It seems the past month – the first month of 2016 – has been devoted to discussing DCAA. It's not that we have an obsession with the Defense Contract Audit Agency (though it's entirely possible that we *do* have such an obsession); it's more like those are the stories that compel us to sit down in front of keyboard and monitor and bang some words out. As we've noted before, we don't write stories that don't seem interesting to us. What's going on with DCAA right now has caught our interest and thus the proliferation of articles.

Today's article is more about the Department of Energy than DCAA, but we think it points to one means by which DOE is going to cope with the loss of DCAA audit services. The Department will have more than one strategy, to be sure. In fact, we heard from a local source that at least one large site in the Nuclear Complex is talking to independent auditors about filling the hole left by DCAA. But that's not what this article is about.

Today's article is about having Management & Operating (M&O) contractors perform audits of their subcontractors.

For those who may not know, M&O contracts – and associated M&O contractors – have been central to the DOE business model since just after World War II. The M&O contractors operate the large laboratories and nuclear complex sites that comprise large portions of the DOE

mission and, as such the M&O contractors are essentially extensions of DOE management. In the words of one early report to Congress—

The working relationship between the Commission and its operating contractors resemble in some respects those between industrial companies and their branch offices. The contractor undertakes to carry on an extensive operation; the Commission establishes the objectives and makes the decisions required to fit the operation into the national program, and exercises the controls necessary to assure security, safety, desirable personnel administration, and prudent use of the public funds.

The DOE M&O contracts are relatively unique but the FAR recognizes them. Under the authority of FAR Subpart 17.6, the Department of Energy Acquisition Regulation (DEAR) has a Part 970 that supplements the FAR and governs the solicitation, award, and administration of DOE's M&O contracts. Interestingly, DOE reports that "In addition, various other Federal agencies have at times recognized DOE's 'special relationship' with its M&O contractors. Prior to enactment of the Competition in Contracting Act in 1984 … the Comptroller General asserted jurisdiction over protests against the award of subcontracts by DOE's M&O contracts, a very limited instance of GAO's assertion of protest jurisdiction over the award of subcontracts under a specific type of contract."

As is relevant to this article, DOE relies "on the DOE Inspector General for auditing its M&O contractors [and] DOE requires the M&O contractor to maintain an internal audit function, which performs critical audit functions under DOE's Cooperative Audit Strategy." Thus, it can be seen that while the DOE IG audits the M&O contractors, those same M&O contractors are being required to audit their subcontractors as part of the "cooperative audit strategy." In other words, DOE doesn't need DCAA to audit a very large portion of its contract portfolio, because the agency holds the M&O contractors accountable for auditing their subcontractors and it relies on the IG to audit the M&O contractors.

A recent example of this evolution was provided by DOE IG audit report number **OAI-V-16-03**. That audit report reported on findings from the IG's audit of Brookhaven National Laboratory, managed under an O&M contract by Brookhaven Science Associates LLC ("BSA").

The audit report discusses DOE's "cooperative audit strategy" with some detail, noting that—

The Department's Office of Inspector General, Office of Acquisition Management, integrated management and operating contractors, and other select contractors have implemented a Cooperative Audit Strategy (Strategy) to make efficient use of available audit resources while ensuring that the Department's contractors claim only allowable costs. This Strategy places reliance on the contractors' internal audit function (Internal Audit) to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with the Strategy, BSA is required by its prime contract to maintain an Internal Audit activity with the responsibility for conducting audits, including audits of the allowability of incurred costs. In addition, BSA is required to conduct or arrange for audits of its subcontractors when costs incurred are a factor in determining the amount payable to a subcontractor.

Basically, then, the DOE IG audits the work performed by the M&O Internal Audit function, which is responsible for auditing the M&O contractor's claimed costs as well as the claimed costs by the contractor's "flexibly priced" subcontractors.

In this case, the DOE IG found nothing with respect to the audits of BSA's claimed costs. Per the audit report—

Based on our assessment, nothing came to our attention to indicate that the allowable cost–related audit work performed by BSA's Internal Audit could not be relied upon. We did not identify any material internal control weaknesses with cost allowability audits, which generally met the International Standards for the Professional Practice of Internal Auditing (Standards) prescribed by the Institute of Internal Auditors (IIA). BSA's Internal Audit identified $1,027,133.24 of questioned costs during FYs 2012 and 2013, all of which had been resolved.

However, the IG found two issues with respect to BSA's audits of its subcontractor's claimed costs. The IG found that (1) BSA was not performing "interim audits" of flexibly priced subcontracts, and (2) BSA was not performing any audits whatsoever on its time-and-materials (T&M) type subcontracts.

With respect to Finding No. 1, in fact BSA did perform reviews of interim vouchers submitted by its subcontractors, in order to detect unallowable costs and prevent them from being paid. However, the IG found that approach was insufficient to meet requirements. The IG emphasized that subcontractor audits "at a minimum" should meet IIA standards. Neither the personnel performing the voucher reviews nor the procedures being performed met those standards. BSA concurred that invoice reviews were not "audits" and that audits would be

performed on “higher-risk” subcontracts.

With respect to Finding No. 2, the IG audit report stated—

A BSA official initially stated that time-and-materials subcontracts were not audited because they were considered low risk, as they have fully negotiated labor rates and the hours utilized were reviewed for technical sufficiency. However, time-and-materials subcontracts often include variable costs, such as materials and travel, which should still be audited. In a subsequent discussion, other BSA officials acknowledged that time-and-materials subcontracts should have been considered for audit because these types of subcontracts have attributes of cost-type subcontracts. We were informed that BSA plans to include time-and-materials subcontracts in future audit universes.

So this may be the future in a world where DCAA no longer performs audits. The non-DoD Federal agencies will pay their big prime contractors to perform the audits that DCAA no longer performs, and will hold them to similar standards. (Though of course the IIA standards are not the same as GAGAS.) The prime contractors will hire auditors, develop procedures, and implement them—and then bill the Federal agencies for the effort expended in doing so.

And as we noted, while DOE is holding its M&O contractors accountable for performing audits on their subcontractors, we are told the agency is talking to independent CPA firms to cover the rest of its contracts.

Is this the model of the future? Obviously we don’t know for sure, but it seems to be working for the Department of Energy.