncompensated overtime. At another office, several employees said that they heard people yelling in the office and raising their voices. We believe these issues have been adequately addressed, and the IG concurs.

The DOD IG did not identify any attempts by DCAA to impede the GAO investigation, other than the letter that was written in August 2007 to one of our senior auditors, which I know this committee is familiar with. As we discussed at the hearing last September, the letter was prepared by one of the Defense Legal Services attorneys that repots to DCAA.

MS. STEPHENSON: The letter was rescinded the day after the hearing last year.

To provide employees an opportunity to report instances of perceived management abuse without fear of retaliation, we launched an anonymous website in September 2008. The website is treated as a hot line and allegations are either investigated by DCAA internal ombudsman team, which we established in late 2008, or referred to the DODIG for investigation.

Mr. Chairman as a result of these oversight reviews we have taken a number of actions. I would like to highlight some of the actions I have not previously discussed in a very brief form.

We completed a bottoms up staffing assessment to determine whether we had the appropriate staffing at all levels in the organization. We have received funding under the Defense Acquisition Workforce Development Fund as Mr. Hale mentioned.

We added 25 new field audit offices, increasing from 79 offices in August 2008 to 104 offices in August 2009 to provide greater training to employees as well as to ensure appropriate oversight of audit quality.
The performance measure process was completely revamped. We eliminated 18 prior measures and added eight new measures to focus on audit quality. Focus groups were held in 2009 and feedback was favorable that most employees reported they did not feel pressure to meet the performance measures on individual assignments.

Auditors did feel pressure to meet additional budget hours and did not feel they could request an extension. So as a result we removed the requirement to meet budget hours from performance standards and inserted new language on the requirement to complete audits in accordance with the auditing standards.

We hired the Center for Defense Management Reform at the Navy post-graduate school to assist with cultural transformation across the Agency.

We instituted a revised process for determining the audit requirements for 2010.

Audit priorities were established based on the audits required under laws and regulations and the field offices developed the audit hours that were necessary, taking into consideration the risk of the contractors, the skill level of the audit staff and the additional hours required to comply with the auditing standards.

This process is consistent with the GAO's recommendation of performing a risk based approach rather than a production line auditing. We engaged the Army Force Management Support Agency to evaluate DCAA's process for planning 2010 audit needs as well as our staffing requirements. We provided training to all employees on quality audits in the work environment.

In closing, Mr. Chairman, I want to underscore that DCA is committed to ensuring the Agency is above reproach. That our audits are performed in accordance with the auditing standards and its culture promotes the kind of vigilance and quality that protects the interests of the American taxpayers.

Mr. Chairman, thank you again for the opportunity to address the committee I would be pleased to take your questions.

SEN. LIEBERMAN: Thank you Ms. Stephenson. We'll go to the seven minute rounds.

Mr. Kuntz let me begin with you just to draw out a little more a couple of the points that were in your findings than you had the time to do in your opening statement.

One of the findings was -- and I paraphrase -- that you found a lack of independence in DCAA. So I want to ask you a lack of independence from whom, the contractors, the Department of Defense, perhaps supervisors. What is the problem?

MR. KUNTZ: It would be more along the lines of the contractors. You know I would say with respect to the example I mentioned in the opening statement that they didn't do additional work because the contractor wouldn't appreciate it.

That's a disturbing finding I think that some would actually believe that that was -- that'd be like us auditing an executive branch agency for you and if they said, "we prefer you don't look at the transactions," we walk away. I mean that's not the way things should work.

SEN. LIEBERMAN: Okay so they were too cozy or whatever, intimidated in some sense by some of the contractors is what you're saying. So they were not performing the independent audits that we presume auditors will perform.

MR. KUNTZ: That and there was also certain other issues with respect to data requests maybe that were made, not filled, and then the audit was completed even though the data was not received at the end of the day. So things like that --

SEN. LIEBERMAN: Without our insisting on it --

MR. KUNTZ: -- or making it a scope restriction. Saying -- you know -- we just didn't have enough incidence to conclude on the system for whatever was being audited. So those are the kinds of things.
SEN. LIEBERMAN: Okay. Second, Senator Collins cited and you did too this case of an auditor spending more than five hundred hours auditing a billing system that didn't exist. So how does that happen?

MR. KUNTZ: Well it wasn't a contractor in this case, it was a grantee and grantees don't bill, they do draw downs on lines of credit and so, that was the issue there. And there was actually a single audit done that would've covered the actually draw down system. So the audit was not necessary in the first place.

So it really wasn't a contractor; it was a grantee --

SEN. LIEBERMAN: Okay so an audit was done, in other words it's not that somebody cheated on their worksheet to describe what they were doing, it's that five hundred hours were spent that weren't necessary.

MR. KUNTZ: Correct, that's what that is. And I think that they agree and they're not going to do that one in the future.

SEN. LIEBERMAN: When there's such a collapsed, if you will, or some uninsured comings in an audit or any organization, obviously there's a lot of blame to go around.

But I was very interested in your comment; again you're drawing from selective -- you couldn't interview every one of the audits. I paraphrase so much you said that your conclusion from the auditors that you did interview is that there are thousands of good auditors trapped in a broken system.

And some of the recommendations you've made are clearly systemic, but then some of the response that I've heard today go more to the individual auditors training opportunities and the like.

So I'm going to ask you first to comment on that and then ask others along the line. Is it both or is it really the system? And if it's the system are you talking about the fact that they're trying to do too many audits?

MR. KUNTZ: Yes I really am. I think Mr. Hale touched on it in his opening statement and I agree with him 100%. You're trying to do 22,000, he mentioned 24,000 or whether its 30,000 audits with 3,600 people. That is not possible.

SEN. LIEBERMAN: You just can't do those audits -- that's 22 to 30 thousand a year.

MR. KUNTZ: Right, you're going to do drive by audits in some cases where you go buy and ask a few questions, look at a couple of transactions and issue an opinion. And that's just -- you're setting up the people in that particular case to fail. You have not given them the proper resourcing.

Now I can't believe there's 22,000 audits that are necessary -- that that gets into the risk based approach that we talk about with respect to -- and I think Mr. Hales hit it on the head -- are those audits necessary, are there things that can be done by either redefining audits, looking at the actual what's generating the audits from the -- (inaudible) -- or whatever the case may be.

If you don't deal with that issue I don't think you'll ever fix this.

SEN. LIEBERMAN: Let me go back -- that's a very powerful point -- let me go back to the whether they -- it's a problem of the auditors or it's a problem of the system. That's part of the indictment of the system that we just talked about that they're trying to -- perhaps trying to do too much and therefore they're doing a lot badly.

But let me ask this direct question is the leadership inadequate? I know it's awkward not just for Stephenson but anyway for the supervisors generally.

MR. KUNTZ: I think it's an insular culture and I think we talked about that. And that's why I think one of our recommendations to bring in some outside expertise to take a fresh look at this is useful.
SEN. LIEBERMAN: Someone to come in and say "okay, how are we doing these audits, how are we deciding which ones to do, are they all mandated, do we have to go back to the source and figure out how we get down?"

Because again, I think if you learn to do an audit where a couple of transactions is enough to opine any system, that doesn't mean you're not a good auditor, it means you were not taught how to do an audit correctly.

I mean if I'd been brought in as an entry level auditor at DCAA and I learned that's the way you do audits, then I would think it was okay. That doesn't necessarily mean that I'm a bad auditor.

It means I really grew up in a system where I learned that was the way you do audits because we have ten audits to do in the next two months and the only way to get them done is to do them quickly.

SEN. LIEBERMAN: Mr. Hale let me ask to comment on this a bit. I know you're relatively new on the job. I appreciate the steps you've taken. When you said you assigned somebody on your staff to oversee or liaison with the CAA, is that going to be their primary responsibility?

MR. HALE: It's probably about half-time; I mean she's doing some other things for me. But I'll devote enough of her time or have her devote enough of her time to see this through.

I told you I'm committed to fixing this. It did happen on a previous watch but nonetheless, it's my responsibility now. And I need those eyes and ears as we go forward. There's still a number of issues that need to be resolved I think we all understand that.

SEN. LIEBERMAN: Do you -- have you since you've been there met regularly with Ms. Stephenson?

MR. HALE: Yes, I mean I see her almost weekly at my staff meetings and we've had a number of one on one discussions and I'd say April and I are e-mail buddies. We have a lot of -- we've had a lot of exchanges.

SEN. LIEBERMAN: So you -- do you agree -- just to draw you out from your testimony that one of the most significant problems here is that DCAA is trying to do too much and therefore it's doing a lot of it badly?

MR. HALE: You've got a tough trade off to make -- I'm concerned about that. We need to look at it, but on the other hand, I don't want to start not doing audits.

SEN. LIEBERMAN: Yeah --

(Cross talk.)

MR. HALE: It could be --

(Cross talk.)

SEN. LIEBERMAN: -- exactly --

(Cross talk.)

MR. HALE: -- protective for the government --

(Cross talk.)

SEN. LIEBERMAN: Right --

(Cross talk.)

MR. HALE: So there's a trade off. And to know, just to clarify the numbers, the 30,000 is the total number of engagements. I thought it was 24,000 under GAGAS audit rules. Maybe it's 22 -- well -- so just to clarify the numbers --

(Cross talk.)

MS. : It's between number of assignments and reports.
SEN. LIEBERMAN: Why don't you make -- press your microphone to clarify --

(Cross talk.)

MS.       : It's merely a difference of the numbers of assignments that we do and the number of reports issued. There are some assignments that incorporate into a single report, so it's not necessarily one for one. The number of reports are around 20,000.

MR. HALE: So I talked to Ms. Stephenson about the numbers. I've talked to Shay Asad (ph), who's the Director of Procurement and Acquisition Policy --

(Cross talk.)

SEN. LIEBERMAN: Right.

MR. HALE: He's the customer --

(Cross talk.)

SEN. LIEBERMAN: Right.

MR. HALE: You need to keep them in mind here.

SEN. LIEBERMAN: Sure.

MR. HALE: I'm concerned the pendulum has swung too far. You know, we weren't paying enough attention to quality. I don't want it to swing back and ignore the customer or we won't meet DOD and the government's and the taxpayers' needs. So there's a balance to be struck. So we've talked to both of them. We need to review the numbers.

SEN. LIEBERMAN: Final question on this: Do you know, or Mr. Kutz, do you have the statutory latitude to selectively audit so you'll reduce the number --

(Cross talk.)

MR. HALE: I'm going to need to get the lawyers involved.

(Cross talk.)

SEN. LIEBERMAN: Mr. Kutz, do you know --

(Cross talk.)

MR. HALE: They may not. Some of it may be the far (ph). Some of it may be laws.

SEN. LIEBERMAN: Yeah.

MR. KUTZ: I would differ to DOD. We did not do an in depth look at that.

SEN. LIEBERMAN: Oh, okay. My time is up.

Senator Collins.

SEN. COLLINS: Thank you, Mr. Chairman.

Ms. Stephenson, I want to read to you your opening testimony before our committee last year on September 10th of 2008. You said, "Mr. Chairman, I want to assure you and all the members of this committee that DCAA is taking the GAO's findings very seriously."
HEARING OF THE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE;  
SUBJECT: DEFENSE CONTRACT AUDIT AGENCY: WHO IS RESPONSIBLE FOR REFORM?: CHAIRED BY:  
SENATOR JOE LIEBERMAN (ID-CT); WITNESSES: GREGORY KUTZ, MANAGING DIRECTOR, FORENSIC  
AUDITS AND SPECIAL INVESTIGATIONS, GOVERNMENT ACCOUNTABILITY OFFICE; GAYLE FISCHER,  
ASSISTANT DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, GOVERNMENT  
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DEPARTMENT OF DEFENSE; APRIL STEPHENSON, DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY,  
DEPARTMENT OF DEFENSE; LOCATION: 342 DIRKSEN SENATE OFFICE BUILDING

This year at the beginning of your hearing -- your testimony you said, "Please be assured that we have taken the GAO's findings very seriously."

In other words, almost the exact same words, but from what I can see very little has changed during the past year. I'm particularly concerned to learn from my staff that one of the executive level managers from the western region who was responsible for the problematic audit has actually since been promoted to Senior Executive -- to the Senior Executive Service.

So what has really changed since you came before us a year ago and assured us that you were taking GAO's audits very seriously? It's not sufficient for you to come back a year later and just repeat those same words.

I had such hope when I heard that from you last year because I knew you were a career employee with a lot of experience who had worked her way up in the agency and only several months before our hearing last year had become head of DCAA.

But words are not enough. We need to see real progress.

MS. STEPHENSON: I agree, Senator, and it's a very fair question to ask, and I will say over the last year we have made significant progress. And let me answer your question in a couple of ways. First, the Senior Executive was promoted in October of 2007. It was not after the hearing. It was a year before the hearing. Just to clarify that.

Second, the number of actions we have taken have ranged from -- we completely changed the way in which we conduct the performance measures. Feedback from employees has been favorable on that. We removed the requirement for employees to meet budget hours, which was one of the primary barriers that people felt. That was removed actually from the performance standards.

Language about quality assurance has been inserted in all standards at all levels within the organization. That's just the beginning. We completely changed the way in which we review contractor documents. No longer do we look at drafts. We only look at a final product.

We have removed any fixed cycle times on assignments. It is now based on the amount of time that is necessary to perform a full and complete audit.

We have reiterated to our workforce the necessary number of transactions that must be reviewed in order to express an opinion, and if there is an impairment such as a time constraint from a contracting officer to have an appropriate disclaimer in a report; that is just the beginning.

I have numerous actions in which I can go through to describe what has changed, but I'll explain what employees tell me as I visit the offices. They tell me that there has been more positive change made in DCAA in the last year than there had been in the prior ten years.

They explain that we have put a workforce environment in place with our anonymous website where they feel they can come forward and discuss and disclose allegations of poor management or an abusive work environment.

I feel that although we have a number of changes yet to be done, we have made significant progress in this past year.

SEN. COLLINS: Ms. Stephenson, I want to clarify the issue you raised about the manager, because you said that the promotion occurred in October of '07, but in fact it was a probationary period, I am told, that extended for a year. So the information was available to managers at the -- to you and yet this woman's probationary period passed, and, in fact, she was made permanent in October of '08. So --

MS. STEPHENSON: Correct.

SEN. COLLINS: -- it's been misleading for you to say that she was promoted prior to your having knowledge of these -
MS. STEPHENSON: It's the difference between promo -- the --

SEN. COLLINS: Right. That's a big difference. It could have -- she could have failed the probationary period. It could have been rescinded. So you had that information --

MS. STEPHENSON: But I did consult with attorneys. We did not have enough information to reduce her appraisal below achieved.

SEN. COLLINS: But, boy, there's something wrong with the performance system then, but I don't want to spend all our time on one --

MS. STEPHENSON: I understand --

SEN. COLLINS: -- employee. I want to go to Mr. Kutz and ask a broader question. You found clear violations of DCAA policy and procedures representing serious departure from what's called the Yellow Book Standards. To your knowledge, were any of the management personnel who were involved in these problematic audits disciplined or retrained or counseled with action taken?

MR. GREGORY D. KUTZ: Probably on the training front, yes. Counseling, I'm not sure. Any serious consequences, none I'm aware of.

SEN. COLLINS: Thank you.

Ms. Fischer, you testified last year that some of the DCAA auditors were scared to talk with you and were nervous about being seen with GAO and telling you what was really going on. Did -- have you seen an improvement in that area or is it still a problem?

MS. FISCHER: Well, I guess I would have to put it in the context of our -- the continuing hotlines we're getting --

SEN. COLLINS: Yes.

MS. FISCHER: -- in our office. Some of the people that have come to us have also gone to DCAA's internal hotline through the website, and I would say there is a greater comfort level coming forward in the agency now than there was before.

I think the management of the hotline is working pretty well, at least in the cases we've looked at, and they have shared that information with us.

SEN. COLLINS: Thank you.

Mr. Hale, my time is almost gone, but let me just make a comment to you. You expressed your concern about the morale of the people working at DCAA, and in a sense you were cautioning us about tipping the balance too far. You said, "I'm concerned about morale at the agency."

Well, I guess I would say to you what affect do you think that it has on morale when managers who are responsible for problematic audits get promoted, when there is pressure to weaken audit findings, when report after report indicate that there's undue pressure for production at the expense of quality?

It seems to me that those problems have a far more devastating impact on the morale of the auditors than our investigations or other reports that are trying to get this agency back on track, and ultimately you're the person to whom DCAA reports, and I think you need to take personal responsibility to get this agency back on track.

MR. HALE: Well, Senator, I think I may have not been clear enough. What I was looking for is a statement from the Committee, and you've done that, that they'd performed valued services. I want them to hear that from me.

I've said it and I hope, and you have said it, too. That's what I was driving at, not that we should not solve the problems that have been identified here or continue to look at them. I'm sorry if I was unclear.
I do worry that the drumbeat of criticism needs to be balanced, as the GAO has pointed out. There are a lot of good people at DCAA trying to do good things, and I want them to continue to hear that.

And I do take this personally. Again, it did occur before I had this job, but it's my job to fix it. I'm here today to tell you I will do my best and I've devoted a fair amount of time in the midst of a fairly chaotic budget environment and two wars to devote my personal time to try to make this better.

SEN. COLLINS: Thank you.

SEN. LIEBERMAN: Thanks, Senator Collins. I had the same reaction Senator Collins expressed in her last question, so I appreciate your response. And I will say that perhaps it's because employees of DCAA know the committee is on the case, but, in fact, the calls from employees to our office have gone up over the last year, not down. So, I'm encouraged to hear that, though the calls have continued, that they seem to reflect some improvement at least as GAO is getting those calls on your hotline. Thanks, Senator Collins.

Senator Coburn is next.

SEN. TOM COBURN (R-OK): Thank you, Mr. Chairman, and thank you for having this. I think it's really important. I read a summary of the GAO report last night and, quite frankly, got sick.

There is a culture that is absolutely unacceptable in your agency, Ms. Stephenson. It still exists. It's not about doing auditing; it's about getting work done and looking like you're doing auditing and, you know, the question I have is -- you've been director since 2008, correct?

MS. STEPHENSON: Correct, sir.

SEN. COBURN: Correct. And do you have any outside auditing experience, outside of this agency?

MS. STEPHENSON: No, I've been with DCAA since college.

SEN. COBURN: You know, there was a firm called Arthur Andersen. It no longer exists because it failed greatly in its ability to audit, independent audit. If we can't trust auditors, we can't trust anybody.

And you know, personally, I can put forward about $50 billion worth of waste a year in the Pentagon. Fifty billion. And now I really understand more why: it is we have a system that we call an audit, that isn't an audit. I mean, that's essentially what the GAO report is saying.

We probably wouldn't see much difference without your organization there, and although there may have been some changes brought forward, the fact that a rescission of 80 audit reports and 65 of 69 were not professionally conducted audits -- didn't meet FASB, didn't meet accounting standards for audit, to me says we've got to start over. You know, I have some questions.

Mr. Kutz what would be the effect of ending or phasing out the direct bill program at the Pentagon?

MR. KUTZ: (Inaudible.)

SEN. COBURN: Do you have any comments on that?

MR. KUTZ: For Ms. Fischer.

MS. FISCHER: Well, either DCAA or the Defense Finance and Accounting Service would need to review vouchers prior to payment or maybe the contracting officers. DCAA has assumed this responsibility for the contracting officers, and the certifying officers in the Defense Finance and Accounting service rely on that work in making payments.

SEN. COBURN: But if we have an agency that's not actually performing its function, what control, what safeguards do we have? You know?

MS. FISCHER: We don't.
SEN. COBURN: We don't, and that's exactly it. You know, the question that comes down to me is the people responsible. I can't understand why they are still there. I don't understand that. I don't understand why the management of this agency hasn't been totally changed.

And people with real experience, with real audit experience in the real world, are brought in to create a culture of true auditing, which means you verify to make sure when you claim an audit that it's accurate and you do the amount of testing that is necessary to make that verification.

Otherwise, you give a qualified opinion and we don't see that. And so, Mr. Chairman, I won't spend all my time on questions. I'm a little bit too upset to go where I really want to go, but I think our committee, we ought to -- Senator McCaskill and her experience --- we ought to look at this thing from the ground up.

And I don't doubt that some efforts have been made to improve things, but if, in fact, Ms. Stephenson's experience at coming up, starting as an auditor trainee and now leading this, tells me that there is a culture that is outside of what we would expect of auditing and it's different than the culture anywhere else in this country in terms of when you get a certified audit.

I've been audited as a businessman. It's tough. As a publicly traded company, you better be able to justify what you're saying. The auditors come --- you pay them, but you want that unqualified opinion when they've finished and you'd better be able to prove what you're doing is accurate.

And I don't think we're anywhere close to having the confidence if that's the case. And this is our biggest agency. It's a half a trillion dollars a year, and we know the waste that's out there.

I mean, we --- in our subcommittee in the last, Tom Carper and I, we've documented the waste and now I understand why it's there. There's not a check. There's not a check on what's going, so I'm highly disappointed, and I thank the GAO for their insight, but I think we ought to stay on this.

And I will tell you, morale will improve. It won't go down. It'll improve when the people are doing what they're supposed to be doing, getting rewarded for doing what they're supposed to be doing, rather than checking the boxes in a culture that says we'll look out for the contractors more than we'll look out for the American people. And I think that's the culture that exists there today. Thank you.

SEN. LIEBERMAN: Thanks, Senator Coburn. I agree with you and, incidentally, the calls that we get from orders on DCAA are exactly along that line, just helpless to make this place better. We know we have an important job to do; we feel like we're not able to do it now.

I don't want to jump ahead, but the committee, just to respond to Senator Coburn, is going to stay on this because it's very important. I mean, there's probably not --- I would say that the number of members of Congress who know that DCAA exists is small, but it's responsibilities are enormous. It's impact on taxpayer spending is enormous.

It's impact, as Senator Collins said in her earlier statement, on the wellbeing and security of our troops is enormous, so we're going to stay on it and, in the short run, I think we're going to really focus on you, Mr. Hale, because this group reports to you. You're new there. You don't have responsibility, if you will, for how it got to where it is, but you do have a responsibility now to fix it and we're going to figure out a way to stay in touch on a regular basis and ask you to report to us. And maybe we'll come back periodically for hearings on how we're progressing. Thanks, Senator Coburn. Senator McCaskill, again, thank you.

SEN. MCCASKILL: Thank you. I used to be a prosecutor before I was an auditor, and in the criminal law we have ordinances, then we have misdemeanors, then we have felonies and then we have capital crimes, and criminal conduct ranges from one end to the other. In the world of auditing what has been committed here is a capital crime. There can be no greater indictment of an audit agency than this GAO report.
Now, how do we begin to get value out of this audit agency after it has had this kind of indictment? I want to make sure I put in the record just one of the case studies because, unfortunately, I know from experience, most people don't read these. Okay?

This is an audit that was done with one of the five largest DOD contractors working in Iraq initiated in November of 2003. In September of 2005, after nearly two years of audit work, the DCAA provided draft findings and recommendations to the contractor that included eight significant deficiencies.

The contractor objected, saying the auditors didn't really understand, the auditors didn't get the new policies and procedures that were being developed for the fast track in Iraq.

Following those objections, various supervisory auditors directed the auditors to revise and delete some work papers, generate new work papers, and in one case copy the signature of a prior supervisor onto new work papers, making it appear that the prior supervisor had approved those work papers.

On August 31st, 2006, after dropping five significant deficiencies and downgrading three significant deficiencies for improvement, DCAA reported "adequate opinion on the contractor's accounting system."

SEN. MCCASKILL: The interim audit supervisor, who instructed the lead auditor to copy and paste the prior supervisor's name onto the risk assessment and work papers, was subsequently promoted to the western region's quality assurance manager, where he served as quality control check over thousands of audits, including some that the GAO reported on last year.

In April 2007, SIGIR, the Special Inspector General for Iraq Reconstruction, reported that despite being paid 3 million (dollars) to complete the renovation of a building in Iraq, the contractor's work led to plumbing failures and electrical fires in a building occupied by the Iraqi civil defense director. Now, I have one simple question. Has that interim audit supervisor been fired?

MS. STEPHENSON: No ma'am.

SEN. MCCASKILL: And in fact has that interim audit supervisor that told that auditor to commit fraud by copying and pasting a supervisor's signature to work papers, have they even been demoted?

MS. STEPHENSON: On the work paper copying, that was an issue where they had copied work papers from one assignment to another. It was not deliberate to copy the signature. It happened when they copied the work papers.

SEN. MCCASKILL: Mr. Kutz, was there in fact a copy and pasting of an auditor's signature on a report that auditor supervisor had never even seen?

MS. STEPHENSON: Senator McCaskill, yes, that did occur because the prior supervisor had moved on and it occurred on a number of work papers, even work papers that were created after the signature date.

SEN. MCCASKILL: Mr. Hale, I've got to tell you, when we had this scandal at Walter Reed I admired Secretary Gates so much because he went to the very top and found accountability. When we had the problems with the Air Force, I admired Secretary Gates, and I really was beginning to believe that we had in the military now someone who understood that when you have a scandal, you must have accountability.

Let me say for the record that no one has been demoted over this capital offense. No one has lost their job. And I will tell you, to add insult to injury, I don't even think the GS-12 auditor --- I don't even think she got a letter of commendation. In fact, I don't think she's even been promoted.

MR. KUTZ: She has been.
SEN. MCCASKILL: Well, it's a lateral. She's training. I mean, give me a break. This is not somebody who's been heralded by the agency as a hero. I've heard no --- there has been no recognition. She's not been called to the Pentagon to be thanked for what she did. And if it wasn't for her, we wouldn't be here. And the people who did this are still there. The culture is still there.

Listen, I know, April, you're new and I know you're trying, but we have got to come to grips with the fact that people who work there work there forever and their sense of outrage is not significant for the American taxpayer and the American military right now.

And honestly, with all due respect, Mr. Heddell, you weren't there, but how in the world does a peer review happen with a clean opinion at 2006 at this audit agency? You also have to look within your own shop. Who were the people that did that peer review? Who said this agency was okay in 2006? Clearly it wasn't.

And it's not the quantity of the audits, it's the quality that matters. If they don't have quality, they are --- it's hard enough to get people to read one that's good. The ones that are horrible -- I mean, who's going to read a DCAA audit right now without joking, without laughing about it?

I mean, this is not --- I've honestly got to tell you, Mr. Hale, that you've got to go back to the Pentagon and you've got to tell them this is not good enough. If somebody's not fired over this, I don't think anybody should ever take this agency seriously again.

Thank you, Mr. Chairman.

SEN. LIEBERMAN: Thank you, Senator McCaskill. Senator Burris.

SEN. ROLAND BURRIS (D-IL): Thank you, Mr. Chairman. I want to echo my colleague, Senator McCaskill, with my experience as a federal bank examiner, my experience as a state comptroller, and my experience on the board of directors just leads me to wonder whether or not the Defense Department shouldn't have to do what we did in private industry.

Senator Coburn made mention of what's happening there. Do you all remember a law that passed here called Sarbanes-Oxley? What you do with cost controls and controls? I understand that the controls here were just not very, very effective at all. The controls in auditing is what really runs it. And if the auditor is not doing his or her job, there's no reliability. You are the first and last line of defense to determine what's happening to the taxpayers' money.

I know you don't want to hear a lecture but what I've read, what I've heard and the testimony that I've heard, it really leaves a lot to be desired. I wonder, Mr. Comptroller, Mr. Hale, how extensive does Sarbanes-Oxley apply -- I know it doesn't apply to the federal government, but have you all tried to use those standards, what you call business to have to spend millions of dollars in order to make sure that their financial reporting was correct? Why wouldn't it be the same thing good for the taxpayers' money with the Defense Department?

MR. HALE: Well, as you say, that particular law doesn't apply to the federal government, but there are extensive standards. You can verify that with GAO, that govern both auditing and internal controls and management. I'm not going to sit here and tell you that we do the greatest job in abiding by all of them, but we're mindful of them and working on them.

SEN. BURRIS: Answer me this question, Ms. Stephenson. In terms of I read in my notes that the DCAA also does outside auditing outside of the Pentagon. So if you don't have enough staff and just hired 700 new people, you don't have enough staff, how are you doing outside audits of other agencies?

MS. STEPHENSON: We perform audits for 34 other civilian agencies on a reimbursable basis. However, we do put the priorities on efforts such as the war and other department initiatives. We have deferred a significant number of audits that we were required to do under law and regulation, really since the beginning of the war. So we have quite a
large backlog, especially of the annual audits of the cost reimbursable contracts. So because we don't have what we need, we defer. It's not as though we try to get them all done in one year. We recognize that we cannot do that.

SEN. BURRIS: Now Mr. Hale, do you as the comptroller of the Defense Department, do you authorize the payment of bills? Is that your responsibility?

MR. HALE: We set the policy for it. The actual authorization is done at lower levels in the organization. I don't personally do it.

SEN. BURRIS: Well, it depends on your jurisdiction.

MR. HALE: Yes.

SEN. BURRIS: Do you also prepare the financial statement for the Defense Department as the comptroller?

MR. HALE: Yes.

SEN. BURRIS: Now is there any type of certification of that financial statement which would come about as a result of what they're spending with outside contractors that the auditors are reporting in to you for the accuracy of that statement?

MR. HALE: Well, there's an overall audit which we do not have auditable financial statements in the Department of Defense. There are also a number of reviews at various levels in the department and outside the department by the IG, by GAO, and by others of particular aspects of those statements. I don't know if that answers your question, but overall the department's financial statements are not auditable.

SEN. BURRIS: Mr. Chairman, there is a deep concern here because I remember when I was president of the National Association of State Auditors, Comptrollers and Treasurers. We came to Washington to try to get the federal government to really begin to set up a structure that would allow more accountability to the taxpayers and what the compromise was.

We tried to create an auditor general who would take over the auditing of the federal government's financial statement, and the current auditor general would become --- the current auditor general would --- the current comptroller general of the U.S. would become the auditor general, and then this person would have the same status as the auditor general --- as the comptroller general has now but he would oversee the financial statement of the executive branch.

The compromise was this. They set a comptroller up in OMB, which is a fourth-level personnel in OMB, and then they put comptrollers in each one of the agencies. That's really why I was questioning Mr. Hale. This position was created as a result of that action that state governments took to bring them in line pretty much with what states were doing. So they didn't quite complete it because they said that they're too big to operate. I think there's no such thing, but we had to compromise in that regard.

I would certainly like to follow up with that action because the whole accounting system of the federal government really needs to be changed.

SEN. BURRIS: This is just a microcosm of what's happening in other agencies -- probably, as what you see is happening in the Defense Department, because what they alleged -- they alleged to us, it's their size.

And, of course, I am also concerned about the personnel, in terms of the skills. I refer to Ms. Stephens (sic), in terms of the new hires. Are you able to hire skilled auditors or CPAs? Just who are the -- and where are you finding these people that you're hiring?
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MS. STEPHENSON: The people that we're hiring are generally entry level. Under the Defense Acquisition Workforce Development Fund, which is the funding that we have for this, it is entry-level interns that are funded for the hiring. So these are entry-level individuals. There are no other auditors that perform the functions that we perform. We are --

SEN. BURRIS: -- (inaudible) -- qualifications --

MS. STEPHENSON: We are a contract --

SEN. BURRIS: -- a Bachelor's degree in accounting?

MS. STEPHENSON: -- we are a contract -- right, it's a degree in accounting. But we're contract auditors. And there are no other contract auditors. And so we have a very unique technical niche in the auditing arena.

But specifically, under the Acquisition Workforce Development Fund, that is limited to interns, and that's what we have hired.

SEN. BURRIS: And we might have a problem with the skills. And who's training these individuals for the skills and responsibilities? And how long is their training period?

GAO, did you all get into any of that, in terms of the skills of those new-hires, the persons coming in?

MR. KUTZ: Not the new-hires. But, as we mentioned, we believe, overall, that the audit staff are -- they're good auditors. And, as I mentioned in my opening statement, I think they were in a bad system, at this point. And one of the things that the department is trying to do is take actions to make a better system for them -- better training, better scoping of audits, and possibly reducing the number of audits they're required to do so they can do more in-depth kind of work that you would expect a normal system type audit to do.

SEN. BURRIS: So there's some concern about the workflow, and the volume of work, and the necessity of particular items being audited with these contractors?

MR. KUTZ: Right. We believe that they're -- it's difficult to image, where there's 22 or 30,000 audits being done a year by 3,600 people -- I know they're trying to hire 700 more, but I still think that denominator is a problem.

SEN. BURRING: Thank you, Mr. Chairman. My time is expired. And I might not be here for the second round, but I would certainly like to follow up with this, because -- and I would like to talk more about the circumstances of the overall system that we try to get established in the federal government.

SEN. LIEBERMAN: Thanks, Senator Burris. You bring a very helpful background, a history about the state -- effect on the auditing controller (sic) system, of the federal government, is very interesting.

Mr. Kutz and Ms. Fischer have raised some -- made some suggestions for longer-term consideration that I think the committee really needs to take seriously, which is whether the placement of DCAA within the department is the correct place. Should it be separated from the controller (sic)? Is there a better place for it to be? Can the deputy secretary handle that? I know Mr. Hale has said that he thinks not.

But the larger question -- which really comes off of the history that Senator Burris refers to, is whether, as you suggest, we ought to take a look at creating a totally independent auditing agency for the federal government overall. Maybe to go back to that idea of an auditor general. That's something I think I'd like to come back to.

But we're not going to do a second round. I think we made the point here that we've -- this committee has lost its patience really, and there's too much on the line to not see the kind of aggressive action, decisive action that members of the committee have asked for.

Mr. Hale, I'm going to ask you to keep in -- to give us a monthly report. It can be letter, whatever, and our staff will work with you on the details of it. And then we'll probably want to come back and do some more specific public hearings on this, and other questions related.
As soon as you're able -- it would be of interest to me anyway, to get your reaction to Mr. Kutz' recommendation, and Ms. Fischer's, that part of the problem here is that the auditors are trying to do too much, and they're doing a lot of it badly. In other words, to go to a risk-based auditing -- I don't know, I'd be interested in hearing whether you need statutory changes to do that.

Now, we understand, as you said -- and you were right, that when you do that you're running the risk that you're not going to audit a contract that you really will look back and say, oh, we should have audited that. But, anyway, I want to have a more detailed evaluation --

SEN. COBURN: If the Chairman would yield?

SEN. LIEBERMAN: -- of that.

Senator Coburn, then we'll go to Senator McCaskill.

SEN. COBURN: If you create the expectation that you're going to get a real audit, and you don't know when you're going to get the real audit, you will change multitudes of behavior.

And what needs to happen is the suppliers and contractors of the Defense Department need to be very worried about when they come into an audit, that, in fact, it's going to be thorough, aggressive and accurate. And you create that expectation, then you won't have to audit everybody every year.

But they won't know when they're going to get audited, and that is a key, in terms of -- (inaudible) -- And that's what -- how auditing works best, is people with the expectation to know that "they're going to uncover our problems."

So quality, as Senator McCaskill (said), it's not quantity.

It's quality, and then create an expectation in the rest of contractor community that you better have it right, otherwise we're going to expose it.

SEN. BURRIS: Mr. Chairman, just one quick point, may I?

SEN. LIEBERMAN: Yes, go ahead. And then we'll go to Senator McCaskill.

SEN. BURRIS: -- (inaudible) -- thank you --

SEN. LIEBERMAN: Go ahead, go ahead.

SEN. BURRIS: Well, when Senator Coburn mentioned that, when we were bank examiner, surprise, that's what we did. The banks didn't know when we were coming.

SEN. LIEBERMAN: Yeah.

SEN. BURRIS: But, of course, Senator Coburn said exactly what we -- (inaudible) -- with the federal government. We would -- you know, the banks don't know, so they got to always be ready because they don't know when the examiners are coming in.

SEN. LIEBERMAN: Yeah, I mean, look, to some extent the IRS depends on this kind of psychology with the auditing. They can't audit every tax return in the country. But because everybody worries that they may be audited, presumably it encourages more honesty.

Senator McCaskill.

SEN. MCCASKILL: And I'm almost disappointed we're not (going to) have a second round so I could be calm in the second round -- (laughs). But let me --

SEN. LIEBERMAN: I prefer to remember you as angry. (Laughter.)
SEN. MCCASKILL: Well, there's just a couple of things I think we need to, like, make sure we have on the record. And one is that -- I know that you may find this shocking, but there are hundreds and hundreds of auditors around the country that aren't doing every audit that's been statutorily mandated.

It's impossible -- because you know what legislators always do? Legislators always say, "audit it" in the legislation, and they never give the resources to audit it. So auditors are constantly struggling with mandated statutory audits that they don't do.

That's why the risk assessment system was born. That's why we have (in the ?) single audit the different levels of programs that are audited because of risk, and the amount of money that's flowing. And clearly, in a contingency -- in the situation like the case study I talked about, that's where you have the most risk. And I just really don't get this reluctance.

And I think that leads to the second point, Mr. Chairman. I think we need to really stay focused on how insular this agency truly is.

I got to tell you the truth, Ms. Stephenson -- the notion that you just testified, that there are no other contract auditors out there, there are. There are hundreds of auditors that have the same government auditing, standard background; that have done the same kind of scope and work on their audits; that have the same kind of supervisory check.

The auditing, yes, there are different kinds and different expertise. But what you guys have always done in that agency, is all you've done is lateral in promotion. You've never brought out anybody from the outside, whether it's on a peer review, or whether it's on deciding whether or not people get promoted. It's always been a birth-to-death organization, and it is dying because of it.

And I just wanted to make sure those -- and I was going to calmly go through those, in questions, if we'd had a second round. I have a number of questions for the record, and I will just let both the chairman and the ranking member know that if there's any of this follow-up work that the subcommittee can do -- as you can see, I'm fairly agitated and involved in this particular subject matter -- (laughs) -- and so if there is anything we can do, in terms of follow-up hearings, we're happy to do that on this subcommittee, if that is your pleasure and prerogative. But, obviously we'll leave it to your decision --

SEN. LIEBERMAN: I think that --

SEN. MCCASKILL: -- as to what work you would like us to do on the subcommittee.

SEN. LIEBERMAN: No, I think it's -- it's a great idea. You're agitated, but you're also experienced, and that's a -- that's a good combination.

Senator Collins.

SEN. COLLINS: Thank you, Mr. Chairman.

I think it's important for our witnesses to know why we feel so strongly and why there is such a sense of outrage among all of us who are here today.

The first reason is that we're talking about contracts that are worth hundreds of billions of dollars -- hundreds of billions of dollars. So what we have on the line here is an investment by the taxpayers, an enormous investment by the taxpayers.

Second, ultimately we're talking about services and goods, in the case of DOD that are going to support our troops in harm's way. Senator McCaskill's example of the Iraq contractor is replicated over and over again.

SEN. COLLINS: So if we don't have good audits that are catching overbilling, shoddy work, the failure to deliver on a contract, contractors who are ripping off the federal government, the people who are being short-changed, in many cases, are the men and women who are risking their lives every day for us. And that's why this matters so much.
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And third, and finally, the frustration you're hearing today is that it appears that virtually nothing has changed since we did our hearing last year. And that is completely unacceptable. So I join the chairman in his commitment to keep on top of this. It is exactly the kind of shoddy work that devalues the very good work that is done by the majority of the auditors, by the hardworking employees at DCAA, whose work I do value, and acknowledge, and acknowledged in my opening statement.

We have got to get this right. We can't be here next September with yet another GAO report that tells us little has changed.

Thank you, Mr. Chairman.

SEN. LIEBERMAN: Thanks, Senator Collins.

I think the time for incremental responses is over. Training programs are good, but this organization really needs bold change. And we're counting on you, Mr. Hale. This is another one of the bonuses that comes with you accepting this position -- to bring that about.

The record of this hearing will stay open for 15 days for additional questions or statements to be filed for the record.

I thank everybody. The hearing is adjourned. (Sounds gavel.)

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