



## Congressional Bill Targets DCAA Audit Performance

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

In spite of its self-acclaimed successes in its 2016 Annual Report to Congress (for the year ended September 30, 2016), DCAA appears to be in the cross-hairs of the HASC (House Armed Services Committee). Specifically, a bill introduced by Congressman Mac Thornberry to improve the acquisition system, improve the acquisition workforce and improve transparency in the acquisition system. The short title of the Act (bill) is Defense Acquisition Streamlining and Transparency” (DASaT); the link to the 80-page bill is:

<https://armedservices.house.gov/issues/defense-reform>

**Streamlined Acquisition—Online Marketplace.** The focus is on expanded use of online market places (commercial items/services) to expedite procurements and to default to commercial terms and conditions and commercial prices as the basis for fair and reasonable prices. Although unstated, DASaT is pushing back on DOD-IG (Inspector General) reports and DDP (Director Defense Pricing) which are routinely challenging commercial pricing in application to spares. For example, the IG and DDP have repeatedly stated that spares sold as catalog-priced commercial items must be based upon at least 50% sales to non-government customers. In stark contrast, DASaT only requires that a commercial product has been purchased within the last year by at least one non-Government entity. DASaT also envisions a dynamic pricing process wherein suppliers may frequently update product prices; an implied challenge to another existing government acquisition process, that of the GSA (whose “schedule” with static pricing simply does not work with dynamic pricing).

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Streamlined Acquisition—Performance of Incurred Cost Audits. If implemented, the DASaT would require DOD to accept incurred indirect cost audits performed by commercial auditors if the contractor does not have a predominance of cost-type contracts and the commercial auditor previously performed an audit of allowability, measurement and assignment to accounting periods and allocation of indirect costs of the contractor (as worded, the commercial audit would opine on compliance with FAR Part 31 Cost Principles and CAS (Cost Accounting Standards)). In addition, the Act would give DCMA the authority to outsource incurred cost audits and requires that not less than 25 percent of the incurred costs are audited by qualified private (commercial) auditors (after September 1, 2020). Inexplicably, with limited exceptions, the Act prohibits multi-year auditing, which properly designed and implemented yield efficiencies for both the auditor and the auditee. Typically, an audit covering two incurred cost years can be accomplished using about 75-80% of the hours required to separately audit the same incurred cost years).

DASaT also provides materiality standards for purpose or reporting or not reporting questioned costs; examples, a 4% threshold for audited costs less than or equal to \$100,000 up to \$503,000 plus .45 percent for audited costs in excess of \$500,000,000. Of note, current FAR (42.709) requires a dollar for dollar penalty for contractors who claim expressly unallowable costs of more than \$10,000; hence, one would assume that implementing DASaT materiality thresholds would need to be reconciled with a much lower materiality threshold in FAR 42.709.

In terms of timeliness of incurred cost audits, DASaT would require i) contractor notification within 30 days after submission of an indirect cost rate proposal that the proposal is qualified (adequate) and ii) audit findings issued within one year after the date of the receipt of a qualified (adequate) incurred cost submission. If the latter is not accomplished, the incurred cost submission will be considered accepted in its entirety (with rare exception). The one year requirement for issuance of audit findings appears to be a very clear rejection of DCAA's self-acclaimed success in timely performing incurred cost audits; notably, DCAA highlighted elapsed days of 138 from the date of the entrance conference to report issuance date. In a footnote, DCAA reported 885 elapsed days from receipt of an adequate incurred cost proposal to the report issuance date, which had been the metric used in the

2011-2015 DCAA Annual Reports to Congress, but for obvious self-serving purposes, DCAA decided to use a more favorable metric. Translated, DASaT does not give DCAA the option of defining its metric start date, DASaT starts the clock when DCAA has an auditable incurred cost proposal and expects completion in no more than 365 days compared to the 885 days (Source for DCAA data: DCAA 2016 Annual Report to Congress).

DCAA Report (Transparency relative to DCAA Return on Investment). DASaT will add data details to those currently required within the DCAA Annual Report to Congress, by type of audit, the aggregate cost of performing the audit and the cost questioned and cost questioned sustained (now reported in total for all types of audits combined). Additionally, the total number and dollar value of incurred cost audits that are pending for a period longer than one year.

Although DASaT defines "sustained questioned costs" as costs that were recovered by the Federal Government as a result of contract negotiations related to such questioned costs, at least conceptually that conforms to the definition already in use by DCAA. The issue isn't the definition, it's the assumptions made by DCAA auditors if/when a government negotiation memorandum does not singularly address each audit exception. Unless DCAA's reported net savings based upon cost questioned sustained are independently audited by a third party, no one will ever know if DCAA's net savings are accurate, inaccurate (overstated), or close enough for government work. Although this particular DASaT requirement isn't until September 1, 2022, it would require DCAA to obtain and pass a peer review by a commercial auditor and such a peer review might expose DCAA's net savings data to an independent review.

One last comment concerning the DASaT (Defense Acquisition Streamlining and Transparency) Act, it is a proposal which is far from final. If/when it is final, we will then know the content and the implementation dates. Moreover, a number of its requirements are effective in 2020 and beyond and given the political nature of the DASaT, it remains to be seen if future elections will cause DASaT to stall. As with far too many bills promoting acquisition streamlining and reform, the results rarely live up to expectations unless one expects essentially status quo.

## DCAA Audit Policies

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

### NASA opts-out on Low Risk Sampling—Incurred Costs

As a reminder that Government Agencies do not always work together, NASA has apparently notified DCAA that NASA will not accept low risk determinations (for incurred costs) for contractors where NASA is the preponderance of the audit work (auditable dollars). In cases where NASA contracts are involved, but less than the preponderance of the audit work, DCAA audit teams must coordinate with NASA to determine if NASA has any concerns with a potential low-risk determination (acceptance of the incurred cost as proposed). Although unstated in the MRD (17-PIC-005), there is also the unanswered question of direct costs on NASA contracts (regardless of DCAA's audit coverage of indirect costs, NASA can retain audit rights for its contracts' direct costs). Another reminder, in this case, that an incurred cost audit results in a final rate agreement letter which only applies to indirect rates; in theory, contract direct costs remain auditable until submission and government acceptance of the final voucher.

### Entrance Conference Dates are Unreliable or at least Inconsistent)

DCAA MRD 17-PIC-004 is basically an internal document which addresses an internal management reporting data field concerning entrance conference dates on low risk memorandum incurred cost audits. Oddly enough low risk audits don't actually involve an entrance conference to initiate an audit (there is no audit), but do require communications with the contractor and the contracting officer (at the point of initiating the low risk memorandum). Ultimately, the only formal communications with the contractor is the rate agreement letter which should be nothing more than a written bilateral agreement accepting the indirect rates as submitted.

DCAA's MRD also identifies the data elements required for low risk incurred cost actions, including the cumulative costs worksheet (if applicable) and the ADV (auditable dollar value) calculations. The ADV is presumably not recorded as dollars audited, but recorded to be able to identify dollars accepted without audit. The reference to a cumulative costs worksheet should be inapplicable for more recent years for which a May

31, 2011 revision to FAR 52.216-7(d)(2)(v) requires the contractor to prepare and to update the schedule of cumulative direct and indirect costs claimed and billed (reference to 52.216-7(d)(2)(iii)(I)) within 60 days of the final rate agreement letter. In most cases, for low risk incurred cost years (costs and rates accepted as submitted), there is nothing to update assuming the contractor properly prepared "Schedule I" within its indirect cost rate proposal.

One passing comment, in DCAA's 2016 Annual Report to Congress, DCAA used the entrance conference date to calculate the elapsed days for incurred cost audits; however, MRD 17-PIC-004 suggests that the entrance conference dates maybe inaccurate. Perhaps one more reason why the HASC Chairperson has proposed a bill which would require the use of the contractor submission date (of an adequate indirect cost rate proposal) for determining due dates for audits (see the first article in this newsletter)

## What do All Government Contracts Have in Common? The Risk of Contract Termination...even those for Commercial Services.

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

As the Government continues to pursue avenues to bring more non-traditional defense contractors (or non-traditional government contractors) into government contracting, contract disputes and published decisions are a reminder that as long as a government contract has a termination for convenience clause, there is a new and different risk to those only familiar with commercial business.

In ASBCA Case 56708, the commercial contract was effectively terminated before contract performance began (stop work order issued 20 days after award due to the filing of a bid protest and subsequent termination before issuing any delivery orders). The contract contained FAR 52.212-4 including Termination for Government Convenience which states that the contractor shall be paid the percentage of the contract price reflecting the percentage of work completed plus reasonable charges the **contractor can demonstrate to the**

**satisfaction of the Contracting Officer** using its (contractor) standard record keeping system, have resulted from the termination (emphasis added). The clause goes on to state that the Government does not have a contractual right to audit the contractor's records (which leaves unanswered exactly how a contractor would demonstrate to the satisfaction of the Contracting Officer that claimed and incurred costs were related to the terminated contract).

Although the Government may not have a contractual right for an audit, in this case the Government did request an audit which was then limited to reliance on the contractor's standard record keeping system (one of the few times that a DCAA auditor performed or attempted to perform an audit without first subjecting it to an "adequacy" review). The audit was requested because the contractor had proposed termination costs of approximately \$6,252,000 including \$5,250,000 for purchased, but unused storage tents (cost of \$6,000,000 less salvage value of \$750,000).

The other itemized expenses included land preparation costs, deposits, storage costs, travel, legal expenses and related party lease costs. Unlike many audits of traditional (non-commercial) government contracts, the auditor did not come in with preconceived notions in terms of documentation required to support the contractor's claimed costs. In fact, the auditor had to defer to the contractor's standard record keeping system (whatever it was) and to potentially accept amounts that would be questioned (but for the commercial contract). For example, payroll records did not have to meet the typical DCAA auditor expectations for individual timesheets, signed by the employee and approved by a supervisor.

In spite of what appears to be an auditor's willingness to consider whatever records the contractor had to offer, the end result was the auditor's recommendation that the Contracting Officer reject almost all of the claimed costs. With respect to the \$6,000,000 for storage tents, the auditor made note that there was no entry (prior year or current year) for that amount (or any amount) either as an asset, in accounts payable or in the tax returns. The amount was not recorded or reported as a period expense or as a capital expense. The entire amounts were questioned due to lack of verifiable evidence. Translated, even a commercial government contractor, particularly a relatively small company for which \$6,000,000 is a very significant amount, must have some evidence that it actually incurred a claim for a \$6,000,000 expenditure.

In the decision, the ASBCA concluded that the contractor was entitled to nothing for work performed because the stop work order had been issued before any delivery order(s) was(were) issued. In terms of the other costs, the contractor recovered less than 5% of its claimed costs. This percentage may have been even less but for a number of Government challenges that were without legal support (i.e. baseless).

If there is one universal message (applicable to all government contracts) as stated in this decision: "it is well established that the contractor has the burden of proving the costs it incurred in the performance of items of work that were terminated". Commercial contracts do not define "proving incurred costs", but those costs must exist somewhere in the contractor system of record keeping. There were numerous verbal assertions (by the contractor) and these could have been corroborating evidence to further support recorded costs...if only there was evidence of a recorded cost.

## Training Opportunities

### 2017 Redstone Government Consulting Sponsored Seminar Schedule

More Training Coming Soon

### 2017 Federal Publications Sponsored Seminar Schedule

**June 13-14, 2017** – Accounting Compliance for Government Contractors

Arlington, VA

**July 17-18, 2017** – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk

Hilton Head, SC

**July 18-20, 2017** – The Masters Institute in Government Contract Costs

Hilton Head, SC

**August 21-22, 2017** – Life Cycle of an Indirect Rate Cost Proposal

Arlington, VA



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**August 22-24, 2017 – The Masters Institute in Government Contract Costs**

Arlington, VA

**August 24-25, 2017 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk**

Arlington, VA

**October 23-24, 2017 – Accounting Compliance for Government Contractors**

Sterling, VA

**December 6-7, 2017 – Accounting Compliance for Government Contractors**

DC Metro Area

Go to <http://www.fedpubseminars.com/> and click on the Government Contracts tab.

## Blog Articles to our Website

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**Time to Tune Up Your Purchasing System**

Posted by Cyndi Dunn on Wed, May 24, 2017 – [Read More](#)

**Program/Project Control – Does my Company Need this Function?**

Posted by Beverly Murphy on Fri, Mar 19, 2017 – [Read More](#)

**5 Tips for Government Contractors Using Quickbooks**

Posted by Cory Scott on Thu, May 11, 2017 – [Read More](#)

**Application of CAS 420 – Independent Research & Development and Bid & Proposal Costs**

Posted by Kimberly Basden on Tues, Apr 25, 2017 – [Read More](#)

**Unaudited Accounting Systems and Government Solicitations – Read the Fine Print**

Posted by Cheryl Anderson on Thurs, Apr 6, 2017 – [Read More](#)

**DCAA Audit Policy Implementing Trump's 2 for 1 Regulatory Reductions**

Posted by Michael Steen on Fri, Mar 31, 2017 – [Read More](#)

**Labor Laws and Regulations Update**

Posted by Sheri Buchanan on Wed, Mar 29, 2017 – [Read More](#)

**DCAA Selection of Incurred Cost Proposals for Audit – What is my Risk?**

Posted by Bob Eldridge on Wed, Mar 15, 2017 – [Read More](#)

**Is My Accounting System Adequate, Acceptable or Approved...Does it Matter?**

Posted by Michael Steen on Wed, Mar 8, 2017 – [Read More](#)

For More Blog Articles: <http://info.redstonegci.com/blog>

## Whitepapers Posted to our Website

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**What Are The Prime Contractor's Risks Related to Subcontracts**

A Whitepaper by Asa Gilliland – [Read More](#)

**The Audit World's Biggest Myths**

A Whitepaper by Wayne Murdock – [Read More](#)

**Government Contracting and Uncompensated Overtime**

A Whitepaper by Wayne Murdock - [Read More](#)

**DCAA Rejection of Incurred Cost Proposals**

A Whitepaper by Michael Steen – [Read More](#)

For More Whitepapers:

<http://www.redstonegci.com/resources/white-papers>

## CFO Roundtable

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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 is TBA. 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](#)

### 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](mailto:lmoses@redstonegci.com), or at 256-704-9811.



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