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# newsletter

## Government Contracts Consulting

Provided by Beason & Nalley, Inc.

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### **DCAA FISCAL YEAR 2009 AUDIT PERFORMANCE METRICS**

Although it has yet to appear on DCAA's public internet site, on September 30, 2008, DCAA's Director, April Stephenson, issued a memorandum to all DCAA employees with the FY2009 Audit Performance Metrics. As expected, in the wake of the July 2008 GAO Report, DCAA eliminated or significantly modified all previous metrics which involved cycle times (driven by due dates) and audit efficiencies (driven by hours incurred on audits). The DCAA Director's memo also reinforced the need for quality above all else ("We will not sacrifice quality for any reason" other than an additional Monday holiday...Okay, we added the Monday Holiday).

Consistent with DCAA's quality "above all", its nine audit metrics are laced with the word "quality" ranging from quality measured externally (PCIE Opinion rendered by the DOD-IG) to those metrics internally measured against an external requirement (i.e. compliance with GAGAS for CPE or Continuing Professional Education). Of passing interest, the PCIE desired opinion, "Unqualified", has consistently been achieved by DCAA in spite of the 14 audits deemed noncompliant (with GAGAS) by the GAO. This enigma merely reinforces the critical variable within any audit; the results are wholly dependent upon what specific transactions or specific activities one audits.

Operating with a large universe of DCAA audits, influenced by low risk assumptions and previous unqualified opinions, it is easy to understand how the DOD-IG missed or overlooked the

significance of these non-compliant DCAA audits. In contrast, nothing improves an audit or investigative "hit rate" (i.e., noncompliant or illegal activity) better than, even partially, accurate information from an inside source. The insider source for information was clearly a factor in the GAO review and report, but often overlooked in public reaction to that GAO Report. No doubt a few more DCAA auditors will, and have already, come forward with their own tales of DCAA miscues. In any case, it is safe to say that the DOD-IG will necessarily raise the bar in terms of its future PCIE review(s) of DCAA.

While DCAA and the DOD-IG measure quality based upon GAGAS compliance, audit quality has an entirely different derivation when measured by DCAA's Goal 4 known as "Audit Reports with Findings".



Findings has a goal of 45% applicable to incurred cost audits, forward pricing proposals and rates, internal controls (ICAPS) and reviews of public vouchers, CAS, compliance as well as Disclosure Statement adequacy, claims and terminations. Findings are also considered, by DCAA, as the tangible value of the audit work; hence, DCAA's connection to audit quality. Unfortunately, this goal represents a very simplistic measure of tangible value given that a finding will be measured based upon the audit report, regardless of the outcome.

Further, DCAA's March 3, 2008 Policy Memo on Reporting Internal Control Deficiencies (08-PAS-011(R)), so lowered the bar on "reportable deficiencies" that many so called deficiencies have no tangible significance other than within the very narrow definitions imposed by auditors for auditors (reference to the GAO revision to GAGAS which in turn applies to DCAA among others). That said, the achievement of the 45% goal will have no other significance other than as a measure of an internal DCAA goal. To be sure it cannot be interpreted as indicative of audit skills given that

almost every ICAPS audit can report a finding based upon the number of attributes tested and the current definition of a reportable deficiency.

The 45% goal is somewhat disconcerting when one considers that one of the informational goals', "keys for success," is to question costs as appropriate regardless of the probability of sustention by the contracting officer. "As appropriate" should mean in full compliance with GAGAS which also means that a competent auditor would come to the same conclusion without any influence from the 45% goal. It is unlikely that any DCAA auditor's opinion will not be influenced by the 45% goal and it is also unlikely that any reviewer (i.e. audit supervisor or branch manager) will be looking for audit findings which should not have been reported given that everyone's interest is focused on those findings which should have been reported, but were not ("everyone" in this case is DCAA, DOD-IG and the GAO).

It should be apparent that DCAA's new quality metrics will most likely generate more audit findings regardless of a contractor's prior experience which may

have been no DCAA findings. The reason, auditor professional judgment is a crucial factor in this process and an auditor's professional judgment can and will be influenced by factors wholly independent of the auditee (the contractor). There is a number of FAR Part 31 regulations which are evaluated based upon subjective criteria making it almost impossible to avoid audit findings if the auditor's inclination is to report findings. We seem to have returned to the environment of "if in doubt, throw it out".

## FAR 31.204 ALLOCABILITY AND THE AFTER-THE-FACT INCURRED COST AUDIT – PART TWO

As reported in last month's newsletter, after the fact audit evaluations of allocation methods is an incurred cost audit test premised upon the application of FAR 31.201-2, determining allowability, which states in part, "that costs which are not allocable are unallowable". Although that seemingly leaves allocability to be determined with each passing audit (i.e. the annual incurred cost audit), in fact DCAA CAM (Contract Audit Manual) has some contrary implications. CAM 6-606.1(c) indicates that methods of allocation which have been tested over an extended period of time and determined satisfactory are presumed to still be satisfactory. However, when the nature of the business changes substantially, the existing methods may not be appropriate and the auditor must evaluate them in accordance with existing conditions.

As stated, it would seem to be some protection from an audit allocability challenge when prior audits have not taken any exception to existing methods. As with any other CAM guidance, it is not regulatory and it is



subject to interpretation (auditor judgment) as it pertains to the interpretation of the phrase “the nature of the business changing substantially”. Nonetheless, it does provide a basis to disagree with a current auditor’s opinion that a previously accepted allocation method is now deemed noncompliant with FAR 31.201-2. If the current auditor asserts that CAM 6.606-1(c) does not apply because the existing method was not “tested over an extended period of time”, one must look at any previously issued DCAA reports to find the answer. In particular, if an annual incurred cost audit or even a forward pricing rate audit indicated that the audit criteria was FAR and there were no audit reported qualifications concerning the allocation methods, the existing method was (by definition) tested.

At the very least, a current auditor should only consider a challenge to an existing allocation with his/her discussion of the substantial changes in the nature of the contractor’s business as opposed to merely asserting that an existing and previously audited method is noncompliant.

## JOINT VENTURES, TEAMING ARRANGEMENTS AND OTHER AGREEMENTS: WHO’S B&P IS IT?

Teaming and other “joint” arrangements are routinely used in pursuing new business including teaming arrangements to pursue a specific solicitation. While such arrangements may enhance the chance for a successful bid, contract award, contractors should proceed with caution in terms of an agreement which includes a requirement to submit a proposal. One reason for caution comes from DCAA’s CAM, Section 7-1506 Cooperative Arrangements/Agreements. The final sentence in that section (subparagraph b) states that “when contractors form a teaming arrangement where a new business segment is established, whether a separate legal entity or not, B&P efforts of that new business segment are allocable only to the contracts of that entity”. Of course, in many applications, the new business segment will only have contracts if it is successful on the bid which is otherwise generating the B&P costs.

Contractors routinely create or at least consider a new (G&A) segment, particularly if such a segment will be a “lean” organization with limited G&A structure/costs. Although such strategies may provide a competitive advantage, it comes with a price should the new segment be unsuccessful in its bid in which case, the “B&P allocable to its contracts” is simply a loss (no means to recover the B&P costs). One additional note of caution, DCAA auditors do misinterpret the guidance and do assert that B&P costs for a joint venture or teaming arrangement are allocable solely to the other entity (without fully understanding that in many cases, the new entity is merely a “shell” and that actual contract performance and its associated allocation base will still reside with the existing business segment). As has been noted by many authors over the years, joint ventures in particular, are not well understood and do present risk merely because it’s an unfamiliar concept. Suffice to say, proceed with caution.

## FY09 DOD AUTHORIZATION BILL

The Senate passed the Fiscal Year (FY) 2009 defense authorization bill inclusive of a few provisions which will impact most defense contractors. Notably, the authorization bill did not include several contracting amendments within a “manager’s package”. In terms of what did pass, the creation of a database covering integrity and performance of DOD contractors awarded contracts over \$500,000 and “balanced competition” between US and Foreign owned firms where offerors cannot submit lower priced proposals as a result of not having to pay payroll taxes.

The latter provision is a response to criticisms of off-shore corporations who typically hire US ex-patriots (Ex-Pats)

thus avoiding any requirements for traditional payroll taxes (e.g. FICA). The restriction applies to defense contracts in excess of \$10 million which appears to leave open individual task orders below that threshold.

There is an additional provision requiring the CAS Board to revisit the exemption applicable to contracts executed and performed in a foreign country notwithstanding that the CAS Board did so in 2008 and lacking any significant public response, left it unchanged.

## TRAINING OPPORTUNITIES

October 17

### Accounting & Auditing Update Seminar

Beason & Nalley, Inc.  
Huntsville, AL

October 28

### FAR Part 31 Cost Principles Training Course

Beason & Nalley, Inc.  
Huntsville, AL

October 28

### Military Affairs Council Roundtable Breakfast Meeting

Beason & Nalley, Inc.  
Washington, DC

### Federal Publications Sponsored Seminars – Calendar Year 2008 Schedule

October 22-23

### A Practical Guide to Incurred Cost Submission (ICS)

Flamingo  
Las Vegas, NV

November 13-14

**A Manager's Guide to EVMS**  
Marvin Conference Center  
Washington DC

December 9-10

**A Manager's Guide to EVMS**  
Flamingo  
Las Vegas, NV

December 11-12

**Government Contract Accounting Systems Compliance**  
Flamingo  
Las Vegas, NV

#### Instructors

- Mike Steen
- Darryl Walker
- Scott Butler
- Chad Braley
- Courtney Edmonson
- Cyndi Dunn

Go to [www.fedpubseminars.com](http://www.fedpubseminars.com) and click on the Government Contracts tab or call Beason & Nalley, Inc. at 256.533.1720.

## Specialized Training

Beason & Nalley, 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. Sandra Baker at [sbaker@beasonnalley.com](mailto:sbaker@beasonnalley.com), or at 256.533.1720.

## Reader Inputs for Future Newsletters

Beason & Nalley, Inc. develops its topics based upon recent regulation, publicly accessible government policies and our experience in assisting clients with regulatory compliance. However, we are also interested in the ongoing compliance experiences of our readers; hence, we invite your input in terms of suggestions for topics based upon your compliance experiences. Suggested topics along with any background information (i.e., your experience) should be sent to [sbaker@beasonnalley.com](mailto:sbaker@beasonnalley.com).

Beason & Nalley, Inc. provides accounting, business, financial and consulting services with a focus on serving government contractors. Beason & Nalley, Inc. goes well beyond the bounds of what one would normally consider to be "typical" services. We provide services such as government contracts services, outsourced accounting, audit, tax and Deltek GCS Premier® and Deltek Costpoint® consulting and more. Our goal is to provide the business owner with options for their financially related administrative needs. Our service list is comprehensive. Contact us:

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