



U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL

EPA Should Improve Policies and Procedures to Ensure Effective DCAA Audit Report Resolution

Report No. 12-P-0071

November 10, 2011

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Abbreviations

ACO	Administrative Contracting Officer
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
EPA	U.S. Environmental Protection Agency
MATS	Management Audit Tracking System
OAM	Office of Acquisition Management
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget

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At a Glance

Why We Did This Review

We conducted this audit to determine whether the U.S. Environmental Protection Agency (EPA) has adequate controls for resolving Defense Contract Audit Agency (DCAA) audit reports, and whether EPA is resolving DCAA audit reports timely.

Background

DCAA performs contract audit services for EPA. Typical DCAA audit services include incurred cost audits, contract audit closing statements, and floor checks. The EPA Office of the Inspector General (OIG) previously requested, tracked, and reported DCAA audits until resolution. Once resolved, EPA tracked the corrective actions until implementation. On January 1, 2009, the OIG transferred its requesting, tracking, and reporting responsibilities to EPA.

For further information, contact our Office of Congressional and Public Affairs at (202) 566-2391.

The full report is at:
www.epa.gov/oig/reports/2012/20111110-12-P-0071.pdf

EPA Should Improve Policies and Procedures to Ensure Effective DCAA Audit Report Resolution

What We Found

EPA should improve its policies and procedures to ensure timely and accurate tracking and reporting of the resolution of DCAA reports. When EPA is the cognizant agency, i.e., responsible for resolving the audit recommendations, it is generally resolving DCAA reports within 6 months, as required by Office of Management and Budget Circular A-50. However, EPA is not always:

- Reporting the status of unresolved DCAA audits to the Administrator
- Accurately recording the management decision dates for DCAA reports, which are used to evaluate the timeliness of resolution and implementation of corrective action
- Resolving DCAA reports within 6 months when EPA is not the cognizant agency
- Accurately defining when DCAA audits are resolved

All of these conditions contribute to the Administrator receiving inaccurate information on the status of resolution of DCAA audit reports. If audits are resolved timely, EPA may be able to deobligate funds on Agency contracts, thereby making funds available for other priorities.

What We Recommend

We recommend that EPA develop and/or revise and implement policies and procedures to ensure that unresolved DCAA audit reports are reported on a semiannual basis to the EPA Administrator, to record management decision and final action dates for DCAA audit reports, and to define the resolution point for the various types of DCAA audits. We also recommend that EPA revise EPA Manual 2750 to reflect current Agency processes for requesting, tracking, and reporting unresolved DCAA reports that impact EPA contracts; reexamine audits that we identify herein as already resolved and provide the OIG an adequate management decision where appropriate; and develop a plan to accelerate audit resolution when not receiving adequate audit support from DCAA. EPA agreed with all of our recommendations and provided milestone dates for each recommendation.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

THE INSPECTOR GENERAL

November 10, 2011

MEMORANDUM

SUBJECT: EPA Should Improve Policies and Procedures to Ensure
Effective DCAA Audit Report Resolution
Report No. 12-P-0071

FROM: Arthur A. Elkins, Jr.
Inspector General

A handwritten signature in black ink, appearing to read "Arthur A. Elkins, Jr.", is written over the printed name.

TO: Craig E. Hooks
Assistant Administrator for Administration and Resources Management

Barbara J. Bennett
Chief Financial Officer

This is our report on the subject audit conducted by the Office of Inspector General (OIG) of the U.S. Environmental Protection Agency (EPA). This report contains findings that describe the problems the OIG has identified and corrective actions the OIG recommends.

Action Required

In responding to the draft report, the Agency provided a corrective action plan for addressing the recommendations with milestone dates. Therefore, a response to the final report is not required. The Agency should track corrective actions not implemented in the Management Audit Tracking System. We have no objections to the further release of this report to the public. The report will be available at <http://www.epa.gov/oig>.

If you or your staff have any questions regarding this report, please contact Melissa Heist, Assistant Inspector General for Audit, at (202) 566-0899 or heist.melissa@epa.gov; or Janet Kasper at (312) 866-3059 or kasper.janet@epa.gov.

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Chapter 1

Introduction

Purpose

The U.S. Environmental Protection Agency (EPA), Office of Inspector General (OIG), conducted this audit to determine whether EPA has adequate internal controls for resolving Defense Contract Audit Agency (DCAA) audit reports, and whether EPA is timely resolving DCAA audit reports.

Background

DCAA performs all contract audits for the U.S. Department of Defense and provides contract audit services to other government agencies when requested. For audits of contractors other than educational institutions and nonprofit organizations, DCAA is generally the responsible government audit agency. At the request of EPA's Office of Administration and Resources Management, Office of Acquisition Management (OAM), DCAA performs several types of contract audits, including incurred cost audits, cost accounting standards audits, and internal control system audits. EPA also receives audit support from DCAA when another federal agency requests an audit of a contractor that also has EPA contracts.

Prior to January 1, 2009, DCAA audits were requested through the OIG, and results were included in the OIG's *Semiannual Report to Congress*. During this time, the OIG was responsible for reviewing Agency management decisions and tracking unresolved DCAA audits (audits without management decisions). EPA used its Management Audit Tracking System (MATS) to track the implementation of corrective actions from DCAA audits.

On January 1, 2009, OAM assumed full responsibility for requesting and tracking DCAA audits. EPA's Financial Analysis and Oversight Service Center now tracks audits with an Excel spreadsheet instead of MATS; according to EPA Manual 2750, MATS is the tracking system for OIG-issued reports. Unresolved audits issued prior to January 1, 2009, are still tracked and reported through the OIG's *Semiannual Report to Congress*. However, the Office of the Chief Financial Officer (OCFO), as the Agency follow-up coordinator, must now report unresolved DCAA audits issued after January 1, 2009, to the EPA Administrator. OAM is responsible for tracking final actions on all DCAA audit reports regardless of whether issued before or after January 1, 2009.

In accordance with Office of Management and Budget (OMB) Circular A-50, all audit reports, including those conducted by other executive branch audit

organizations such as DCAA, are to be resolved within 6 months after issuance of a final report. Resolution is the point at which the audit organization and agency management or contracting officials agree on action to be taken on reported findings and recommendations. The cognizant federal agency is responsible for resolving audit recommendations. The cognizant federal agency normally will be the agency with the largest dollar amount of negotiated contracts, including options. Audits that remain unresolved after 6 months are to be included in a semiannual report to the head of the cognizant agency.

Noteworthy Achievements

Even though there are no regulations requiring the Agency to do so, EPA has continually tracked all DCAA audits that affect EPA contracts, even when it is not the cognizant agency. Tracking all audits that affect EPA contracts keeps the Agency aware of findings and recommendations for contractors with which it does business.

Additionally, EPA generally resolved DCAA audits within the 6-month guideline when it was the cognizant agency. From October 2006 to December 2008, EPA was cognizant for 54 resolved audits. The average time to resolve these audits was 117 days. From January 1, 2009, when OAM became responsible for requesting and tracking DCAA audits, to February 18, 2011, EPA has been cognizant for 13 resolved audits. It took an average of 125 days to resolve those 13 audits.

Scope and Methodology

We performed this audit from January to September 2011 in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To determine whether EPA is recording resolution dates, we identified and reviewed 36 audits from the audit program manager's tracking spreadsheet that had final actions taken and that were processed after January 1, 2009. We reviewed key data fields from the audit program manager's tracking spreadsheet to ensure resolution dates were correct for each audit in the sample.

To determine whether EPA has adequate internal controls for resolving DCAA audits, we reviewed OMB Circular A-50; applicable Federal Acquisition Regulations sections; EPA Manual 2750, *EPA's Audit Management Process*; and EPA's policies and procedures relating to resolving audits. We interviewed staff from EPA's Financial Analysis and Oversight Service Center, including the audit

program manager for DCAA monitoring; the financial administrative contracting officers (ACOs); and staff from the DCAA monitoring team within OAM.

We conducted tests of internal controls to verify adherence to written guidance and procedures. These tests included examining whether EPA is:

- Tracking audits with trackable issues
- Tracking issues relevant to EPA contracts when another agency is cognizant over the contractor
- Tracking all DCAA audits received in the audit program manager's spreadsheet
- Reporting audits unresolved after 6 months to the EPA Administrator
- Closing out audit reports with proper documentation
- Recording resolution dates

To determine whether EPA is timely resolving DCAA audits, we examined dates obtained from MATS, OAM's DCAA monitoring application, and the audit program manager's Excel tracking spreadsheet. These dates were used to determine the average time it took EPA to resolve DCAA audits for two periods. The first period was from October 1, 2006, to December 31, 2008. The second period was from January 1, 2009, to February 18, 2011. We identified 38 DCAA audits that did not have a management decision (unresolved) within the 6-month time frame as of March 31, 2011. We selected a judgmental sample of 24 of the 38 audits. The sample was chosen to ensure that a variety of types of audits were reviewed, but emphasis was placed on incurred cost audits with questioned costs. We included in the sample 17 audits issued prior to January 1, 2009, and 7 issued subsequent to January 1, 2009. We reviewed the case file and contacted contracting officers from the cognizant federal agency for each audit to determine whether a management decision had been made.

We reviewed documents EPA completed in compliance with the Federal Managers' Financial Integrity Act, including the Office of Administration and Resources Management's Fiscal Year 2010 Federal Managers' Financial Integrity Act Assurance Letter. EPA did not identify internal control weaknesses directly related to the audit's objectives.

Prior Audit Coverage

EPA OIG Report No. 10-P-0075, *EPA Does Not Always Receive Adjustment Vouchers from Contractors*, issued March 8, 2010, was the only previous audit related to EPA's resolution of DCAA audits. However, the recommendations cited in that report were not relevant to the objectives of this audit.

Chapter 2

EPA Is Not Reporting Unresolved DCAA Audits to Its Administrator

EPA is not reporting unresolved DCAA audit reports (audit reports without management decisions) to the EPA Administrator on a semiannual basis as OMB Circular A-50 requires. We identified two unresolved DCAA audit reports that were past the required 6-month time frame for resolution that were not reported to the Administrator, and for which EPA was cognizant. OMB Circular A-50 requires that inspectors general or other executive branch organization audit reports not resolved within 6 months be reported to the agency head on a semiannual basis. EPA staff were unaware that they were required to report unresolved other executive branch audit organization reports to the Administrator because EPA Manual 2750 does not address these reports. As a result, EPA is not in compliance with OMB Circular A-50, and the Administrator cannot fully evaluate management's corrective actions on resolving findings and recommendations, which relate to improving the effectiveness and efficiency of contractor operations.

OMB Circular A-50 Requires Audit Follow-Up Reporting

OMB Circular A-50 requires the audit follow-up official to provide the agency head a status report on all unresolved audits on a semiannual basis. Specifically, section 8a(8) of the circular requires that the audit follow-up coordinator provide semiannual reports to the agency head on the status of all unresolved audit reports over 6 months old, the reasons therefore, and a timetable for their resolution; the number of reports or recommendations resolved during the period; the amount of disallowed costs; and collections, offsets, write-offs, demands for payment, and other monetary benefits resulting from audits. It further states that reports should include an update on the status of previously reported unresolved audits. The circular defines resolution under section 6b(1) as the point at which the audit organization and agency management or contracting officials agree on action to be taken on reported findings and recommendations.

EPA Manual 2750 implements the reporting requirements that direct agency heads to report to Congress semiannually on the status of follow-up on OIG audit report recommendations. EPA Manual 2750, chapter 11, section 8, requires the OIG to report to Congress on unresolved audit reports and requires the Agency to report to the Administrator on the status of completion of final corrective actions.

Unresolved DCAA Audits Not Reported to the Administrator

EPA is not reporting unresolved DCAA audit reports to the EPA Administrator on a semiannual basis as OMB Circular A-50 requires. As of January 1, 2009, the OIG no longer includes new DCAA audits in its semiannual report because it no longer issues DCAA audit reports. Instead, DCAA issues its audit reports directly to OAM. Therefore, the reporting responsibilities for unresolved DCAA audit reports transferred to EPA's OCFO because OCFO is the Agency's audit follow-up coordinator. According to OCFO staff, the audit follow-up coordinator is responsible for reporting unresolved audit reports.

We identified two unresolved DCAA audit reports for which EPA was cognizant and resolution exceeded the 6-month time frame. Accordingly, these two unresolved audit reports should have been reported to the EPA Administrator for the semiannual reporting period ended September 30, 2010, and one of them also should have been reported in the semiannual reporting period ended March 31, 2011. OCFO staff confirmed that they have not been reporting unresolved DCAA audit reports to the EPA Administrator on a semiannual basis. The unreported audit reports contained the following findings:

- The first unresolved audit report was on a contractor's postaward accounting system. DCAA's opinion was that the accounting system was inadequate for accumulating and billing costs under government contracts. DCAA issued the report on October 23, 2009. In accordance with OMB Circular A-50, a management decision, or resolution, was required on or before April 21, 2010. OAM resolved the recommendations in the report on January 19, 2011.
- The second unresolved audit report was on a contractor's fiscal year 2007 incurred costs. DCAA questioned \$4,689 of direct costs and \$460,129 of indirect costs. DCAA issued the report on February 26, 2010, and OAM resolved it on April 12, 2011. In accordance with OMB Circular A-50, a management decision, or resolution, was required on or before August 25, 2010.

OCFO Unaware of Reporting Requirements

OCFO staff were unaware that OMB Circular A-50 required EPA to report unresolved other executive branch audit organization reports, such as those by DCAA, to the EPA Administrator. EPA is to report on the status of audits DCAA issues when it is the cognizant federal agency. OCFO staff use EPA Manual 2750, the Agency's implementation of OMB Circular A-50, as the primary criteria for audit follow-up. Although EPA Manual 2750 addresses OIG audit report recommendations, it does not address other executive branch audit organization reports, nor does it address procedures for handling such reports when issued

directly to EPA. Accordingly, EPA Manual 2750 does not fully reflect OMB Circular A-50's requirements.

Conclusion

Because EPA is not reporting on a semiannual basis unresolved DCAA audits that exceed the 6-month time frame for resolution, the Agency is not in compliance with OMB Circular A-50, and the EPA Administrator cannot fully evaluate compliance with time frames for reaching a management decision or the implementation of corrective actions. Oversight of actions taken in response to findings and recommendations contributes to improving the effectiveness and efficiency of government operations.

Recommendations

We recommend that the Chief Financial Officer, in conjunction with the Assistant Administrator for Administration and Resources Management:

1. Develop and implement policies and procedures to ensure that unresolved DCAA audit reports are reported on a semiannual basis to the EPA Administrator in accordance with OMB Circular A-50.
2. Revise EPA Manual 2750 to reflect current Agency processes used when requesting, tracking, and reporting unresolved DCAA reports that impact EPA contracts.

Agency Response and OIG Evaluation

EPA concurred with our recommendations and, with the fourth quarter of fiscal year 2011, will begin providing a listing of unresolved DCAA audits that have not been resolved within 180 days to the Administrator on a quarterly basis. EPA will also report the status of unresolved DCAA audit reports in the Annual Financial Report to the Administrator. EPA is in the process of updating EPA Manual 2750 to reflect current Agency processes when requesting, tracking, and reporting unresolved DCAA reports. EPA anticipates completing the revision of EPA Manual 2750 by the end of fiscal year 2012. In the interim, EPA will develop guidance documenting current Agency processes and will ensure that the revision of EPA Manual 2750 incorporates the updated guidance. The OIG concurs with EPA's proposed actions and milestone dates to address both the recommendations. EPA's complete response is in appendix C.

Chapter 3

EPA Is Not Recording Management Decisions

EPA is not recording management decision dates for DCAA audit reports issued after January 1, 2009, in accordance with OMB Circular A-50 and EPA Manual 2750. Both require the Agency to enter report tracking data, including management decision dates, in the Agency tracking system. Thirty-three out of 36 closed audits sampled did not have a management decision date recorded in the OAM tracking system. EPA has not established guidance or standard operating procedures for entering management decisions or final action dates for DCAA audits in the new tracking system. As a result, management cannot fully evaluate the time frames for reaching a management decision or the implementation of corrective actions. In addition, not recording management decisions increases the Agency's risk of inaccurate reporting to the EPA Administrator.

OMB Circular A-50 Requires Recording of Management Decision Dates

OMB Circular A-50 states that the audit follow-up official has personal responsibility for ensuring that systems of audit follow-up, resolution, and corrective action are documented and in place. The circular requires that follow-up systems maintain accurate records of the status of audit reports or recommendations through the entire process of resolution and corrective action. It further requires that follow-up systems assure that resolution actions are consistent with law, regulation, and Administration policy.

For contract audits, EPA Manual 2750 requires the Agency to enter data in its tracking system, including management decision dates, final action dates, and narrative status fields. The manual defines resolution as an approved management decision and states that a management decision must address each of the findings or recommendations in a report. Final action, as defined in EPA Manual 2750, is the completion and documentation of all actions specified in the management decision. For the Agency to consider an audit closed, the audit report must have a management decision that addresses the audit's recommendations, and all corrective actions identified in the management decision must be implemented.

EPA Is Not Recording Management Decision Dates

EPA is not recording management decision dates for resolved DCAA audit reports issued after January 1, 2009. OAM created an Excel spreadsheet to track resolved and unresolved DCAA audit reports. We found that 33 of the 36 closed audits did not have a management decision date recorded in OAM's tracking

system. The audit program manager stated that the following procedures were being used to record management decision dates:

- If the resolution occurs in less than 180 days and corrective actions have been implemented, the Final Action Date field represents both the management decision and final action dates.
- If resolution exceeds 180 days, OAM records the management decision date in the Final Determination Letter Date field, and records the date corrective actions have been implemented in the Final Action Date field.

However, EPA did not follow these procedures, as 33 of the 36 closed audits did not have a management decision date recorded.

Lack of Procedures for New Tracking System Hindering Recording of Management Decisions

While EPA Manual 2750 requires EPA to record management decision dates in MATS, the manual only addresses OIG audit reports. After January 1, 2009, DCAA reports were provided directly to EPA, were no longer assigned an OIG report number, and were no longer tracked in MATS. OAM created an Excel spreadsheet to track DCAA audits after this date; however, it did not create formal written policies and procedures related to the OAM tracking system. Further, the process that was being used was not compliant with OMB Circular A-50 or EPA Manual 2750's definitions and procedures for resolution in that regardless of the timing and who conducted the audit, a management decision date must always be recorded.

Conclusion

Because EPA is not recording management decision dates for DCAA audits, the Agency is not in compliance with OMB Circular A-50 or EPA Manual 2750. If management decisions are not recorded correctly, management cannot fully evaluate compliance with time frames for reaching a management decision and the implementation of corrective actions. In addition, not recording management decisions increases the Agency's risk of inaccurate reporting to the EPA Administrator.

Recommendation

We recommend that the Assistant Administrator for Administration and Resources Management:

3. Develop and implement written policies and procedures to record management decision and final action dates for DCAA audit reports in OAM's tracking system.

Agency Response and OIG Evaluation

EPA concurred with our recommendation and will implement standard operating procedures to record management decision and final action dates for DCAA audit reports in OAM's tracking system by January 31, 2012. The OIG concurs with EPA's proposed actions and the milestone date provided to address the recommendation. EPA's complete response is in appendix C.

Chapter 4

EPA Should Improve Procedures for Resolving DCAA Audits When Not Cognizant

EPA is not always able to resolve DCAA audits in a timely manner when it is not the cognizant agency. In some cases, EPA could resolve the audits if it obtained the documentation from the cognizant agency. In other cases, EPA is waiting for the cognizant agency to take action. OMB Circular A-50 and EPA Manual 2750 require that agencies resolve audits within 6 months of issuing a final report. However, OAM conservatively interprets both OMB Circular A-50 and EPA Manual 2750 when resolving DCAA audit reports. The Agency waits for final action, or in some cases, for verification of final action, to be completed before considering an audit to be resolved, instead of considering it resolved after a management decision has been made. Therefore, EPA is erroneously holding DCAA audits in an unresolved status, causing unnecessary tracking and follow-up work.¹

OMB Guidance Requires Audits to Be Resolved Within 6 Months

OMB Circular A-50 requires that agencies resolve audit reports within a maximum of 6 months after issuance of a final report. The circular defines resolution as the point at which the audit organization and agency management or contracting officials agree on action to be taken on reported findings and recommendations. EPA Manual 2750 states that resolution takes the form of an approved management decision. A management decision must:

1. Address each of the findings or recommendations in the report
2. Set forth appropriate actions including milestone dates for completing the corrective actions
3. Provide references to supporting documentation, including legal basis or precedent, if the action official's position differs from the auditor's position
4. Accurately summarize the total disallowed cost

The cognizant agency is responsible for negotiating with contractors to resolve DCAA audits. The cognizant agency will normally be the agency with the largest dollar amount of negotiated contracts, including options.

¹ In some cases, EPA may need to track implementation of the corrective actions after it makes a management decision. However, EPA has not been separately tracking resolution and corrective action for DCAA audits, and continued to track corrective actions after they were implemented.

EPA Could Have Resolved Some Audits With Improved Procedures

EPA is not always considering DCAA audits to be resolved within the time frame identified in OMB Circular A-50, even when the cognizant agency has resolved an audit. We selected a sample of 24 DCAA audit reports that were identified as being unresolved for over 6 months as of March 31, 2011. EPA was only cognizant for one contractor, which accounted for one unresolved audit in the sample.

We determined that EPA could have considered 8 of the 24 DCAA audits resolved if OAM had obtained proper documentation from the cognizant agencies. In the cases of systems audits, the documentation we obtained from the cognizant ACOs details the contractor's corrective action to be taken or already taken in agreement with the contracting officer. For incurred cost audits, we obtained contracting-officer-negotiated rate agreements. These documents meet the definition of resolution as established in OMB Circular A-50.²

The remaining 16 audits have not been resolved for a number of reasons. The primary reason, as shown in table 1, is that EPA is waiting for the cognizant agency to negotiate with the contractor to resolve the audit. Only the cognizant agency can negotiate with the contractor. Four audits appear to have had action taken on them, or DCAA performed a follow-up audit that superseded the original. However, we were unable to obtain sufficient documentation from the cognizant agencies to consider these audits resolved. As of March 31, 2011, all 16 audits remained unresolved for more than 1 year. In one case, an audit remained unresolved for over 6 years.

Table 1: Reasons audits in our sample remain unresolved

Reason unresolved	Number
Awaiting cognizant agency negotiations	6
Cognizant agency stated audit was resolved but was unable to provide supporting documentation	4
Cognizant agency awaiting additional DCAA audit work	4
Cognizant agency unaware whether corrective action was taken	2

Source: OIG analysis.

The 16 audits represent a combined \$3,236,013 in EPA's share of questioned costs from the DCAA reports. Individual questioned costs are broken down by audit in appendix A. Six of the audits were system audits and do not contain questioned costs. However, the DCAA report did note deficiencies with the contractor's systems along with the impact of those deficiencies.

² After discussions between the OIG and the Agency, EPA took action to resolve the audits. See appendix C for details.

Impediments to Resolution of DCAA Audits

Conservative Interpretation of Resolution Guidance

EPA's practice for determining resolution of DCAA audit reports is based on a conservative interpretation of OMB Circular A-50 and EPA Manual 2750. OMB Circular A-50 states that resolution is achieved when an agreement is reached on actions that the contractor needs to take in response to an audit report's findings. EPA Manual 2750 contains a similar definition. However, we determined from interviews with the Financial Analysis and Oversight Service Center audit program manager, and from documentation in the files, that EPA considers resolution of some DCAA audits, such as systems audits, to be achieved only after DCAA performs a follow-up audit verifying that deficiencies have been corrected. This practice goes beyond the criteria laid out in OMB Circular A-50 and EPA Manual 2750.

This conservative interpretation partly stems from the way the OIG closed out audits prior to January 1, 2009. When a management decision had been made for an audit, OAM would send the decision to the OIG for approval. The OIG did not consider an audit resolved until DCAA had conducted a follow-up to verify corrective actions had been taken. The audit program manager stated that the model of how to handle closing DCAA audits has not changed since OAM took over the process in January 2009.

Lack of Support from DCAA Causes Delays

In some instances, lack of support from DCAA in conducting supplemental work caused delays in DCAA audit report resolution. DCAA supplements audit reports issued when it becomes aware of information which, had it been known at the time the report was issued, would have affected the report's conclusions. DCAA has had a backlog of audits for years and is understaffed in some areas where supplemental work needs to be done. For example, DCAA requested a chance to bolster its original position for an audit under the cognizance of the Defense Contract Management Agency (DCMA). However, according to DCMA staff, DCAA keeps extending follow-up work due to staffing shortages. We identified three other instances in which DCAA caused a delay in the resolution of the audits.

Conservative Interpretation Causes Unnecessary Work

As a result of the conservative interpretation of OMB Circular A-50 and EPA Manual 2750, EPA is unnecessarily holding some DCAA audits in an unresolved status, which leads to unnecessary tracking and follow-up work. For example, we determined that six audits we reviewed have been resolved with final action implemented. In most cases, these audits could have been closed out prior to the start of this audit. Instead, the audits were kept unresolved until the follow-up

audit was performed to verify implementation and reported to the EPA Administrator on a semiannual basis. Additionally, the questioned costs associated with the audits are also not being addressed. For the audits we reviewed, the questioned costs involved \$3,236,013.

Conclusion

Revising EPA's policies and procedures for resolving DCAA audits could reduce the amount of time and resources spent on tracking and resolving DCAA audit reports. OAM's conservative interpretation of OMB Circular A-50 and EPA Manual 2750 has led to audits being considered unresolved in EPA's tracking systems past the point at which the cognizant agency has actually resolved the audit. If audits are resolved timely, EPA may be able to deobligate funds on Agency contracts, thereby making funds available for other priorities.

Recommendations

We recommend that the Chief Financial Officer, in conjunction with the Assistant Administrator for Administration and Resources Management:

4. Revise and implement policies and procedures to define the resolution point for the various types of DCAA audits (including, but not limited to, systems, incurred cost, and cost accounting standards) consistent with OMB Circular A-50.

We recommend that the Assistant Administrator for Administration and Resources Management:

5. Reexamine audits that the OIG identified in this report as already being resolved and, where appropriate, provide the OIG an adequate management decision in accordance with EPA Manual 2750. In cases where OAM is responsible, management decisions should be recorded and documented in OAM files.
6. Develop and implement a plan for alternative actions to accelerate the resolution and implementation process for unresolved audits when not receiving adequate audit support from DCAA.

Agency Response and OIG Evaluation

EPA concurred with our recommendations and will implement revised standard operating procedures that define the resolution point for the various types of DCAA audits by January 31, 2012. EPA also reexamined the audits listed in appendix B and took action necessary to resolve the audits in its tracking system. Additionally, EPA plans to use CPA firms to provide targeted audit services for situations in which DCAA audit support has not been adequate. The OIG concurs

with EPA's proposed actions and milestone dates to address these recommendations. EPA's complete response is in appendix C.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed-To Amount
1	6	Develop and implement policies and procedures to ensure that unresolved DCAA audit reports are reported on a semiannual basis to the EPA Administrator in accordance with OMB Circular A-50.	O	Chief Financial Officer, in conjunction with Assistant Administrator for Administration and Resources Management	11/15/2011		
2	6	Revise EPA Manual 2750 to reflect current Agency processes used when requesting, tracking, and reporting unresolved DCAA reports that impact EPA contracts.	O	Chief Financial Officer, in conjunction with Assistant Administrator for Administration and Resources Management	09/30/2012		
3	9	Develop and implement written policies and procedures to record management decision and final action dates for DCAA audit reports in OAM's tracking system.	O	Assistant Administrator for Administration and Resources Management	01/31/2012		
4	13	Revise and implement policies and procedures to define the resolution point for the various types of DCAA audits (including, but not limited to, systems, incurred cost, and cost accounting standards) consistent with OMB Circular A-50.	O	Chief Financial Officer, in conjunction with Assistant Administrator for Administration and Resources Management	01/31/2012		
5	13	Reexamine audits that the OIG has identified in this audit report as already being resolved and, where appropriate, provide the OIG an adequate management decision in accordance with EPA Manual 2750. In cases where OAM is responsible, management decisions should be recorded and documented in OAM files.	C	Assistant Administrator for Administration and Resources Management	09/15/2011		
6	13	Develop and implement a plan for alternative actions to accelerate the resolution and implementation process for unresolved audits when not receiving adequate audit support from DCAA.	O	Assistant Administrator for Administration and Resources Management	01/31/2012		

O = recommendation is open with agreed-to corrective actions pending
 C = recommendation is closed with all agreed-to actions completed
 U = recommendation is unresolved with resolution efforts in progress

Impact of Unresolved Audits

Table A-1: Unresolved audits and their impact, 2006–2011

Audit report	Impact
1. 2006-4-00120 National Academy of Sciences—2006 IT System General Internal Controls	The deficiencies listed could adversely affect the organization's ability to record, process, summarize, and report direct and indirect costs consistent with applicable government contract laws and regulations.
2. 2006-4-00165 National Academy of Sciences—Review of Internal Controls for the Indirect and Other Direct Costs System	The deficiencies noted in the report could adversely affect the organization's ability to record, process, summarize, and report indirect and other direct costs in a manner consistent with applicable government contract laws and regulations.
3. 2006-4-00169 National Academy of Sciences—Labor Accounting System Internal Controls	The deficiencies noted in the report could adversely affect the organization's ability to record, process, summarize, and report labor costs in a manner consistent with applicable government contract laws and regulations.
4. 2007-1-00016 URS—URSGI Incurred Costs for Fiscal Year Ending November 2, 2001	\$1,328,189 in direct costs was questioned for EPA contract 68-W9-8225.
5. 2007-1-00061 Lockheed Martin Services—Incurred Costs for Calendar Year Ending December 31, 2004	EPA's share of the questioned direct and indirect costs is \$694,178.
6. 2007-1-00079 Science Applications International Corporation—Direct and Indirect Cost for Contractor's Fiscal Year (CFY) 2005	EPA's share of the questioned direct and indirect costs is \$119,696.
7. 2007-1-00080 Lockheed Martin Services—2005 Incurred Costs	EPA's share of the questioned indirect questioned costs is \$133,069.
8. 2007-4-00058 Science Applications International Corporation—Report on Evaluation of Contractor Fiscal Year (CFY) 2007 Labor Timekeeping Practices and Floorcheck (MAAR 6)	The deficiency listed could have a material impact on the accuracy of labor data reported in the contractor's systems. This could result in distorted labor costs reported in public vouchers, progress payments, and other costs.
9. 2007-4-00080 National Academy of Sciences—National Academy of Sciences—Follow-up Audit for Budget and Planning System Internal Control	Deficiencies not corrected were long-term strategic plans not utilized, budget approval process not well documented, and policies and procedures not in place for management to evaluate variances between budget and actual performance.
10. 2008-1-00114 Weston Solutions—Incurred Cost for Fiscal Year Ended December 31, 2004	EPA's share of questioned indirect costs is \$197,869 over 11 contracts.
11. 2008-1-00130 Washington Group—International—1999 Incurred Cost	EPA's share of questioned costs related to the Package Policy Insurance Costs is \$10,393.

12. 2008-1-00131 Washington Group—WGI CFY 2001 Incurred Costs	EPA's share of questioned costs related to the Package Policy Insurance Costs is \$6,126.
13. 2008-4-00002 Science Applications International Corporation—Follow-Up Compensation System Internal Controls	The deficiencies noted in the report could adversely affect the organization's ability to record, process, summarize, and report compensation in a manner consistent with applicable government contract laws and regulations.
14. 2009-1-00034 Lockheed Martin Services—Incurred Costs Calendar Year Ending December 31, 2006	EPA's share of questioned direct and indirect costs is \$710,170.
15. 2009-112384 Shaw Environmental and Infrastructure—Incurred Costs for Fiscal Year 2006	Questioned direct costs resolved. There were no questioned indirect costs related to EPA contracts, but a rate agreement has not been negotiated.
16. 2011-113643 Booz Allen Hamilton—Independent Audit of Booz Allen Hamilton U.S. Consulting (BAH)'s Incurred Costs for Fiscal Year Ending March 31, 2007	Indirect rates are not acceptable and \$36,323 in direct costs related to EPA contracts was questioned.

Source: OIG analysis of DCAA audit reports.

Resolved Audits

Table B-1: DCAA audit reports for which we obtained resolution documentation during the course of this audit

Report no.	Report title	Basis for OIG decision
2004-1-00099	Lockheed—Incurred Costs Calendar Year Ending December 31, 2002	Obtained price negotiation memorandum from DCMA ACO
2008-4-00208	MACTEC—Noncompliance with Cost Accounting Standard (CAS) 409	Obtained Final Determination Letter from DCMA ACO on noncompliance
2008-4-00308	Tetra Tech—Information Technology General Internal Controls	Obtained resolution memorandum from DCMA ACO
2009-112344	CH2M Hill—Purchasing System Internal Controls	Obtained resolution memorandum from DCMA ACO
2010-1-12796	SRA—Noncompliance with Cost Accounting Standard 420, Accounting for Independent Research and Development and Bid and Proposal Costs	Obtained Final Determination Letter from DCMA ACO on noncompliance
2010-113036	Northbridge—FY 2007 Incurred Costs	Obtained Final Indirect Cost Rate Agreement from EPA ACO
2010-113289	Black and Veatch—Contractor's Purchase Existence and Consumption Practices	Obtained resolution memorandum from DCMA ACO
2010-312713	AECOM—Assist Audit Floor Check	Follow-up audit issued by DCAA stated that there were no deficiencies

Source: OIG analysis of DCAA audit reports.

Agency Response to Draft Report

October 17, 2011

MEMORANDUM

SUBJECT: Response to Draft Office of Inspector General Audit Report, Project No. OA-FY11-0064: *EPA Should Improve Policies and Procedures to Ensure Effective DCAA Audit Report Resolution*

FROM: Barbara J. Bennett, Chief Financial Officer \s\
Office of the Chief Financial Officer

Craig E. Hooks, Assistant Administrator \s\
Office of Administration and Resources Management

TO: Melissa M. Heist, Assistant Inspector General for Audits
Office of Inspector General

Thank you for the opportunity to comment on the subject OIG draft Audit Report (Report) dated September 9, 2011.

The expressed purpose of the audit was to determine whether the EPA has adequate internal controls for resolving Defense Contract Audit Agency audit reports, and whether the EPA is timely resolving DCAA audit reports. We generally agree with the Report's findings and overall recommendation for the EPA to improve its policies and procedures to ensure timely and accurate tracking and reporting of the resolution of DCAA reports.

Our specific comments on the Report's findings and recommendations are provided below:

Comments on the Report's Findings and Recommendations

We recommend that the Chief Financial Officer, in conjunction with the Assistant Administrator for Administration and Resources Management:

- 1. Develop and implement policies and procedures to ensure that unresolved DCAA audit reports are reported on a semiannual basis to the EPA administrator in accordance with OMB Circular A-50*

Response: We concur with the recommendation. OCFO prepares quarterly reports for the Administrator and senior managers on the agency's audit follow-up activities. These reports

present the status of Management Decisions and Corrective Actions on active OIG audits. To comply with the reporting requirements of OMB Circular A-50, effective Quarter 4 FY 2011, OCFO will include a listing of DCAA audits for which the EPA is the cognizant agency that have not reached resolution within 180 days of issuance. OCFO will also include this information in EPA's annual Agency Financial Report.

2. *Revise EPA Manual 2750 to reflect current agency processes used when requesting, tracking, and reporting unresolved DCAA reports that impact EPA contracts.*

Response: We concur with the recommendation. OCFO is leading an agency workgroup to update the EPA Order 2750. The updated Order is anticipated to be issued by the end of FY 2012. In the interim, OARM will develop guidance documenting current agency processes. OCFO will ensure that the revised Manual 2750 incorporates the updated guidance.

We recommend that the Assistant Administrator for Administration and Resources Management:

3. *Develop and implement written policies and procedures to record management decision and final action dates for DCAA audit reports in OAM's tracking system.*

Response: We concur with the recommendation. OAM will develop and implement standard operating procedures to record management decision and final action dates for DCAA audit reports in OAM's tracking system by January 31, 2012.

We recommend that the Chief Financial Officer, in conjunction with the Assistant Administrator for Administration and Resources Management:

4. *Revise and implement policies and procedures to define the resolution point for the various types of DCAA audits (e.g., systems, incurred cost, cost accounting standards, etc.) consistent with OMB Circular A-50.*

Response: OARM and OCFO concur with the recommendation. By January 31, 2012, OAM will revise and implement standard operating procedures that are consistent with OMB Circular A-50 so that the resolution date becomes the date that agreement is reached on actions that the contractor needs to take in response to an audit report's findings.

We recommend that the Assistant Administrator for Administration and Resources Management:

5. *Reexamine audits that the OIG identified in the report as already being resolved and that are listed in appendix B, and where appropriate, provide the OIG an adequate management decision in accordance with EPA Manual 2750. In cases where OAM is responsible, management decisions should be recorded and documented in OAM files.*

Response: We concur with the recommendation. Of the eight audits listed in Appendix B, three of the audits originally issued by OIG and thus tracked in MATS were closed by the OIG on September 15, 2011. The five remaining audits OAM requested DCAA to perform were closed by OAM by August 4, 2011.

6. *Develop and implement a plan for alternative actions to accelerate the resolution and implementation process for unresolved audits when not receiving adequate audit support from DCAA.*

Response: We concur with the recommendation. For those contractors for which the EPA is the cognizant agency, OAM is preparing to award a contract by January 31, 2012, for CPA firms to provide targeted audit services in situations where DCAA audit support has not been adequate.

Thank you again for the opportunity to comment on the report. If you have any questions concerning this matter, please contact either of us directly.

cc: Nanci Gelb
Maryann Froehlich
John Bashista
Kathy O'Brien
Janet Kasper
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