

Starting 2013 with a Look at 2012

Written by Nick Sanders

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For the first couple of years this site was active, we always started off the New Year with an open letter to the Director of the Defense Contract Audit Agency (DCAA). But that was just a stunt; we never actually believed that the Director would have either the time or inclination to read our letter. And even if he did (by some miracle) read our letter, it never seemed to make any difference. So we discontinued that practice.

Even so, we still like to start off a New Year with something special. It's a hopeful time and we like to offer some hopeful thoughts to those fellow government contracting enthusiasts who read this blog. This year, we wanted to start off by looking back at the past twelve months' worth of events, to see if they might foretell something about the next twelve months to come.

The first thing that stands out about 2012 is that many people woke up to the fact that DCAA had mismanaged itself into a corner. In responding to 2008 and 2009 Government Accountability Office (GAO) findings that too many of its audits were of poor quality, and to the "expiration" of its externally reviewed quality control system, the audit agency seemed to go out of its way to create a culture that emphasized work paper documentation at the expense of actually issuing audit reports. Auditors spent so much time performing risk assessments and documenting the files in preparation for one internal review after another—and then re-performing work and preparing additional file documentation in response to review "notes"—that the productivity of the entire agency fell like a boulder falling off a cliff.

Audit quality actually may have improved. We don't think so but, then again, we don't see every audit report. However, even if audit quality did improve, timeliness crashed and burned. The backlog of audits has grown over the past four years, and is now at the point that it's nearly unimaginably large. And that fact got noticed in 2012.

The Defense Department—led primarily by the Honorable Shay Assad—took action to try to help DCAA with its audit backlog problem. The assistance did not come in the form of helping the audit agency reform its management approach or in the form of helping the auditors figure out how to audit faster while maintaining audit quality. Instead, the assistance came in the form of shifting the workload away from DCAA and permitting DCAA to waive certain audits that it normally would have had to perform.

We didn't think very highly of that bureaucratic maneuver. And we were not alone in that

regard.

DOD's internal Procedures, Guidance, and Instructions (PGI) document was revised to reduce DCAA's involvement in audits of contractor proposals submitted in hopes of receiving new contract awards. As the DOD Inspector General noted, this change had the effect of shifting the proposal analysis workload from DCAA to the Defense Contract Management Agency (DCMA)—who by all accounts was ill-prepared to accept it (having had its own mismanagement crisis that led to the “loss of critical skill sets” in relevant areas). Moreover, as the DOD IG reported, DCAA's own back-tracking on the officially approved PGI revisions led to a situation where significantly less audit hours were saved than had been initially estimated.

In addition, DCAA implemented a new “risk-based” approach to the audits of contractor annual proposals to establish final billing rates (inaccurately called by DCAA “incurred cost proposals”). This new approach stratified the contractor proposals by auditable dollar value (ADV). Lower ADV proposals were subjected to a “risk assessment,” and those proposals found to be “low risk” would have a significantly reduced chance of being audited ... ever.

We'll repeat that: If a contractor's proposal was both low ADV and low risk, it might not *ever* be audited by DCAA, and then it would be up to DCMA to negotiate final billing rates without the benefit of an audit report.

This was a huge sea change in DCAA's audit approach. Formerly, the contractor “final incurred cost proposal” was the primary means by which DCAA audited a contractor's indirect costs for allowability, allocability, and reasonableness. (Which is redundant, because in order for a cost to be allowable it must also be allocable and reasonable ... but we digress.) Even today, the multiple “mandatory annual audit requirements” that DCAA imposes on itself are tied to performance of the “10100” audit of a contractor's proposal to establish final billing rates. So DCAA's decision to not perform a certain (unknown) percentage of its audit backlog in this area is a game-changing management decision. It's so significant that everybody—including GAO—is awaiting the results.

So the big news of 2012 was that DCAA had a ginormous audit backlog, and was going to reduce that backlog by choosing not to perform certain audits that it had formerly considered to be mission essential. It also created “virtual incurred cost audit teams” and shifted workloads internally, between Field Audit Offices (FAOs), so that it could focus on whittling down the huge backlog that still remained even after its policy changes.

Will the 2012 policy changes affect 2013? We're not confident that they will. We believe that DCAA's problems are too intractable and that they will continue to persist. Let us offer some observations in support of that belief:

We noticed that the most recent DOD Inspector General Semi-Annual Report to Congress told lawmakers that DCAA had issued a paltry 22 post-award "defective pricing" audits in the past six months. *Twenty-two. Across the entire audit agency.* And we noticed that the implementation of the still new DFARS "business system definition and administration" oversight regime has been limited to only the very largest defense contractors at this point. And we haven't seen very many CAS compliance audits for a while. And DCAA still has to review Disclosure Statements for adequacy sooner or later. And those timekeeping "floorcheck" audits aren't going to perform themselves.

Just to mention a couple of audit areas that DCAA still considers to be mission essential (as of this date).

Accordingly, we think the backlog of unperformed audits is still there, waiting like the elephant in the room, as soon as Congress picks itself up from the bottom of the fiscal cliff it's just about to run over as we write this. And if Sequestration has the cataclysmic effect predicted by many doomsayers, then DCAA is going to have a backlog of Termination Settlement Proposal audits to add to its already fantastically large pile of unperformed audits.

Sooner or later, somebody on The Mall is going to notice what's happening—and perhaps more importantly *what's not happening*—at DCAA. And then, we predict, the grilling that Mr. Fitzgerald will receive is going to make the grilling that Ms. Stephenson got before Senator McCaskill look tame in comparison.

Many critics like to point out problems without offering solutions. That ain't us. We used to write an open letter to the DCAA Director each year, offering what we thought were practical, constructive, solutions. In addition, we frequently offer suggestions for improvement of Defense oversight on this site. So far, nobody in Fort Belvoir or in the Pentagon seems to be listening.

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Which is fine.

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.

For our readership, we intend to continue telling the truth throughout 2013. To our readers, we wish you a Happy New Year.