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Wednesday, 11 April 2012 00:00

On March 22, 2012, the Defense Contract Audit Agency (DCAA) issued audit guidance concerning the proper charging of Bids & Proposals (B&P) and Independent Research & Development (IR&D) costs. This topic is not new to readers of this blog. Indeed, in December, 2011, we **told you** about the policy memo from Shay Assad (Director, Defense Pricing) that addressed this very topic. In fact, the bulk of this particular DCAA Memorandum for Regional Directors (MRD) is essentially a letter of transmittal of that Assad policy memo. (Why it took DCAA four months to pass the memo to its auditors remains a mystery.)

We already reported on the Assad memo (link above) but DCAA has added some additional pointers to assist its auditors. (When do they not?) The MRD states—

Auditors should examine disclosed practices and report a noncompliance with CAS 402 and CAS 420 if disclosed practices allow the contractor to charge proposal costs directly, absent a specific contractual provision for the effort. Auditors should be alert for vague and misleading wording in the disclosure statement that could lead to direct charging proposal costs that are not specifically required by an existing contract. If the examination is not within the scope of a current assignment, a focused audit of the specific cost accounting practice should be initiated under the 19100 activity code. Identified noncompliances should be reported immediately under the 19200 activity code. In addition, auditors should test proposal preparation costs identified in forward pricing and incurred cost audits for compliance with CAS 402 and 420.

Why do we take issue with the foregoing audit guidance?

First of all, our experience with this issue (and we have *lots* of experience with this issue) tells us that the “specific contractual provision” is not a clear as the audit guidance would presuppose. By way of explanation, let’s discuss a hypothetical example. Suppose you have a contract and the contract is silent regarding submission of a follow-on proposal. Then one day you receive a phone call from your authorized Contracting Officer, telling you to prepare a follow-on proposal and charge proposal preparation costs to the existing contract. What do you do?

In our view, if you have explicit direction from a Government representative with authority to direct you, then you follow that direction. (Unless, of course, if following the direction would lead you into a cost accounting practice that would be inconsistent with your disclosed or established cost accounting practices. Contracting Officers do not have authority to direct a contractor to violate a statute.) In this case, the CO’s direction essentially added the follow-on proposal to the list of contract deliverables (CDRLs). Since the proposal was a contract

deliverable, the costs of preparing that proposal should be treated as direct costs of the benefiting contract.

So that's what the DCAA audit guidance missed.

Second, we are apprehensive that DCAA auditors will have little if any idea exactly what "vague and misleading wording in the disclosure statement" might look like. In our experience, Disclosure Statement language is, by necessity, general and somewhat vague regarding specifics, since the language has to cover all situations. So we think that bit of direction will lead nowhere good.

Finally, readers of this blog may have familiarity with our views on DCAA audit quality and timeliness. (How could you not? We cram it down your throat every week.) This guidance directs auditor to "test proposal preparation costs" in contractors' new business cost proposals, as well as in Final Incurred Cost Proposals (FICP) for compliance with CAS 402 and 420. (Add to that also testing within Forward Pricing Rate Agreements.) It's not that we object to CAS compliance testing within those assignments—we have no problem with that, assuming that DCAA can perform its work timely. But the problem is that the audit agency *cannot* perform its work timely right now. Adding to the workload will only add to the duration of the audits. And that serves nobody.

If DCAA wants to evaluate contractors' compliance with the Cost Accounting Standards, then have at it. But don't try to cram in yet another tasking within the already high priority and high stress forward pricing and FICP audits.