DEFENSE CONTRACT AUDIT AGENCY
Agency Financial Report 2009

A COMMITMENT TO EXCELLENCE

DCAA Vision

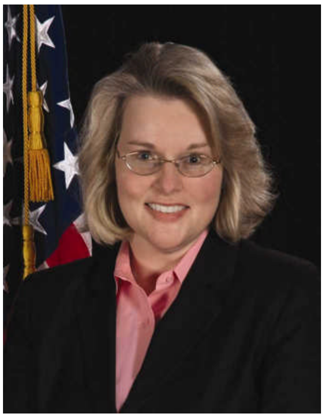
In support of the National Interest, we are dedicated to providing timely and responsive audits, reports, and financial advisory services to Department of Defense contracting officers and other customers.

*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) 2009. The report summarizes the Agency's mission, organization, programmatic achievements, financial status, and business priorities for FY 2009. 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 2009, DCAA employed an all civilian workforce comprised of 4,328 professional contract auditors and administrative support personnel. Approximately 31 percent of DCAA's audit workforce is Certified Public Accountants; 99 percent have bachelor's degrees; and 28 percent have advanced degrees.

The DCAA is also committed to organizational excellence and sound financial management. I am pleased to report that for FY 2009, DCAA received an unqualified "clean" audit opinion on its financial statements for the ninth 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 Stephenson

April G. Stephenson
Director

Defense Contract Audit Agency
Management's Discussion and Analysis

OVERVIEW OF DCAA

Mission

More than 40 years of professional experience with complex, high dollar government contracts has given the Defense Contract Audit Agency (DCAA) the skills to provide best value audit and financial services through continuous evaluation and improvement of audit and administrative processes.

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, General Counsel, and the Assistant Directors for Operations, Policy and Plans, Resources, and Quality Assurance.

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) 2009, the six regional offices provided oversight and management for more than 370 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 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.

In FY 2009, DCAA utilized the Defense Acquisition Workforce Fund (DAWDF). The funding was used for recruiting and training of acquisition personnel. The DAWDF funds were provided by Defense Acquisition University (DAU), and these funds are part of DAU’s financial reporting. The DAWDF funds are not shown on DCAA’s financial statements.

As of September 2009, DCAA employed an all civilian workforce comprised of 4,328 professional contract auditors and administrative support personnel, 377 were hired with

DAWDF funds. Approximately 31 percent of the DCAA's audit workforce is Certified Public Accountants (CPAs); 99 percent have bachelor's degrees; and 28 percent have advanced degrees.

THE DEFENSE CONTRACT AUDIT AGENCY STRATEGIC PLAN

On August 19, 2008, the Deputy Secretary of Defense established an Independent Review Panel under the Defense Business Board (DBB) to review DCAA's operations and make recommendations for improvement. In January 2009, the Defense Business Board issued its report which contained recommendations for the Secretary of Defense to revise DCAA's mission statement and for DCAA to develop a strategic plan that cascades from the revised mission statement. DCAA is in the process of developing its new Strategic Plan and incorporating the elements required by the Government Performance Results Act of 1993. The new Strategic Plan will be issued in FY 2010.

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

The GAO issued a report in July 2008 in which it concluded that DCAA took short cuts in order to meet performance metrics – ultimately resulting in noncompliance with generally accepted government auditing standards (GAGAS). At the end of September 2008, DCAA completely revamped its performance measures and the process for applying the measures, eliminating 18 metrics that focused on productivity and hours per audits, and implementing 8 new measures. The new measures emphasize audit quality and compliance with GAGAS as the most important priorities for the Agency. The measures selected for inclusion in the FY 2009 DCAA Performance Plan highlight the most important actions for successful accomplishment of the DCAA mission. The FY 2009 measures are grouped into three categories: quality, timeliness, and efficiency. Informational measures, for which no goals are established, are also presented. The FY 2009 goals were established using history as the initial baseline and adjustments were made due to changes in the audit processes. DCAA did not meet its timeliness and efficiency goals, and met only half its quality-related goals for FY 2009.

Although DCAA does not set specific goals for savings and return on investment, these do provide indicators of the value of DCAA audit services to the U.S. taxpayer. Savings to the government, as a result of contract audit services, far exceed the cost of DCAA operations. For example, in FY 2009, the Agency audited $72 billion of incurred cost and 7,004 forward pricing proposals amounting to $219.0 billion. Approximately $2.6 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 $499.8 million expended from the Agency's current year O&M funding and DAWDF funding, the return on taxpayers' investments in DCAA was approximately $5.1 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 thirteenth year of preparing financial statements, and the tenth year that an independent accounting firm has audited the statements. The independent audit firm, Leonard G. Birnbaum and Company, has been retained to examine the Agency's FY 2009 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 $19.2 million. Total liabilities include long-term liabilities of approximately $13.8 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 $54.5 million as of September 30, 2009. Fund Balance with Treasury (FBWT) of $49.6 million and Accounts Receivable of $4.7 million comprised 99.6 percent of this amount. In comparison, the Agency had total assets of $48.5 million as of September 30, 2008. Fund Balance with Treasury of $43.8 million and Accounts Receivable of $4.3 million comprised 99.2 percent of this amount. The increase in FBWT of 13.1 percent is due to a net effect of the increase in outlays, an increase in appropriations received and a decrease in reimbursements collected from Federal customers.

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 $73.7 million as of September 30, 2009. Accounts Payable were $7.0 million, 9.5 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 $12.3 million, 16.7 percent of the total. Other Liabilities of $54.4 million comprised the remaining 73.8 percent of the total. Unfunded Liabilities of $31.5 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, 2009.

The following chart presents comparative data for total liabilities as of September 20, 2009 and September 30, 2008.

Liability Comparisons
$ in millions

	FY 2009	FY 2008	% Change
Total Liabilities			
Accounts Payable	$7.0	$6.6	6.1%
FECA Actuarial Liabilities	12.3	12.5	(1.6%)
Other Liabilities	54.4	49.0	11.0%
Total	$73.7	$68.1	8.2%
Unfunded Liabilities	$31.5	$28.2	11.7%

Liabilities have increased nearly $5.6 million primarily due to the increase in Other Liabilities. In FY 2009, there was a new requirement to include the employer's portion of benefits payable for leave.

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 $19.2 million as of September 30, 2009. This amount consisted of Unexpended Appropriations of $23.7 million and a Cumulative Results of Operations of a negative $42.9 million.

The following chart presents comparative data for the net position and results of operations as of September 30, 2009 and September 30, 2008.

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

	FY 2009	FY 2008	% Change
Net Position:	($19.2)	($19.5)	1.5%
Unexpended Appropriations	23.7	20.6	15.0%
Cumulative Results of Operations	(42.9)	(40.1)	7.0%
Cumulative Results of Operations:	(42.9)	(40.1)	7.0%
Net Cost of Operations	471.9	441.3	6.9%
Net Results of Operations	(2.7)	(0.6)	350.0%

Results of Operations. The results of operations are reported in the Consolidated Statements of Changes in Net Position. The DCAA had financing sources of $469.1 million and Net Cost of Operations of $471.9 million. The net results of operations were a negative $2.7 million. The cumulative results of operations were a negative $42.9 million. Total costs increased 4.5 percent and revenues decreased 14.5 percent over prior year. The DCAA spent approximately $16.0 million for overseas contingency operations, formally known as global war on terror.

Budgetary Results

The total current year budget authority for DCAA's operations was $493.2 million with obligations of $491.6 million. This represents an execution rate of 99.7 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. In FY 2009, DCAA received DAWDF funding for recruiting and training of acquisition personnel of the Department of Defense. The DCAA hired 377 auditors in FY 2009 and will hire a total of 700 auditors by FY 2011. Our total FY 2009 workyear execution with DAWDF was 4,084.

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 to ensure 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 2009, 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, with the exception of the material weakness described on page 13. The material weakness was found in the internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations. No other material weaknesses were found in the design or operation of the internal controls. Additionally, in FY 2008, DCAA reported a material weakness related to certain audits that did not meet professional standards. This material weakness was corrected.

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, 2009, 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
- Payroll

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, and
    - 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 DCAA 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

Insufficient Transaction Testing of Contractor's Internal Control Systems. On September 23, 2009, the GAO issued its final report (GAO 09-468) on its review of DCAA audits of internal controls over contractors' significant cost-related systems (Code 195099). The GAO concluded that 33 of 37 internal control audits issued from October 2004 through September 2006, did not comply with the auditing standards due to insufficient transaction testing and that DCAA's quality assurance program was ineffective. The GAO came to this conclusion even though the DoDIG had previously approved DCAA's audit quality assurance program and DCAA's policy on testing for internal control audits. The DCAA considers the lack of sufficient transaction testing to be a material weakness. Consequently, DCAA has established a comprehensive action plan to address all the findings and has initiated corrective actions to address the issues raised by the GAO.

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, 2009 and 2008; we have considered internal control over financial reporting in place as of September 30, 2009; and we have tested compliance with selected laws and regulations.

In our opinion, DCAA's 2009 and 2008 Annual Financial Statements are presented fairly in all material respects.

We found no material conflicts with DCAA's 2009 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, 2009 and 2008, 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, 2009 and 2008, 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.

Under standards issued by the American Institute of Certified Public Accountants, a material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We noted no matters involving internal control or its operations that we considered to be material weaknesses as defined herein.

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 9, 2009.

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 solely for the information and use of DCAA's management, the Department of Defense, the Department of Defense Office of Inspector General, OMB, the Government Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

Leonard G. Birnbaum and Company, LLP

Alexandria, Virginia
November 9, 2009

DEFENSE CONTRACT AUDIT AGENCY

PRINCIPAL FINANCIAL STATEMENTS

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

	2009	2008
Assets (Note 2):		
Intragovernmental:		
Fund balance with Treasury (Note 3)	$ 49,551	$ 43,786
Accounts receivable (Note 5)	4,488	4,082
Total intragovernmental assets	54,039	47,868
Accounts receivable, net (Note 5)	198	194
General property, plant and equipment, net (Note 6)	68	93
Other assets (Note 2)	185	374
Total assets	$ 54,490	$ 48,529
Liabilities:		
Intragovernmental:		
Accounts payable (Note 7)	$ 2,109	$ 1,670
Other liabilities (Note 8)	5,466	5,306
Total intragovernmental liabilities	7,575	6,976
Accounts payable (Note 7)	4,912	4,892
Other Federal employment benefits (Note 7)	12,318	12,524
Other liabilities (Note 8)	48,862	43,681
Total liabilities	$ 73,667	$ 68,073
Net position:		
Unexpended appropriations	23,712	20,605
Cumulative results of operations	(42,889)	(40,149)
Total net position	$ (19,177)	$ (19,544)
Total liabilities and net position	$ 54,490	$ 48,529

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 2009**	**Total 2008**
Program Costs:					
Gross Costs	$ 237,776	$ 166,495	$ 116,026	$ 520,297	$ 497,937
(Less: Earned Revenue)	(22,129)	(15,496)	(10,799)	(48,424)	(56,633)
Net Program Costs	215,647	150,999	105,227	471,873	441,304
Net Cost of Operations	$ 215,647	$ 150,999	$ 105,227	$ 471,873	$ 441,304

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,

	2009	2008
Cumulative Results of Operations:		
Beginning Balances	$ (40,149)	$ (39,536)
Beginning balances, as adjusted	(40,149)	(39,536)
Budgetary Financing Sources:		
Appropriations used	440,633	414,908
Other Financing Sources:		
Imputed financing from costs absorbed by others	28,500	25,783
Total Financing Sources	469,133	440,691
Net Cost of Operations	471,873	441,304
Net Change	(2,740)	(613)
Cumulative Results of Operations	$ (42,889)	$ (40,149)
Unexpended Appropriations:		
Beginning Balances	$ 20,605	$ 26,227
Beginning Balances, as adjusted	20,605	26,227
Budgetary Financing Sources:		
Appropriations received	448,724	415,617
Appropriations transferred – in/out	(2,394)	(4,693)
Other adjustments (rescissions, etc)	(2,590)	(1,638)
Appropriations used	(440,633)	(414,908)
Total Budgetary Financing Sources	3,107	(5,622)
Unexpended Appropriations	23,712	20,605
Net Position	$ (19,177)	$ (19,544)

The accompanying notes are an integral part of these statements.

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

	2009	2008
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 6,040	$ 7,996
Recoveries of prior year unpaid obligations	3,497	3,522
Budget authority:		
Appropriation	448,724	415,617
Spending authority from offsetting collections		
Earned		
Collected	48,022	56,349
Change in receivables from Federal sources	403	275
Change in unfilled customer orders		
Advance received	0	(38)
Nonexpenditure transfers, net, anticipated and actual	(2,394)	(4,693)
Permanently not available	(2,590)	(1,638)
Total Budgetary Resources	$ 501,702	$ 477,390
Status of Budgetary Resources:		
Obligations incurred		
Direct	444,987	415,009
Reimbursable	48,083	56,341
Unobligated balances, apportioned	2,345	1,034
Unobligated balance not available	6,287	5,006
Total Status of Budgetary Resources	$ 501,702	$ 477,390
Change in Obligated Balance:		
Obligated balance, unpaid obligations, brought forward, October 1	41,828	41,463
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(4,083)	(3,808)
Total unpaid obligated balance	37,745	37,655
Obligations incurred, net	493,069	471,350
Less: Gross outlays	(485,995)	(467,462)
Less: Recoveries of prior year unpaid obligations	(3,497)	(3,522)
Change in uncollected customer payments from Federal sources	(403)	(275)
Obligated balance, net, end of period		
Unpaid obligations	45,406	41,828
Less: Uncollected customer payments from Federal sources	(4,487)	(4,083)
Total, unpaid obligated balance, net, end of period	40,919	37,745
Net Outlays:		
Gross outlays	485,995	467,462
Less: Offsetting collections	(48,021)	(56,311)
Net Outlays	$ 437,974	$ 411,151

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 and results of operations of 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, and to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB); the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements; and the Department of Defense (DoD), Financial Management Regulation (FMR). 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 USGAAP for federal entities. Currently, DCAA is unable to implement fully all elements of USGAAP and the OMB Circular A-136, due to limitations of its financial and nonfinancial management processes and systems that support the financial statements. The DCAA derives 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 USGAAP. The DCAA continues to implement process and system improvements addressing these limitations. In addition, the preparation of financial statements in conformity with USGAAP 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 DoD currently has 13 auditor identified material weaknesses in the Department's financial statement reporting. However, the agency's independent audit firm has not identified any of the Department's material weaknesses in DCAA's financial statements.

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

The DCAA's financial management systems are unable to meet all of the requirements for full accrual accounting requirements. 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 USGAAP. 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 USGAAP, 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. When authorized by legislation, 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, User Charges. Under the reimbursable order process, DCAA recognizes revenue when earned.

Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on a full accrual accounting basis. Accruals are made from major items such as payroll expenses, accounts payable and unbilled revenue.

Accounting for Intragovernmental Activities

The U.S. Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide" and Treasury Financial Manual Part 2 – Chapter 4700, "Agency Reporting Requirements for the Federal Report of the United States Government," provide guidance for reporting and reconciling intragovernmental balances. While DCAA is unable to fully reconcile intragovernmental transactions with all of its nonDoD Federal Agencies, DCAA is able to reconcile balances pertaining to Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to Federal Agencies. The DoD's financial statements do not report any public debt, interest or 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 Intragovernmental Business Rules published in the Treasury Financial Manual at http://www.fms.treas.gov/tfm/vol1/07-03.pdf.

General Property, Plant and Equipment

The DCAA's General Property Plant & Equipment (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's 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, 2009 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 net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. Beginning with FY 1998, the cumulative results of operations 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 USGAAP 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,	**2009**			**2008**
(Amounts in thousands)	Nonentity	Entity	Total	Total
Intragovernmental Assets:				
Fund Balance with Treasury	$ -	$ 49,551	$ 49,551	$ 43,786
Accounts Receivable, Net		4,488	4,488	4,082
Total Intragovernmental Assets	-	$ 54,039	$ 54,039	$ 47,868

Nonfederal Assets:				
Accounts Receivable, Net	$ 1	$ 197	$ 198	$ 194
General Property, Plant and Equipment, Net	-	68	68	93
Other Assets	-	185	185	374
Total Nonfederal Assets	$ 1	$ 450	$ 451	$ 661
Total Assets	$ 1	$ 54,489	$ 54,490	$ 48,529

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 $49.6 million is reflected as a reconciling amount.

As of September 30, (Amounts in thousands)	**2009**	**2008**
Fund Balance:		
Appropriated Funds	$ 49,551	$ 43,786
Total Fund Balance	$ 49,551	$ 43,786
Fund Balance Per Treasury Versus Agency:		
Fund Balance per Treasury	$ -	$ -
Fund Balance per DCAA	49,551	43,786
Reconciling Amount	$ 49,551	$ 43,786

4. STATUS OF FUND BALANCE WITH TREASURY

The Status of FBWT reflects the budgetary resources to support the FBWT and is a reconciliation between budgetary and proprietary accounts. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations.

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 represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. The unavailable balance consists primarily of funds invested in U.S. Treasury securities that are temporarily precluded from obligations by law.

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 and services not received and those received but not paid.

NonFBWT Budgetary Accounts reduced the Status of FBWT, such as accounts receivable and unfilled orders without advance from customers. The amount shown as NonFBWT Budgetary Accounts on the chart below, $4.5 million represents reimbursement earned but not collected on September 30, 2009.

As of September 30, (Amounts in thousands)	**2009**	**2008**
Unobligated Balance:		
Available	$ 2,345	$ 1,034
Unavailable	6,287	5,007
Obligated Balance not yet Disburse	$ 45,406	$ 41,828
NonFBWT Budgetary Accounts	$ (4,487)	$ (4,083)
Total	$ 49,551	$ 43,786

5. ACCOUNTS RECEIVABLE

As of September 30,	**2009**			**2008**
(Amounts in thousands)	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
Intragovernmental Receivables:	$ 4,488	$ N/A	$ 4,488	$ 4,082
Nonfederal Receivables (From the Public):	211	(13)	198	194
Total Accounts Receivable:	$ 4,699	$ (13)	$ 4,686	$ 4,276

6. GENERAL PROPERTY PLANT AND EQUIPMENT, NET

As of September 30, (Amounts in thousands)	**2009**			**2008**
	Acquisition Value	Accumulated Depreciation	Net Book Value	Prior FY Net Book Value
General Equipment	$ 124	$ (56)	$ 68	$ 93
Total General PP&E	$ 124	$ (56)	$ 68	$ 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)	**2009** Covered By Budgetary Resources	Not Covered By Budgetary Resources	Total	**2008** Total
Intragovernmental Liabilities:				
Accounts Payable	$ 2,109	$ -	$ 2,109	$ 1,670
Other	2,729	2,737	5,466	5,306
Total Intragovernmental Liabilities	4,838	2,737	7,575	6,976
Nonfederal Liabilities:				
Accounts Payable	4,912	-	4,912	4,892
Other Federal Employment Benefit	-	12,318	12,318	12,524
Other Liabilities	17,325	31,537	48,862	43,681
Total Nonfederal Liabilities	22,237	43,855	66,092	61,097
Total Liabilities	$ 27,075	$ 46,592	$ 73,667	$ 68,073

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, 4.223% and for Years 2+, 4.715%.

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:

CBY	COLA	CPIM
2009	N/A	N/A
2010	0.47%	3.42%
2011	1.40%	3.29%
2012	1.50%	3.48%
2013	1.80%	3.71%
2014+ And thereafter	2.00%	3.71%

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 loses per case (a measure of case-severity) in CBY 2009 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 2009 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 $206 thousand.

8. OTHER LIABILITIES

As of September 30, (Amounts in thousands)	**2009** Current Liability	Noncurrent Liability	Total	**2008** Total
Intragovernmental:				
FECA Reimbursement to the Department of Labor	$ 1,268	$ 1,470	$ 2,738	$ 2,881
Custodial Liabilities	-	-	-	3
Other Liabilities	2,728	-	2,728	2,422
Total Intragovernmental Other Liabilities	3,996	1,470	5,466	5,306
Nonfederal:				
Accrued Funded Payroll And Benefits	17,325	-	17,325	15,493
Accrued Unfunded Annual Leave	31,537	-	31,537	28,188
Advances from Others	-	-	-	-
Total Nonfederal Other Liabilities	48,862	-	48,862	43,681
Total Other Liabilities	$ 52,858	$ 1,470	$ 54,328	$ 48,987

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)	**2009**	**2008**
Intragovernmental Costs	$ 136,973	$ 134,416
Public Costs	383,324	363,521
Total Costs	$ 520,297	$ 497,937
Intragovermental Earned Revenue	$ (48,373)	$ (56,633)
Public Earned Revenue	(51)	-
Total Earned Revenue	$ (48,424)	$ (56,633)
Net Cost of Operations	$ 471,873	$ 441,304

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 SNC 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 2009, DCAA reported $445.0 million in direct obligations incurred and $48.1 million in reimbursable obligations incurred. The net amount of budgetary resources obligated for undelivered orders as of September 30, 2009 and 2008 is $18.5 million and $17.7 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) $3.3 million in Unobligated balance, brought forward, October 1, 2008, (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 2009 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)	**2009**	**2008**
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations incurred	$ 493,070	$ 471,350
Less: Spending authority from offsetting collections and recoveries	(51,921)	(60,108)
Net Obligations	$ 441,149	$ 411,242
Other Resources		
Imputed financing from costs absorbed by others	$ 28,500	$ 25,783
Net other resources used to finance activities	$ 28,500	$ 25,783
Total resources used to finance activities	$ 469,649	$ 437,025
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	$ (792)	$ 3,391
Unfilled Customer Orders	-	(38)
Resources that fund expenses recognized in prior periods	(349)	(442)
Resources that finance the acquisition of assets	-	(124)
Total resources used to finance items not part of the Net Cost of Operations	(1,141)	2,787
Total resources used to finance Net Cost of Operations	$ 468,508	$ 439,812

Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Increase in annual leave liability	$ 3,349	$ 1,416
Depreciation and amortization	25	31
Other	$ (7)	$ 45
Total components of the Net Cost of Operations that will not Require or Generate Resources in the current period	$ 3,367	$ 1,492
Net Cost of Operations	$ 471,875	$ 441,304

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, 2009 for each of the next 5 years and in aggregate are as follows (Amounts in Thousands)

Year Ended September 30	**Operating Lease Amounts**
2010	11,427
2011	9,645
2012	8,231
2013	6,255
2014	5,521
2015 and thereafter	12,181
Total Minimum Future Lease Payments	$ 53,260

Amounts reported as of September 30, 2009 for operating lease future payments represent amounts gathered from lease occupancy agreements.

DEFENSE CONTRACT AUDIT AGENCY

OTHER ACCOMPANYING INFORMATION

DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

OFFICE OF THE DIRECTOR

November 12, 2009

Leonard G. Birnbaum and Company, LLP
Certified Public Accountants
6285 Franconia Road
Alexandria, Virginia 22310-2510

Dear Sirs:

This letter is in connection with your audits of the Defense Contract Audit Agency's (DCAA) balance sheet as of September 30, 2009, and 2008, and the related statements of net costs, changes in net position, and budgetary resources for the years then ended for the purposes of (1) expressing an opinion as to whether the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America, (2) reporting on DCAA's internal control as of September 30, 2009, (3) reporting whether the Agency's financial management systems substantially comply with Federal accounting standards and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2009, and (4) testing for compliance with applicable laws and regulations.

Certain representations in this letter are described as being limited to matters that are material. For purposes of this letter, matters are considered material if they involve $1,000,000 or more. Items also are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations were made to you during the audit. These representations update the representations we provided in conjunction with your audit of the financial statements as of and for the year ended September 30, 2009.

1. We are responsible for the fair presentation of the financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for the preparation of the Management's Discussion and Analysis (MD&A) and other supplementary information.

2. The financial statements are fairly presented in conformity with U.S. generally accepted accounting principles. The MD&A and other supplementary information are fairly presented and are consistent with the financial statements.

3. We have made available to you, all:

   a. financial records and related data;

   b. where applicable, minutes of meetings of the Audit Committee or summaries of actions of recent meetings for which minutes have not been prepared; and

   c. any communications from the Office of Management and Budget (OMB) concerning noncompliance with or deficiencies in financial reporting practices.

4. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements or disclosed in the notes to the financial statements.

5. We believe that the effects of the uncorrected financial statement misstatements summarized in the attached summary are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

6. The Agency has satisfactory title to all owned assets. There are no liens or encumbrances on these assets and no assets have been pledged.

7. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities or that we were required to disclose in the financial statements.

8. There are no guarantees under which the Agency is contingently liable that require reporting or disclosure in the financial statement.

9. There are no related party transactions which need to be recorded or disclosed in the financial statements.

10. No material events or transactions have occurred subsequent to September 30, 2009, that have not been properly recorded in the financial statements or disclosed in the notes.

11. All intraentity transactions and balances have been appropriately identified and eliminated for financial reporting purposes. All intragovernmental transactions and activities have been appropriately identified, recorded, and disclosed in the financial statements. Through the Defense Finance and Accounting Service (DFAS), we have reconciled intragovernmental transactions and balances with the appropriate trading partners for the four fiduciary transactions identified in the U.S. Treasury's Intra-governmental Fiduciary Transactions Accounting Guide, and other intragovernmental asset, liability, and revenue amounts as required by the applicable OMB Circular.

12. We are responsible for establishing and maintaining internal control.

13. Pursuant to 31 U.S.C. 3512(c), (d) (commonly known as the Federal Manager's Financial Integrity Act), we have assessed the effectiveness of DCAA's internal control in achieving the following objectives::

    a. Reliability of financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with generally accepted accounting principles in the United States, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.

    b. Compliance with applicable laws and regulation: Transactions are executed in accordance with laws governing the use of budget authority; other laws and regulations that could have a direct and material effect on the financial statements, and any other laws and regulations identified by the OMB audit guidance.

14. There have been no changes to internal control subsequent to September 30, 2009, or other factors that might significantly affect it.

15. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.

16. We have no knowledge of any fraud or suspected fraud affecting the Agency involving:

    a. management,

    b. employees who have significant roles in internal control, or

    c. others where the fraud could have a material effect on the financial statements.

17. We have no knowledge of any allegations of fraud or suspected fraud affecting the Agency received in communications from employees, former employees, or others.

18. The Defense Finance and Accounting Service is responsible for implementing and maintaining financial management systems for DCAA that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, the United States Standard General Ledger at the transaction level and the DoD Financial Management Regulation as prescribed by the DoD Comptroller.

19. The financial management systems substantially complied with Federal financial management systems requirements, federal accounting standards, and the U.S.

Government Standard General Ledger at the transaction level as of September 30, 2009.

20. We are responsible for the DCAA's compliance with applicable laws and regulations.

21. We have identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts.

22. There are no:

    a. violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency,

    b. material liabilities or gain or loss contingencies that are required to be accrued or disclosed that have not been accrued or disclosed, or

    c. unasserted claims or assessments that are probable of assertion and must be disclosed that have not been disclosed.

23. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

24. We are not aware of any violations of the Antideficiency Act that we must report to the Congress and the President for the year ended September 30, 2009 and through the date of this letter.

25. The information presented in the Agency's Statement of Budgetary Resources agrees with the information submitted on the Agency's year-end Reports on Budget Execution and Budgetary Resources (SF 133s). This information will be used as input for the fiscal year 2009 actual column of the Program and Financing Schedules reported in the fiscal year 2011 Budget of the U.S. Government. Such information is supported by the related financial records and other data.

for Gary L. Simpson

J. Philip Anderson
Assistant Director, Resources
Defense Contract Audit Agency

Francis P. Summers

Francis P. Summers, Jr.
Deputy Director
Defense Contract Audit Agency

Enclosure
a/s

DEFENSE CONTRACT AUDIT AGENCY
AUDIT OF PRINCIPAL FINANCIAL STATEMENTS
FISCAL YEAR ENDED SEPTEMBER 30, 2009

AS OF SEPTEMBER 30, 2009

ACCOUNT DESCRIPTION	KNOWN ERROR IN F/S	LIKELY / PROJECTED ERROR IN F/S
FUND BALANCE WITH TREASURY	-	-
ACCOUNTS RECEIVABLE	-	-
ADVANCES	-	-
PROPERTY	-	-
ACCOUNTS PAYABLE	-	-
ACCRUED PAYROLL & BENEFITS	-	-
UNDELIVERED ORDERS	-	496,206
REIMBURSABLE REVENUE	-	-
EXPENSES - PAYROLL AND RELATED	-	-
EXPENSES - NON PAYROLL	-	-
IMPUTED FINANCING	-	-
TOTAL	-	496,206
PLANNING MATERIALITY	15,608,911	
TOTAL KNOWN ERROR	-	
TOTAL PROJECTED ERROR	496,206	
TOTAL POTENTIAL & KNOWN ERROR	496,206	
AMOUNT BELOW MATERIALITY	**15,112,705**	

DEFENSE LEGAL SERVICES

GENERAL COUNSEL
Defense Contract Audit Agency
8725 John J. Kingman Road, Suite 2135
Fort Belvoir, VA 22060-6219

DL 240 November 9, 2009

Leonard G. Birnbaum and Company
6285 Franconia Road
Alexandria, VA 22310

REFERENCES:

(a) Interoffice Memorandum from Assistant Director, Resources, Defense Contract Audit Agency (DCAA), dated November 4, 2009
(b) Statement of Federal Financial Accounting Standard (SFFAS) No. 5, "Accounting for Contingencies," December 1995, as amended by SFFAS Number 12, and Interpretation Number 2 of SFFAS Numbers 4 and 5
(c) American Bar Association Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information (December 1975)

This letter responds to reference (a) which requests that I provide information involving matters with respect to which I have been engaged and to which I have devoted substantive attention on behalf of DCAA in the form of legal consultation or representation where the amount of potential loss exceeds $1,000,000. Reference (a) requests that a response be provided including matters that existed as of September 30, 2009. Reference (a) further requests information concerning unasserted claims and assessments and requests confirmation that legal counsel are disclosing material loss contingencies as defined in reference (b).

As General Counsel of DCAA, I advise you as follows in connection with your examination of the DCAA concerning matters that existed as of September 30, 2009.

. As General Counsel of DCAA, I have supervisory authority with respect to claims and litigation made against DCAA. In such capacity, I or one of the lawyers over whom I exercise general supervision would have reviewed litigation and claims threatened or asserted involving DCAA.

Known Claims, Litigation, and Assessments

Subject to the foregoing, and to the last paragraph of this letter, I advise you that, for the period ending September 30, 2009, neither I nor any of the lawyers over whom I exercise general supervision have given substantive attention to, or represented, DCAA in connection with any known litigation, claim, or assessment of $1,000,000 or more made against DCAA.

Unasserted Claims and Assessments

Information is also requested concerning unasserted claims and assessments that this office considers probable of assertion and, if asserted, would have a reasonable possibility of an unfavorable outcome. I have interpreted this request to refer to unasserted claims and assessments which, if asserted, have a reasonable possibility of resulting in a material unfavorable outcome where materiality is defined as $1,000,000 or more.

Subject to the last paragraph of this letter, I advise you that neither I nor any of the lawyers over whom I exercise general supervision have given substantive attention to, or represented, DCAA in connection with any unasserted claims or assessments which, if asserted, would constitute a material loss contingency within the scope of clause (a) of Paragraph 5 of reference (c).

Representation Concerning Disclosure

Subject to the last paragraph of this letter, and consistent with the last sentence of Paragraph 6 of reference (c), this will confirm that whenever, in the course of performing legal services for DCAA with respect to a matter recognized to involve an unasserted possible material claim or assessment against DCAA that may call for financial statement disclosure, I or one of the lawyers over whom I exercise general supervision have formed a professional conclusion that DCAA must disclose, or consider disclosure, concerning such possible claim or assessment, the lawyer forming such professional conclusion will so advise DCAA and will consult with DCAA financial managers concerning the question of such disclosure and the applicable requirements of reference (b).

Limitation on This Response

This response is limited by, and made in accordance with, the ABA Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information (December 1975) (reference (c)). Without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of reference (c) and the accompanying Commentary (which is an integral part of this Statement). In addition, we do not interpret reference (a) to require or authorize the release of information subject to the attorney-client privilege or the work product doctrine, and in responding to reference (a) we have provided no information subject to that privilege or doctrine. Moreover, the information set forth herein is as of September 30, 2009, and I expressly disclaim any undertaking to advise you of changes which may be brought to my attention or to the attention of the lawyers over whom I exercise general supervision after the date of this letter.

Sincerely,

John M Farenish

John M. Farenish
General Counsel

Copy furnished: C