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DCAA's 2015 Annual Report to Congress

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

DCAA just posted its "Report to Congress on FY 2015 Activities" (www.dcaa.mil/report-to-congress.html) wherein DCAA highlights DCAA's key successes, audit performance, industry outreach activities and recommended actions to improve the audit process. The format is essentially unchanged as are many of the self-accolades (the latter should be expected in any government agency report to Congress, after all who highlights one's failings, unless of course one can attribute them to uncontrollable circumstances such as the ubiquitous "scarce resources"). Regarding scarce resources, DCAA does make reference to staffing issues (hiring freeze) attributable to the 2016 NDAA; although not specifically mentioned, it is Section 893 of the 2016 NDAA which prohibits DCAA from performing audits for civilian agencies, an "Act of Congress" to motivate DCAA to get current on its incurred cost backlog. Section 893 and the newly proposed section 820 (to rescind Section 893) are further discussed in our blog at http://info.redstonegci.com/blog.

Before discussing some of DCAA's statements, particularly those involving statistics (e.g. net savings and ROI/Return on Investment), a note of caution that DCAA's representations are unaudited. Although DCAA maintains that it is conservative in reporting net savings and ROI, the simple fact is that the data is unaudited with all of the implications/risks of reliance on unaudited data. Further, absent reporting standards, which compel comparability, a risk that comparative results and trends have been presented which aren't quite "apples-to-apples". Although this discussion highlights some of the flaws within DCAA's reporting, the author can't fault DCAA for taking advantage of the "reporting flexibilities". Further, if Congress wants to accept unaudited data presented in a report without any reporting standards, so be it.

THIS ISSUE:

In its FY 2015 Report, DCAA presents a number of statistics (current FY along with trends) along with explanations for negative trends such as the FY2015 decline in its net savings and its ROI (return on investment). Although FY 2015 net savings were $3.1 billion, that amount is less than each of the four preceding years (which ranged from $3.5 billion to $4.5 billion); however, DCAA's explanation is basically a confession that net savings in a fiscal year are not related to the audit resources/efforts/costs for that fiscal year. Specifically, "by the end of FY 2014, we had successfully dispositioned a significant portion of those contract actions (old contract actions generated be earlier fiscal year audits) which impacted net savings in FY 2015". In spite of this acknowledgment that audit resources and the resultant net savings are in different fiscal years, for all years including FY 2015, DCAA computes ROI based upon net savings (dispositioned actions) divided by the current fiscal year budget. Perhaps unintended, but something of a self-confession that the reported ROIs aren't actually comparing audit resources with audit results (there can be a significant fiscal year time lag between the use of audit resources and the fiscal year in which the action is dispositioned). So now we know that DCAA has been reporting (or misreporting) its calculation of its ROI without this full-disclosure for four years, a strategy which worked as long as the ROI increased. Unfortunately, FY 2015's decline compelled DCAA to "fall on its sword" to explain the down-turn.

With respect to DCAA's ROI, it essentially nose-dived from $6.9 to $1 (FY 2014) to $4.8 to $1 (FY 2015); however, DCAA explains this by disclosing that the audit mix has changed; specifically, DCAA is doing proportionately fewer bid proposal/forward pricing audits which are the high pay-back audits. Again, this full disclosure was missing from 2011-2013 when DCAA's ROI ramped-up in large part due to the audit mix (proportionately more bid proposals). Absent any reporting standards, starting in 2011, DCAA had previously compared its 2009-2013 ROIs to 2002-2008 knowing full well that it was an "apples-to-oranges" comparison with the relative increase in ROI almost entirely attributable to a very different mix of audit types. Seems to confirm the importance of auditing and reporting standards along with independently audited data.

A few of the highlights as reported by DCAA:

- DCAA issued 4,546 audit reports which reflects a continuing downward trend in audit reports issued. Their historical high-water mark was approximately 44,000/year; however, those may have included a number of audits/reports, which did not fully comply with auditing standards, thus unnecessarily risking taxpayer dollars. In order to alleviate this problem, DCAA now performs very comprehensive and time-consuming audits or it writes off thousands of contractor incurred costs without audit (through low risk sampling). Not sure how DCAA's current strategy protects the taxpayer, but it does lessen the chance that DCAA will issue any audit report which does not comply with GAGAS (Generally Accepted Government Auditing Standards). Perhaps most important, no one (i.e. Congress) seems to notice that DCAA has established an inverse correlation trend of issuing fewer and fewer audit reports, even when DCAA's audit staffing increases.
- DCAA closed approximately 9.400 incurred cost years while issuing 1,925 incurred cost audit reports. The two numbers do not match in small part due to the number of multi-year audits (with one report) and in large part due to the number of incurred cost years which are dispositioned without audit (low risk sampling). A hidden problem for DCAA (but finally disclosed in part in the FY 2015 Report) is that DCAA has disproportionately dispositioned the low-hanging fruit (low risk incurred cost submissions) leaving it with the more complex (large contractor) submissions. Once again, disappointing that as long as the results were going the right direction, no explanation or disclosure, but as the table's turn, DCAA is compelled to explain the unfavorable shift. Even more disappointing, that DCAA maintains that beginning in FY 2010 it intentionally deferred audits of incurred cost years to shift resources to higher priority audits. DCAA has never disclosed or reported the number of in-process audits which were simply never completed (i.e. cancelled without any audit report) as DCAA routinely shifted audit priorities and redirected audit resources. Intentionally deferring incurred cost audits implicates a plan; with DCAA it was simply the byproduct of management without a focus and/or with no attempt to stay-the-course (plan and execute that plan) other than to avoid any audits which might not match-up to auditing standards.

- DCAA's highest audit priority remains the time sensitive forward pricing audits (audits of contractor bid proposals and/or forward pricing proposed rates) wherein DCAA reports that the elapsed days to complete an audit have steadily declined from 120 (2011) to 85 (2015). One caution, DCAA measures these dates from the date it receives an adequate proposal to the date it issues the audit report and DCAA has developed an adequacy checklist (now incorporated into DFARS) which coincidentally maximizes the opportunity to delay the clock (the start date). Gone are the days when DCAA's goal was to audit and issue an audit report within 30 days, many times working with the contractor bid proposal as submitted.
- Questioned cost sustained for FY 2015 was 50.6%, up "significantly" from 46.4% in FY 2014 (but down from 2011 which reported 58.9% sustention). These unaudited sustention rates don't reconcile with data reported by the DOD-IG (semi-annual reports); however, the two sources differ in that the DOD-IG does not report sustention rates on forward pricing. Noting that in recent years the DOD-IG has reported DCAA sustention rates as low as 22% suggests that DCAA does much better on forward pricing than it does on incurred cost audit…or that it's much easier to take credit for net savings on forward pricing…or that unaudited representations may not be accurate.

In the category of Recommended Actions or Resources to Improve the Audit Process; DCAA recommends the following

- Additional resources to perform business systems audits, for which DCAA states that it needs to do over 2,000 per year (6,000+ over a three-year cycle covering three of six business systems in DFARS). DCAA has averaged only 22 business system audits per year; in part because of the cost to perform an audit. DCAA's FY 2016 Audit Plan included 5,000 hours for each estimating system audit and 4,000 hours for each MMAS (Material Management and Accounting). In comparison, DCMA is responsible for reviewing (not auditing) the other three business systems and DCMA appears to require less than 10 percent of the hours (per system) to satisfactorily address contractor compliance with regulatory requirements. Perhaps the solution is to offload more business systems compliance reviews to DCMA.
- Additional resources to perform TINA (Truth in Negotiations Act or Truthful Cost or Pricing Data) compliance audits. In FY 2015 DCAA completed 26 TINA audits with recommended price adjustments of $151.8 million, averaging $5.8 million per audit. Unfortunately, (and consistent with other non-disclosures by DCAA), no information concerning the actual dispersion of the price adjustments (i.e. is the $5.8 million simply a mathematical computation, $151.8 divided by 26, or is it representative of some degree of commonality across the 26 audits). Perhaps a FOIA request would answer the question, but history shows that there are typically a small number of high payback audits; whereas the majority are low or no payback. Besides, a recommended price adjustment is far short of a bird-in-hand because the burden of proof is on the government (to prove defective pricing). Oddly enough, DCAA describes defective pricing as a contractor failure to "provide adequate support", in which case DCAA determines how much the Government paid and provides the contracting officer with a recommended price adjustment. Inadequate support is not defective pricing.

Again, this discussion is a bit cynical, but fully appreciative of the circumstances within which DCAA attempts to complete its mission (starting with the GAO Report in July 2008 which has been followed by a significant amount of "outside assistance" and oversight). To anyone familiar with DCAA and auditing in general, DCAA has over-reacted and "circled the wagons" to overly focus on compliance with Government Auditing Standards. At some point, DCAA might return to true risk based auditing accompanied by due dates and budgets (the incurred cost backlog has resurrected budgets and due dates, but unfortunately this resulted from external pressures culminating with Section 893 of the 2016 NDAA, discussed in the separate blog). As it stands and for each year in reporting to Congress, DCAA continues to compare itself to itself (other than for the all-important Federal Employees Viewpoint Survey). The lack of any meaningful external comparisons does make it easy for DCAA's Director to conclude that "I am confident in our ability to deliver another year of exceptional value to the Department and the acquisition community in 2016." Oddly, as an auditor, DCAA's Director should fully understand that without any external comparative data, her representation of "exceptional value" is wholly unsupported.

Untimely Government Actions and CAS (Cost Accounting Standards)

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

One of the most common complaints from Government contractors relates to untimely government actions, ranging from delays in issuing solicitations, delays in awarding contracts, delays in issuing additional task orders or additional funding, delays in audits and dispositioning audits and in making decisions on contractor claims (discussed in more detail in the article which follows). Industry attempts to compel the government to be more timely have gone nowhere as evidenced by the May 31, 2011 changes to FAR 52.216-7 wherein numerous public comments sought regulatory relief in terms of compelling government agencies to more timely audit and to more timely disposition any audit exceptions (The May 31, 2011 change was purportedly to streamline the processes for contract close-out). The FAR Councils rejected public comments (suggestions) for due dates imposed on the Government based upon the fact that due dates could impact the quality of the Government audits or administrative decisions.

Recent experience (and an unrelated court case) serve as a reminder that the Government can inexplicably delay issue resolution; however, the Government's inactions do not necessarily stop the "interest clock". In the case of a noncompliance with CAS, to the extent the noncompliance increased costs on government contracts, a contractor is subject to refunding the increased costs as well as incurring interest charges based upon IRS Section 6621 and 6622 (section 6622 implicates compound interest). The recent (client) experience involved a CAS noncompliance to which the contractor concurred and provided a General Dollar Magnitude cost impact in late 2010. Absolutely nothing happened until early 2016 when the ACO engaged DCAA to audit the contractor's 2010 cost impact, DCAA timely completed its analysis and provided alternative (slightly higher) amounts for the cost impact. In addition, DCAA provided the ACO with a calculation of Section 6621/6622 compound interest and the ACO issued a demand letter for the principle and interest (the interest portion added approximately 40% to the tab). The contractor cried "foul", noting the inequity of being assessed an interest charge while the Government made no attempt to timely disposition the matter; unfortunately, the CAS Administrative Clause (FAR 52.230-6) is what it is and the ACO asserts that he/she cannot dismiss the interest nor can the ACO agree to resolve the issue as adjustments to current contract prices or billings (the amount must be paid to the US Treasury).

It is more than coincidental that the Government awakened in early 2016 (on an issue which dates back to October 2010) because of FAR 33.206(b), the six- year statute of limitations which requires the Government to issue a written decision on any Government claim initiated against a contractor within 6 years of the accrual date of the claim. At this point the Government's actions are about 6 months shy of passing the 6-year limitation and contractually the Government remains entitled to the amount of the cost impact and the compound interest. The unrelated decision is Secretary of Defense v. Raytheon Co., 2009 WL 2914340, Sept. 14, 2009).

Is The Contracting Officer Taking Too Long To Process Requests For Equitable Adjustments?

Guest article by Jerry Gabig, Attorney, Wilmer & Lee

Often Contracting Officers take an inordinate amount of time to respond to requests for equitable adjustment ("REA"). Sometimes, the Contracting Officer is busy and places a low priority on a contractor's REA. Other times, the Contracting Officer is intentionally "slow rolling" the processing of REAs as a negotiation tactic since there is no incentive for the Government to reach a quick settlement. Fortunately, there are strategies available to a contractor who is faced with a Contracting Officer who is unreasonably delaying the processing of an REA.

Although the term "equitable adjustment" appears in various places in the Federal Acquisition Regulation (FAR), the term is never defined. Generally, an REA is a request under the Changes clause requesting the Contracting Officer to negotiate an increase in price for some event that has occurred during contract performance that was not included in

the original contract price. There are no firm deadlines on a Contracting Officer to respond to an REA.

Other noteworthy aspects of an REA include: the cost of preparing an REA and negotiating the equitable adjustment are typically allowable;[1] the contractor is not entitled to interest for the period of time that the REA is pending; and DOD requires a certification for REA that exceed the simplified acquisition threshold.[2]

If an agency procrastinates an unreasonable amount of time in processing an REA, the contractor is entitled to convert the REA into a claim. The following is the definition of a "claim" in the FAR:

> "Claim" means a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. However, a written demand or written assertion by the contractor seeking the payment of money exceeding $100,000 is not a claim under 41 U. S. C. chapter 71, Contract Disputes, until certified as required by the statute. A voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim. The submission may be converted to a claim, by written notice to the contracting officer as provided in 33.206(a), if it is disputed either as to liability or amount or is **not acted upon in a reasonable time**.

FAR § 2.101 (emphasis added). Notice the bolded language above, which shows that a routine request for an equitable adjustment can become a claim if "not acted upon in a reasonable time."

In converting an REA to a claim, the contractor must certify the claim using the language set forth in FAR § 33.207(c). By converting an REA to a claim, the contractor is entitled to interest on a meritorious claim beginning the date the Contracting Officer receives a properly certified claim.[3] Additionally, if the claim specifically requests a final decision, the Contracting Officer is confronted with deadlines to either resolve the claim or issue a final decision. If the claim is for $100,000 or less, the Contracting Officer must issue a final decision within 60 days.[4] If the claim is for more the $100,000, the Contracting Officer must either issue a final decision within 60 days or notify the contractor within 60 days of a specific date on which the final decision will be issued.[5]

In setting an issuance date beyond 60 days, the FAR requires the date be: within a reasonable time, taking into account --

(1) The size and complexity of the claim;
(2) The adequacy of the contractor's supporting data; and
(3) Any other relevant factors.

FAR § 33.211(d). If a contractor thinks the date set by the Contracting Officer is an unreasonably long amount of time, the contractor can petition a Board of Contract Appeals or the Court of Federal Claims to order the Contracting Officer to more promptly issue the final decision.[6]

The bottom line is that if a Contracting Officer is taking an unreasonable amount of time to pay an REA, pressure can be placed on the Contracting Officer by converting the REA into a claim and seeking a final decision. Anecdotally, the pressure on the Contracting Officer to act more expeditiously has occasionally caused the government to settle on terms that are more beneficial to the contractor. Also, pursing the REA as a claim has the benefit of reminding the Contracting Officer that his or her decision will not be given any credence by the Board of Contract Appeals or the Court of Federal Claims since the judge will decide the matter *de novo.*[7]

If, within 60 days of receiving the claim, the Contracting Officer ignores his or her duty under FAR § 33.211 to identify the date in which he or she will issue a final decision, the claim is deemed denied. Stated differently, after receiving a claim that seeks a final decision, if the Contracting Officer has not notified the contractor within 60 days of a specific date by which the final decision will be issued, the contractor is

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[1] See Bill Strong Enterprises, Inc. v. Shannon, 49 F.3d 1541 (Fed. Cir. 1995).
[2] DFARS § 243.204-71(a).
[3] FAR § 33.208.
[4] FAR § 33.211(c)(1).
[5] FAR § 33.211(c)(2).
[6] See SoCo-Piedmont, J.V., LLC, ASBCA No. 59318, 14-1 BCA ¶ 35,665 (2014); SUFI Network Services, Inc. v. United States, 102 Fed. Cl. 656 (2012).
[7] De novo means starting from the beginning; anew; afresh. 41 U.S.C. § 7104 states that contracting officer decisions are reviewed "de novo."

permitted to appeal to either a Board of Contract Appeals or the Court of Federal Claims.

In Aetna Government Health Plans, ASBCA No. 60207, 16-1 BCA 36247 (2016), Aetna filed a claim that requested a final decision. The Contracting Officer failed to give notification within 60 days. The Contracting Officer responded that the Government needed additional documentation to review the claim and would issue a final decision within 90 days after receipt of such documentation.

Without providing the requested documentation, Aetna appealed to the Armed Services Board of Contact Appeals (ASBCA) on a "deemed denial" basis. The Government moved to dismiss since there was no Contracting Officer final decision. The Board held that the failure of the Contracting Officer, within 60 days of receiving the claim with a request for a final decision, to commit to a specific date constituted a deemed denial of the claim.

The bottom line is that once a matter is docketed with a Board of Contract Appeals or the Court of Federal Claims, it can no longer be neglected by the Contracting Officer. In fact, if the matter is before the Court of Federal Claims, the Contracting Officer no longer has authority to settle the matter. Put in perspective, proceeding towards litigation as a means to accelerate settlement usually is a good tactic for contractors to stop the government from extensive procrastination. Moreover, sometimes the contractor settles on more favorable terms when the Contracting Officer is pressured to meet deadlines. It is true that litigation itself is undesirable because of its expense and uncertainty, however, proceeding towards litigation does not necessarily dictate that litigation is likely to occur. In fact, most claims before a Board of Contract Appeals or the Court of Federal Claims are settled without any hearing.

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Instructors:

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- Scott Butler
- Cyndi Dunn
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- Sheri Buchanan
- Darryl Walker
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Redstone Government Consulting

CFO Roundtable

Redstone Government Consulting, Inc., Radiance Technologies, Inc., & Warren Averett will be sponsoring a CFO/Controller roundtable for Government Contractors.

All Government contractor CFO's or Controllers are invited to participate. The meetings will be held quarterly and will include lunch and networking from 11:30am – 1:00pm. The next meeting will be held on May 18, 2016 in Research Park at Radiance Technologies located at 350 Wynn Drive, Huntsville, AL 35805. Participants will be notified via email announcements for all future locations and seminar topics.

The CFO Roundtable is **free** to attend. All participants will be invited to share topics of interest and the group will be interactive. Redstone GCI, Radiance Technologies, and Warren Averett will strive to provide speakers on topics that are of interest to the group each quarter. Please provide us your email address and we will notify you 30 days in advance of each meeting. RSVP's are required.

Sign up for CFO Roundtable here

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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.

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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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