



DCAA Policy on Access to Contractor Internal Audits – Predictably They Are All Relevant to All DCAA's Audits

By Michael E. Steen, CPA, Director at Redstone Government Consulting, Inc.

DCAA issued its MRD (Audit Policy) 13-PPS-007(R), dated April 23, 2013 to establish (or clarify pre-existing) audit policies concerning access to contractor internal audits. This audit policy implements the 2013 National Defense Authorization Act (NDAA) section 832 which requires DCAA to revise its guidance with respect to contractor internal audits to require the following documentation (at a minimum):

1. Written determination that access to such reports is necessary to complete required evaluations of contractor business systems.
2. Copy of any request from DCAA to a contractor for access to such reports.
3. Contractor response including contractor rationale if access was not granted.

Additionally, the 2013 NDAA requires DCAA guidance to implement safeguards to ensure that contractor internal audit reports cannot be used by DCAA for any purpose other than evaluating and testing the efficacy (effectiveness) of contractor internal controls and the reliability of associated contractor business systems. Further, the 2013 NDAA refers to risk based auditing wherein contractor internal controls shall serve as the basis for increased reliance or reduced testing, as appropriate although internal audits shall not be the sole basis for reliance.

DCAA's audit policy partially gets it correct by restating items 1-3 (listed above), but then DCAA does an all-too-typical DCAA policy maneuver by incorrectly translating the 2013 NDAA requirements for safeguards limiting the use of contractor internal audits. First, DCAA discusses the physical controls to ensure that contractor internal audits are safeguarded (just like all contractor proprietary data) and that a DCAA audit should not include a copy of contractor

THIS ISSUE:

- ❖ DCAA Policy on Access to Contractor Internal Audits – Predictably They Are All Relevant to All DCAA's Audits
- ❖ DCAA Iterates "Auditor Communication" with Government Customer and Contractor
- ❖ Incurred Cost Proposals due June 30, 2013: Last Chance to Avoid "Adequacy" Problems
- ❖ GAO Recommends Government Employ Private Sector Acquisition Strategy
- ❖ Training Opportunities
 - ❖ Incurred Cost Proposal (ICP) – Adequacy Requirements Webinar – [REGISTER HERE](#)
 - ❖ Incurred Cost Proposal (ICP) DCAA Audit Results: Report & Issue Resolution Webinar – [REGISTER HERE](#)

internal audits, but should only refer to the internal audits and how the DCAA considered them in the DCAA audit plan. After misleading the reader into thinking that DCAA is seriously limiting the use of contractor internal audits to the narrow application of assessing contractor business systems (in which case DCAA would only be looking at internal audits which were focused on a business system), DCAA then states that the “law allows us to use internal audits to understand the efficiency of contractor internal controls, which we do as part of our risk assessment of every audit”.

Hence, DCAA is by no means adhering to the intent of the 2013 NDAA even though DCAA goes on to state that requests for internal audit reports will occur only when the auditor/supervisor can demonstrate how the report will support the risk assessment. In reality, the DCAA auditor/supervisor will simply assert that the internal audit reports are relevant to their risk assessment as if that’s sufficient to demonstrate how the (internal audit) reports will support the risk assessment. In fact DCAA’s logic or lack thereof create a conundrum; specifically, the DCAA auditor/supervisor cannot demonstrate how an internal audit report is relevant to a risk assessment for a specific audit until the auditor obtains the internal audit report(s) and determines if the internal audit report is relevant (predictably internal audits will be considered relevant by DCAA, even if tangential at best).

In a perfect world, the list of the contractor internal audit reports would assist DCAA in narrowing its request to only those internal audit reports which are relevant to DCAA’s evaluation of business system internal controls. In such a perfect world, DCAA could minimize the use of its and contractor resources in requesting and reviewing contractor documentation (internal audit reports) with the objective of maximizing DCAA’s reliance on those internal audit reports and reducing DCAA’s needs to independently test contractor transactions. Unfortunately DCAA has created an imperfect world defined by auditor independence, highly subjective interpretations of regulation or “law” and over-auditing to avoid any possibility that anyone could challenge DCAA’s compliance with government auditing standards. In the narrow context of internal audits, DCAA has publicly stated that its quest for internal audits would not become a “fishing expedition”; however, with respect to actually engaging in a fishing expedition the only thing lacking from DCAA’s recent

audit policy (13-PPS-007) is an instruction to its field auditors on how to apply for a fishing license.

DCAA Iterates “Auditor Communication” with Government Customer and Contractor

By Darryl L. Walker, CPA, CFE, CGFM Director at Redstone Government Consulting, Inc.

In its April 30, 2013 memorandum to auditors (13-PAS-009(R)), the Defense Contract Audit Agency (DCAA) reminds auditors of the “critical role that communication plays in producing quality audits”. The expectations of auditor communications applies to government contractors as well as government contracting agencies, and auditors are reminded that communication is essential during all phases of the audit.

Notable communication expectations shown within in this memo that relate to communicating with the contractors throughout the audit process include the following:

- Audit issues are identified early on
- Potential problems can be dealt with immediately
- Audit processes, results and conclusions are better understood
- Throughout the audit, auditors should communicate potential audit findings to contractor to ensure that the auditor has and considers all relevant facts

Our experience in supporting contractors in interpreting and resolving audit issues, specifically business systems’ deficiency as well as questioned costs arising from incurred cost proposals (ICP) audits, would support the DCAA’s need to reiterate the importance of communication with the auditor, since too frequently audit problems and findings and the basis of those findings, are not communicated sufficiently, either during the audit, at exit meetings, or within draft report verbiage, to the government contractor.

Although DCAA auditors are generally professional and courteous in working with contractors during contract audits, an expression that there may be findings, coupled with the reasons for potential systems deficiencies or questioned costs,

is not always made clear to the contractor. Clear communication of “potential audit findings to the contractor” whereby auditors can confirm potential findings often falls short; dialogue provided to contractors is sometimes ambiguous and is framed in a such a generic manner, often leaving the contractor with no idea that there is a problem much less the rationale for the potential finding. Rarely is there any attempt to quantify or explain the significance of a finding until the auditor presents a draft report to the contractor and mandates a response to those findings within a few days. Although auditors may not necessarily be able to precisely describe a system deficiency or to precisely identify questioned costs for a potential issue until vetted with the DCAA management, in our opinion, the contractor should be allowed a reasonable amount of time to evaluate and respond to DCAA reported issues.

A typical disconnect between auditors and contractors in ICP evaluations lies within audit requests for supporting documentation. In many cases, auditors will provide a detailed list of documents to support cost transactions selected for review, and will “explain” the reasons for the data required. Too frequently, however, data requests are vague or non-specific because the auditor is unsure what to ask for (we call it the, “I’ll know it when I see it” syndrome) and subsequently the contractor retrieves information that is later determined by the auditor as insufficient, without further communication with contractor, thus the auditor questions costs.

Prior to contractor/auditor exit meetings, the DCAA auditor theoretically will have adequately communicated conclusions in sufficient detail leaving little doubt with contractors as to likely findings, and the rationale supporting system deficiencies or questioned costs; the DCAA presumption is often that all facts and information have been adequately communicated with the contractor during audit and therefore supports a false DCAA notion that contractors should be able to provide written responses within a few days after the exit meeting. To summarize our discussion above, this is not always the case. It is rare that contractors have been sufficiently made aware of audit findings during the course of the audit which is equal to the depth of information presented, during the exit meeting, within a 75 page audit report that contains multiple SOCRs (statement of condition and recommendations), schedules, detailed supporting calculations, expansive explanatory notes, and findings sometimes based on complex regulatory requirements.

The draft audit report is frequently the first time that the contractor has been made fully aware of all facts, conditions, costs, and rationale behind audit conclusions. While the contractor cannot reasonably expect auditors to present, during the audit, all information that will be compiled within the audit report, the audit communication process with the contractor should nonetheless include granting a reasonable amount of time to digest draft findings, ask questions of the auditor following an exit meeting, and respond in writing to those findings. Unfortunately, in those cases where a contractor does provide a very detailed and well supported rebuttal to DCAA audit findings (during or at the conclusion of an audit), the DCAA final audit report simply ignores the contractor rebuttal, in which case, auditor communications are at best a façade. Nonetheless, DCAA’s recent audit policy on auditor communications can and should be referenced by contractors to encourage more timely and more complete discussions throughout the audit.

Incurred Cost Proposals Due June 30, 2013: Last Chance to Avoid “Adequacy” Problems

By Darryl L. Walker, CPA, CFE, CGFM, Director at Redstone Government Consulting, Inc.

Government contractors facing the June 30, 2013 regulatory deadline for submitting an incurred cost proposal (ICP) for fiscal year ended December 31, 2012, should take all necessary quality and due diligence precautions before handing the ICP to the ACO and the DCAA. First and foremost to consider before submitting and ICP is the DCAA adequacy checklist requirements to reduce the risk of having the ICP deemed inadequate and bounced back.

The most critical process in preparing your ICP is to ensure data included within the ICP is reconcilable to your general ledger, project ledgers, and billing information, and that all other information such as Sch. J, “Subcontract Information”, is complete and reconcilable to cost information when applicable. An equally import task during ICP preparation is to perform at least two “scrubs” of expenses, particularly those charged as indirect, to remove unallowable costs from your final rate presentation. Remember that expressly unallowable indirect

costs included in your submitted final rate claim can be subjected to “penalties”, as stipulated in FAR 52.242-3 (the penalties do not apply to direct costs nor to subcontract costs).

Submission of ICP schedules and information required for a proposal to be considered “adequate” are found within the “Allowable Cost and Payment” clause, FAR 52.216-7(d)(2) (iii); supplemental data and schedules that are not required for adequacy, but may be nonetheless requested by the ACO or DCAA, are found in FAR 52.216-7(d)(2)(iv). The first priority in eliminating the hardship of having your proposal deemed inadequate is to include all required information, and to ensure schedules/information are complete in content (or otherwise annotated as not applicable, with the reason data is not relevant), and that cost information is traceable from one schedule to another (e.g., Sch. H matches Sch. I, Sch. A summary of proposed indirect rates match those rates in Sch. H, etc.). It should be noted that the FAR 52.216-7(d)(2)(iii) does not require “schedules” per se; however, DCAA clearly prefers schedules (spreadsheets) including links and formulas.

The DCAA is largely responsible for making an initial adequacy determination, with their results reported to the ACO and a concurrent DCAA notification letter to the contractor. Rest assured that in almost all cases, the ACO will support an auditor’s adequacy or inadequacy determination although audit citations of inadequacies are often inconsistent with the regulations (or DCAA’s own adequacy checklist), insignificant cosmetic or presentation flaws, or subjective personal preferences as to verbiage or added data this is not required for initial adequacy determination. Hence, the necessity to meticulously scrub the proposal before it is submitted. We recommend that you employ the DCAA “Guide for Determining Adequacy of Incurred Cost Proposal” in your review process to determine if the ICP may face audit adequacy challenges.

There are several tiers of undesired consequences of submitting an inadequate, late, or inaccurately prepared ICP. Submissions are due no later than six months after the end of the contractor’s fiscal year; failure to meet that deadline can be considered by the ACO as indicative of a systemic billing or accounting system problem, especially if late submissions are a recurring trend. Compounding the perception of insufficient accounting internal controls is the inclusion of expressly unallowable costs, schedules that cannot be reconciled to financial or cost accounting records, or presentations that are inconsistent with the accounting practices in place for the fiscal

year in which the ICP is submitted. A late, inaccurate, or non-compliant ICP can lead to adverse internal controls audit reports and suspension of billed costs, especially for DOD contracts (CAS covered) that are subject to the DFARS Accounting System Administration business system criteria found in DFARS 252.242-7006.

Incurred cost proposals that are deemed inadequate will be excluded from the DCAA’s “low risk” sampling techniques, which if applicable to a specific ICP’s annual dollar volume, would otherwise escape DCAA audit. Under the DCAA ICP sample audit policy, issued in September 6, 2012 (MRD 12-PPD-023), DCAA may simply bypass any audits of non-sampled low-risk incurred cost proposals that are under \$250 million in ADV (value of incurred flexibly-priced or cost reimbursable government contracts or subcontracts). However, the initial rejection of an ICP as inadequate can potentially eliminate a contractor from potentially benefitting by avoiding the burden of undergoing DCAA ICP audits via the “low risk” sampling process—the reason, a rejected proposal can be viewed as sufficient risk whereby the subject ICP would require audit.

GAO Recommends Government Employ Private Sector Acquisition Strategy

By Darryl L. Walker, CPA, CFE, CGFM, Director at Redstone Government Consulting, Inc.

The Government Accountability Office (GAO,) in its May 15, 2013 report, states that the U.S. government could benefit significantly from utilization of private sector strategic acquisition sourcing strategies when acquiring services, a move that could save the government several billion dollars in costs annually. The GAO targeted government procurement practices for services since prior findings noted that agencies have difficulty efficiently managing service awards. Contributing factors to inefficiencies in award and administration of services contracts include difficulty in defining services requirements, inability to leverage use of contract types, and absence of competition because of certain restrictive and complex procurement regulations and internal agency guidelines.

The GAO was requested to identify leading company practices for purchasing services, and potential opportunities for federal agencies to incorporate those practices. The GAO selected seven companies, an industry group, and a consulting firm and compared the types of services procured by government agencies in FY 2012 to those purchased by the selected companies. Leading private sector companies selected for determination of procurement practices included Dell, Boeing, Delphi, Humana, MasterCard, Wal-Mart, and Pfizer.

GAO concluded that leading private sector companies utilize a strategic sourcing approach that continuously focuses on improved efficiency in procurement practices and setting goals for costs savings. The report identifies five “foundational principles to leverage spending and market knowledge” in achieving a higher level of procurement efficiency:

- Maintain spending visibility—process for integrating procurement and financial systems maximizing automated processes and quickly identify inefficiencies
- Centralize procurement—expanding ability to share knowledge internally, maintain consistently applied procurement tactics throughout the company, and ensuring services spending goes through approved contracts
- Develop category strategy—maintaining services category-specific procurement processes and strategies, effectively adding flexibility for defining sourcing strategies by service offering when necessary
- Focus on total cost of ownership—considering factors beyond price of procured services, for example, taking into account whether the services are really needed
- Regular review strategies and tactics—continuous evaluating of company procurement practices and changing practices to conform to changing market trends; for example, “new ways to invite bids and new types of pricing tiers by which to lower prices”

The GAO identifies an often overlooked best practice necessary to achieve purchasing efficiency; that practice is tailoring procurement tactics by type of service. An effective procurement policy cannot assume a “one-size-fits-all approach to individual service purchase decisions”. Factors such as complexity of service and availability of suppliers have to be considered by individual service offerings. In short,

procurement processes should not be uniform in all respects throughout a large company for each and every service type, and the absence of flexibility allowing differing procurement tactics by service group will ultimately cause increased administrative expenses.

The GAO concludes that “adoption of leading companies’ practices could help agencies increase the portion of and types of services they strategically source”—noting that leading companies have saved between 4 and 15 percent annually on service procurements.

What the GAO does not specifically address are certain regulatory acquisition and government agency internal guidance barriers that will inhibit the implementation of more effective acquisition policies utilized by leading companies for non-government contract purchases. For example, private sector companies acquiring services for non-government requirements do not always utilize a documented price evaluation process to determine source selection, but rather rely on buyer judgment. Moreover, complicated contract clauses that require flow-down into government contract or subcontract awards, which often have the unintended impact of reducing competition and dismissing otherwise qualified sources, are not required in non-government vendor or subcontracted service arrangements.

The adaptation by the government agencies to private sector procurement practices will necessarily require alignment of industry procurement practices to government procurement regulations. Until the government chooses to truly streamline acquisition practices by simplifying existing or eliminating unnecessary contract administration requirements and/or implementing contract clauses, implementation of industry procurement practices that contravene government regulations will not be entirely practical.

Training Opportunities

2013 Redstone Government Consulting Sponsored Seminar Schedule

June 11, 2013 – Incurred Cost Submission – Adequacy Requirements

WEBINAR – [REGISTER HERE](#)

July 24, 2013 – Incurred Cost Submission DCAA Audit Results: Report & Issue Resolution

WEBINAR – [REGISTER HERE](#)

August 1, 2013 – 2013 Government Contractor Challenges Mid-Year Update

WEBINAR

August 21, 2013 – Cost Accounting Standards (CAS) Basics

WEBINAR

August 28, 2013 – Documentation & Records Retention

WEBINAR

September 18, 2013 – Forward Pricing Bid Rates

WEBINAR

October 8, 2013 – Government Audits – DCAA's Latest Strategies

WEBINAR

October 22, 2013 – Purchasing System/CPSR Basics

WEBINAR

November 7, 2013 – Documentation & Records Retention

WEBINAR

December 11, 2013 – Business Ethics & Control Environment

WEBINAR



Redstone Government Consulting, Inc. is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: www.learningmarket.org.

2013 Federal Publications Sponsored Seminar Schedule

July 8-9, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Hilton Head, SC

August 5-6, 2013 – Accounting Compliance for Government Contractors
Washington, DC

August 7-8, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Washington, DC

August 7-9, 2013 – The Masters Institute in Government Contract Costs
Washington, DC

October 9-10, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Orlando, FL

October 21-22, 2013 – Accounting Compliance for Government Contractors
Arlington, VA

December 4-5, 2013 – Accounting Compliance for Government Contractors
Las Vegas, NV

Instructors

- Mike Steen
- Darryl Walker
- Scott Butler
- Courtney Edmonson
- Cyndi Dunn
- Wayne Murdock
- Asa Gilliland
- Adam Collet

Go to www.fedpubseminars.com and click on the Government Contracts tab.

About Redstone Government Consulting, Inc.

Our Company's Mission Statement: RGCI enables contractors doing business with the U.S. government to comply with the complex and challenging procurement regulatory provisions and contract requirements by providing superior cost, pricing, accounting, and contracts administration consulting expertise to clients expeditiously, efficiently, and within customer expectations. Our consulting expertise and experience is unparalleled in understanding unique challenges of government contractors, our operating procedures are crafted and monitored to ensure rock-solid compliance, and our company's charter and implementing policies are designed to continuously meet needs of clients while fostering a long-term partnership with each client through pro-active communication with our clients

In achieving government contractor goals, all consulting services are planned and executed utilizing a quality control system to ensure client objectives and goals are fully understood; the right mix of experts with the proper experience are assigned to the requested task; clients are kept abreast of work progress; continuous communication is maintained during the engagement; work is managed and reviewed during the engagement; deliverables are consistent with and tailored to the original agreed-to scope of work, and; follow-up communication to determine the effectiveness of solutions and guidance provided by our experts.

Specialized Training

Redstone Government Consulting, Inc. will develop and provide specialized Government contracts compliance training for client / contractor audiences. Topics on which we can provide training include estimating systems, FAR Part 31 Cost Principles, TINA and defective pricing, cost accounting system requirements, and basics of Cost Accounting Standards, just to name a few. If you have an interest in training, with educational needs specific to your company, please contact Ms. Lori Beth Moses at lmoses@redstonegci.com, or at 800-416-1946.



REDSTONE
Government Consulting

Redstone Government Consulting, Inc.

Huntsville, AL
101 Monroe Street
Huntsville, AL 35801
T: 256.533.1720
Toll Free: 1.800.416.1946

Email: info@redstonegci.com
On the web: www.redstonegci.com