Written by Nick Sanders
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Oh this is a good one.

If you've read our stuff, you know that this so-called "issue" has *never* been an issue except in the minds of a couple of DOD Senior Executives and some DCAA auditors. Essentially, it's an issue that's been almost entirely fabricated and hyped-up to amazing levels, when in reality it's been (at best) a minor ankle-biter that never amounted to a pittance of an immaterial impact at any major contractor ever audited.
[1]

In our view, it has become the poster child that illustrates how a few DOD leaders, fed by misinformation from below and eager to trumpet a new assertion of contractor misbehavior, have used their power to exercise contractors for no good reason.

We discussed this issue in some depth in **this article** .

We explored some of DCAA's "audit findings" related to the issue **over here** . We cited several examples of questionable "findings"—including one audit report wherein DCAA questioned $20 million of health and dental insurance costs "because the contractor lacks adequate documentation and internal controls to verify eligibility." And that was just one of the bizarre ineligible dependent "findings" DCAA foisted off on Contracting Officers as a result of allegedly GAGAS-compliant audits.

Regardless of our views on this "issue," the DAR Council believes it's real—to the extent that it is in the middle of **an attempt** to revise the DFARS in order to penalize contractors for failing to spend many thousands of dollars in order to prevent the incurrence of a few hundreds of unallowable dollars (metaphorically speaking).

DCAA may have finally realized that its approach to this issue was flawed, because it just issued new **audit guidance** . The MRD states—

This memorandum transmits a February 17, 2012 memorandum from the Director of Defense Pricing (DDP) to the Directors of DCAA and DCMA regarding unallowable costs for ineligible dependent health care benefits. The DDP memorandum states that costs incurred for ineligible dependent health care are unallowable under FAR 31.201-3 and violate the selected cost principle at FAR 31.205-6(m); however, these unallowable costs are not expressly unallowable.

Therefore, auditors should not pursue application of penalties under FAR 42.709 to the questioned ineligible dependent health care benefit costs. Accordingly, auditors also should not cite contractors that fail to exclude these costs from Government contracts for noncompliance with CAS 405.

We are updating the guidance provided in MRD 09-PSP-016(R) and MRD 11-PAC-002(R) for the clarifying guidance provided in the DDP memorandum and will incorporate it into CAM 7-505, 7-506.6, 8-502.5, and the audit program titled Incurred Insurance Cost, CAS 416 and FAR Compliance. Accordingly, once the guidance is updated, we will cancel MRD 09-PSP016(R) and MRD 11-PAC-002(R).

Well, isn't that *special*.

The audit guidance first issued in August, 2009, is being rescinded because the Director of Defense Pricing told DCAA it was wrong. Let's be very clear on this: *it's been nearly four years since the audit guidance was issued*
. It's been nearly four years that DCAA has been tormenting contractors and forcing them to support audits and to prepare CAS cost impacts for an imaginary non-compliance with CAS 405. It's taken four years for everybody to calm down and take a deep breath and realize that they have been wasting everybody's time.

And wasting many thousands of taxpayer dollars.

The audit agency is changing course. What should the auditors (and Contracting Officers) do with the old reports? Here's what the MRD says—

In instances where a FAO issued a report in which it identified ineligible dependent health care benefits costs as expressly unallowable and recommended the application of penalties, the FAO will need to supplement the report or document that a supplement would not serve a useful purpose. If the FAO issued a report citing the contractor for noncompliance with CAS 405, the FAO should consider the DDP memo a subsequent event that, if known at the time the FAO issued the audit report, would have affected the audit results. When this type of event occurs, Generally Accepted Government Auditing Standards (GAGAS) require that the auditor disclose this information to the parties currently relying on or likely to rely on the audit report. The disclosure to the contracting officer should describe the nature of the subsequently acquired information and the affect it would have had on the audit report. *It should advise the recipient not to rely upon the audit report. The FAO also should include adequate documentation in the working papers and the FAO's permanent files to ensure that auditors no longer rely on the audit report.*

[Emphasis added.]

So here's the thing.

It's nice that DCAA has admitted a mistake. It's nice that the audit reports issued under the past four years of erroneous guidance are (in effect) being rescinded. That's good.

DCAA was wrong. We've been telling our readers that DCAA has been wrong for four years. And they have finally admitted it—but *only because Shay Assad told them so*. Not because they recognize what the FAR says, but because a Senior Executive at DOD told them they were wrong.

Why does it take a memo from DDP to get DCAA to reassess its position? Does the audit agency not have sufficient internal resources to determine—on its own—what its audit positions should be?

More to the point, if DCAA changes its positions on regulatory compliance solely based on the direction of an outsider—somebody who's not even a CPA—what does that say about the independence of DCAA?

Think about it.

1 At a recent industry meeting, we heard from many major defense contractors. All had been dealing with this issue. All had spent thousands upon thousands of dollars evaluating their employees' claimed dependents, and supporting DCAA audits. *None* had found any issues with ineligible dependents that impacted their healthcare costs to a material extent. That's not to say that there were no ineligible dependents: there were. It's just that the premium and/or claim costs associated with ineligible dependents was trivial in amount.