

How to Survive a DCAA Audit



How to Survive a DCAA Audit - Overview

Areas of interest and expectations of a typical audit:

1. Introduction
2. The DCAA and Types of audits
3. Preparing for the audit
4. Responding to the auditors request
5. Dealing with auditors
6. Minimizing exposure to fines, penalties, and interest.

1. Introduction

- Cost and pricing mean different things to different people in different firms in different agencies. However, the basic concepts are at the core of all.
- Understanding the concepts will improve chance of success
- You must become very familiar with the unique requirements and environment of government contracting before you can make it work for you. It is ever evolving and changing!

Penalties for Mischarging

Criminal Penalties for Manipulation of charges under 18 USC 1001 reads as follows:

Whoever, in ANY MATTER, knowingly and willfully

1. Falsifies, conceals or covers up... a material fact;
2. Makes any materially false, fictitious or fraudulent statement or representation; or
3. Makes or uses any false writing or document knowing the same to contain any materially false, fictitious or fraudulent statement or entry;
4. Shall be fined or imprisoned for not more than 5 years, or both.
5. Penalties may be assessed for including costs in final indirect cost rate proposal which are:
 - expressly unallowable costs, or
 - costs previously determined unallowable



It is impossible to memorize all of the rules, regulations, guidelines, etc. needed to do your job well and succeed.

However

You can learn to find, select, and use tools and resources for issues and situations specific to your firm.



What Do We Mean By Tools?

- Books - Related to your field
- Related Websites
- FAR – Federal Acquisition Regulations
Also related FAR Supplements (e.g. DFARS)
- Defense Contract Audit Manual
- Information for Contractors per DCAA
- Specialized Workshops and Training
- Specialized Newsletters or Associations



Learn how to navigate and use all to get results

Remember

The process of acquiring wisdom takes time.

Some things are learned only through the school of experience.

**Understanding the cost and pricing process takes
time and repetition, repetition, repetition....**

Don't forget to commit resources to this area!



The DCAA and You (Defense Contract Audit Agency)

- The audit agency responsible for carrying out the audit function for contracts with the Department of Defense (DoD).
- The **best known** and **most influential** of the various Government audit agencies.
- Makes its services available to many other civilian agencies

Types of Audits

The Defense Contract Audit Manual (CAM) depicts the numerous types of audits performed. More familiar are:

- Pre-award survey/audits
- Incurred Cost Audits
- Cost Estimates & Price Proposal Audits
- Labor/Timekeeping Audits

Chapter 14 of the CAM lists numerous other types and there can be many types within the main categories

Audit Issues to Consider

- 1. Request a list of what auditor is looking for**
- 2. Request an estimated time frame/length**
- 3. Audit time will depend on completeness and adequacy of the proposal and support.**
- 4. Auditor should be granted access to required information**
- 5. Auditor will determine allowability based on Reasonableness, Allocability, GAAP, CAS, Contract Terms, and FAR 31.**
- 6. Be prepared to provide supporting schedules and other documentation in detail if required**
- 7. Request a copy of audit report**

General Audit Interests

- All activities related to proposed or incurred costs of government contracts**
- Financial Policies, Procedures, and Internal Controls**
- Opportunities for contractors to reduce or avoid costs**
- Contractor Compliance**
- Contractor Self Governance**

Major Areas Of Concern

1. Accuracy and reasonableness of **cost representations**
2. Financial capability
3. Policies and procedures
4. Contractual provisions having significance
5. Internal control systems
6. Management policies

POLICIES & PROCEDURES

- Documented
- Implemented & Complied With
- Consistently Applied
- Distributed
- Management & Employee Training
- Updated, Revised

Pre-award Surveys

FINANCIAL CAPABILITY REVIEW

- Financial statements
- Cash flow forecasts
- Financial history

What Are They Looking For ?

- Adequate Financial Resources To Perform
- Indicators of Solvency

Preaward Surveys, cont'd

- ACCOUNTING SYSTEM REVIEW

- **DCAA will not develop your system**

- Under General Ledger Control
 - Segregation of direct from indirect cost
 - Direct cost by contract
 - Allocation of indirect cost to cost objectives
 - Labor/Timekeeping system
 - Routine Posting (Ability to determine costs charged by contract)
 - Segregation of Unallowable costs

REMEMBER:

No matter how nice your reports, schedules, proposals, or verbal explanations are, it all comes down to:

What is the Basis (Support) for your information?

Documentation, Documentation, Documentation
(Reliable and Verifiable)

Get the picture?

Support can cover a multitude of oversights!

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2. Two Basic Groups of Cost

1.DIRECT COST

2.INDIRECT COST

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Far Part 31 defines these cost as follows

Direct Costs

Any cost, which is identified specifically with a particular final cost objective (contract).

Indirect Costs

An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives.

Typical Direct Cost Groupings

1. Direct Labor
2. Direct Materials
3. Direct Travel
4. Direct Subcontracts/Consultants
5. Direct Equipment and Equipment Rentals
6. Other Direct Cost (ODC's)
 - Special tooling and test equipment
 - Royalties and License Fees
 - Preservation, packaging, and packing costs

Direct Labor - Basis (Support)

- List of internal labor classifications
[In proposal: cross referenced to contract categories]
- Actual labor hours by classification from system reports
[In proposal: cross referenced to technical proposal]
- **Direct Labor rates**
 - Actual current rates or wages per payroll records
 - Historic rates or wages
 - Wage & Salary surveys
 - Legal limits (e.g. service contract act, davis bacon, union, etc.)
 - Signed letters of intent, letters of commitment, etc.

Direct Materials - Basis (Support)

Most Common Is Some Form Of Bill Of Materials

- A listing of all the materials, including part numbers and quantities of all the parts or items required to complete the contract
- Any estimates should identify the item, source, quantity and price
- Vendor quotes or estimates (dated), and
- Historical data for similar items: e.g. - Invoices

Other Direct Costs (ODC's) - Basis (Support)

Description of purpose, vendor quotes and estimates, consulting and other agreements, historical data for similar items, and types of competition used. [Your files should have the details]

– Some types of ODC's

- Special tooling and test equipment
- Direct Consulting
- Direct Travel
- Royalties and License Fees
- Preservation, packaging, and packing costs
- Equipment and Equipment Rental

Indirect Costs - Basis (Support)

- Supporting schedules,
- Spreadsheets,
- Reports,
- Written descriptions, etc.



These should explain and show *in detail* how your Indirect Costs are classified and accounted for in the accounting system. Also describe how Indirect Rates are developed and calculated.

3. Indirect Costs

Broad Categories are:

1. Fringe Benefits & Payroll Taxes
2. Overhead
3. General & Administrative

For each Indirect Cost Pool:

Provide a pool **definition**

Identify pool key **cost elements**

Identify **base** used to allocate pool cost

Federal Acquisition Regulations



The FAR provisions are **subject to interpretation**

FAR parts mainly applying to cost and pricing are FAR Parts 52, 42, **31**, and 15

FAR

What is FAR Part 31?

Provides detailed guidance on cost accounting issues. For example:

- 1. Defines direct and indirect costs**
- 2. Provides guidelines on accounting treatment**
- 3. Identifies allowable and unallowable costs and their treatment**
- 4. Identifies Cost Accounting Standards (CAS) which apply**
- 5. Refers to Generally Accepted Accounting Practices (GAAP) which apply**

FAR on Consistency



To ensure the Individual Contractor (you) treat financial activities using:

- **Same method in like circumstances**

Situation 1

Situation 2

Situation 3

- **Same method over different periods**

Period 1

Period 2

Period 3

FAR on ALLOWABILITY

Those costs that are permissible or acceptable under government contracts.



Allowability Factors:

1. Reasonable in amount
2. Allocable to the contract
3. Acceptable under CAS; otherwise acceptable under GAAP and practices appropriate to the circumstances
4. In accordance with Terms of Contract
5. Allowable per FAR 31.205

Accounting Software

Approved by DCAA

N O N E

**It's not the software,
It's the Setup!**

SF 1408 [item 2] Provisions

- a. Segregation of direct from indirect cost
- b. Direct cost by contract
- c. Logical and consistent allocation of indirect cost to cost objectives
- d. Under general ledger control
- e. Timekeeping system
- f. Labor distribution system

SF 1408 [item 2] Provisions, cont'd..

- g. Through routine posting (ability to determine direct costs charged by contract)
- h. Segregation of unallowable costs

How To Deal With Auditors *(And Other's)*

- Remember That Auditors, Contracting Officer's, Prime Contractor Staff, etc.
 - Are generally normal people too
 - They do make mistakes
 - They do not know everything
- Your **Attitude** can have a direct impact on decisions related to current issues, but more importantly on future issues you may never be aware of.

How To Deal With Auditors (*And Other's*), *cont'd*

- Watch the Attitude, Be Cooperative
- Plan and budget for an Adequate Accounting and Labor/Timekeeping System
- Know Your Cost
- Be organized and prepared to provide supporting documentation for all numbers/assumptions
- Understand risks and materiality of decisions

How To Deal With Auditors (*And Other's*), *cont'd*

- Get to know your contracting officer/price analyst, DCAA supervisor or auditor
- Understand what areas are negotiable and what are not (be flexible)
- Retain someone experienced and trained in this area. (budget for and include the cost in projections)
 - (Use your new knowledge to ask the right questions of potential employees, accountants, CPA's, and consultants)

SUMMARY

Paul's 10 Keys To Cover Yourself

- 1) Get everything in writing including time extensions
- 2) Brief your contracts
- 3) Exclude unallowable cost on proposals, bids, invoices, all submissions
- 4) Provide adequate support for all proposed & actual cost
- 5) Adequate accounting system
- 6) Notify CO or DCAA of major changes in policy or accounting system
- 7) Report any updated information prior to final negotiations, mods, or change orders
- 8) Be consistent
- 9) Maintain files on all activity from award up to contract completion and closing
- 10) Use the contract, FAR and related supplements as your guide. Don't take anyone's word!

Paul's Recommended Websites

1. DCAA www.dcaa.mil
2. FAR www.acquisition.gov/far
3. Gov Store <http://bookstore.gpo.gov>



www.paulgunn.com

Q&A Time



Thank You