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DCAA's FY 2014 Staff Allocation Plan: Audits Targeted as High Priority

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

The Defense Contract Audit Agency (DCAA) has released its Government Fiscal Year (GFY) 2014 staffing resources plan which outlines prioritized audits to be either begun and/or completed during the GFY period October 1, 2013 through September 30, 2014. In the memo's introductory comments, DCAA identifies planned audit resources of 4,931 staff work years to accomplish its mission during GFY 2014.

While requested (demand) audits (those requested by DOD contracting offices, such as bid proposals), will take center stage as top audit priorities, reduction of the incurred cost proposal backlog for DOD contractors, starting with the oldest contactor fiscal years submissions, is the single highest DCAA audit priority for discretionary (non-demand) audits. In addition, specific contractor audits identified by the DOD as high risk for completion include carryover of "Reachback" audits (overseas contingency contracts requiring close-out, largely incurred cost—DCMA initiative) and high risk post-award (defective pricing).

A summary of principal GFY 2014 DCAA audit completion goals follows:

- Requested (demand) forward pricing cost or rate proposals; however, DCAA is still limited by DOD policy to auditing only those that fall within proposed values—FFP or cost reimbursable bids equal to or exceeding $10 mil or $100 mil, respectively. Pre-award accounting system reviews in conjunction with a bid proposal audit, a condition of contract award, will also be treated with equal priority as the proposal itself.

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- Incurred cost proposal (ICP) audits—goal of completing all contractor fiscal year (CFY) 2008 and a portion of CFY 2009 audits during GFY 2014, but at a minimum completing CFY audits ending December 2007 no later than March 31, 2014, and CFY audits ending June 30, 2008 by September 30, 2014. Although it is not stated or acknowledged by DCAA, these completion dates are to facilitate a government claim which is within the FAR 33.206 six year statute of limitations. DCAA will continue to utilize audit offices dedicated solely to performing ICP audits, and utilize its established policy of identifying and sampling low risk ICPs. ICP priorities will encompass:
    - Reachback and DCMA priority audits—includes high risk overseas contingency operations audits for FY 2009 under the Cost Recovery Initiative, which would include home office, service center, etc. for which costs flow into those specific contractor ICPs
    - Remaining CFY 2008 and earlier assignments
    - Corporate, group, home office and service center audit where costs are allocated to FY 2008 contractor ICPs
    - OMB Circular A-133 audits
    - Direct cost contractors
- Related incurred cost proposal initiatives:
    - Timely "adequacy" reviews of forthcoming ICPs and segregation between high risk vs. low risk, and identification to specific sampling pool strata
    - Settlement of low risk ICPs, where ICPs were not selected for review
    - Performing "real time" labor (MAAR 6) and materials (MAAR 13) audits to reduce audit effort in subsequent year ICP audits and eliminate the necessity to issue qualified or disclaimed opinions on claimed labor or materials costs
- Defective pricing audits currently in progress, and remaining audits identified by DPAP with significant risk, e.g., high profit contracts, or others considered high risk by audit offices
- Unaudited revisions to CASB Disclosure Statements where such revisions may have a significant impact on contract costs; CAS compliance reviews ordinarily performed on a cyclical basis will be limited only to contractors that present the highest risk to the government—the agency does not have resources to perform recurring compliance testing audits for all contractors
- Billing and accounting system audits at pilot sites carried over from GFY 2013 and new business system audits only at high risk locations (presumably for major contractors). DCAA admits it does not have resources to plan new business systems for GFY 2014
- Earned Value Management (EVM) validation audit assistance to DCMA; DCAA asserts that such audits will be requested by DCMA during the forthcoming year

Post-award accounting system reviews, and ostensibly follow-up system reviews for corrective action where deficiencies were previously reported, will be performed on a case by case basis in coordination with the applicable contracting offices. Other DCAA audits with a low priority are defective pricing (other than specific high risk pricing actions), CAS compliance testing, and DFARS business systems audits for "low risk" contractors. And of course, ICP audits for contractor fiscal years 2010 forward are nowhere on the radar screen for audit, unless auditors determine that multi-year audits for low dollar ICPs can be accomplished going beyond the FY 2009 ICP completion objective.

DCAA Audit Polices: Scanned Records and Forward Pricing Rate Proposals (FPRP)

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

In addition to four audit policies (MRDs or Memorandums for Regional Directors) issued in July and the subject of an article in our August 2013 Newsletter, DCAA recently issued two audit policies including 13-PPS-016(R), *Audit Guidance on*

Placing Reliance on Scanned Images, and 13-PSP-019(R), *Audit Alert on DCMA Forward Pricing Rate Process Change and DCAA Forward Pricing Rate Audit Process.*

Regarding scanned images, DCAA has finally rescinded its audit policies (Section 1-505 of its Contract Audit Manual) which grossly overstated the actual regulatory requirements in FAR 4.703 (discussed in our October 2012 Newsletter); requirements which are now simply and accurately restated in the recent DCAA audit policy. Basically, the requirements include established procedures to ensure accurate imaging, effective indexing to permit timely access, and retaining original documents for one year after scanning to permit validation. Additionally for electronic records transferred to another electronic medium, DCAA's audit policy accurately states: "FAR 4.703(d) allows contractors to transfer images from one reliable computer medium to another if the process maintains the integrity, reliability, and security of the original data and an audit trail is retained. Although one reaction is to applaud DCAA for creating an audit policy consistent with the FAR and rescinding a previous policy which grossly overstated the regulatory requirements, it remains to be seen why DCAA had the previous policy in the first place (a policy which goes back at least to July 2008 and potentially earlier). Apparently DCAA lacks (or lacked) internal controls sufficient to prevent its policy division from essentially re-writing FAR and equally disconcerting, no one or no agency external to DCAA appears to provide any oversight to ensure that DCAA's audit criteria conforms with the regulations.

DCAA's current guidance also provides internal direction to its field auditors in terms of the timing for testing contractor scanning for which auditors are to test annually by incorporating this testing into one of the first audits during the contractor fiscal year. Once documented, future audits/auditors can then rely on the scanned documentation for the applicable fiscal year. Regarding prior contractor fiscal years for which DCAA was not testing contractor scanning, auditors will test contractor scanning if the contractor has preserved the original documents; if original documents have not been retained, the auditor will consider risk factors to ensure there is no reason why DCAA should not rely on the scanned documents (but would still qualify the audit report if scanned documents could not be tested against originals).

As with virtually every other DCAA audit which involves transaction testing which implicates FAR, testing the scanned documents to originals includes a risk that DCAA might identify a non-compliance with FAR 4.703(c). If the field auditor identifies a FAR noncompliance, the DCAA audit policy requires its auditors to report the deficiency as a DFARS 252.242-7006(c)(1) accounting system deficiency (without considering if the contractor has any contracts which include this clause). Even though DCAA has corrected a long-standing audit policy on scanning, they simply cannot avoid expanding the audit scope to include a secondary issue. Optimistically the only accounting system issue which would be sustained by a contracting officer would be if the scanned documents did not match the original documents (the only "objective" criterion in FAR 4.703(c)). However, the wildcard (potential accounting system issues) will be the highly subjective procedural issues even though contractors and DCAA have better things to do then to debate an indexing system, timely retrieval, or the sufficiency of the audit trail.

Regarding DCAA's MRD 13-PSP-019(R), DCMA Forward Pricing Process and DCAA Forward Pricing Rate Audit Process, we are now seeing DCMA's (and the acquisition community) frustration with DCAA's lack of timely audits. Although DCAA's Strategic Plan and other DCAA policies indicate that a quality audit must be a timely audit, DCAA's forward pricing rate audits are anything but timely. In many cases, DCAA subjects contractor FPRPs to non-regulatory adequacy checklists from which large numbers of FPRPs are rejected and re-rejected for highly subjective and inconsequential issues. In fact, this process is being used by DCAA to "pass the buck", blaming inadequate contractor FPRPs for the lack of forward pricing rate agreements (FPRAs) or recommendations (FPRRs) for use by procurement agencies in negotiating contract prices. Unfortunately to an unbiased outside observer, this endless loop gives the appearance that DCAA is more interested in superficial reasons for not doing an audit than in doing the audit and facilitating contract negotiations.

DCAA's inability to timely start and/or to complete audits of contractor FPRPs has apparently led to the DCMA policy wherein DCMA now encourages the completion of an FPRR (government rate recommendation applicable to a contractor for use by procurement agencies in negotiating contracts) within 30 days of receipt of an FPRP followed by starting FPRA negotiations within 60 days of the FPRP. In reaction to (and seemingly in denial of the reasons for) the DCMA policy, DCAA's policy states that "audit teams should continue to

accomplish their FPRP audits expeditiously". Apparently DCAA's definition of "expeditiously" is something different than the remainder of the acquisition community, including DCMA, which has been compelled to implement a policy and to develop the internal capabilities to timely act on FPRPs with or without DCAA.

Although unstated within DCAA's audit policy, DCMA has been forced to assume a greater role in the FPRP/FPRR/FPRA process because DCAA has not timely completed audits leaving the government procurement contracting officers without any meaningful inputs on indirect rates and/or direct labor rates for negotiating government contracts. On a recurring basis, DCAA has been unable to audit a contractor FPRP before the contractor submitted its next cycle FPRP (e.g. typically a cycle is a one year interval). Even more disturbing (and non-value added), even after a contractor submitted its next cycle FPRP, DCAA has continued to audit the prior FPRP including continuing requests for data in support of a now useless FPRP. The DCMA policy wherein DCMA will continue with or more likely without DCAA should be a wake-up call to DCAA or more importantly a wake-up call to DOD. As long as DCAA's sole focus is on absolute compliance with Government Auditing Standards, including seemingly unnecessary and redundant internal reviews and processes, timely acquisitions and contract administration will not happen unless the acquisition process no longer waits for DCAA's input..

Proposal Cost and Pricing Data: Top Four Risk Issues Facing Government Contractors

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

Government contractors who are required to submit certified cost and pricing data as part of a bid proposal face increasingly greater risks of government rejection or award disqualification during pre-award review or even worse, defective pricing allegations after award causing government mandated downward negotiated price adjustments. In today's government procurement environment where procurement commands and their auditors hold contractors to solicitation and cost analysis provisions with such rigidity, equating to a zero error tolerance during proposal evaluations, contractors must not fail to meet the "certified cost or pricing data" submission or disclosure expectations in the pre-award proposal preparation process as intended within the Truth-in-Negotiations Act (TINA).

Contractor lapses in following the rules of FAR 15.408, Table 15-2, in proposal presentation, or missteps in submission of all relevant cost or pricing data before price agreement, even though immaterial in impact to proposed costs are sometimes perceived as severe systemic estimating problems, or intentional withholding of cost/pricing data, either scenario of which can create roadblocks to contractors wishing to bid on future work.

Our experience in working with clients who have faced government cost proposal challenges reveal four specific areas of risk for contractors to dodge during proposal preparation and follow-up disclosures to the government, when "cost or pricing data is required".

1. ***"Cost or pricing data", and how such data was used in developing proposal, is not identified***—FAR 15.408, Table 15-2 makes it clear that contractors disclose such data and describe how individual factual cost/pricing sources were used to calculate proposed costs by cost element. Contractors must understand the definition of "cost or pricing data" as contemplated in the TINA, apply that definition to the type of cost/pricing data used for estimating its unique products and services, and be clear (especially during audit) in the conversion of that pricing data to cost estimates. This requirement is amplified in DCAA's internal proposal adequacy checklist, as well as the new DOD proposal checklist which contractors are now required to prepare and submit with any proposal requiring cost or pricing data under DFARS 252.215-7009.

2. ***Data used as basis for pricing is obviously outdated***—submission and use of non-current cost or pricing data for proposing direct labor hours or rates, and materials quantities or unit prices, for a new bid will elevate the likelihood of defective pricing and raise the contracting officer's suspicion that a contractor may be gaming the system (e.g., inflating the estimate), particularly when older data is used instead of more current cost/pricing data relevant to

purchased supplies or services. Older purchase history information, may produce a more "accurate" estimate if, for example, the prices for those earlier quantities purchased are more in line given symmetrical quantities of materials required for the new bid. However, when later data is available, and no clear rationale for not using the more current data is evident, better explain (and disclose) in the current bid proposal.

3. ***Excessive use of judgment rather than available factual data***—try submitting a cost proposal with over 50% of proposed costs based on engineering estimates, current industry standards (no source for such standards provided), and other non-descriptive bases for those costs. Government procurement officials may potentially view estimates based on excessive judgment as non-responsive, or symptomatic of the "lazy estimating" syndrome, especially where pricing data could have readily been produced for the services or supplies required. Judgment may be the only alternative, however, for new R&D or early production prototype development, where existing contractor pricing resources are not valid. Nonetheless, significant costs based on nothing but judgment increases risk of rejected proposals, questioned costs, and defective pricing.

4. ***Non-Disclosure of or failure to use history for same or like services or supplies being bid***—even though cost estimators may deem historical direct labor or materials costs for same or similar items not entirely relevant or accurate as a baseline for projecting future bid requirements (e.g. significant configuration changes), the government will nonetheless view any type of direct incurred costs for services or supplies even remotely similar to new bid requirements as worthy of disclosure, and will request that data during the pre-award analysis. Contractors sometimes discount the use of historical information in these circumstances, and substitute engineering or program management judgment as a basis for projections, which may ultimately result in a more accurate estimate given significant changes between services/services historically provided and those requiring a current bid estimate. However a best practice is to disclose that history, include it or a reference to it as part of your bid submission, and explain why that data was not used as pricing data.

A reiteration of consequences in failing to adhere to TINA/cost or pricing data requirements—disqualification of proposals, significant audit questioned or unsupported costs (with implications that the proposal is not suitable for negotiations), disapproved estimating system, and more splendid hours with auditors while they audit historical awards for evidence of defective pricing.

Although defective pricing may seem to be a non-existent risk (because DCAA does not appear to be performing many post-award/defective pricing audits), the fact remains that the presence of the TINA clause is a potential risk which can have very negative implications to a government contractor. This risk is reinforced by a July Department of Justice Press Release wherein a contractor agreed to pay $1.9 million to resolve False Claims Allegations which pertained to the contractor's alleged failure to provide current cost or pricing data involving labor hours. In this case, the defective pricing allegation came from a "whistleblower"; hence, in the absence of DCAA audits, there are other reasons to never discount the risks associated with noncompliance with TINA.

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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

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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.

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