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DCAA's Fiscal Year 2013 Report to Congress Unverifiable Self-Declarations of "Getting Better Every Year"

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

In its March 24, 2014 annual report to Congressional Defense Committees, DCAA has once again declared success in spite of overwhelming obstacles such as budget constraints and a hiring freeze. In particular, DCAA's assertion that its efforts helped contracting officials achieve $4.4 billion in "documented" savings which translates into a return on taxpayer investment of $7.30 for each dollar invested (DCAA's budget or taxpayer "investment" is $602 million). Additionally, DCAA's Director reported that the current year (FY2013) return on (taxpayer) investment (ROI) is 75% more than the annual average during FYs 2003-2009 which happen to be fiscal years when DCAA's Director was someone other than the current DCAA Director. It seems to be a common theme that an incumbent benchmarks him/herself against a predecessor who has no opportunity to counter or in this case to highlight the fact that DCAA's ROI maybe "documented", but it is misleading and not subjected to audit by a competent, independent audit firm.

In addition to the record setting ROI, DCAA also reported "significant deficiencies and recommendations to improve the audit process". To no one's surprise, none of the significant deficiencies have any connection to DCAA inefficiencies (which just might exist given that since 2007 DCAA has added at least 30% more auditors while producing 80% fewer audits---a remarkable dis-achievement, but not highlighted in any of DCAA's annual reports).

The significant deficiencies are (of course) all attributable to government contractors who allegedly stymie DCAA at every turn. In the world according to DCAA, but for recalcitrant contractors, there would be no incurred cost audit backlog and audits of contractor bid proposals would be accomplished in no less than 120 days (20 days for the DCAA risk assessment, 6 days to perform the audit fieldwork, and 94 days for DCAA's internal review processes). In regard to the specific deficiencies reported to Congress, these are more accurately re-reported to Congress because most were reported in the FY2012 report, but Congress was apparently disinterested and never took any action.

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Just to highlight a few of DCAA's "significant deficiencies", we take particular note of the following:

- Commercial item pricing; in particular lack of sufficient documentation to substantiate that the arm's length commercial price is fair and reasonable. DCAA envisions commercial item vendors who will freely provide highly proprietary sales history to a single customer regardless of the fact that the commercial item vendor provides no sales history to any other customer. In the words of too many DCAA auditors, "what's the big deal" in terms of a commercial company opening its books to a single customer who would love to have highly proprietary sales data. DCAA is ignoring the fact that one critical aspect of government FAR Part 15 procurement regulations is to put the contractor and the government on equal footing which is exactly the case when both the contractor and the government are dealing with a commercial supplier who is willing to disclose a "take it or leave it" price.

- Expanding DCAA's subpoena authority to include "other than certified cost or pricing data" because contractors have allegedly been reluctant to provide such data. In many cases, the government demand for other than certified cost or pricing data involves competitive procurements where the government demands "other than certified cost or pricing data" simply because it can (a bidder's only recourse is to "walk away" from the potential contract). In cases where the government demands "other than cost or pricing data" and the contractor is disinclined to provide that data, the government has the same option which is to "walk away" from awarding the contract. Apparently DCAA would prefer that the government have a much better option than that afforded contractors during the pre-contract phase.

- Changing the FAR (Access to Records Clause 52.215-2) to expressly require access to contractor employees. DCAA asserts that government professional (auditing) standards require that auditors must have access to contractor employees; however, DCAA has never cited any auditing standard which explicitly or implicitly requires access to employees because it does not exist. Oddly enough, virtually every other audit (government or non-government) requires access to accounting records and access to employees is merely coincidental or an activity confined to investigations (e.g. where irregularities are detected during the audit of accounting records). In this and other audit policies, DCAA has "clearly" blurred the lines between a routine audit and an investigation. One reason DCAA believes that it must have access to contractor employees is to confirm (by physical observation) the actual existence of the employee as if contractor employees are the same as a physical inventory of equipment, materials, supplies, etc., We have not yet located an auditing textbook which expands the concept of a physical inventory to employees/human beings, but DCAA has apparently authored its own auditing standard and/or textbook.

- DCAA requires read only access to contractor electronic accounting records because without such access DCAA's audits are apparently hampered by the need to request accounting records from the auditee (the contractor). Oddly enough, virtually every other audit (government or financial statement) involves requesting accounting records from the auditee rather than a data dump from which the auditor than has unfettered access to accounting records freely searching (or more accurately "fishing") among hundreds, thousands or millions of records. To anyone familiar with audits versus investigations, freely "fishing" among millions of records is limited to investigations (other than in the creative vision of DCAA). DCAA portrays this as advancing DCAA audits by allowing real time contract cost monitoring and continuous risk analysis. In reality this would allow DCAA to waste countless hours while continuously looking at records without ever having introduced a specific audit or having a stated audit objective. Although this online read-only access is critical to DCAA, the remainder of the audit world has somehow been able to timely and efficiently complete audits without such access. DCAA also states that online read-only access will save contractors resources and time; this is highly unlikely as contractors will be constantly dealing with spontaneous DCAA requests for additional information and/or access to employees to explain accounting records which DCAA reviewed while "fishing" among thousands of records while performing no particular audit.

- DCAA asserts that it must have access to contractor internal audits (or internal management reports) as a critical step towards DCAA's audit efficiencies. Unfortunately, DCAA has never demonstrated any

ability to rely on contractor internal audits to decrease DCAA's audit scope/testing; in fact, DCAA is no longer auditing contractor internal controls (business systems) which is the one area for which contractor internal audits would potentially contribute to a reduction in DCAA's audit scope. Somehow DCAA no longer makes any attempt to actually consider contractor internal controls as a prerequisite to planning and performing an audit in accordance with professional (government) auditing standards. Thus, it is not exactly clear how access to contractor internal audits will improve DCAA's audit efficiencies (or more accurately reduce DCAA's inefficiencies) when DCAA has never demonstrably de-scoped its audits through reliance on contractor internal audits.

Beyond DCAA's vision of an audit process perfected by Congressional action to remediate the "significant deficiencies" reported by DCAA (flaws allegedly caused by government contractors), we must also comment on some of the data presented by DCAA. As previously noted, DCAA's results are neither audited nor presented/reported in accordance with any reporting standards. Third party reliance on such data should consider the fact that DCAA's results maybe self-serving and/or that in the absence of any reporting standards, nothing prevents reporting "comparative data" which is anything but comparative. In particular, DCAA compares its current ROI to an average for 2003-2009 when DCAA performed significantly more low ROI audits (i.e. incurred cost audits) and more importantly, DCAA held its auditors to audit quality standards which were measured in large part based upon cost questioned sustained (which approximated 65-70% which meant that for every dollar questioned in a DCAA audit, the contracting officer sustained 65 to 70 cents).

In FY 2013 (and the two previous years), it is obvious that DCAA has no interest in cost questioned sustained, but is clearly interested in absolute maximization of cost questioned (regardless of dismal sustention rates). Although there is a timing lag factor between cost questioned and issue resolution (cost questioned sustained), it is notable that DCAA's FY2013 data reflects cost questioned of $16.035 billion and net savings of $4.4 billion. That equates to a sustention rate of 27 percent which confirms that DCAA has embraced a strategy of questioning costs to the maxim and most likely blaming low sustention rates on someone else (the contracting officers who disposition DCAA audits).

One other notable statistic is that DCAA proudly announced that it has tackled the incurred cost backlog by completing 55 percent of the baseline backlog with expectations that it will substantially eliminate the baseline backlog by the end of 2014 (easily achievable by simply creating and self-defining the concept of a "baseline backlog"). In terms of DCAA's strategy to reduce the incurred cost backlog, it's noteworthy that DCAA "completed" 8,636 incurred cost years while only issuing 1,899 incurred cost audit reports. The difference, 6,737 incurred cost years are "completed" without audits based upon low risk sampling policy for selecting incurred cost proposals for audit, which means that 78 percent of the "completed" years are simply written-off without audit. For those incurred cost years (proposals) that were audited, the total cost questioned in FY2013 was an astonishing $3.214 billion (compared to $.440 billion in FY 2011 and $1.5 billion in FY2012).

As confirmed by more than one DCAA auditor, the objective of a DCAA audit is to protect the taxpayer by questioning costs, be it proposed costs or incurred costs. In pursuing that objective with no concern for the validity of the cost questioned (i.e. no concern for rapidly sinking and dismal cost questioned sustention rates), the end result is easily predictable--audits with poorly supported audit assertions but eye-popping cost questioned. Suffice to say that DCAA will continue down this path of record ROIs (unverified/unaudited) so long as the recipients of these annual reports do not challenge the results. If DCAA's ROI is ever audited and implodes, DCAA will predictably blame someone else.

2013 Senate Bill Would Put Brakes on Excessive Service Contract Spending

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

A Senate bill has been introduced to Congressional legislators which, if enacted, would substantially increase oversight of contracts awarded by the Department of Defense (DOD) to service contractors, and require evidence of DOD's diligence in managing such awards through recurring reporting requirements.

The catalyst of the bill is a series of facts and presumptions supporting the notion that DOD has let service contract awards get out of hand, and that the cost for services provided by government contractors is excessive (although there is no standard for measuring an appropriate level of contracting for services). The Senate entitles this bill (S 2286) as *"Cutting Contractor Use and Taxpayer Savings Act of 2014*", which speaks volumes as to the Congressional mindset that service awards to the private sector cost too much in comparison to the benefits derived.

Examples of evidence presented in the bill supporting enhanced accountability measures on DOD procurement officials in awarding service contracts include the following:

- DOD awards to service contractors in 2013 topped $180 billion making DOD the largest buyer of services in the Federal Government;
- Outsourcing work to the private sector has created an impression that government contractors are overly dependent on the taxpayers as a sole source of contractor revenue;
- Studies demonstrate that service contractors are paid too much when compared to what it would cost if the same services were delegated to Federal employees—a case made for insourcing work, a long-standing goal by the White House to "federalize" as much existing government contractor work as possible, and;
- Government Accountability Office (GAO) noted that DOD has not satisfactory met its obligation in demonstrating via "metrics" its compliance with legislation requiring management of service contractors.

The bill would require a series of recurring reviews and reports by DOD agencies, examples of which include an analysis of the types of service contracts which "were significantly expanded after 2002"; a plan to improve services acquisition processes, and; a report from DCAA identifying percentage of payments to government contractors holding contracts with both manufacturing and service elements.

The bill also includes a contractor employee compensation "limitation" provision, which restricts allowable annual contractor and subcontractor employee compensation to the annual salary of the President, with some exceptions if approved by the head of an executive agency. This provision is redundant in some respects to the recent Government Fiscal Year 2014 Federal Budget signed into law by President Obama which would, beginning in 2014, restrict allowable compensation to $487,000.

The main distinction in the proposed bill's contractor compensation limitation and the Federal Budget cap for 2014 is that this proposed legislation would ostensibly restrict contractor salaries year after year to the President's annual salary without the annual evaluation process currently required via the National Defense Authorization Act (NDAA). In establishing NDAA annual compensation caps, Congressional legislators determine government contractor compensation caps using a series of evaluation factors, and historically, caps have not been benchmarked to a specific government public sector executive.

It remains to be seen how far this bill will progress through the legislative process, and if such a bill is voted into law, whether the original verbiage will have been significantly altered. Nonetheless, the proposed legislation is another of many warning signs to government contractors: contractors cost too much money when compared to federal bureaucrats, those same contractors rely too much on government programs for their livelihood, and taxpayers are unfairly absorbing excessive spending for service contract work provided by the private sector. Missing in action is any independent, unbiased study which provides any empirical data supporting these beliefs (or myths); however, legislative actions are rarely based upon empirical data lending credence to the cliché, why confuse the issue with facts.

ASBCA Determines Termination Claim Can Be Heard, Wage Claim on Hold

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

The ASBCA determined that a government contractor's claim for lost revenue due to the Navy's contract termination for convenience (ASBCA 58828) can go forward for adjudication, but denied the contractor's claim for additional wages that the contractor should have been paid to its employees due to a

government error in misclassification of wage rates which were implemented within the contract's terms and conditions implemented by the Service Contact Act (SCA) (ASBCA 58827).

Puget Sound Environmental (PSE) filed a claim with the Navy for lost potential revenues amounting to $3.3 million because the government terminated a task order under a contract because that effort was no longer needed; subsequently, however the Navy continued to award task orders for the same type of work to other contractors which PSE contended was a breach of contract. The government contracting office disagreed stating that PSE's claim for lost revenues was essentially a bid protest outside the Contracts Disputes Act (CDA) in which case the ASBCA had no jurisdiction. Subsequently, the government filed a motion to dismiss the claim on that basis. The court disagreed that the claim represented a bid protest and denied the government's motion to dismiss, allowing PSE's claim to go forward for review by the ASBCA.

The PSE claim for $2.2 million in additional wages that should have been collected from the government and paid to employees working under a Navy SCA contract was filed because the government was responsible for incorrectly matching PSE labor categories to the Wage Determination Guidelines (WDG) schedule, and the WDG hourly rates were used as basis for reimbursing employees working in those positions. PSE asserted that the government had provided the WDG hourly rate which that matched a particular PSE labor skill, and apparently PSE did not question that decision. PSE later learned, via a discussion with the Department of Labor, that the government incorrectly matched the WDS labor category to the PSE labor skill for determining the minimum hourly rate, and that employees working in that skill should have been paid a much higher hourly rate. In May 2012, a Department of Labor complaint was filed against PSE for unpaid wages, amounting to $1.4 million, plus fringe benefits, to 215 of its employees.

PSE subsequently filed a claim against the government for the underpaid wages, and the government sought dismissal on the basis that the DOL had not yet completely adjudicated the case with the contractor, thus the ASBCA had no jurisdiction at this point. The ASBCA agreed with the government and the motion for dismissal was granted. The court stated that until the DOL had reached a final settlement with PSE, the court had no authority to undertake the PSE claim within the CDA.

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Sterling, VA

August 13-14, 2014 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Sterling, VA

August 13-15, 2014 – The Masters Institute in Government Contract Costs
Sterling, VA

October 20-21, 2014 – Accounting Compliance for Government Contractors
Arlington, VA

December 9-10, 2014 – Accounting Compliance for Government Contractors
Las Vegas, NV

Instructors

- Mike Steen
- Darryl Walker
- Scott Butler
- Courtney Edmonson
- Cyndi Dunn
- Wayne Murdock
- Cheryl Anderson
- Robert Eldridge
- Asa Gilliland

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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.

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 256-704-9811.

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