

In Which We Say to DCAA: GOOD JOB

Written by Nick Sanders
Wednesday, 10 April 2013 00:00



You would think that, in the more than 650 blog articles published on this website over the past four years, we would have found some complimentary things to say about the Defense Contract Audit Agency. Unfortunately, we have been unable to find very many things for which to praise the audit agency, and thus the complimentary blog articles do not exist. More often, we have been scathing in our assessments of audit guidance and the audit process and lack of quality and lack of timeliness and lack of value-add to the procurement process. It's fair to say we have not pulled many punches with respect to the Pentagon's premier audit agency.

Even in a [recent article](#) about the rescission of a piece of terrible audit guidance—in which we wrote, “It’s nice that DCAA has admitted a mistake”—we still felt compelled to point out that (a) it took DCAA about four years to recognize it was wrong, and (b) that the only reason that agency rescinded the problematic audit guidance was because an outsider (Shay Assad) told them to. And so even in the midst of saying “good job,” we found significant points of policy disagreement.

We’ve promised our readers that, in the unlikely event that DCAA ever warranted it, we would be among the first to offer positive words and praise. Well, readers, we can hardly believe it ourselves ... but here are some positive words and praise for DCAA.

We are talking about [MRD 13-PSP-003\(R\)](#), entitled “Audit Guidance on Developing a Finding in a Price Proposal Audit.” It seems to be a breath of fresh air wafting out of the stinking miasma of the past four years’ of agency audit guidance.

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Which is to say: we like it. *A Lot.*

In all honesty, we were nervous at first, initially bristling at language such as, “the audit team [will be required] to identify and obtain evidence that was not used by the contractor to develop its estimate.” We were prepared to assert that auditors would claim that the contractor’s proposal was inadequate, simply as a pretext for going fishing into the contractor’s accounting system or into other areas. We were nervous that the auditors would be encouraged to substitute their judgment for the judgment of the contractor’s personnel. Happily, that does not appear to be the case.

By way of background, certain larger defense contractors have asserted that a GAGAS-compliant audit simply *cannot be performed* on an estimate of future costs, especially an estimate based largely on application of technical judgment. Those contractors have complained to certain government parties that DCAA’s touting of “audit findings” in the area of price proposal audits is largely smoke and mirrors.

And as you may know, we here at Apogee Consulting, Inc., don’t think much of asserted “taxpayer savings” associated with questioned and/or unsupported costs. We discussed our point of view in some depth in [this article](#). Our position has been that the only savings that should be reported are those that lead directly to Contracting Officer-negotiated price reductions. More specifically, questioned and unsupported costs reported on contractor proposals that never result in an awarded contract should never be claimed as taxpayer savings. The taxpayers saved nothing because the contract was never awarded.

And as you may have gathered over the past 650+ blog articles, we don’t think very highly of *any* audit report that does not assist the Contracting Officer in reaching an equitable negotiated settlement with the contractor. Far too often, DCAA audit findings of “unsupported” and/or “questioned” costs with respect to contractors’ estimated future costs don’t add value to the negotiation process (for various reasons) and thus the Contracting Officer is no better off than if s/he had never requested field pricing assistance in the first place.

Well, the good news is that the new audit guidance seems to be a strong attempt to push auditors into going beyond “questioned” and/or “unsupported” proposed costs and, instead,

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develop meaningful audit findings that would actually add value to the price negotiation process. If implemented as drafted, this could go a long way towards rectifying past problems and returning DCAA to its previous place as an integral part of the DOD contract award process.

The MRD stated—

To ensure our audits bring the greatest possible value to the acquisition process and we deliver a quality product, the audit team should plan and perform procedures to develop elements of a finding that are relevant and necessary to achieve the audit objectives. The audit procedures may disclose that the contractor's estimate does not comply with the audit criteria (i.e., FAR Part 15) because the contractor's estimating method or the set of underlying data used to develop the estimate were incomplete or inconsistent. In these instances, the audit team should gather the appropriate evidence and perform the necessary procedures to quantify the effect of the noncompliance and report the difference as questioned costs. On occasion, this will require the audit team to identify and obtain evidence that was not used by the contractor to develop its estimate. ... The audit team should make all practical attempts to obtain the appropriate evidence and apply the necessary procedures to determine questioned costs. If the evidence obtained from the contractor together with evidence obtained from other sources does not permit reaching a definitive conclusion on the impact of the noncompliance, the audit team should then classify the costs as unsupported.

The audit guidance clearly discourages those auditors who—

... have chosen to immediately classify all proposed costs associated with significantly deficient estimates as unsupported rather than applying the necessary procedures to develop the finding that are relevant and necessary to achieve the audit objectives and quantify the impact as questioned costs.

Instead, the audit guidance directs auditors as follows—

The audit team should develop a sound position by evaluating the contractor's cost data provided in support of its price proposal and, if necessary, other evidence available either in the contractor's files or from other reliable third-party sources. The audit team should gain a clear understanding of the audit criteria, the contractor's basis of estimate, and the underlying supporting data as soon as practical after receiving the proposal. Professional judgment must be used to determine if the proposal is sufficiently adequate for audit, following the guidance at CAM 9-204 (i.e., all reasonably available data has been submitted or identified). If the proposal is deemed adequate, or the proposal is inadequate but the contracting officer maintains the request for audit (see CAM 9-205d), the audit team should design procedures in order to detect noncompliance with the audit criteria (e.g., FAR 15/31). If the estimating method and/or

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the condition of the underlying data have caused the proposal not to meet the audit criteria, the audit team should follow the 'Rules of Engagement' and immediately discuss the potential noncompliance with the contractor to ensure an accurate understanding. If a noncompliance is identified, the audit team should plan and perform procedures to develop the elements of the finding that are relevant and necessary to achieve the audit objectives (2011 GAGAS 5.11).

The MRD includes a three-page FAQ attachment that provides additional reinforcing guidance. It's very helpful and you should review it. For example—

Question 7:

A proposal we are examining includes significant direct labor hours based on engineering estimates, despite the fact that this is a follow-on contract. The contractor contends that the historical hours are not representative of future performance due to design changes directed by the request for proposal. We disagree with the estimating method, believing that historical direct labor hours should be considered. If we use the historical hours to help determine the reasonableness of the proposed hours, we would essentially be fixing the contractor's proposal, which would require a lot of time and possibly impair our independence. Is it appropriate to classify the proposed labor hours as unsupported because the estimating method is flawed?

Answer:

No. First, you should gather evidence to evaluate the contractor's estimating method. If the evidence indicates that historical labor hours, properly adjusted for the effect of validated design changes should have been considered in the estimate, you should use the historical labor hours to fully develop the audit finding. The audit team may disagree with an estimating method, which often requires obtaining and evaluating evidence not used by the contractor to develop its estimate. While the estimating method may not necessarily be a FAR 15 noncompliance, the audit procedures may disclose a portion of the contractor's labor hour estimate is unreasonable (e.g., FAR 31.201-3). The audit team should also consider the need to issue a deficiency report for noncompliance with the DFARS Estimating System Requirements (e.g., DFARS 252.215-7002(d)(4)(ix)). In addition, the auditor is reminded that developing the elements of an audit finding that is relevant and necessary to achieve the audit objectives should not be considered 'fixing' the contractor's proposal and does not impair auditor's independence.

(Note: We do not necessarily agree that 31.201-3 would be applicable to an estimated cost.)

As you can see from the foregoing example, the audit guidance seems designed to direct auditors to do sufficient procedures to develop quantitative, substantive, and value-added findings. It seems designed to minimize "unsupported costs," which are difficult for Contracting Officers to deal with in price negotiations.

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We like it. We like it a lot.

Good job, DCAA! Good job, Donald J. McKenzie, Assistant Director, Policy and Plans!

We need more like this.