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Oversight Review

July 28, 2010

Report on Allegation of Unsatisfactory
Conditions Regarding Actions by the
Defense Contract Management Agency,
Earned Value Management Center

Report No. D-2010-6-002

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Acronyms

ANSI/EIA	American National Standards Institute/Electronic Industries Alliance
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
GAGAS	Generally Accepted Government Auditing Standards



INSPECTOR GENERAL
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JUL 28 2010

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT
AGENCY
DIRECTOR, EARNED VALUE MANAGEMENT CENTER

SUBJECT: Report on Allegation of Unsatisfactory Conditions Regarding Actions by the
Defense Contract Management Agency, Earned Value Management Center
(Report No. D-2010-6-002)

We are providing this report for your review and comment. We performed this review in response to a reported allegation of unsatisfactory conditions dated December 17, 2008. We considered management comments on a draft of this report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Contract Management Agency comments were partially responsive. Please reconsider your nonconcurrence with Finding A and partial concurrence to Recommendation A1. We request additional comments to Finding A and Recommendations A.1., A.2., A.3., B.1., and B.2., by August 27, 2010.

Please provide comments that conform to the requirements of DoD Directive 7650.3. If possible, send management comments in electronic format (Adobe Acrobat file only) to the e-mail address cited in the last paragraph of this memorandum. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature.

We appreciate the courtesies extended to the staff. Questions should be directed to Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877), carolyn.davis@dodig.mil.

For: 
Randolph R. Stone
Deputy Inspector General
for Policy and Oversight

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Allegations of Unsatisfactory Conditions Regarding Actions by the Defense Contract Management Agency Earned Value Management Center

Results In Brief

What We Did

We conducted this review to determine the validity of alleged unsatisfactory conditions involving reviews performed in Tucson, Arizona by the Defense Contract Management Agency Earned Value Management Center.

What We Found

We substantiated the alleged unsatisfactory conditions. During two reviews of a DoD contractor in 2008, the Earned Value Management Center failed to (1) allow the Defense Contract Audit Agency (DCAA) sufficient time to perform an audit of the contractor's system, (2) adequately resolve the DCAA findings, and (3) demonstrate independence and objectivity in fulfilling its oversight responsibilities.

In addition to the substantiated allegations, we found that the Earned Value Management Center did not issue compliance review reports as required, or recommend suspending or withdrawing approval of the contractor's system for continued noncompliances with earned value management guidelines.

What We Recommend

The Director, Defense Contract Management Agency (DCMA), should

prohibit joint surveillance reviews or other joint activities with contractors that could compromise independence and objectivity, and request DCAA participation in conducting surveillance reviews. The Earned Value Management Center Director should work with DCAA to establish reasonable due dates for conducting audits, hold discussions with DCAA to help resolve disagreements, and issue a written report on the results of earned value management reviews. The Commander, Tucson Contract Management Office, should ensure that contracting officers adequately resolve DCAA-reported deficiencies. The Commander, Tucson Contract Management Office should also suspend or withdraw the acceptance of an earned value management system and implement appropriate contractual actions and remedies for significant system deficiencies.

Management Comments

DCMA concurred with 7 of 8 recommendations and with Finding B. We request that DCMA reconsider its nonconcurrences. We also request that DCMA reconsider its responses to the recommendations because the proposed corrective actions were partially responsive. We request additional comments to Finding A and Recommendations A.1., A.2., A.3., B.1., and B.2., by August 27, 2010.

United States Department of Defense Office of Inspector General
(Project No. D2009-DIP0AI-0022.001)
Report No. D-2010-6-002
July 28, 2010

Introduction

Objective

We conducted this review to determine the validity of alleged unsatisfactory conditions involving the actions taken by the Defense Contract Management Agency Earned Value Management Center at Tucson between March and August 2008. According to the alleged unsatisfactory conditions, the Earned Value Management Center failed to:

- Provide DCAA sufficient time to perform a comprehensive review of the contractor's compliance with the earned value management guidelines,
- Adequately resolve DCAA's compliance review findings with DCAA, and
- Remain independent and objective in performing compliance reviews.

See Appendix A for details regarding our scope and methodology.

Background

Earned Value Management is a program management tool used by DoD and industry to provide early warning of potential contract cost and schedule performance problems. To be effective, earned value management must be implemented in a disciplined manner consistent with the 32 earned value management guidelines contained in American National Standards Institute/Electronic Industries Alliance Standard 748 (ANSI/EIA-748). These guidelines are the universally accepted criteria against which industry and the government gauge the reliability and effectiveness of earned value management systems. Defense Federal Acquisition Regulation Supplement 234.201 provides that (i) for cost or incentive contracts and subcontracts valued at \$20 million or more, a DoD contractor's earned value management system shall comply with ANSI/EIA-748 guidelines, and (ii) for cost or incentive contracts and subcontracts valued at \$50 million or more, the cognizant Federal agency must accept the contractor's earned value management system based on a review for compliance with the guidelines.

Defense Contract Audit Agency (DCAA), under the authority, direction, and control of the Under Secretary of Defense (Comptroller), is responsible for performing all contract audits for DoD and providing accounting and financial advisory services regarding contracts and subcontracts to all DoD Components responsible for procurement and contract administration. These services are provided in connection with negotiation, administration, and settlement of contracts and subcontracts. DCAA issues audit reports resulting from several types of audits, such as audits on compliance with earned value management guidelines.

Defense Contract Management Agency (DCMA) is the DoD Component that works directly with Defense suppliers to help ensure that DoD, Federal, and allied government supplies and services are delivered on time at projected cost and meet performance requirements. According to the Under Secretary of Defense (Acquisition, Technology and Logistics) memorandum,

“Earned Value Management Requirements and Reporting,” the DCMA Director has the primary responsibility for conducting contractor earned value management system reviews for compliance with the ANSI/EIA-748 guidelines. DCMA has assigned its contract management offices with the authority and responsibility of determining the acceptability of the DoD contractor earned value management system under their cognizance.

The DCMA Contract Management Office located in Tucson, Arizona, is one of 47 such offices established throughout the United States. In addition, DCMA has established an Earned Value Management Center (the Center) to conduct initial “compliance” reviews of DoD contractor systems for compliance with the ANSI/EIA-748 guidelines. The Center is currently comprised of a team of approximately 31 earned value management specialists who perform compliance reviews across the United States on a full time basis. The Center also performs follow-up reviews of significant deficiencies until they are corrected. Once the Center makes an initial determination that a contractor complies with the guidelines, the Contract Management Office will recognize such compliance through the issuance of either an Advance Agreement or a Letter of Acceptance. Thereafter, the Contract Management Office conducts “surveillance” reviews on an ongoing basis to verify a contractor’s continued compliance with the guidelines. If a surveillance review detects significant noncompliances, the Contract Management Office may request that the Center perform another compliance review of all or parts of the contractor’s earned value management system and could withdraw acceptance of the system until the contractor reestablishes compliance.

This report addresses two DCMA Earned Value Management Center reviews conducted at a DoD contractor facility in Tucson, Arizona. The first was a compliance review completed in April 2008, and the second was a follow-up review completed in August 2008. The April 2008 compliance review disclosed several noncompliances with the ANSI/EIA-748 guidelines. The contractor took corrective actions on the noncompliances and the DCMA follow-up review determined that those actions were adequate.

The Center requested that DCAA participate in the April and August 2008 compliance reviews performed in Tucson. DCAA participated in the April 2008 compliance review and, in accordance with DCAA procedure, issued an audit report to the Center which expressed its opinion on the adequacy of the contractor’s earned value management system. DCAA did not participate in the follow-up review in part because it believed the 4-day time frame established by the Center was insufficient to perform the review and report on the results.

DCMA is responsible for considering the DCAA opinion in determining the overall acceptability of the earned value management system. Enclosure 3 of DoD Instruction 7640.02, “Policy for Follow-up on Contract Audit Reports,” August 22, 2008, outlines the responsibilities for resolving and completing the disposition of DCAA audit reports. (Note: This Instruction replaced DoD Directive 7640.2, same subject, which included the same requirement) It requires that DCMA document the rationale for not upholding any DCAA findings and recommendations, including those involving earned value management systems.

Findings

A. Allegation of Unsatisfactory Conditions

We substantiated the allegation of unsatisfactory conditions. As part of the April and August 2008 reviews of a contractor's earned value management system, the DCMA Earned Value Management Center failed to:

- Provide DCAA sufficient time to perform reviews of the earned value management guidelines;
- Adequately resolve DCAA's reported findings and recommendations; and
- Remain independent and objective in performing compliance reviews of the earned value management system.

Insufficient Time for DCAA to Perform an Audit. The Earned Value Management Center did not allow sufficient time for DCAA to meaningfully participate in the April and August 2008 reviews. The unreasonably short time frames effectively prevented DCAA from fulfilling its participation responsibilities established in the Under Secretary of Defense (Acquisition, Technology and Logistics) memorandum, "Use of Earned Value Management (EVM) in the Department of Defense," July 3, 2007. Consequently, the Center issued its conclusions on the acceptability of the contractor's earned value management system without adequately resolving DCAA-reported noncompliances or obtaining any DCAA expert audit advice on the financial and accounting related ANSI/EIA-748 guidelines.

April 2008 Compliance Review. The Center established a 2-week time frame to complete a comprehensive review of the contractor's system for compliance with all 32 ANSI/EIA-748 guidelines. As requested, DCAA participated in the review by auditing the contractor's compliance with 8 of the accounting and financial related guidelines. Before receiving the DCAA audit results, DCMA held an exit conference with the contractor on April 4, 2008 (the last day of the 2-week period) to advise them of the review results and provide a list of deficiencies. DCAA issued its audit report 6 weeks later on May 15, 2008, which reported additional noncompliances with 2 of the guidelines. The Center should have waited for the DCAA audit report before holding the exit conference with the contractor and providing a list of deficiencies. While the Center did consider an April 2008 draft of the DCAA report, the Center failed to adequately document its rationale for not upholding the DCAA findings (See "Failure to Adequately Resolve DCAA Findings" below for additional details).

The Earned Value Management Center Director advised us that the 2-week time frame was "standard operating procedure" for performing compliance reviews at major DoD contractor facilities across the United States. In August 2008, the DCAA Director expressed to the DCMA Director her concern that the 2-week time frame did not allow sufficient time for DCAA auditors to perform an adequate review and report on their conclusions. The DCAA Director requested

that the two agencies work together to analyze whether the 2-week time frame is sufficient and to develop a mutually acceptable process on future reviews. To our knowledge, DCMA and DCAA have not yet developed a process for future compliance reviews. Nevertheless, the Center should not have established an arbitrary and inflexible time frame to conduct reviews at all major DoD contractors. The established time frame should be based on a careful consideration of the risks and circumstances at each contractor location.

August Follow-Up Review. The Center established a 4-day time frame to complete the follow-up review. On August 12, 2008, DCAA notified the Center that it could not participate in the follow-up review because (i) the scope of the review had been restricted to the specific programs where the deficiencies were initially identified, (ii) the programs, cost reports, and period of time subjected to review had been selected and pre-announced to the contractor, and (iii) DCAA could not complete a follow-up review within the 4-day time frame established by the Center. Nevertheless, DCAA offered to perform a follow-up review in a timely manner that would still allow for incorporation into the final DCMA report. The Center did not adjust the 4-day requested due date for completing the DCAA follow-up. Rather than utilize DCAA, the Center used an ex-DCAA auditor on its staff to follow-up on the DCAA-reported noncompliances.

We agree with the DCAA decision not to participate in the 4-day follow-up review. DCAA is required to comply with Generally Accepted Government Auditing Standards (GAGAS), which requires the auditor to independently plan the scope of review.

GAGAS also requires adequate time to plan and implement audit testing. The DCMA imposed 4-day time frame constitutes an external impairment as defined in GAGAS Section 3.10, which states, *“Audit organizations must be free from external impairments to independence. Factors external to the audit organization may restrict the work or interfere with auditors’ ability to form independent and objective opinions, findings, and conclusions.”* An example of an external impairment cited in GAGAS Section 3.10 includes, *“unreasonable restrictions on the time allowed to complete an audit or issue the report is a condition that may impair the auditor’s freedom to make an independent and objective judgment thereby adversely affecting the audit.”*

The use of an ex-DCAA employee is not an adequate substitute for obtaining DCAA participation as required by the Under Secretary of Defense (Acquisition, Technology and Logistics) memorandum, “Use of Earned Value Management (EVM) in the Department of Defense,” July 3, 2007. The conclusions of the ex-DCAA auditor do not represent those of DCAA. DCMA should have coordinated a revised due date with DCAA that would have allowed sufficient time for DCAA to perform an independent follow-up audit of its own previously reported noncompliances.

Failure to Adequately Resolve the DCAA Findings. The DCMA Earned Value Management Center did not adequately resolve DCAA’s reported findings prior to making a final determination of contractor compliance with all 32 earned value management guidelines. The Center did not comply with DoD Instruction 7640.02, “Policy for Follow-up on Contract Audit Reports,” August 22, 2008, enclosure 3, paragraph 2.c., which requires adequate rationale

for any disagreement with the audit findings [or prior DoD Directive 7640.2 (same subject), paragraph 6.4.1., February 12, 1988]. The Center should hold discussions with DCAA in an attempt to resolve any disagreements, and request DCAA participation in contractor surveillance activities.

DCAA Compliance Audit Report. In Audit Report No. 3561-2008N17750001, May 15, 2008, DCAA reported significant noncompliances with two of the eight guidelines reviewed, including Guidelines 16 (Record Direct Costs) and 21 (Material Accounting).

Guideline 16 Noncompliance. DCAA reported that the contractor did not have adequate controls to ensure costs reflected in the contractor's Cost Performance Reports are consistent with the cost recording in the official books and records. According to DCAA, the inadequate controls reduced the reliability of amounts reflected in the contractor's Cost Performance Reports and diminished the effectiveness of the system.

Guideline 21 Noncompliance. DCAA reported that the contractor could not completely explain variances related to recorded material cost due to inadequate training. As a result, the contractor could have inaccurately reported actual performance statistics in the system.

Earned Value Management Center Determination. The Center did not uphold the DCAA findings. The Center determined that the DCAA-reported noncompliances were not systemic or pervasive based on the following:

- Both noncompliances were found on only one program. Compliance testing performed on other programs did not disclose the same deficiencies.
- DCAA lacked evidence to demonstrate that the Guideline 16 noncompliance (involving "remapping"¹) significantly distorted reported earned value management data.

We disagree with the DCMA conclusion that the deficiencies were not systemic. DCAA found noncompliances with 2 of the 5 (40 percent) programs reviewed. In addition, we noted that DCMA had issued three "Deficiency Reports" involving the same type of noncompliances on two programs.

We also disagree that the DCAA-reported Guideline 16 (Record Direct Costs) noncompliance lacked evidentiary support. DCMA did not adequately document its rationale for this conclusion. The DCAA audit report documents indications of inadequate internal controls that could significantly distort reported earned value management data. For example, DCAA reported that an excessive amount of "remapped" costs had occurred, which is strong evidence that the contractor was not relying on its accounting system to control its earned value management system reporting.

¹ Remapping is the contractor's process of realigning accounting system costs to budgeted amounts reflected in cost performance reports.

Lack of Communication Between DCMA and DCAA. DCMA failed to hold any discussions with DCAA prior to deciding not to uphold the DCAA findings. As recently highlighted in the Under Secretary of Defense (Acquisition, Technology and Logistics) memorandum, “Resolving Contract Audit Recommendations,” December 4, 2009, it is essential that agencies attempt to resolve significant issues brought to their attention in DCAA audit reports. DCMA should hold discussions with DCAA in an attempt to resolve any disagreements, and document those discussions in the contract file.

Finally, we noted that DCMA Instruction “Earned Value Management System (EVMS) System-Level Surveillance,” January 2008, does not encourage DCAA participation in conducting surveillance activities. The Under Secretary of Defense (Acquisition, Technology and Logistics) memorandum, “Use of Earned Value Management (EVM) in the Department of Defense,” July 3, 2007, specifically cites participation in contractor surveillance activities as one of DCAA’s roles and responsibilities. To further help communication and cooperation, this DCMA Instruction should be revised to request such DCAA participation.

Compromise of Independence/Objectivity in Appearance. DCMA practices for selecting programs for review and the procedures for conducting compliance and surveillance reviews give the appearance that DCMA was not sufficiently independent or objective.

Flawed Selection of Programs. We disagree with the approach used by the Center to select programs it reviewed for compliance with the guidelines. First, the Center notified the contractor well in advance which programs and related cost reports it selected for review. As a result, the contractor’s compliance efforts could have focused exclusively on those pre-selected programs. Second, the Center did not vary the selection of programs reviewed. DCMA reviewed the same five programs during the April and August 2008 reviews as it did in a prior December 2006 review. Therefore, the Government has no reasonable assurance of the contractor’s compliance on other programs. DCMA has not reviewed approximately ten additional contractor programs subject to the earned value management guidelines.

Conducting Joint Activities with the Contractor. The Earned Value Management Center and Tucson Contract Management Office representatives held joint activities with the contractor on two separate occasions which could have compromised DCMA’s independence and objectivity. In January 2007, following a December 2006 DCMA compliance review, DCMA Tucson Contract Management Office representatives participated in a week-long contractor review to identify root causes of various deficiencies and to develop a corrective action plan. In December 2007, representatives from DCMA Tucson Contract Management Office and the Center attended the contractor’s internal audit of its system in preparation for the April 2008 DCMA compliance review. DCMA officials charged with determining system compliance should not participate with the contractor in developing corrective action plans or performing internal audits. Participation in such activities may compromise the ability of DCMA to independently determine system compliance and continued acceptability of the earned value management system.

We also noted that DCMA Instruction “Earned Value Management System (EVMS) System-Level Surveillance,” January 2008, strongly encourages contractor participation in planning and conducting DCMA surveillance reviews. For example, Paragraph 2.2 of the Instruction entitled, “Responsibilities,” states:

“A joint surveillance process between the CMO, the EVM (Earned Value Management) Center, and supplier (contractor) is encouraged and, if established, should be documented as part of the Standard Surveillance Plan.....The supplier is not required to participate in the government surveillance process but is strongly encouraged to do so. Teaming is an essential ingredient to an effective surveillance program.” (clarification added)

DCMA should not plan or conduct joint surveillance reviews with the contractor. Such procedures could create an appearance that DCMA is not sufficiently independent and objective in conducting surveillance activities. In accordance with DFARS 234.201, “Policy,” DCMA is responsible for determining compliance on DoD contracts. This is not a shared responsibility with the contractor and should not be confused with the contractor’s responsibility for implementing and maintaining an acceptable earned value management system. DCMA should revise the Instruction to remove the encouragement of contractor participation in the surveillance review process.

Management Comments on the Finding and Our Response

Management Comments: Insufficient Time for DCAA to Perform an Audit. The DCMA Director did not concur. The Director acknowledged that DCAA’s goal is to provide thorough and complete audits that often take time. The Director states that DCMA’s reviews lose their effectiveness and impact if DCMA’s results are presented to the contractor long after the review has been completed.

The May 15, 2008 DCAA Audit Report indicated that DCAA would follow up on its findings in ninety days. Although DCAA declined to participate in DCMA’s follow-up review one week prior to the scheduled August 2008 review date, DCAA participated on joint oversight surveillance activities with DCMA. DCAA declined to participate in the August follow-up review, in part, because “the scope of the review had been restricted to the specific programs where the deficiencies were initially found.” The purpose of the follow-up review is to confirm that initial findings have been remedied rather than look at other programs.

DoD IG Response. We disagree with the management comments. DCMA does not explain how the review loses its effectiveness. The reviews would be significantly more effective if DCMA and DCAA agreed to a reasonable timeframe so that the contractor would be provided with comprehensive results from DCMA. DCAA is required to perform their audits in accordance with Generally Accepted Government Auditing

Standards. These standards require that auditors be provided adequate time to complete an audit and issue the report. Two weeks and certainly four days, is not sufficient time for DCAA to perform an audit and submit a report on a large major contractor. DCMA's reviews would be more effective if DCMA received DCAA's audit report before the results of the compliance review are presented to the contractor. DCMA should work together with DCAA in developing mutually acceptable due dates on future compliance reviews.

DCAA notified DCMA that the scope of the August 2008 follow-up review had been restricted to the specific programs where the deficiencies were identified in April 2008. The earned value management system is used by programs other than those previously reviewed. A previously reported deficiency could exist on other programs. All programs should be subject to testing. Therefore, the follow-up review should not be limited to previously tested programs. The scope of the follow-up review may be focused on certain guidelines to determine if the deficiencies have been remedied; however, all programs that use the earned value management system should be subject to review. Therefore, the scope of a follow-up review should include transaction testing on all programs, rather than only the programs where deficiencies were previously found.

Management Comments: Failure to Adequately Resolve the DCAA Findings.

The DCMA Director did not concur. The DCMA Director agreed that the DCAA findings of noncompliance were valid. However, DCMA did not consider the issues systemic. Therefore, the DCMA Contract Management Office worked with DCAA to correct the issues as part of the contractor's Corrective Action Plan. The management comments state that of the three unrelated EVMS deficiencies cited by DCAA in their May 15, 2008 audit report, each deficiency was found on only one of fourteen EVM programs. Because the DCAA findings were not systemic, they could have been followed-up and verified through joint surveillance.

The DCMA Contract Management Office August 2008 surveillance report indicated that issues related to the DCAA May 15, 2008 audit report were corrected. Also a DCAA October 2008 memorandum recognized the contractor had completed all Corrective Action Plan actions. The management comments state that DCAA provided the final subsequent audit report nineteen months after the DCAA May 15, 2008 audit report. The effectiveness of DCMA's compliance determination efforts requires more time-sensitive responses. DCMA is committed to providing better documentation of any determinations it makes that are inconsistent with DCAA recommendations.

DoD IG Response. We disagree with the management comments. Audit findings reported by DCAA were not adequately resolved with DCAA. Deficiencies with Guideline 16 were found on three of the five programs reviewed. Guideline 16 deficiencies were found by DCAA on two programs and by DCMA on a third program. Therefore, we do not agree that the deficiencies with Guideline 16 are not systemic.

The effectiveness of DCMA's compliance determinations is not dependent on a time-sensitive response from DCAA. By denying DCAA the time that it needs to perform adequate testing, DCMA gives an advantage to the contractor. DCMA compliance determinations should be based on recommendations from DCAA. DCMA should not make a determination of compliance until it has received the recommendations that it needs from DCAA.

DCAA issued an October 2, 2008, memorandum to DCMA that reported the contractor completed its corrective action plan. DCAA stated that in order to determine compliance and the effectiveness of the contractor's corrective actions, DCAA needs to perform a review by testing selected programs. However, DCMA did not resolve DCAA's reported findings of noncompliance prior to making a determination that the contractor is compliant with all 32 earned value management guidelines. It is the responsibility of DCMA to resolve and disposition audit report findings and recommendations. Communication and discussion with the auditor is required to fully understand and resolve reported audit findings.

Management Comments: Compromise of Independence/Objectivity in Appearance. The DCMA Director did not concur. The Director states that DCMA has established and maintains a cooperative Government-contractor relationship that does not compromise the independence of their decisions. A Review for Cause is a focused review of specific elements of the contractor's earned value management system in order to confirm the acceptability of the system. Advance notification to the contractor is necessary to ensure the contractor can support a review during the time period, key employees are available for interview, and the data requested is provided to the review team before the review.

DoD IG Response. We disagree with the management comments. In accordance with DFARS 234.201, "Policy," DCMA is responsible for monitoring the contractor's system for compliance with the earned value management guidelines. This responsibility is not a shared responsibility with the contractor. The contractor is responsible for establishing and maintaining an acceptable earned value management system. DCMA should encourage the contractor to perform its own surveillance activities to improve their system. DCMA's Surveillance Report dated August 31, 2008, is signed by the contractor as well as DCMA. Joint surveillance reviews with the contractor could create an appearance to third parties that DCMA is not sufficiently independent and objective in their decision regarding compliance of the contractor's system.

We do not agree that advance notification should be given to the contractor. On December 14, 2007, DCMA provided the contractor with nearly four months advance notice that the earned value management system would be reviewed on March 25, 2008. In addition, DCMA did not vary the selection of programs reviewed. As a result,

contractor's compliance efforts could have focused exclusively on these pre-selected programs.

Recommendations, Management Comments and Our Response

Recommendation A.

1. We recommend that the Director, Defense Contract Management Agency, revise Defense Contract Management Agency Instruction, "Earned Value Management System (EVMS) System-Level Surveillance," January 2008, to:

- a. Prohibit joint surveillance reviews or other joint activities with a contractor that could compromise the independence and objectivity of Defense Contract Management Agency to carry out its earned value management oversight responsibilities.**

Management Comments. The DCMA Director non-concurred in part. DCMA agrees with and is committed to ensuring that the decisions which result from its surveillance and compliance reviews represent an independent DCMA decision. DCMA does not agree that the only way to achieve this independence is by isolating the contractor from the review process. Joint surveillance reviews provide the opportunity for the contractor and Government officials to fully understand the critical elements of the earned value management system and how they work together to ensure that reports generated by this system are accurate. The contractor's internal oversight organizations are invited and encouraged to participate in DCMA's surveillance activities. The contractor members who participate are not representatives of the programs under review but are usually officials from the contractor's policy/compliance staff.

DoD IG Response. We request that the DCMA Director reconsider his position. We agree with DCMA that their decisions resulting from its surveillance and compliance reviews should represent an independent DCMA decision. We agree that the contractor should not be isolated from the review process when the contractor's system is being reviewed by the Government. We do not agree that DCMA should conduct joint surveillance reviews with the contractor, because the Government is responsible for making independent decisions whether the contractor's system is compliant.

DCMA is responsible for determining compliance on DoD contracts in accordance with DFARS 234.201, "Policy." This is not a shared responsibility with the contractor and should not be confused with the contractor's responsibility for implementing and maintaining an acceptable earned value management system. DCMA should encourage the contractor to perform its own surveillance activities to maintain and

improve its system. Joint surveillance with the contractor could create an appearance to third parties that DCMA is not independent or objective in conducting surveillance activities.

DCMA's Instruction "Earned Value Management System (EVMS) System-Level Surveillance," January 2008, paragraph 2.2 states that joint surveillance is when DCMA and the contractor leads jointly conduct a review. Although the Instruction does not require the contractor to participate in the Government surveillance process, the contractor is strongly encouraged to do so. We request that the DCMA Director reconsider his position and revise this Instruction to remove the encouragement of contractor participation in the surveillance review process. Therefore, we request that the DCMA Director provide revised comments.

b. Request Defense Contract Audit Agency participation in conducting surveillance reviews of contractor earned value management systems.

Management Comments. The DCMA Director concurred. The Director states that it routinely requests DCAA participation in surveillance reviews and is working aggressively to synchronize surveillance review schedules.

DoDIG Response. Although management concurred, their proposed corrective actions are only partially responsive. The Under Secretary of Defense (Acquisition, Technology and Logistics) memorandum, "Use of Earned Value Management (EVM) in the Department of Defense," July 3, 2007, specifically cites participation in contractor surveillance activities as one of DCAA's roles and responsibilities. We request that the DCMA Director provide a response to the final report describing the revisions it plans to make to DCMA Instruction, "Earned Value Management System (EVMS) System-Level Surveillance," January 2008, to ensure DCAA participation in surveillance activities. Also, provide the completion dates for actions planned.

2. We recommend that the Director, Defense Contract Management Agency Earned Value Management Center, implement quality assurance procedures to:

a. In conjunction with the Defense Contract Audit Agency, establish reasonable due dates for performing earned value management reviews that properly consider the risks and circumstances of each contractor location.

Management Comments. The DCMA Director concurred. The Director states that the agencies will continue to work cooperatively to reach agreement or develop alternate processes.

DoD IG Response. Although management concurred, their proposed corrective actions are only partially responsive. We request that the DCMA Director provide a response to the final report describing the quality assurance procedures the DCMA

Earned Value Management Center plans to implement that will ensure reasonable due dates are established with DCAA for performing earned value management system reviews. Also provide the completion dates for actions taken or planned.

- b. Require that earned value management specialists hold and document discussions with the Defense Contract Audit Agency to help resolve auditor-reported earned value management system deficiencies.**

Management Comments. The DCMA Director concurred. The Director stated that the agencies will continue to work cooperatively to develop a satisfactory process.

DoD IG Response. Although management concurred, their proposed corrective actions are only partially responsive. We request that the DCMA Director provide a response to the final report describing the quality assurance procedures the DCMA Earned Value Management Center plans to implement that will require earned value management specialists to hold and document discussions with DCAA to resolve system deficiencies reported by the auditor. Also provide the completion dates for actions taken or planned.

- 3. We recommend that the Commander, Tucson Contract Management Office, Defense Contract Management Agency, implement quality assurance procedures to help ensure that deficiencies reported by the Defense Contract Audit Agency are adequately resolved and dispositioned in accordance with Enclosure 3, paragraphs 2 and 3 of DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports," August 22, 2008.**

Management Comments. The DCMA Director concurred. The Director states procedures are already in place.

DoD IG Response. Although management concurred, their proposed corrective actions are only partially responsive. We request that the DCMA Director provide a response to the final report describing the quality assurance procedures the Commander, Tucson Contract Management Office, took or plans to take for ensuring that deficiencies reported by DCAA are adequately resolved and dispositioned in accordance with DoD Instruction 7640.02. Also provide the completion dates for actions taken or planned.

B. Other Issues to be Reported

Issue One: Compliance Review for Cause (RFC) Reports. The Earned Value Management Center failed to issue a written report of its findings on either the April or August 2008 reviews, which is not in compliance with DoD Earned Value Management Implementation Guide, October 2006. The DoD Earned Value Management Implementation Guide, section 2.3.5.4, *RFC Results*, states “A formal report is prepared by the Review Director within 30 working days after completion of the review.” A written report of DCMA findings is essential to provide a record of the deficiencies found and corrective actions recommended.

Issue Two: Validation of the Contractor’s Earned Value Management System. The contractor’s system, based in Tucson, Arizona, has been validated and accepted since 1999. DCMA did not suspend or withdraw the validation of the contractor’s system even though a February 2007 DCMA report documented contractor noncompliances with 20 of the 32 earned value management guidelines. A prior 2003 Naval Audit Service review had also disclosed several noncompliances. The DoD Earned Value Management Implementation Guide, section 2.3.7.2, *Withdrawal of Validation*, states:

“If the contractor fails to demonstrate correction of all system deficiencies, the PCO (procurement contracting officer) and/or ACO (administrative contracting officer) in coordination with the DCMA EVM (Earned Value Management) Center formally withdraws the validation of the contractor’s EVM System....The contractor may not claim to have an accepted EVM system in any new proposal until re-validation of the EV system has been achieved. To obtain re-validation, the contractor is required to demonstrate full compliance with all 32 guidelines in a Validation Review.” (clarification added)

According to the February 2007 report, the contractor had made “very little progress” toward correcting the noncompliances reported since 2003 (a 4-year period). At a minimum, DCMA should have immediately suspended validation of the contractor’s system based on the contractor’s lack of progress in correcting the deficiencies. The failure of DCMA to suspend the validation of the contractor’s system subjected the Government to unnecessary risk. To further protect the Government’s interests, DCMA should have also documented its consideration of contractual actions and remedies in accordance with section 2.3.6.2 of the DoD Earned Value Management Implementation Guide which states, “The appropriate use of contractual actions and remedies is required to protect the Government’s interest if noncompliance occurs.” The uniform and consistent application of actions and remedies for earned value management system noncompliances is essential for promoting contractor-initiated corrective action and protecting the Government’s interests.

Recommendations, Management Comments and Our Response

Recommendation B.

1. We recommend that the Director, Defense Contract Management Agency Earned Value Management Center implement through policy or procedural guidance the requirement to issue written reports on the results of all earned value management system reviews, as section 2.3.5.4 of the DoD Earned Value Management Implementation Guide (October 2006) requires.

Management Comments. The DCMA Director concurred. The Director states that organizational changes are being implemented to ensure quality assurance and configuration management of the reporting process. DCMA expects to complete the changes in the fourth quarter FY 2010.

DoD IG Response. The management comments are only partially responsive. We request that the DCMA Director provide a response to the final report describing the action the DCMA Earned Value Management Center plans to take.

2. We recommend that the Commander, Tucson Contract Management Office, Defense Contract Management Agency, establish quality assurance procedures to ensure that contracting officers take action to:

- a. Suspend or withdraw the validation and acceptance of contractor earned value management systems with significant deficiencies in accordance with section 2.3.7 of the DoD Earned Value Management Implementation Guide; and**

Management Comments. The DCMA Director concurred. DCMA states a process is already in place.

DoD IG Response. The management comments are only partially responsive. We request that the DCMA Director provide a response to the final report describing the quality assurance procedures the Commander, Tucson Contract Management Office, took or plans to take for ensuring that contracting officers suspend or withdraw the validation and acceptance of a contractor's earned value management system when a contractor fails to correct reported system deficiencies. Also provide the completion dates for actions taken or planned.

-
- b. Implement contractual actions and remedies to protect the Government interests associated with significant earned value management system deficiencies in accordance with section 2.3.6.2 of the DoD Earned Value Management Implementation Guide.**

Management Comments. The DCMA Director concurred and in conjunction with OSD and DCAA, DCMA is taking steps to implement this recommendation.

DoD IG Response. The management comments are only partially responsive. We request that the DCMA Director provide a response to the final report describing the quality assurance procedures the Commander, Tucson Contract Management Office, took or plans to take for ensuring that contracting officers implement contractual actions and remedies when significant earned value management system deficiencies are not corrected by a contractor. Also provide the completion dates for actions taken or planned.

Appendix A. Scope and Methodology

We evaluated the validity of alleged unsatisfactory conditions involving the DCMA Earned Value Management Center. Specifically, we:

- reviewed Earned Value Management Center, DCMA Tucson Contract Management Office, and DCAA Tucson office documents and records;
- interviewed employees of the DCAA Tucson office involved with Audit Report No. 3561-2008N17750001, May 15, 2008, and reviewed the associated working papers;
- interviewed Earned Value Management Center employees involved in the April and August 2008 reviews of a contractor's earned value management system; and
- determined if the actions taken by the Center were compliant with applicable standards, public law, and DoD regulations, directives, and instructions.

We performed this review from April 2009 through December 2009.

Use of Computer-Processed Data. We did not rely on any computer-processed data as part of our review.

Prior Coverage. In the last 5 years, we issued six other reports related to Defense Contract Management Agency actions on Defense Contract Audit Agency audit reports.

- DoD IG Report No. D-2009-6-008, "Report on Hotline Complaint Regarding the Actions by a Contracting Officer at the Defense Contract Management Agency, East Harford Office," August 31, 2009
- DoD IG Report No. D-2009-6-004, "Defense Contract Management Agency Actions on Audits of Cost Accounting Standards and Internal Control Systems at DoD Contractors Involved in Iraq Reconstruction Activities," April 8, 2009
- DoD IG Report No. D-2007-6-010, "Reimbursement of Settlement Costs at Defense Contract Management Agency Melbourne," September 28, 2007
- DoD IG Report No. D-2007-6-009, "Actions on Reportable Contract Audit Reports by the Defense Contract Management Agency's Northrop Grumman El Segundo Office," September 28, 2007
- DoD IG Report No. D-2007-6-004, "Defense Contract Management Agency Virginia's Actions on Incurred Cost Audit Reports," April 20, 2007
- DoD IG Report No. D-2005-6-003, "Defense Contract Management Agency Santa Ana Office's Actions on Incurred Cost Audits," March 17, 2005

Defense Contract Management Agency Comments



DEFENSE CONTRACT MANAGEMENT AGENCY
6350 WALKER LANE, SUITE 300
ALEXANDRIA, VIRGINIA 22310-3226

10 March 2010

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR POLICY AND
OVERSIGHT ATTN: MR. CHARLES W. BEARDALL

SUBJECT: Draft Report - Allegation of Unsatisfactory Conditions Regarding Actions by
the DCMA Earned Value Management Center dated January 25, 2010

Reference: Project No. D2009-DIP0AI-0022.001

Please find attached the Defense Contract Management Agency (DCMA)
response to the DoD IG draft report, D2009-DIP0AI-0022.001, "Review of Alleged
Unsatisfactory Conditions Regarding Actions by the DCMA EVM Center," dated January
25, 2010.

A summary of our response to the report's recommendations and findings can
be found at attachment 1. We have given great consideration to our non-concurrence in
part with recommendation A1 regarding the independence of our reviews. We take the
independence of our decisions very seriously and work very hard to ensure that the
independence of decision making is not compromised by the need to have open
engagement with key stakeholders in this process. As a result, DCMA has successfully
demonstrated that having open channels of communication with contractors increases
transparency of issues and leads to more lasting solutions.

DCMA is working to strengthen our partnership with DCAA not only in
Earned Value Management System (EVMS) surveillance reviews but in all business
systems audits. I have established quarterly update meetings with the DCAA Director and
will work to establish processes that ensure both Agencies are able to work together to
produce the best outcomes for the Department. We have offered to also assist DCAA in
obtaining the information it requires from industry to support its audits in an attempt to
help DCAA improve the timeliness of audits.

We appreciate the opportunity to comment on the draft report. My point of
contact is David Kester at 804-416-9074 or David.Kester@dema.mil.


Charlie E. Williams, Jr.
Director

Enclosure One:
Summary Response

DCMA Response to the DoD IG Draft Report, D2009-DIP0AI-0022.001, "Allegation of Unsatisfactory Conditions Regarding Actions by the Defense Contract Management Agency, Earned Value Management Center," dated January 25, 2010

RECOMMENDATION A:

1. We recommend that the Director, Defense Contract Management Agency, revise Defense Contract Management Agency Instruction, "Earned Value Management System (EVMS) System-Level Surveillance," January 2008, to:

- a. Prohibit joint surveillance reviews or other joint activities with a contractor that could compromise the independence and objectivity of Defense Contract Management Agency to carry out its earned value management oversight responsibilities; and

DCMA Response: Non-concur in part; DCMA agrees with and is committed to ensuring that the decisions which result from its surveillance and compliance reviews represent an independent DCMA decision. DCMA does not agree that the only way to achieve this independence is by isolating the contractor from the review process. Joint surveillance reviews provide the opportunity for the contractor and government officials to fully understand the critical elements of the EVM system and how they work together to ensure that reports generated by this system are accurate. The make-up of the DCMA surveillance/compliance team is robust and includes multiple governmental stakeholders. The contractor's internal oversight organizations are invited and encouraged to participate in DCMA's surveillance activities. The contractor members who participate are not representatives of the programs under review but are usually officials from the contractor's policy/compliance staff. Involving these officials early in the process enhances their understanding of the problems identified by the DCMA team and the required corrective actions. Conversely, it provides the DCMA team access to individuals with knowledge about the system and how it is used which is very beneficial. We do not believe this process compromises the independence of our decisions. In fact, the proof is evident by simply reviewing DCMA's current industry EVMS ratings. By and large our ratings reflect serious issues with respect to the state of EVMS in industry and DCMA has consistently articulated these concerns. We believe establishing and maintaining a cooperative Government-contractor relationship is an efficient and effective way of reaching the Government's EVMS goals. One method to maintain this efficiency is to focus surveillance and assessment efforts on those programs with the greatest payback. Another is to ensure rapid availability of data and key personnel during reviews and assessments. Through targeted program selection, eliminating contractor participants involved with those programs and advance notice of review areas, we maintain our independence while at the same time providing flexible, time-sensitive EVMS reviews.

- b. Request Defense Contract Audit Agency participation in conducting surveillance reviews of contractor earned value management systems.

DCMA Response: Concur. DCMA concurs and routinely requests DCAA participation in surveillance reviews. We are already working aggressively to synchronize surveillance review schedules.

DCMA Response to the DoD IG Draft Report, D2009-DIP0AI-0022.001, "Allegation of Unsatisfactory Conditions Regarding Actions by the Defense Contract Management Agency, Earned Value Management Center," dated January 25, 2010

2. We recommend that the Director, Defense Contract Management Agency Earned Value Management Center, implement quality assurance procedures to:

- a. In conjunction with the Defense Contract Audit Agency, establish reasonable due dates for performing earned value management reviews that properly consider the risks and circumstances of each contractor location;

DCMA Response: Concur. The agencies will continue to work cooperatively to reach agreement or develop alternate processes.

- b. Require that earned value management specialists hold and document discussions with the Defense Contract Audit Agency to help resolve auditor-reported earned value management system deficiencies."

DCMA Response: Concur. DCMA concurs and the agencies will continue to work cooperatively to develop satisfactory process.

3. We recommend that the Commander, Tucson Contract Management Office, Defense Contract Management Agency, implement quality assurance procedures to help ensure that deficiencies reported by the Defense Contract Audit Agency are adequately resolved and dispositioned in accordance with Enclosure 3, paragraphs 2 and 3 of DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports," August 22, 2008."

DCMA Response: Concur. Procedures are already in place, but EVMS validation suspension or withdrawal is not appropriate in this particular instance. Deficiencies noted are either resolved or not as widespread or costly as to be considered systemic.

RECOMMENDATION B:

1. We recommend that the Director, Defense Contract Management Agency Earned Value Management Center implement, through policy or procedural guidance, the requirement to issue written reports on the results of all earned value management system reviews, as section 2.3.5.4 of the DoD Earned Value Management Implementation Guide (October 2006) requires.

DCMA Response: Concur. DCMA concurs and does issue written reports, and organizational changes are being implemented to ensure quality assurance and configuration management of the reporting process.

DCMA Response to the DoD IG Draft Report, D2009-DIP0AI-0022.001, "Allegation of Unsatisfactory Conditions Regarding Actions by the Defense Contract Management Agency, Earned Value Management Center," dated January 25, 2010

2. We recommend that the Commander, Tucson Contract Management Office, Defense Contract Management Agency, establish quality assurance procedures to ensure that contracting officers take action to:

- a. Suspend or withdraw the validation and acceptance of contractor earned value management systems with significant deficiencies in accordance with section 2.3.7 of the DoD Earned Value Management Implementation Guide; and

DCMA Response: Concur. DCMA concurs and notes that a process is already in place. However, EVMS suspension/withdrawal is not warranted in this particular instance.

- b. Implement contractual actions and remedies to protect the Government interests associated with significant earned value management system deficiencies in accordance with section 2.3.6.2 of the DoD Earned Value Management Implementation Guide."

DCMA Response: Concur. DCMA concurs and in conjunction with OSD and DCAA, is taking steps to implement this recommendation.

FINDING: (Starting at top of Page 4) – A. Allegation of Unsatisfactory Conditions

Insufficient Time for DCAA to Perform an Audit.

DCMA Response: Non-concur. DCMA acknowledges that DCAA's goal is to provide thorough and complete audits and that this often takes time. Notwithstanding, DCMA's EVMS reviews lose their effectiveness and impact if our results are presented to the contractor long after the review has been completed. In this case DCAA had been involved in the review process since December 2006 and participated on the EVMS reviews until new DCAA policy was established in August 2008 to not participate in IPTs. Prior to this, the DCAA had worked closely with the DCMA since December 2007 on contractor EVMS Corrective Action Plan (CAP) status and provided evidential data to demonstrate CAP progress. The May 2008 DCAA report indicated DCAA's intent to follow up on its EVMS findings in ninety (90) days which coincided with the scheduled DCMA August 2008 EVMS Review for Cause (RFC). Although the DCAA declined to participate on DCMA's follow-up review one week prior to the scheduled August review date, the DCAA continued to participate on joint oversight surveillance activities with DCMA. In addition, the sampling of contractor EVMS data (provided at weekly CAP meetings) facilitated DCAA's participation in the RFC as verification activities continued. DCAA declined to participate in the follow-up review, in part, because "the scope of the review had been restricted to the specific programs where the deficiencies were

DCMA Response to the DoD IG Draft Report, D2009-DIP0AI-0022.001, "Allegation of Unsatisfactory Conditions Regarding Actions by the Defense Contract Management Agency, Earned Value Management Center," dated January 25, 2010

initially found." It should be noted that the purpose of a follow-up review is to explore improvements enacted since initial findings, and to confirm they have been remedied. It is not to look at other programs as part of a "de novo" review.

Failure to Adequately Resolve the DCAA Findings.

DCMA Response: Non-concur. All DCAA findings are carefully evaluated and considered by the DCMA. In the present case, DCMA's conclusions were, in part based on the March 2008 DCAA audit, the contractor's subsequent actions and the DCMA follow up review in August 2008, which was conducted in the absence of a DCAA follow up audit. While the DCMA EVM Center agreed that the DCAA findings of noncompliance were valid, the DCMA EVM Center did not consider the issues systemic and the DCMA Contract Management Office (CMO) worked with the DCAA to correct the issues as part of the contractor's CAP. Of the three unrelated EVMS deficiencies cited by DCAA in the May 2008 Audit report, each deficiency was found on only one of fourteen EVM applicable RMS programs. Deficiency reports resulting from DCMA EVMS reviews were not the same type that were noted by the DCAA and were considered as either immaterial or non-systemic. The May 2008 DCAA audit report indicated the RMS Accounting System and Overall Control Environment, Material Management and Accounting (MMAS), Budget and Planning System, Labor System, and Indirect Cost/Other Direct Cost Systems (IDC/ODC) were considered to be adequate. Because the DCAA findings were not systemic, they could have been followed-up and verified through joint surveillance. The CMO August 2008 surveillance report indicated that issues related to the DCAA May report were corrected and a DCAA October 2008 memorandum recognized the contractor had completed all CAP actions. While DCAA did provide the final subsequent audit report, it was nineteen (19) months after the May 2008 audit report was released. The effectiveness of DCMA's EVMS compliance determination efforts requires more time-sensitive responses. As executive agent for the Government, DCMA's charter is somewhat different from that of DCAA's, and DCMA's summary findings may not always be consistent with those of DCAA. However, DCMA is committed to increase cooperation with DCAA in resolving review findings and, in particular, DCMA is committed to providing better documentation of any determinations it makes that are inconsistent with DCAA recommendations.

Compromise of Independence/Objectivity in Appearance.

DCMA Response: Non-concur. The DCMA has established and maintains a cooperative Government-contractor relationship as an efficient and more effective way of reaching the Government's EV goals. We do not believe the process used compromises the independence of our decisions. The proof is evident by simply reviewing the current state of industry as assessed by DCMA. If our

DCMA Response to the DoD IG Draft Report, D2009-DIP0AI-0022.001, “Allegation of Unsatisfactory Conditions Regarding Actions by the Defense Contract Management Agency, Earned Value Management Center,” dated January 25, 2010

independence was compromised DCMA’s assessment of industry EVMS wouldn’t show the degree or number of troubled contractors that DCMA is reporting. All contracts with EVMS requirements at a given contractor location are reviewed on a continual basis through ongoing surveillance. An EVMS RFC is a focused review of specific elements of the contractor’s EVMS in order to solve a major system application problem and reaffirm system acceptability. In order to avoid program disruption, the selection of programs, the scope and conduct of the RFC is limited to only the system processes that are affected. Prior notification provided the contractor in advance of what programs are selected for review is necessary to ensure that the programs selected are able to support a comprehensive review during the time period involved, key managers are available for interviews, and that the data requested is provided to the review team in advance of the review.

FINDING: (Starting at top of Page 10) – B. Other Issues to Be Reported

Issue One: Compliance Review for Cause (RFC) Reports – Center Failed to Issue Written Report.

DCMA Response: Concur. DCMA does issue written reports, and organizational changes are being implemented to ensure quality assurance and configuration management of the reporting process. Est: 4Q FY2010.

Issue Two: Validation of the Contractor’s EVMS –DCMA Failure to Suspend/Withdraw EV System Validation.

DCMA Response: Concur. A revision to the compliance determination process is being considered to strengthen contractor accountability for noncompliance to include imposing contractual remedies in line with the proposed DFARS rule should it be implemented. Because all RMS EVMS deficiencies have been corrected withdrawal is not warranted in this particular instance.



Inspector General Department *of* Defense

