

## We Are Not Alone

Written by Nick Sanders  
Monday, 07 January 2013 00:00

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In typical melodramatic fashion we recently posted—

We are perhaps a lone voice in the wilderness. Or perhaps we're that little boy in the crowd, shouting that the Emperor has no clothes. In either case, we say what we mean, and we mean what we say. The truth is out there, whether or not those in power wish to hear it.

*Yeah.* Not so much, actually.

The truth of the matter is that we are not the only voices asking troubling questions. We are not the only fingers pointing out serious problems in the current Defense contract oversight regime. The Government Accountability Office (GAO) has reported significant concerns several times over the past few years. The DOD Inspector General has reported significant concerns several times over the past few years. The Project on Government Oversight has reported significant concerns several times over the past few years. People who know the situation are publicly questioning DOD leadership decisions regarding how contract audits are conducted (or *are not conducted*, as the case may be).

In late December, 2012, the GAO once again [weighed-in](#) on DCAA's audit backlog and its effect on the ability of DOD to close-out physically completed contracts, in a report to the Senate's Committee on Armed Services (GAO-13-131). Basically, it's a *terrible*

report. Not only is it superficial—glossing over important issues—but it is also untimely as well. The work was conducted before DCAA has had much of a chance to evaluate the impact of its recent changes in management approach.

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As a result, while the report spends significant verbiage discussing DCAA's new "risk-based" approach to triaging its audits of contractors' proposals to establish final billing rates, it is forced to conclude that "DCAA has not yet fully developed measures to evaluate the initiative's results and assess whether the changes will require further adjustments" and "it is too early to tell whether DCAA will achieve its goal of eliminating the backlog by 2016, in part because DCAA does not yet know how many proposals under \$250 million ADV will be determined low or high risk and its initial estimates have proven inaccurate." Those types of audit conclusions aren't going to be helping any Senator figure out why DOD can't close-out its contracts.

The audit report devotes significant word count to the May 2011 revisions to the FAR "quick close-out procedures" but fails to discuss whether or not those revisions helped, or *perhaps actually impeded*

, contracting officers' ability to close out contracts. We expressed our opinion

[right here](#)

. We wrote—

... this rule does nothing to streamline contract close-outs. Instead, it gives DCAA sole authority to determine whether a contractor has submitted an 'adequate' incurred cost submission/final indirect cost rate proposal. ... The [final] rule omits any discussion regarding whether the ACO's determination constitutes a 'final decision' under the Contracts Dispute Act. If the determination is a final decision under the CDA, then it is appealable to the U.S. Court of Federal Claims or to the appropriate Board of Contract Appeals. If it is not a final decision, then no appeal is possible.

And any attempt to fight DCAA's checklist approach to adequacy, to argue that certain mandatory schedules are not applicable to the facts and circumstances of a particular contractor, will result in monetary penalties—as the ACO invokes *mandatory* fee withholds that will not [be] released until the contractor agrees (under financial duress) to submit exactly the schedules that DCAA demands.

While we found much to criticize in the FAR revisions, the GAO report had nothing *at all* to say about them—other than to note that even though DCMA had provided its contracting officers with a FAR deviation that permitted them to make "broader use" of quick close-out procedures, "DCMA and the contracting offices we reviewed made only limited use" of them.

*Gee, we wonder why that could be.* Perhaps it's because the rules, even with the DCMA deviation, are still too restrictive? Apparently, GAO couldn't be bothered to address that foundational issue in its evaluation of DOD efforts to close-out aged contracts.

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Still, there were some nuggets to be mined out of the report. We offer the following---

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The DCAA backlog is approximately 25,000 incurred cost audits as of the end of [government] fiscal year 2011, some dating as far back as 1996. This backlog represents hundreds of billions of dollars in unsettled costs, and according to DCAA has quadrupled over 10 years.

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DCAA raised the threshold above which an audit is required based on “Auditable Dollar Value” (ADV) from \$15 million to \$250 million, thereby decreasing the number of proposals automatically qualifying for audit from 5,194 to 659, based on the backlog as of the end of fiscal year 2011. (19,528 out of 24,722—or 79 percent—of contractor incurred cost proposals awaiting audit at the end of GFY 2011 had ADVs of less than \$15 million dollars.)

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DCAA does not yet know how many proposals under \$250 million ADV will be determined low or high risk and its initial estimates have proven inaccurate. DCAA auditors have completed risk assessments on 13,522 contractor proposals that had an ADV of less than \$15 million—out of a universe of 19,528 proposals—as of September 2012. Of 13,522 risk assessments completed, DCAA determined that 7,815 proposals were high risk, or *about two-and-a-half times more than it had initially anticipated*. DCAA determined that the number of high risk proposals is higher than expected because over 3,500 of those proposals belong to contractors with no incurred cost audit history. [  
*Note: we predicted this would be the case.*  
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DCAA officials stated they plan to increase their staffing levels from 4,900 employees in 2011 to 5,600 by 2016.

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By 2016, DCAA estimates it will reduce the backlog and reach a steady state of audits, which it defines as two fiscal years of proposals awaiting review.

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DCAA's ability to reach a steady state by 2016 will also depend on whether DCAA completes its audits within anticipated time frames. However, DCAA was not able to complete the number of audits it planned to in 2012. Specifically, DCAA planned to address 4,065 incurred cost proposals in fiscal year 2012 by, for example, completing an audit or desk review, but the agency reported that it addressed 2,930 as of the end of September 2012. *[Note: that's better than FY 2011 productivity, but still far short of what is needed.]*

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The October 2011 DCMA FAR Deviation allows a DCMA contracting officer to waive the requirement for an incurred cost audit, in consultation with DCAA, when a compelling reason exists. DCMA guidance indicates that compelling reasons may include contracts with funds at risk of canceling, contracts that have been over-age for 6 or more years, and contracts where a contractor's historical final indirect cost rates have been fairly consistent with proposed certified final indirect cost rates. Yet, contracting officers don't make use of their authority. *[Note: perhaps because they are afraid of being criticized for doing so.]*

So that's it for the GAO assessment of why DCAA can't issue audit reports and why DOD can't close-out contracts. While the report provided some interesting insights, we think a reasonable person would agree it failed to even identify, let alone address, the fundamental roadblocks in the various close-out processes. Color us disappointed.

But that's not all we have to report on this topic.

The mid-Atlantic regional audit/accounting firm of Aronson LLC has recently [voiced](#) its concerns about DCAA's backlog of unperformed audits on the blog of its Government Contract Services Group, writing—

... Controllers 'dream' about how they will have to pull data from seven or more years ago by digging through records of the organization that were prepared and filed in a 'logical' manner by their predecessor to ultimately survive the audit. The dream is stressful with a constant search for the documentation to support an expense incurred in some cases seven years ago. The receipt is found stapled to the voucher but it has faded with age and is no longer readable. The

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audit starts and stops for months and years with auditors coming and going; either leaving the agency or being reassigned to another priority. With each new auditor and each delay in the work, inefficiency is the result not an audit report. ...

While the Controllers 'dream' about pulling old documents for an audit; DCAA Directors and Branch Managers 'dream' about the stacks and stacks of ICS's awaiting audit, the piles of work that continue to build and the constant requests for new audits and new priorities. ... DCAA had estimated that there are approximately 15,000 Incurred Cost Submissions awaiting audit (this number has fluctuated in reports but we will stick with this one as a conservative estimate). Per last year's report to Congress DCAA completed 349 Incurred Cost Audits; at this rate we will clear the backlog in approximately 40 years. I am not sure either side will survive! ...

Darrell Oyer, a former DCAA bigwig who has run his own successful government contract accounting consultancy for many years—and who has acted as a mentor to us over the years—has also offered his opinion of the current state of Defense audit. His opinion is not an optimistic one.

As we have previously reported to our readers, DCAA did not fare well in litigation before the ASBCA when contractors challenged audit findings related to questioned Executive Compensation costs. Mr. Oyer expressed his concerns with DCAA's apparent failure to change its audit methodology in the face of two strong repudiations by the Courts. Writing in his December 31, 2012 newsletter, Mr. Oyer stated—

A long-time associate commented on last month's Newsletter regarding DCAA and executive compensation. The basic comment was that from all appearances DCAA is simply pretending that neither case (FJ Taylor nor Metron) ever happened. And likely, internally DCAA has rationalized that DCMA poorly present[ed] the cases. This is but one example of how different DCAA is today versus the years before. In the past when the government lost [a] court decision, the word went out that DCAA should not be using the same approach to pursue similar issues. DCAA management should be embarrassed; however, due to the influx of noncontract auditors into key management positions there is insufficient knowledgeable of government contracting to even know that embarrassment is the operative word. ...

Much of the new DCAA attitude is derived from the difference between a 'contract' audit and an 'internal' audit. For the latter the auditor's word is final. For the former, there is the potential for litigation to correct wrong audit conclusions. It must be shocking to an internal auditor to find that there is a 'higher authority.' [*Ed. Note: E.g., the ASBCA.*] An internal auditor may merely plow ahead despite the lack of merits of a position; whereas for a contract audit, inappropriate findings and decisions may see the light of day and may be corrected via litigation. This 'internal audit' philosophy applied to a 'contract audit' environment provides little value to a besieged contracting officer who must make a 'contract administration' decision with irrelevant internal audit type findings!

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So no, Apogee Consulting, Inc., is not alone in expressing concerns—*grave concerns*—about the management of the Defense oversight regime. In particular, we think Mr. Oyer's comments on the differences between performing internal audits and contract audits are particularly insightful. We've [expressed](#) some of the same thoughts—though not with Mr. Oyer's depth of background experience or his eloquence.

Unfortunately, we've come to the reluctant conclusion that those bureaucrats with the power to change the management—and implementation—of Defense contractor oversight have little to gain by making changes. We suspect they have everything to gain by maintaining the *status quo ante* of inefficient and ineffectual contract audits and administration—of which the inability to timely close-out completed contracts is but one of the many symptoms.

What would seem to be needed is *radical change*, not more of the same. Let us offer some thoughts for consideration.

1.

Get DCAA out of the forward priced cost proposal business. *Entirely*. DCAA does not belong in the business of applying its rigorous audit procedures to what are essentially guesses of future costs to be incurred. GAGAS is simply not applicable to such reviews. DCMA should perform its own cost and price analyses, and negotiate with contractors based on those internal efforts. All those hours that DCAA now spends auditing contractor proposals—the results of which are used to grossly inflate its estimates of taxpayer savings—should be redirected at other audits. The truth of the matter is that DCAA saves taxpayers very little by such audits; the most that can be said of them is that they identify areas in which the DOD negotiators may be able to reduce the agreed-upon contract price during negotiations with the contractor. DCAA has better uses for its scarce audit resources.

2.

DCAA should be forced to determine that a contractor's proposal to establish final billing rates is or is not adequate within 90 days of receiving it. A failure to do so should act like a waiver, and thus the proposal will be found to be adequate after 90 days unless DCAA determines it is inadequate. Though current DCAA audit guidance calls for that determination to be made "timely," that establishes a goal, and a paper one at that. There is

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no downside to taking months to evaluate a contractor's proposal for adequacy, nor is there any downside to determining that a proposal is adequate only to declare (years later when the audit finally starts) that the proposal has now been found to be inadequate. We need to force DCAA to make that adequacy determination quickly, and then stick with it even if audit guidance subsequently changes.

3.

DCAA should be forced to start all "incurred cost" (10100) audit assignments within 12 months of receipt of a demand letter from a Contracting Officer. Any 10100 assignment not started within 12 months should be cancelled, with a letter to the CO stating that the work cannot be performed timely. DCAA should be forced to report to Congress metrics regarding such cancelled audits. FAO Managers should have that metric used in annual performance evaluations.

4.

DCAA should be forced to complete all 10100 audit assignments within 24 months (two years) of starting them. For ADVs of less than \$15 million, it should be forced to complete the 10100 assignments within 12 months of starting them. Failures to complete the work timely should be reported to Congress, along with the causes. DOD IG should review all such reported audit failures to verify the root cause(s) and recommend appropriate corrective actions. Metrics on cancelled 10100 assignments should be used in annual performance evaluations of all staff.

5.

DCAA should be forced to issue *all* audit reports within six months of completion of testing and field procedures. Any audit reports not issued after that time should be cancelled and reperformed. In such cases, the cognizant Supervisory Auditor and FAO Manager (and other interested parties such as Tech Specialists) should have a letter of reprimand placed in their files. Any individual who receives more than two letters of reprimand in one year should receive an annual performance rating of "Needs Improvement."

6.

DCAA must get back in the mode of performing business system reviews and other MAAR-type audits, so that it can rely on the contractors' reported data. DCAA used to have a system where the "incurred cost" assignments built on a foundation of system reviews and other compliance audits. Nowadays, the prevailing philosophy is that every audit report must stand alone, on its own. That philosophy leads to additional testing and working paper requirements, which slows down the audits. The audit agency needs to get back to its old

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integrated-audit approach. If it doesn't, then virtually every contractor is going to be assessed as a "high risk" contractor, because it will have too many unassessed business systems. And consequently DCAA won't be able to take advantage of its new "risk based" audit approach.

7.

With respect to the new "risk based" audit approach that permits a percentage of contractors' proposals to establish final billing rates to go completely unaudited, we have only one comment. ***DON'T.***

So to sum this all up, there are many parties—both within and outside of government—who think the current DCAA approach to managing its audits has left the Defense Department in an untenable position. Or (as we used to write in audit reports) "there is room for improvement". We are not alone.

But when looking at recent DOD IG and GAO reports of the situation, we tend to think we are alone in pointing out some of the issues, and making concrete recommendations for corrective action. We wish that were not the case; but it seems very much to be so. We think it's time—past time—for the other guys to start earning their salaries.