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DCAA Contract Audits: Current Trends and Issues

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**Darryl L. Walker, CPA
Technical Director
Beason & Nalley, Inc.**

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Outline

- **Background events affecting DCAA audit priorities and approach**
- **Impact of events on audits**
- **Changes in DCMA & DCAA interface & responsibilities**
- **What audits come first**
- **What audits come later**
- **Primary audit issues:**
 - **Cost proposals**
 - **Incurring costs**
 - **Accounting systems**
- **Predictions going into FY 2012**

Events that Changed DCAA Landscape

- **2008 and 2009 GAO reports:**
 - Independence challenges—too close to contractors
 - Failure to perform adequate internal controls audits
 - Insufficient transaction testing in proposals (historical and forward pricing)
 - Audit supervisors overriding auditor findings
 - Lack of auditor training
 - Too much focus on hurrying up audits to meet metrics
- **GAO recommended:**
 - More audit work to substantiate conclusions
 - Focus on quality
 - Risk based audit approach
 - Disregard metrics as basis for time spent
 - More authority s/b given to DCAA in access to records

Events that Changed DCAA Landscape

Commission on Wartime Contracting:

- **First interim report identified problem #1 = lack of sufficient numbers of competent government acquisition officials (ACOs, PCOs, Contract Specialist)**
- **August 2009 Hearing pitted DCMA against DCAA**
 - **DCAA audits s/b taken at face value (DCAA referred to as “experts” on internal controls/business systems)**
 - **DCMA allegedly “sided with contractor at every opportunity”**
 - **DOD Solution: DFARS Proposed Rule on Contractor Business Systems (Case 2010-D038)**
- **2010 Hearings ramped up government challenges to prime contractor management of subcontractors (lack of competitive bids, failure to document “fair and reasonable price”)**



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Initial Impact on DCAA

- **More distance between DCAA & (1) contractors and (2) government customers (independence)**
- **More substantive testing—significant increase in audit hours**
- **Less interface with contractors during audits & upon completion (however, Rules of Engagement clarified audit relationships)**
- **More aggressive access to records policy**
- **Less focus on materiality & increase in audit findings**
- **All internal controls deficiencies deemed significant—contractor systems rendered in adequate**
- **Move toward increase in audit staffing**
- **Movement toward appealing ACO & PCO decisions not consistent with audit findings**
- **Lack of resources to do all required work: Changes in DCAA & DCMA priorities & duties**

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Relationship w/ DCMA and COs

- **DCMA/ACOs accepting without question more DCAA reported issues as final—ex., application of penalties on unallowable indirect costs (incurred cost proposal audits)**
- **DPAP Policy on Resolving Differences (Contracting Officer vs. DCAA) on Proposals (DPAP Memo Issued 12/4/09)**
 - Issued to provide DCAA appeal process if PCO in discarding less than 75% of audit findings in bid proposal audits
 - DCAA expanded elevation of other issues to DPAP where ACO or PCO disregards all or part of DCAA findings
 - Effect: Dilution of CO authority—COs default to accepting audit findings in some cases
- **September 14, 2010 Ashton Carter Memo to “Acquisition Professionals”**
 - Align DCMA and DCAA processes to ensure work is complementary
 - Increase use of FRRs to reduce administrative costs



Relationship with DCMA and COs

- **Shifts in responsibilities:**
 - **Jan 2011 DPAP memo identifying changes in DCMA/DCAA responsibilities—changes made because of lack of DCAA resources & delayed audits:**
 - **DCAA gives up cost analysis of bid proposals for FFP under \$10 mil, & CP under \$100 mil—cost analysis shifts to DCMA**
 - **DCAA not initiating financial capability/risk analysis—shifts to DCMA**
 - **DCAA not initiating purchasing system reviews—responsibility to lead these is DCMA**
 - **FPRAs and FRRs established by DCMA—but for FRR, DCAA data must be used by DCMA**
 - **DFARS business system rule—clearly places final decision on system adequacy w/ACO (DCMA)**
 - **DCAA gives up self-initiating EVMS audits—DCMA assumes responsibility—may request DCAA to participate**



DCAA Audits—Highest Priority


- **Any demand requests from DOD**
- **Cost proposals (FFP over \$10 mil; CP over \$100 mil)**
- **REAs, termination, & change order proposals**
- **Follow-up audits—accounting systems, review for corrective action only**
- **Defective pricing audits—maybe—FFP over \$100 mil likely to be pursued, but others delayed**
- **Support for closing outstanding audit issues under DOD Oct 2010 DCMA and DCAA Joint Cost Recovery Initiative—DCAA issued Jan 2011 memo on outstanding CAS cost impact statements**



DCAA Audits—Secondary Priority

- **Incurred cost proposals**
- **Internal controls—ICAPS systems (major contractors)-**
 - **Pilot testing on billing & accounting system in progress**
 - **Until completed, no new internal controls audits will be initiated**
- **Any accounting system audit (unless requested, or where corrective action in pre-award audit must be determined)**
- **Civilian Agency audits—consequence, some agencies pursuing support outside DCAA (i.e., DOE)**

Expect stop and go audits of these—particular issues in closing out final indirect rates for closing out flexibly-priced contracts

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Issues on DCAA's Hot Spot List

- **Cost proposals:**
 - Overall adequacy issues—FAR 15.408, Table 15-2
 - Forward pricing indirect rates—out years not supported by adequate budgetary info.
 - Insufficient cost support for subcontractor proposals
- **Accounting systems—if requested or for follow-up**
 - Attribute stat. sampling of transactions
 - Accounting for unallowable costs
 - Insufficient documentation
 - Lack of written policies
 - Almost all deficiencies regardless of apparent insignificance will be deemed significant
 - High probability system will be deemed inadequate
 - Unpredictable time frame for corrective action follow-up



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Issues on DCAA's Hot Spot List

- **Incurring cost proposals (if initiated):**
 - **Extensive testing--variable sampling**
 - **Costs questioned if documentation not sufficient—higher use of “reasonableness test”**
 - **Focus on sensitive accounts—entertainment/recreation, advertising, exec. compensation, prof. fees, & organization costs**
 - **Recommendations of penalties application (expressly unallowable indirect costs)**



Predictions

- **Turnaround time for completing discretionary audits (second priority) not likely to improve until more audit resources are available**
- **Completion of any internal controls type audits and incurred cost proposals may be lengthy**
- **Auditors will continue with reporting any & all internal controls deficiencies**
- **More pressure on contractors to provide access to records—emphasis on internal audit data**
- **Improvement in auditor communication**
- **Continued extensive request for and testing of data**



Comments and Questions



Beason & Nalley, Inc.
101 Monroe Street
Huntsville, Alabama 35801
256-533-1720

Darryl Walker, Government Compliance Technical Director
dwalker@beasonnalley.com