

DCAA Implements Major Changes to Incurred Cost Audit Program

Written by Nick Sanders

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On May 2, 2012, the Defense Contract Audit Agency issued MRD 12-PPD-014(R), announcing that the audit agency had eliminated the standard audit program for auditing the “incurred costs” of “non-major” contractors. Instead of having two audit programs—one focused on the larger “major” contractors and the other focused on the smaller, less risky, “non-major” contractors—the audit agency will henceforth have only one audit program for performing “incurred cost” audits.

The agency offered no substantive explanation for the change, reporting only that—

As part of Policy’s ongoing assessment of current audit programs supported by the Strategic Plan Ad Hoc on Incurred Cost, an in-depth review of the major and non-major incurred cost audit programs was performed. Based on this assessment, a decision was made to eliminate the non-major incurred cost audit program.

As readers know, we (and others) have opined that DCAA’s policy choices regarding GAGAS compliance and audit prioritization (as well as other choices we could list) have led the audit agency to an untenable place where its backlog of unperformed/uncompleted audits is too large to reduce in any meaningful way. A recent Federal Times editorial suggested that the Contract Disputes Act’s Statute of Limitations would soon render much of the backlog unauditible. That’s not necessarily true, but it’s very possible that the CDA SoL would make any Government action to collect money (allegedly) owed from DCAA audit findings unenforceable in court, should a contractor choose to contest them. So there would be little point to performing the audits.

Some might suggest that DCAA is undertaking this significant reform in order to speed the audits. We don’t know. We did notice that the MRD emphasized (for the first time in recent memory) the use of auditor “professional judgment” in order to “tailor the audit program to

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efficiently and effectively accomplish the audit objectives.” In fact, the MRD states—

In tailoring the audit program steps, the auditor, in consultation with his or her supervisor, should apply professional judgment, considering the significance of the claimed amounts and known risk factors. Auditors are reminded that the standard audit program provides the overall framework for performing the audit in compliance with GAGAS and it is expected that the program will be tailored for the specific contract audit based on the risk assessment.

So now there is one approach to performing “incurred cost” audits, and it is based on every contractor being as risky as the larger contractors. The funny thing is, DCAA did not extend the logic into other areas. For example, the 10310 audit program, entitled “Audit Program for Non-Major Contractors Labor Floorchecks,” still maintains the distinction between major and non-major contractors. Hmmm....

We have seen it suggested, by self-identified current and former DCAA employees, that the agency intends to reduce its enormous backlog by “risking-away” the smaller dollar value audits. As we [told you](#), one commenter wrote—

Concerning the incurred cost workload, the plan for getting current is to sample the submissions that are less than \$250M. Those that are less than \$1M will likely never be audited because HQ views those audits as cost losers, which is no wonder given the amount of preparatory work (the risk assessment, increased transaction testing, and the greater number of reviews) now required. HQ is talking about more and more sampling (leaving more submissions completely unaudited), which will certainly incentivize some contractors to push the envelope when it comes to questioned costs. ...

Another commenter asserted—

... DCAA wants to waive all possible incurred cost audits under \$1 million too. And the metrics will show that we actually completed these audits. Waiving 1 low dollar incurred cost = completing 1 (only in DCAA does 0 = 1). Then there's our audit guidance - all of our audit guidance is being written for the largest contractors. Does our upper management get the risks at the nonmajors especially at a time when there is less spending and companies are going out of business or being bought out? ... We can get plenty of these audits done if we had the prior audit programs that were geared towards non-major contractors. The new B2 is overkill and redundant. It's confusing. It's too much for a small contractor where an audit is performed by 1 person. Who really understands it? It's not user-friendly for auditors. Then it appears HQs wants to staff up the largest contractors with more people because that's the only places where risk exists to them. ...

Well, we certainly don't know what's in the minds of DCAA leadership. Quite possibly the

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intention is to re-emphasize auditor judgment—a move that we would heartily endorse. Or perhaps, as the commenters quoted above implied, there is an ulterior motive behind the elimination of the “non-major” contractor category with respect to incurred cost audits. Again, we do not know.

But we know that the smaller, formerly “non-major” contractors should prepare themselves for a rough ride.