

DEFENSE CONTRACT AUDIT AGENCY

Agency Financial Report 2008



A COMMITMENT TO EXCELLENCE

DCAA Vision

In support of the National Interest, we are dedicated to providing timely and responsive audits, reports, and financial advisory services to Department of Defense contracting officers and other customers.

*Our aim is to be **THE** audit organization with the foremost reputation for competence, integrity, and customer satisfaction by:*

- Creating an environment of teamwork, open communication, trust, and mutual respect, and*
- Developing highly qualified employees dedicated to the concept of continuous improvement.*

Message from the Director



I am pleased to present the Defense Contract Audit Agency's (DCAA) Management's Discussion and Analysis for fiscal year (FY) 2008. The report summarizes the Agency's mission, organization, programmatic achievements, financial status, and business priorities for FY 2008. The DCAA's job is to provide advice to the contracting community in their determination of fair and reasonable prices for goods and services. We accomplish this in an effective and efficient manner through continuous process improvement.

As of September 2008, DCAA employed an all civilian workforce comprised of 4,179 professional contract auditors and administrative support personnel. Approximately 33 percent of DCAA's audit workforce is Certified Public Accountants; 99 percent have bachelor's degrees; and 26 percent have advanced degrees.

The DCAA is also committed to organizational excellence and sound financial management. I am pleased to report that for FY 2008, DCAA received an unqualified "clean" audit opinion on its financial statements for the eighth consecutive year. This audit result indicates that the DCAA's financial statements are a reliable reflection of the Agency's financial position.

As required by Section 1116(e) of Title 31 of the U.S.C., the financial and performance information contained in this report is complete and reliable, and DCAA is in substantial compliance with the requirements of the Federal Managers' Financial Integrity Act (FMFIA) and Federal Financial Management Improvement Act (FFMIA).


April G. Stephenson
Director

Defense Contract Audit Agency Management's Discussion and Analysis

OVERVIEW OF DCAA

Mission

More than 40 years of professional audit experience with complex, high dollar government contracts has made the Defense Contract Audit Agency (DCAA) *the* audit organization with the foremost reputation for competence, integrity, and customer satisfaction.

The DCAA is a worldwide, single mission Agency dedicated to providing timely and responsive audits, reports, and financial advisory services to the Department of Defense (DoD) contracting officers and other customers. The DCAA's primary customers are contracting officers in the Army, Navy, Air Force, and Defense Contract Management Agency (DCMA). However, the Agency also performs, on a reimbursable basis, contract audit services for the majority of other Federal agencies.

The majority of the DCAA's workload is driven by statutory and regulatory requirements designed to ensure that the government meets its fiduciary responsibilities to the public when awarding and administering contracts. In this capacity, DCAA supports the oversight and internal control responsibilities of the Office of the Secretary of Defense, the DoD Inspector General (IG), the Government Accountability Office (GAO), and the Congress.

Organization and Structure

The DCAA was established in 1965 by then Secretary of Defense Robert S. McNamara, who determined that Department of Defense contract audit functions would be more effective and efficient if performed by a single organization. The Agency operates under the direction, authority, and control of the Under Secretary of Defense (Comptroller). A member of the Senior Executive Service, the Director of DCAA, is appointed by the Secretary of Defense.

The Agency is organized into seven major components: a Headquarters and six regions. The Headquarters is located at the Andrew T. McNamara Headquarters Complex, Ft. Belvoir, VA. Principal elements of Headquarters are the Director, Deputy Director, Executive Officer, Special Assistant for Quality, General Counsel, and the Assistant Directors for Operations, Policy and Plans, and Resources.

Regional offices are located in Smyrna, GA; Lowell, MA; Irving, TX; La Mirada, CA; Philadelphia, PA; and Northern Virginia. The regions direct and administer the accomplishment of the DCAA audit mission for assigned geographical areas; manage personnel and resources assigned to the regions; and direct the operation of Field Audit Offices (FAOs) within their region. Principal elements of regional offices are the Regional Director, Deputy Regional Director, Special Assistant to the Regional Director for Quality, Regional Audit Managers, Regional Special Programs Manager, and Regional Resources Manager. During fiscal year (FY)

2008, the six regional offices provided oversight and management for more than 340 FAOs and suboffices located throughout the United States and overseas.

An FAO is identified as either a branch office or a resident office. A resident office is established at a contractor's location when the amount of audit workload justifies the assignment of a permanent audit and support staff. A branch office is established at a strategically situated location within the region, and is responsible for performing all contract audit services within the assigned geographical area, exclusive of contract audit services performed by a resident or liaison office within the area. Regional Directors establish suboffices as extensions of FAOs when required to furnish contract audit service more economically. A suboffice is dependent on its parent FAO for release of audit reports and other administrative support.

The Agency has established liaison offices at DoD and some non-DoD procurement or contract administration offices to provide effective communication and coordination among procurement, contract administration, and DCAA contract audit elements. In addition, financial advisors are stationed at selected procurement offices to improve the quality of audit information for decision-makers by providing confidence about the reliability and relevance of financial information.

The DCAA assists acquisition personnel by evaluating contractor submitted forward pricing proposals; providing contracting officers with accounting and financial advisory services useful to "should cost" assessments and negotiations; verifying the propriety and acceptability of costs charged by contractors to flexibly priced government contracts; and deterring contractors' inefficient practices which, if not detected and corrected, could lead to excessive costs and contract prices.

The Defense Contract Audit Institute (DCAI) in Memphis, TN provides specialized contract audit training for the DCAA's audit staff. In addition, DCAI's trained instructors provide contract audit training segments in courses and seminars offered by other DoD and non-DoD agencies.

As of September 2008, DCAA employed an all civilian workforce comprised of 4,179 professional contract auditors and administrative support personnel. Approximately 33 percent of the DCAA's audit workforce is Certified Public Accountants (CPAs); 99 percent have bachelor's degrees and 26 percent have advanced degrees.

THE DEFENSE CONTRACT AUDIT AGENCY STRATEGIC PLAN

During 2008, DCAA added a number of Objectives to its Strategic Plan (first prepared in 1990), to reflect continued support for the goals set out in the DoD Quadrennial Review (QDR) which implements the Government Performance and Results Act (GPRA); as well as metrics associated with the President's Management Agenda and the DoD's implementation of these initiatives and programs. The DCAA's Strategic Plan defines the mission, goals, objectives, strategies, and performance measures for DCAA. The goals provide a framework for supporting the aforementioned DoD initiatives and each strategic plan objective includes metrics to measure

performance against the plan. The plan, which is available to the public at DCAA's web site, (<http://www.dcaa.mil>), is reviewed and updated continuously by DCAA's Executive Steering Committee.

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

The measures selected for inclusion in the DCAA Performance Plan highlight the most important actions for successful accomplishment of the DCAA mission and to support the President's and DoD's initiatives. Each measure in the Performance Plan can be linked to the President's Management Agenda (PMA) and the DoD Balanced Scorecard/Risk Management Framework. The measures are grouped based on the PMA's five general initiatives: Human Capital; Competitive Sourcing; Financial Management; E-Government; and Performance Improvement.

The DCAA Performance Plan sets performance goals for its two major product lines – forward pricing and incurred cost audits. Together, these audit categories account for approximately 75 percent of DCAA's direct audit workload. Forward pricing audits generally are performed on sole-source, fixed price contracts valued at more than \$650,000 and on flexibly priced contracts valued at more than \$10 million. Forward pricing audit efforts include, but are not limited to, price proposal audits, forward pricing rate reviews, contractor estimating system surveys, and "should cost" studies. Incurred cost audits are performed on cost claims submitted by contractors for reimbursement under flexibly priced contracts. Contractor claims are reviewed to determine if costs are acceptable and are in accordance with regulations and the terms of the Performance Plan. Selected Performance Plan goals versus actuals for FY 2008 were as follows:

	FY 2008 Goal	FY 2008 Actual
Forward Pricing:		
Forward pricing audits accomplished within 60 days	99%	99%
<i>Incurred Cost:</i>		
Complete audits within 12 months of receipt at major contractors and corporate offices	99%	97%
Complete audits within 24 months of receipt for all other submissions	99%	99%

These goals were established to meet contracting officer needs for awarding and closing out contracting actions.

The Performance Plan also includes Agency-wide goals:

1. Achieve an Agency-wide average cost per direct audit hour of \$113.45.

The cost per direct hour reports were developed to serve as a reporting tool used in measuring how well DCAA controlled costs. It is also used as a tool to assist in measuring the DCAA's cost competitiveness. The DCAA's cost per direct audit hour for FY 2008 was \$111.95, which is \$1.50 per hour less than the FY 2008 objective. The favorable variance is due

to a combination of factors. First, payroll costs increased less than the general pay raise due to hiring auditors at the entry level. Second, nonpayroll costs were lower than the FY 2007 costs which were the basis for setting the FY 2008 goal. Finally, an increase in direct audit hours allowed the nonpayroll costs to be spread over a larger base, thereby decreasing the cost per hour. The DCAA's benchmarking cost per direct audit hour for FY 2007 was \$118.37. The rate calculation reflects the DCAA's FY 2008 Operations and Maintenance (O&M) and Procurement funds plus \$25.8 million of imputed costs for post retirement benefits (i.e., pension, health insurance, and life insurance) using Office of Personnel Management's prescribed rates. GSA's FY 2008 Scheduled rates reflected a comparable labor rate for national accounting firms of \$162.94, which results in a DCAA rate that is approximately 27 percent lower than the composite national firm rate.

2. Obtain at least 95 percent of contractor submissions electronically.

Since the inception of this metric in FY 2005, DCAA has steadily increased the level of accomplishment for this metric. The goal for FY 2008 was 95 percent and DCAA received 96 percent of contractors' submissions in an electronic format.

Savings to the government, as a result of contract audit services, far exceed the cost of DCAA operations. For example, in FY 2008, the Agency audited \$138 billion of incurred cost and 8,113 forward pricing proposals amounting to \$313 billion. Approximately \$3.3 billion in net savings were reported during the year. These savings are available to the Military Services' budgets for use on other high priority procurements. When compared to the \$470.5 million expended from the Agency's current year O&M funding, the return on taxpayers' investments in DCAA was approximately \$7.00 for each dollar invested.

ANALYSIS OF FINANCIAL STATEMENTS

For external reporting purposes, DCAA reports its financial information in four principal financial statements, including a consolidated Balance Sheet along with statements of Net Cost, Changes in Net Position, and Budgetary Resources. These statements reflect the Agency's financial position and changes in both proprietary and budgetary activities. The DCAA has prepared its financial statements as part of DCAA's and DoD's overall goal to improve financial management in the Department and to provide accurate, reliable information that is useful in assessing Agency performance and allocating resources. This is DCAA's twelfth year of preparing financial statements, and the ninth year that an independent accounting firm has audited the statements.

Leonard G. Birnbaum and Company has been retained to examine the Agency's FY 2008 financial statements. Subjecting the financial statements to an independent audit enhances the reliability of the statements and aids the Agency in promoting improved accountability and stewardship over the public resources entrusted to DCAA. The auditor's report is based on an audit conducted in accordance with generally accepted government auditing standards, (GAGAS) issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements* and its amendments.

Financial Analysis

The DCAA's total liabilities exceed total assets by approximately \$19.5 million. Total liabilities include long-term liabilities of approximately \$14.2 million for future cost of civilian retirement, health, and other employee benefits which significantly influence the long-term financial outlook.

Assets. The Agency had total assets of \$48.5 million as of September 30, 2008. Fund Balance with Treasury (FBWT) of \$43.8 million and Accounts Receivable of \$4.3 million comprised 99.2 percent of this amount. In comparison, the Agency had total assets of \$50.0 million as of September 30, 2007. Fund Balance with Treasury of \$45.7 million and Accounts Receivable of \$4.0 million comprised 99.4 percent of this amount. The decrease in FBWT of 4.1% is due to a net effect of the increase in outlays and an increase in appropriations received.

The reimbursable accounts receivable balances are continuously reviewed. The DCAA is coordinating with DFAS Columbus to ensure that aged accounts receivable are reviewed in a timely manner and appropriate action taken. The over-aged accounts have been analyzed, collections have been pursued, adjustments for erroneous billings have been made, and reversals of invalid account balances have been accomplished.

Liabilities. The DCAA's liabilities are classified as covered by budgetary resources (funded) or not covered by budgetary resources (unfunded). The Agency had total liabilities of \$68.1 million as of September 30, 2008. Accounts Payable were \$6.6 million, 9.7 percent of the total liabilities. Unfunded liabilities consist primarily of other employment benefits and leave, and remain to be funded from future DoD appropriations. Other Employment Actuarial Liabilities for workmen's compensation (FECA) were \$12.5 million, 18.3 percent of the total. Other Liabilities of \$49.0 million comprised the remaining 72.0 percent of the total. Unfunded Liabilities of \$28.2 million for annual leave, compensatory leave and credit hours earned show the net amount that employees have accrued, which will be paid from future funds as the leave is taken. The balance in the unfunded liability account was adjusted to reflect current pay rates as of September 30, 2008.

The following chart presents comparative data for total liabilities as of September 20, 2008 and September 30, 2007.

Liability Comparisons \$ in millions

	FY 2008	FY 2007	% Change
<i>Total Liabilities</i>			
Accounts Payable	\$6.6	\$6.4	3.1%
FECA Actuarial Liabilities	12.5	13.0	(3.9%)
Other Liabilities	49.0	43.9	11.6%
<i>Total</i>	\$68.1	\$63.3	7.6%
Unfunded Liabilities	\$28.2	\$26.8	5.2%

Liabilities have increased nearly \$4.8 million primarily due to the increase in Other Liabilities.

The Statement of Changes in Net Position represents those accounting transactions that caused the net position of the balance sheet to change from the beginning of the reporting period. Various financing sources increase net position, including appropriations, revenue, and imputed financing from costs absorbed by others. The DCAA's net cost of operations reduced net position.

Net Position. The Agency's Net Position was a negative \$19.5 million as of September 30, 2008. This amount consisted of Unexpended Appropriations of \$20.6 million and a Cumulative Results of Operations of a negative \$40.1 million.

The following chart presents comparative data for the net position and results of operations as of September 20, 2008 and September 30, 2007.

Change in Net Position and Cumulative Results of Operations
\$ in millions

	FY 2008	FY 2007	% Change
<i>Net Position:</i>	(19.5)	(\$13.3)	46.6%
Unexpended Appropriations	20.6	26.2	(21.4%)
Cumulative Results of Operations	(40.1)	(39.5)	1.5%
<i>Cumulative Results of Operations:</i>	(40.1)	(39.5)	1.5%
Net Cost of Operations	441.3	418.9	5.3%
Net Results of Operations	(0.6)	6.6	(109.1%)

Results of Operations. The results of operations are reported in the Consolidated Statements of Changes in Net Position. The DCAA had financing sources of \$440.7 million and Net Cost of Operations of \$441.3 million. The net results of operations were a negative \$0.6 million. The cumulative results of operations were a negative \$40.1 million. Total costs increased 5.0 percent and revenues increased 2.5 percent over prior year. The DCAA spent approximately \$13.9 million for the global war on terror.

Budgetary Results

The total current year budget authority for DCAA's operations was \$470.5 million with obligations of \$470.2 million. This represents an execution rate of 99.9 percent. Approximately 85 percent of the DCAA's operating budget is for pay and benefits; the balance of funds covers the necessary support costs – travel, office space, telecommunications, infrastructure, and supplies and equipment. Funding for DCAA operations is made available from two sources: appropriated funds provide for audits of DoD contracts while reimbursable funding is provided (on a per hour basis) for performance of contract audits for numerous non-Defense agencies.

Since 1999, DCAA's work-year levels had been fairly constant at approximately 4,000 workyears. As a result of the cumulative effect of several years of unfunded pay raises, workyears declined between FY 2004 and FY 2007. In FY 2008, Congress provided additional dollars for contract management oversight. These additional dollars increased workyear execution to 3,989 for FY 2008. Workyear levels through FY 2015 should remain at or above the 4,000 level. We are currently working with the Department to achieve an even greater workyear level as a result of the findings of the FY 2008 GAO review report. Projected audit requirements are commensurate with planned changes in DoD procurement levels, departmental acquisition streamlining initiatives, and required effort to complete audits of prior year contract expenditures. Staffing levels also reflect incorporation of previous QDR recommendations and related DoD initiatives.

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

The DCAA financial statements are prepared by Defense Financial and Accounting Service (DFAS) based on data input into the Defense Business Management System (DBMS), a legacy accounting system. The DoD legacy accounting systems were developed to track budget execution, not to capture the information necessary to create financial statements. It was not until the Chief Financial Officers (CFO) Act of 1990 that CFOs of executive departments and agencies were required to prepare (and have audits of) annual financial statements.

The Federal Financial Management Improvement Act of 1996 required, among other things, that the audit reports state whether the Agency financial management systems comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In addition, Federal agencies are required to support full disclosure of federal financial data, including the costs of federal programs and activities. The DoD and DFAS have developed long-term strategies to replace the many non-compliant accounting systems such as DBMS. However, until such time as the systems are replaced, DCAA is committed to implementing processes that support the accuracy and auditability of the DCAA's financial statements.

The DCAA system of accounting and administrative internal management controls is adequate to ensure that transactions are executed in accordance with budgetary and financial laws and other requirements, are consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards. Reasonable assurance is provided that assets are properly acquired, used, and safeguarded to deter theft, accidental loss or unauthorized disposition, and fraud.

Management Assurances

In its Annual Statement of Assurance (SOA) for FY 2008, DCAA reported a qualified statement of reasonable assurance to the Secretary of Defense, that its internal controls met the objectives of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. The material weakness was related to certain audits that did not meet professional standards [page 13]. No other material weaknesses were found in the design or operation of the internal controls.

The Agency has in place a rigorous system of internal accounting and administrative controls to ensure effective management of the Agency's resources. This system provides the reasonable assurance required to certify that the objectives of the FMFIA are achieved. The FMFIA requires federal agencies to assess the effectiveness of internal controls for program, operational, and administrative areas as well as accounting and financial management.

As an audit organization, DCAA is particularly aware of the importance of management internal controls. Specific reviews and field visits were made during the past year to evaluate adequacy and consistency in the implementation of audit and procedural guidance. Other objectives of these reviews included (1) identifying areas requiring additional policy coverage; and (2) determining the adequacy of existing coverage.

The DCAA Executive Officer oversees the Agency's management control program. Individual assurance statements from each Headquarters Principal Staff Element and Regional Director serve as the primary basis for the Agency's assurance that management controls are adequate. The statements are based on information from various sources such as the managers' own knowledge of day-to-day operations and controls, program reviews, management initiated evaluations, and audits, reviews, and investigations performed by the DoDIG and/or the GAO.

The DCAA continued to evaluate its system of internal accounting and administrative controls in effect during the fiscal year ending September 30, 2008 in accordance with the guidance in OMB Circular No. A-123, Management's Responsibility for Internal Control. The objectives of the system of internal accounting and administrative controls of DCAA are to provide reasonable assurance that:

1. The obligations and costs are in compliance with applicable laws.
2. Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
3. Revenues and expenditures applicable to Agency operations are properly recorded and accounted for to permit the preparation of reliable accounting, financial and statistical reports and to maintain accountability over the assets.

The DCAA and DFAS conducted assessments of internal control effectiveness over financial reporting according to the OMB A-123, Appendix A, Internal Control Over Financial Reporting (ICOFR), for the following:

- Fund Balance With Treasury
- Accounts Receivable
- Accounts Payable
- Financial Statement Compilation
- Federal Employees' Compensation Act Liabilities
- Other Liabilities
- Appropriations Received

Financial reporting is not limited to financial statement reporting. In addition to the financial statements, Appendix A also included within the definition of “financial reporting” other significant internal and external financial reports that could materially affect spending, budgetary or other financial decisions. Appendix A prescribed a process for assessing internal controls over financial reporting. The process included:

- Establishing a high-level governance body such as a Senior Assessment Team (SAT),
- Evaluating internal controls at the entity level by understanding management’s attitude, awareness and actions of internal control, to include:
 - Integrity and ethical standards
 - Commitment to competence
 - Management philosophy
 - Organizational structure
 - Assignment of authority and responsibility
- Evaluating internal controls at the process, transaction, or application levels and obtaining knowledge of the organization’s key processes by
 - Performing process risk assessments with regard to financial assertions of completeness, obligations and rights, valuation, existence and occurrence, reporting and presentation, compliance with laws and regulations, and safeguarding of assets from fraud, waste and abuse
 - Identifying existing key controls intended to mitigate identified risk
- Assessing and testing the design and operation of internal controls over financial reporting
- Documenting the entire assessment process from the establishment of a SAT to the identification of deficiencies and development of corrective action plans
- Issuing a SOA on ICOFR as a subset of the Annual Federal Managers’ Financial Integrity Act Statement of Assurance.

The SAT, established in December 2005, provided oversight, accountability and an assessment as to whether there is reasonable assurance that the DCAA’s internal controls are in place, operating effectively, and being used for financial reporting. The SAT, composed of senior leadership-level representatives to indicate the DCAA’s top down commitment, is maintaining complete records of the assessment documentation to explain significant decisions made in identifying material business processes, results of the assessments, internal control test plans, and in determining if material weaknesses exist which are to be reported outside of DCAA.

The DCAA Director reemphasized in the annual Control Environment memorandum that compliance and the evaluation of management controls extends to each executive, manager, supervisor, auditor and administrative employee in the Agency. In addition, every responsibility and activity undertaken by DCAA is subject to financial, administrative and operational controls. The developed process narratives and flowcharts for each area previously identified. Risk assessments were performed and found to be either low or moderate. Separate tests were conducted to assess the effectiveness of internal controls and no material weaknesses were found in the design or operation of the internal controls. The DCAA reported an unqualified statement of assurance on ICOFR in its annual FMFIA SOA.

The concept of reasonable assurance recognizes that (1) the cost of management controls should not exceed the benefits expected to be derived and (2) the benefits consist of reductions in the risks of failing to achieve the stated objectives. The expected benefits and related costs of control procedures should be addressed using estimates and managerial judgment. Moreover, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, congressional restrictions, and other factors.

In addition, DCAA has implemented internal controls that provide reasonable assurance that performance data and metrics are reliable and relevant. Procedures are in place that control access to the DCAA's Management Information System (DMIS). Access to DMIS is now through the Common Access Card (CAC). The DMIS login works hand-in-hand with the CAC network login. DMIS checks the user's network profile setting to determine how the user will login to DMIS. These login procedures control the level of access to the information system. Point-of-data entry edit checks, numerous data accuracy queries run throughout the year, and specific quarterly reviews performed by Headquarters, the Regions and FAOs assure performance data and metrics are not significantly misstated for the period.

In addition to the built-in data entry edit checks to prevent certain data input errors, other rigorous data accuracy queries are run after the data is entered to ensure performance data and metrics are accurate and reliable. These queries focus on data relationships to highlight significant amounts that, if erroneous, could materially affect reported statistics for the period. The Agency maintains consistent and constant oversight of DMIS from data entry through transaction processing and reporting. The annual review of the Federal Information Security Management Act found DCAA within the compliance standards for all reportable areas.

UNCORRECTED MATERIAL WEAKNESS

Certain DCAA Audits Did Not Meet Professional Standards. On July 22, 2008, the GAO issued its report entitled DCAA AUDITS: Allegation that Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated (GAO-08-857). GAO concluded that certain audits in the Western Region did not comply with GAGAS and therefore did not meet professional standards. The report determined that at two locations (1) working papers did not support reported opinions; (2) supervisors dropped findings and changed audit opinions without adequate evidence for their changes; (3) sufficient work was not performed to support audit conclusions; and (4) during the course of the GAO investigation, managers took actions against staff, attempting to intimidate auditors, preventing them from speaking with investigators and creating a generally abusive environment. At a third location the workpapers were not reviewed prior to report issuance. The DCAA established a comprehensive action plan to address all the findings and has initiated corrective actions.

LIMITATIONS OF THE FINANCIAL STATEMENTS

The DCAA's financial statements are prepared by DFAS in conjunction with DCAA. The principal financial statements have been prepared to report the financial position and results of operations of DCAA, pursuant to the requirements of 31 U.S.C. 3515 (b). The statements have been prepared from the books and records of DCAA in accordance with OMB A-136 and, to the extent possible, generally accepted accounting principles for Federal entities. The statements are in addition to financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so.

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INDEPENDENT AUDITOR'S REPORT

To the Director, Defense Contract Audit Agency:

We have audited the Defense Contract Audit Agency's (DCAA) Consolidated Balance Sheets, Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, and Combined Statements of Budgetary Resources (Annual Financial Statements) as of, and for the years ended, September 30, 2008 and 2007; we have considered internal control over financial reporting in place as of September 30, 2008; and we have tested compliance with selected laws and regulations.

In our opinion, DCAA's 2008 and 2007 Annual Financial Statements are presented fairly in all material respects.

We found no material conflicts with DCAA's 2008 report on management controls prepared as required by the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

Each of these conclusions is discussed in more detail below. This report also discusses the scope of our work.

ANNUAL FINANCIAL STATEMENTS

In our opinion, DCAA's Annual Financial Statements, including the notes thereto, present fairly, in all material respects, the agency's financial position as of September 30, 2008 and 2007, and its net cost of operations, changes in net position, and use of budgetary resources, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

INTERNAL CONTROL

In planning and performing our audits of DCAA's financial statements as of, and for the years ended, September 30, 2008 and 2007, in accordance with auditing standards generally accepted in the United States of America, we considered internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the annual

financial statements but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, we do not express such an opinion. We limited our consideration of internal control to those controls necessary to achieve the objectives described in Office of Management and Budget Bulletin 07-04, *Audit Requirements for Federal Financial Statements*. We did not consider all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to ensuring efficient operations. Since DCAA's financial recording and reporting, including the compilation of its financial statements, are performed by the Defense Finance and Accounting Service (DFAS), our consideration of internal control included those aspects of DFAS' internal controls which were relevant to DCAA

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the following objectives are met:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over assets;
- funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition;
- transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that the OMB, Department of Defense (DoD) management, its Office of Inspector General (OIG), or DCAA management have identified as being significant and for which compliance can be objectively measured and evaluated; and

Our consideration of internal control over financial reporting would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. Under standards issued by the American Institute of Certified Public Accountants, a significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in a more than remote likelihood that a material misstatement of the financial statements will not be prevented or detected. Our tests of internal control did not disclose any material weaknesses.

The DoD OIG has identified several design deficiencies in the processing of financial data, including the compilation of financial statements, by DFAS for other DoD entities. While some of these deficiencies are present in DFAS' processing of DCAA's financial data, appropriate

procedures and processes have been implemented by DFAS and/or DCAA to mitigate the effect of these deficiencies.

We noted certain other issues related to internal control that we have communicated to DCAA's management in a separate letter dated November 6, 2008.

COMPLIANCE WITH LAWS AND REGULATIONS

DCAA's management is responsible for complying with laws and regulations applicable to its operations. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of DCAA's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin 07-04. Since DCAA's financial recording and reporting, including the issuance of financial statements, are performed by DFAS, we considered DFAS' compliance with laws and regulations relevant to work performed by DFAS' on behalf of DCAA. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to DCAA. The objective of our audit of the Annual Financial Statements, including our tests of compliance with selected provisions of applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions in statutes or regulations, that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements or that sensitivity warrants disclosure thereof.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph disclosed no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* or OMB Bulletin 07-04.

RESPONSIBILITIES AND METHODOLOGY

DCAA management has the responsibility for:

- preparing the annual financial statements in conformity with accounting principles generally accepted in the United States of America;
- establishing and maintaining effective internal control; and
- complying with applicable laws and regulations.

Our responsibility is to express an opinion on the annual financial statements based on our audits. Auditing standards generally accepted in the United States of America require that we plan and perform the audit to obtain reasonable assurance about whether the annual financial statements are free of material misrepresentation and presented fairly in accordance with accounting principles generally accepted in the United States of America. We are responsible for

obtaining reasonable assurance about whether DCAA's management maintained effective internal control. We are also responsible for testing compliance with selected provisions of applicable laws and regulations that may materially affect the financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the annual financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the Principal Financial Statements;
- obtained an understanding of the design effectiveness of internal control over financial reporting, determined whether the controls had been placed in operation, assessed control risk, and performed tests of controls;
- tested, or obtained evidence of, compliance with selected provisions of laws and regulations that may materially affect the annual financial statements;
- obtained written representations from DCAA's management, and
- performed other procedures as we considered necessary in the circumstances.

Our audits were conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin 07-04. We believe that our audits provide a reasonable basis for our opinion.

The Management Discussion and Analysis and Required Supplementary Information are not a required part of the Principal Financial Statements, but are supplementary information required by OMB Circular A-136, *Financial Reporting Requirements*, Volume 6B of the Department of Defense Financial Management Regulation and the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

This report is intended for the information of DCAA management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.



Leonard G. Birnbaum and Company, LLP

Alexandria, Virginia
November 6, 2008

**DEFENSE CONTRACT
AUDIT AGENCY**



**PRINCIPAL
FINANCIAL STATEMENTS**

Department of Defense
Defense Contract Audit Agency
CONSOLIDATED BALANCE SHEET
(Amounts in Thousands)
As of September 30,

	<u>2008</u>	<u>2007</u>
Assets (Note 2):		
Intragovernmental:		
Fund balance with Treasury (Note 3)	\$ 43,786	\$ 45,652
Accounts receivable (Note 5)	4,082	3,834
Total intragovernmental assets	<u>47,868</u>	<u>49,486</u>
Accounts receivable, net (Note 5)	194	202
General property, plant and equipment, net (Note 6)	93	-
Other assets (Note 2)	374	262
Total assets	<u><u>\$ 48,529</u></u>	<u><u>\$ 49,950</u></u>
Liabilities:		
Intragovernmental:		
Accounts payable (Note 7)	\$ 1,670	\$ 1,921
Other liabilities (Note 8)	5,306	4,803
Total intragovernmental liabilities	<u>6,976</u>	<u>6,724</u>
Accounts payable (Note 7)	4,892	4,513
Other Federal employment benefits (Note 7)	12,524	12,967
Other liabilities (Note 8)	43,681	39,055
Total liabilities	<u><u>\$ 68,073</u></u>	<u><u>\$ 63,259</u></u>
Net position:		
Unexpended appropriations	20,605	26,227
Cumulative results of operations	(40,149)	(39,536)
Total net position	<u><u>\$ (19,544)</u></u>	<u><u>\$ (13,309)</u></u>
Total liabilities and net position	<u><u>\$ 48,529</u></u>	<u><u>\$ 49,950</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Contract Audit Agency
CONSOLIDATED STATEMENT OF NET COST
(Amounts in Thousands)
As of September 30,

	Incurred Costs	Forward Pricing	Other	Total 2008	Total 2007
Program Costs:					
Gross Costs	\$ 264,902	\$ 126,476	\$ 106,559	\$ 497,937	\$ 474,139
(Less: Earned Revenue)	<u>(30,129)</u>	<u>(14,385)</u>	<u>(12,119)</u>	<u>(56,633)</u>	<u>(55,271)</u>
Net Program Costs	<u>234,774</u>	<u>112,091</u>	<u>94,439</u>	<u>441,304</u>	<u>418,868</u>
Net Cost of Operations	<u><u>\$ 234,774</u></u>	<u><u>\$ 112,091</u></u>	<u><u>\$ 94,439</u></u>	<u><u>\$ 441,304</u></u>	<u><u>\$ 418,868</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense
Defense Contract Audit Agency
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
(Amounts in Thousands)
As of September 30,

	<u>2008</u>	<u>2007</u>
Cumulative Results of Operations:		
Beginning Balances	\$ (39,536)	\$ (46,195)
Beginning balances, as adjusted	(39,536)	(46,195)
Budgetary Financing Sources:		
Appropriations used	414,908	397,083
Other Financing Sources:		
Imputed financing from costs absorbed by others	25,783	28,444
Total Financing Sources	440,691	425,527
Net Cost of Operations	441,304	418,868
Net Change	(613)	6,659
Cumulative Results of Operations	<u>\$ (40,149)</u>	<u>\$ (39,536)</u>
Unexpended Appropriations:		
Beginning Balances	\$ 26,227	\$ 25,232
Beginning Balances, as adjusted	26,227	25,232
Budgetary Financing Sources:		
Appropriations received	415,617	400,135
Appropriations transferred -- in/out	(4,693)	(1,439)
Other adjustments (rescissions, etc)	(1,638)	(618)
Appropriations used	(414,908)	(397,083)
Total Budgetary Financing Sources	(5,622)	995
Unexpended Appropriations	20,605	26,227
Net Position	<u>\$ (19,544)</u>	<u>\$ (13,309)</u>

Department of Defense
Defense Contract Audit Agency
COMBINED STATEMENT OF BUDGETARY RESOURCES
(Amounts in Thousands)
As of September 30,

	<u>2008</u>	<u>2007</u>
Budgetary Resources:		
Unobligated balance, brought forward, October 1	\$ 7,996	\$ 6,834
Recoveries of prior year unpaid obligations	3,522	5,743
Budget authority:		
Appropriation	415,617	400,135
Spending authority from offsetting collections		
Earned		
Collected	56,349	55,289
Change in receivables from Federal sources	275	(17)
Change in unfilled customer orders		
Advance received	(38)	28
Nonexpenditure transfers, net, anticipated and actual	(4,693)	(1,439)
Permanently not available	(1,638)	(617)
Total Budgetary Resources	<u><u>\$ 477,390</u></u>	<u><u>\$ 465,956</u></u>
Status of Budgetary Resources:		
Obligations incurred		
Direct	415,009	402,382
Reimbursable	56,341	55,578
Unobligated balances, apportioned	1,034	1,533
Unobligated balance not available	5,006	6,463
Total Status of Budgetary Resources	<u><u>\$ 477,390</u></u>	<u><u>\$ 465,956</u></u>
Change in Obligated Balance:		
Obligated balance, unpaid obligations, brought forward, October 1	41,463	37,472
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(3,808)	(3,825)
Total unpaid obligated balance	37,655	33,647
Obligations incurred, net	471,350	457,960
Less: Gross outlays	(467,462)	(448,226)
Less: Recoveries of prior year unpaid obligations	(3,522)	(5,743)
Change in uncollected customer payments from Federal sources	(275)	17
Obligated balance, net, end of period		
Unpaid obligations	41,828	41,463
Less: Uncollected customer payments from Federal sources	(4,083)	(3,808)
Total, unpaid obligated balance, net, end of period	37,745	37,655
Net Outlays:		
Gross outlays	467,462	448,226
Less: Offsetting collections	(56,311)	(55,316)
Net Outlays	<u><u>\$ 411,151</u></u>	<u><u>\$ 392,910</u></u>

The accompanying notes are an integral part of these statements.

**DEFENSE CONTRACT
AUDIT AGENCY**



**NOTES TO THE PRINCIPAL
FINANCIAL STATEMENTS**

NOTES TO PRINCIPAL FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The financial statements present the financial position, net cost of operations, and changes in net position, budgetary resources and financing for the Defense Contract Audit Agency (DCAA), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other applicable legislation. The financial statements have been prepared from the books and records of DCAA in accordance with the Department of Defense (DoD) Financial Management Regulation, the Office of Management and Budget (OMB) Circular A-136, "Financial Reporting Requirements," and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which DCAA is responsible unless otherwise noted.

The Federal Accounting Standards Board is recognized as the standards setting body to establish GAAP for federal entities. Currently, DCAA is unable to implement fully all elements of GAAP and the OMB Circular A-136, due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The DCAA derives its reported values and information for major asset and liability categories, largely from nonfinancial systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The DCAA continues to implement process and system improvements addressing these limitations. In addition, the preparation of financial statements in conformity with GAAP requires DCAA's management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

The DCAA's financial statements are prepared to provide information with which the Congress, agency managers, the public, and other interested parties can assess management performance and stewardship. Although, DoD currently has several auditor identified financial statement material weaknesses, DCAA has had none of the Department's material weaknesses identified to its financial statements by its independent audit firm.

Mission and Organization

The DCAA was established in 1965 by the Secretary of Defense Robert S. McNamara. The DCAA is a worldwide, single mission agency dedicated to providing timely and responsive audits and financial advisory services to the DoD contracting officers and other customers. The DCAA's primary customers are contracting officers in the Military Services, and the Defense Contract Management Agency. The Agency also performs, on a reimbursable basis, contract audit services for other federal agencies. The majority of DCAA's workload originates from statutory and regulatory requirements designed to ensure that the government meets its fiduciary responsibilities to the public when awarding and administering contracts.

The Agency is organized into seven major components: a Headquarters and six regions. The Headquarters staff is responsible for the overall management of the Agency's operations, development of policies and plans, and allocation and accounting for the Agency's resources. The regions direct, manage and administer the personnel and resources allocated to their assigned geographical areas in the accomplishment of the DCAA's mission.

Basis of Accounting

For FY 2008 DCAA's financial management systems are unable to meet all of the requirements for full accrual accounting. Transactions are recorded using financial (accrual) and budgetary bases of accounting. Budgetary and financial accounting information are complementary, but the types of information and timing of their recognition cause differences between the two bases of accounting. Budgetary accounting facilitates compliance with legal constraints and statutory controls over the use of federal funds. Financial accounting supports accrual accounting and financial reporting by accounting for assets, liabilities, net position, revenues, and expenses to show actual financial position and net costs of operations. Under accrual accounting, exchange revenues are recognized when earned and operating expenses are recognized when incurred, without regard to the receipt or payment of cash.

The DoD has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger. Until all of the financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DCAA's financial data will be derived from budgetary and proprietary transactions, transactions from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and Federal Employee Compensation Act liability.

Revenues and Other Financing Sources

Financing sources for general funds are provided primarily through Congressional appropriations that are received on an annual and multi-year basis. In addition, when authorized, these appropriations are supplemented by revenues generated by sales of services to other Federal agencies on a reimbursable order basis. The DCAA recognizes revenue as a result of costs incurred or services performed on behalf of other Federal Agencies and the public. Full cost pricing is DCAA's standard policy for services provided as required by the OMB Circular A-25, Transmittal Memorandum # 1, User Charges. Under the reimbursable order process, DCAA recognizes revenue when earned.

Recognition of Expenses

For financial reporting purposes, it is the policy of DoD to recognize operating expenses in the period incurred. However, the DCAA's financial and nonfinancial feeder systems were not designed to collect and record financial and nonfinancial information on the full accrual accounting basis. Accruals are made for major items such as payroll expenses, accounts payable and unbilled revenue.

Accounting for Intragovernmental Activities

Most DoD and other Federal accounting systems do not capture accounts receivable or accounts payable data to identify the corresponding buying or selling agency. However, the DCAA's accounting systems capture trading partner data at the transaction level. The Defense Finance & Accounting Service (DFAS) reviews expenses at the transaction level by trading partner to ensure expenses are properly identified. Any potential error in intragovernmental accounts receivable or accounts payable and the corresponding revenue or expense is not material to the DCAA's financial statements. IntraDoD intragovernmental balances are eliminated.

The U.S. Treasury Financial Management Service is responsible for eliminating transactions between DoD and other Federal Agencies. The U.S. Treasury Financial Manual provides guidance for reporting and reconciling intragovernmental balances. DCAA reconciles balances pertaining to Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The Federal Government does not apportion debt and its related costs to Federal Agencies. The DCAA's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the financial statements report the source of public financing whether from issuance of debt or tax revenues.

Fund Balance with Treasury

The DCAA receives its spending authorizations as allotments from DoD appropriations. The DoD reconciles Fund Balance with Treasury at the agency-wide level. As such, what is presented on the DCAA's balance sheet is not reconcilable with account balances maintained by the U.S. Treasury.

Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. The DCAA established an allowance for uncollectible accounts due from the public by determining the established percentage of debts based on the age of the receivable. The DCAA does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intergovernmental Business Rules published in the Treasury Financial Manual.

General Property, Plant and Equipment

The DCAA's General Property Plant & Equipment (General PP&E) capitalization threshold is \$100 thousand except for real property which is \$20 thousand. The DCAA does not have any real property and is currently using the capitalization threshold of \$100 thousand for all General PP&E. General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the DoD

capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed DoD capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DoD depreciates all General PP&E, other than land, on a straight line basis.

Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as assets on the balance sheet. Advances and prepayments are recognized as expenditures when the related goods and service are received.

Lease Agreements

The DCAA does not have any capital leases. Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and recorded as expenses, as payments are made over the lease term. The DCAA has operating leases on office space that expire at various times. The lease terms depend on individual contracts and locations.

Other Assets

Other assets represent payments of salary and travel advances made to civilian employees to defray anticipated business expenses while on official travel.

Accrued Leave

Civilian annual leave, compensatory time and credit hours are accrued as earned and the unfunded liability for the accrued amounts is reduced as leave is taken. The balance for these unfunded liabilities on September 30, 2008 reflects current pay rates for the leave that is earned but not taken. Sick and other types of non-vested leave are expensed as taken.

Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include the amount of unobligated allotments which have not been rescinded or withdrawn and amounts obligated but for which liabilities for payments had not been incurred at the end of the year.

Cumulative results of operations represent the accumulated difference between (1) financing sources and revenues and (2) expenses since the inception of DCAA. Beginning with FY 1998, the cumulative results also include donations and transfers in and out of assets that were not reimbursed.

Management's Use of Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Comparative Data

The DCAA's financial statements and notes are presented on a comparative basis.

Unexpended Obligations

The DCAA obligates funds to provide goods and services for outstanding orders not yet delivered. Unless the title has passed, the financial statements do not reflect a liability for payment for goods and services not yet delivered. Unexpended obligations includes both obligations for which goods and services have been delivered (title passed) and a liability recognized, and obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources, and is referred to as "Total, unpaid obligated balances, net, end of period."

Contingencies and Other liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DCAA recognizes contingent liabilities on an annual basis when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The DCAA's loss contingencies may arise as a result of uncollectible receivables, pending or threatened litigation, or other possible claims and assessments.

2. ASSETS

The DCAA's assets are classified as entity or nonentity. Entity assets are resources that DCAA has the authority and the legal obligation to use. Nonentity assets are held by DCAA, but are not available for use in its operations. Entity assets include accounts receivable, general (PP&E) other assets and balances with Treasury comprised of appropriated funds and cash collected for reimbursable audit work.

As of September 30, (Amounts in thousands)	2008			2007
	Nonentity	Entity	Total	Total
Intragovernmental Assets:				
Fund Balance with Treasury	\$ -	\$ 43,786	\$ 43,786	\$ 45,652
Accounts Receivable, Net		4,082	4,082	3,834
Total Intragovernmental Assets	-	\$ 47,868	\$ 47,868	\$ 49,486
Nonfederal Assets:				
Accounts Receivable, Net	\$ 3	\$ 191	\$ 194	\$ 202
General Property, Plant and Equipment, Net	-	93	93	
Other Assets	-	374	374	262
Total Nonfederal Assets	\$ 3	\$ 658	\$ 661	\$ 464
Total Assets	\$ 3	\$ 48,526	\$ 48,529	\$ 49,950

3. FUND BALANCE WITH TREASURY

The United States Treasury maintains and reports fund balances at the Treasury Index appropriation level. The DCAA is included at the Treasury Index 97 appropriation level, an aggregate level that does not provide identification of the separate Defense Agencies. As a result, the United States Treasury does not separately report an amount for DCAA; therefore, the entire DCAA Fund Balance with Treasury (FBWT) amount of \$43.8 million is reflected as a reconciling amount.

As of September 30, (Amounts in thousands)	2008	2007
Fund Balance:		
Appropriated Funds	\$ 43,786	\$ 45,652
Total Fund Balance	\$ 43,786	\$ 45,652
Fund Balance Per Treasury Versus Agency:		
Fund Balance per Treasury	\$ -	\$ -
Fund Balance per DCAA	43,786	45,652
Reconciling Amount	\$ 43,786	\$ 45,652

4. STATUS OF FUND BALANCE WITH TREASURY

The Status of FBWT reflects the budgetary resources to support the FBWT.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or

unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed.

Unobligated balances are segregated to show available and unavailable amounts in the note schedule. Certain unobligated balances may be restricted to future use and are not apportioned for current use. There are no restrictions on unobligated balances.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

NonFBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT, such as accounts receivable and unfilled orders without advance from customers. This category reduces the Status of FBWT. The amount shown as NonFBWT Budgetary Accounts on the chart above, \$4.1 million represents reimbursement earned but not collected on September 30, 2008.

As of September 30, (Amounts in thousands)	2008	2007
Unobligated Balance:		
Available	\$ 1,034	\$ 1,533
Unavailable	5,007	6,464
Obligated Balance not yet Disburse	\$ 41,828	\$ 41,463
NonFBWT Budgetary Accounts	\$ (4,083)	\$ (3,808)
Total	\$ 43,786	\$ 45,652

5. ACCOUNTS RECEIVABLE

As of September 30, (Amounts in thousands)	2008			2007
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
Intragovernmental Receivables:	\$ 4,082	\$ N/A	\$ 4,082	\$ 3,834
Nonfederal Receivables (From the Public):	248	(54)	194	202
Total Accounts Receivable:	\$ 4,330	\$ (54)	\$ 4,276	\$ 4,036

6. GENERAL PROPERTY PLANT AND EQUIPMENT, NET

As of September 30, (Amounts in thousands)	2008			2007
	Acquisition Value	Accumulated Depreciation	Net Book Value	Prior FY Net Book Value
General Equipment	\$ 124	\$ (31)	\$ 93	\$ -
Total General PP&E	\$ 124	\$ (31)	\$ 93	\$ -

7. LIABILITIES

The DCAA's liabilities are classified as covered by available budgetary resources or not covered by budgetary resources. Available budgetary resources have been made available by Congressional action.

As of September 30, (Amounts in thousands)	2008			2007
	Covered By Budgetary Resources	Not Covered By Budgetary Resources	Total	Total
Intragovernmental Liabilities:				
Accounts Payable	\$ 1,670	\$ -	\$ 1,670	\$ 1,921
Other	2,423	2,883	5,306	4,803
Total Intragovernmental Liabilities	4,093	2,883	6,976	6,724
Nonfederal Liabilities:				
Accounts Payable	4,892	-	4,892	4,513
Other Federal				
Employment Benefit	-	12,524	12,524	12,967
Other Liabilities	15,493	28,188	43,681	39,055
Total Nonfederal Liabilities	20,385	40,712	61,097	56,535
Total Liabilities	\$ 24,478	\$ 43,595	\$ 68,073	\$ 63,259

Federal Employees Compensation Act (FECA)

The actuarial liability for workers' compensation benefits is developed by the Department of Labor (DOL) and is provided to DCAA at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined by using historical benefit payment patterns to predict the future payments. Cost-of-living adjustments (COLAs) and medical inflation factors are also included in the calculation of projected future benefits. Consistent with past practices, these projected annual benefit payments are then discounted to present value using the Office of Management and Budget's economic assumptions for 10-year U.S. Treasury notes and bonds.

Interest rate assumptions used for discounting were for Year 1, 4.368% and for Years 2+, 4.770%.

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors, COLAs and medical inflation factors (consumer price index-medical, or CPIMs) were applied to the calculation of projected future benefits. These factors were also used in adjusting the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various chargeback years (CBY) were as follows:

<u>CBY</u>	<u>COLA</u>	<u>CPIM</u>
2008	3.03%	4.71%
2009	3.87%	4.01%
2010	2.73%	3.86%
2011	2.20%	3.87%
2012	2.23%	3.93%
2013+	2.30%	3.93%
And thereafter		

The DOL analyzed this model's resulting projections to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2008 to the average pattern observed during the most current three charge back years; and (4) a comparison of the estimated liability per case in the 2008 projection to the average pattern for the projections of the most recent three years.

The estimated actuarial liability is updated only at the end of each fiscal year. The change in Unfunded Actuarial Liabilities is negative \$443 thousand.

8. OTHER LIABILITIES

As of September 30, (Amounts in thousands)	<u>2008</u>			<u>2007</u>
	<u>Current Liability</u>	<u>Noncurrent Liability</u>	<u>Total</u>	<u>Total</u>
Intragovernmental:				
FECA Reimbursement to the Department of Labor	\$ 1,233	\$ 1,648	\$ 2,881	\$ 2,874
Custodial Liabilities	3	-	3	-
Other Liabilities	<u>2,422</u>	<u>-</u>	<u>2,422</u>	<u>1,929</u>
Total Intragovernmental Other Liabilities	3,658	1,648	5,036	4,803

Nonfederal:

Accrued Funded Payroll And Benefits	15,493	-	15,493	12,246
Accrued Unfunded Annual Leave	28,188	-	28,188	26,771
Advances from Others	-	-	-	38
Total Nonfederal Other Liabilities	43,681	-	43,681	39,055
Total Other Liabilities	\$ 47,339	\$ 1,648	\$ 48,987	\$ 43,858

9. STATEMENT OF NET COST

The Statement of Net Cost reports DCAA's gross and net costs arrayed as between its two major product lines, forward pricing and incurred cost audits, and other work. The presentation of the two major product lines correlates to DCAA's performance standards/stretch goals as set forth in DCAA Director's Performance Plan with the DoD Comptroller.

As of September 30, (Amounts in thousands)	<u>2008</u>	<u>2007</u>
Intragovernmental Costs	\$ 134,416	\$ 108,283
Public Costs	<u>363,521</u>	<u>365,856</u>
Total Costs	<u>\$ 497,937</u>	<u>\$ 474,139</u>
Intragovernmental Earned Revenue	\$ (56,633)	\$ (55,216)
Public Earned Revenue	<u>-</u>	<u>(55)</u>
Total Earned Revenue	<u>\$ (56,633)</u>	<u>\$ (55,271)</u>
Net Cost of Operations	\$ 441,304	\$ 418,868

The intent of the Statement of Net Cost (SNC) is to provide gross and net cost information related to the amount of output or outcome for a given program or organization or organization administered by a responsible reporting entity.

Intragovernmental costs and revenue are related to transactions made between two reporting entities within the Federal Government. Public costs and revenue are exchange transactions made between the reporting entity and a nonfederal entity. The DCAA is able to compare its intragovernmental costs and revenues with the corresponding balances of its intragovernmental trading partners within the Department of Defense and disclose any material differences identified.

The amounts presented in the Consolidated Statement of Net Cost are based on budgetary obligations, accruals, and collection and disbursement transactions. The information presented also includes data from non-financial feeder systems to capture payroll expenses.

10. STATEMENT OF BUDGETARY RESOURCES

The DCAA's apportionment category for direct and reimbursable obligations incurred is category A: Amount required to be apportioned for each quarter in the fiscal year. For 4th Quarter, FY 2008, DCAA reported \$415.0 million in direct obligations incurred and \$56.3 million in reimbursable obligations incurred. The net amount of budgetary resources obligated for undelivered orders as of September 30, 2008 and 2007 is \$17.7 million and \$21.1 million, respectively.

Other Disclosures

Intraentity transactions have not been eliminated because the statements are presented as combined.

The DCAA has material differences between the SF 133, Report on Budgetary Execution and the Statement of Budgetary Resources (SBR) of (1) \$3.2 million in Unobligated balance, brought forward, October 1, 2007, (2) \$3.3 million in Total Budgetary Resources, (3) \$3.3 million in Unobligated balance not available, and (4) \$3.3 million in Total Status of Budgetary Resources. The differences are primarily because the SBR includes the year-end post closing trial balance and adjustments of prior year undelivered orders and obligations, whereas the SF 133 only reflects current year activities.

11. RECONCILIATION OF NET COST OF OPERATION TO BUDGET

Beginning 4th Quarter, FY 2007 the Department of Defense (DoD) began presenting the Statement of Financing as a note schedule "reconciliation of Net Cost of Operation to budget" in accordance with the Office of Management and Budget Circular A-136.

As of September 30, (Amounts in thousands)	2008	2007
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations incurred	\$ 471,350	\$ 457,960
Less: Spending authority from offsetting collections and recoveries	(60,108)	(61,043)
Net Obligations	\$ 411,242	\$ 396,917
Other Resources		
Imputed financing from costs absorbed by others	\$ 25,783	\$ 28,443
Net other resources used to finance activities	\$ 25,783	\$ 28,443
Total resources used to finance activities	\$ 437,025	\$ 425,360

Resources Used to Finance Items not Part of the Net**Cost of Operations**

Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:

Undelivered Orders	\$ 3,391	\$ (3,013)
Unfilled Customer Orders	(38)	28
Resources that fund expenses recognized in prior periods	(442)	(3,646)
Resources that finance the acquisition of assets	(124)	-
Total resources used to finance items not part of the Net Cost of Operations	<u>2,787</u>	<u>(6,631)</u>
Total resources used to finance Net Cost of Operations	\$ 439,812	\$ 418,729

Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period

Increase in annual leave liability	\$ 1,416	\$ 243
Depreciation and amortization	31	-
Other	<u>\$ 45</u>	<u>\$ (104)</u>
Total components of the Net Cost of Operations that will not Require or Generate Resources in the current period	\$ 1,492	\$ 139

Net Cost of Operations	\$ 441,304	\$ 418,868
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Due to DoD financial system limitations, the DCAA's budgetary data is not in agreement with proprietary expenses. These differences between budgetary and proprietary data are a previously identified deficiency for DoD.

The note schedule lines are presented as combined instead of consolidated due to intraagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

12. LEASES

The DCAA leases real property under operating leases. These leases expire in various years. Minimum rental payments under operating leases having remaining terms in excess of one year as of September 30, 2008 for each of the next 5 years and in aggregate are as follows (Amounts in Thousands)

<u>Year Ended September 30</u>	<u>Operating Lease Amounts</u>
2009	11,525
2010	9,938
2011	8,063
2012	6,885
2013	5,427
<u>2014 and thereafter</u>	<u>14,335</u>

Total Minimum Future Lease Payments\$ 56,173

Amounts reported as of September 30, 2008 for operating lease future payments represent amounts gathered from lease occupancy agreements.