



In the [previous article](#) we mused on the panoply of issues confronting the Defense Contract Audit Agency (DCAA), which range from an agency-wide lack of productivity to a pervasive lack of audit quality in the few reports that do manage to slip past multiple levels of review. We discussed how DCAA's systemic GAGAS compliance failures, originally alleged in 2008, 2009, and 2010, continue to haunt the audit agency today. We discussed how DOD has permitted (or perhaps directed?) DCAA to shift the audit workload onto the backs of others, most notably DCMA Contracting Officers and their staffs. The first example of this trend was the decision to have DCAA stop performing "field pricing assistance" on certain contractor proposals, so that the audit agency could focus on more important audits. The Department of Defense Inspector General (DOD IG) questioned that decision and reported it had not led to the performance improvements originally contemplated by the decision-makers.

That decision, which was an intentional effort to reduce DCAA auditor workload by increasing DCMA Contracting Officer workload, was the first step down the road, but it was by no means the last. Other management decisions have continued that trend.

One of those other decisions was the 2010 "contractor recovery initiative" in which DCAA and DCMA teamed-up to disposition some 400 "reportable audits" and roughly 300 DCAA Form 1's that had been awaiting Contracting Officer disposition. We didn't think too much of that initiative [at the time](#) and opined as follows:

If you look closely at the resolution process, and the roles and responsibilities, you'll see that *D CMA has all the actions*

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. Moreover, you'll see that DCMA has to make its dispositions 'in consideration of the DCAA audit report'-which seems very much like direction to the ACOs to 'accept the DCAA audit report as if it had merit'. Well, after nearly three years of GAO and DOD IG criticism of the quality of DCAA audit reports, we don't expect that guidance to result in many fair, reasonable and/or correct ACO decisions.

We didn't remark much on it at the time, but in retrospect CRI was blazing a trail for future DCMA/DCAA/contractor interaction in aspects beyond merely shifting workload to DCMA. Not only did it mark the diminution of "independent business judgment" of the warranted Contracting Officer in the face of a DCAA audit finding, but it also marked the first real use by DCAA of non-GAGAS memoranda and ROMs to quantify the auditors' so-called findings. The reverberations of that particular sea change still echo today.

We were not the only ones to note the sea change. In another article we quoted respected attorney John Pachter (of the firm Smith, Pachter, McWhorter), who opined (in an article published by the ABA's Public Contract Law Journal)-

Contracting Officers must confront the notion, expressed in various ways, that auditors' advice is presumptively correct. Rather than being allowed to rely on the advice of auditors and then make a considered decision as the FAR contemplates, *Contracting Officers now have the burden of justifying their decisions when they differ from those of auditors.*

[Emphasis added.]

The trend continued with the publication in late May 2011 of the FAR revisions ostensibly designed to improve the contract close-out process. Instead, DCAA drove significant changes to the Allowable Cost and Payment contract clause (52.216-7) that required contractors to use the 15 "Incurred Cost Electronically" Schedules developed by DCAA, regardless of whether or not those Schedules actually had anything to do with calculating final billing rates or claiming allowable incurred costs.

This was perhaps the biggest workload shift ever seen to date, and it shifted the workload from those doing the auditing to the contractors being audited.

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Readers, some of those now-mandatory Schedules were previously DCAA audit working papers. Some of the Schedules now prepared by contractors were internal DCAA schedules that used to be prepared by auditors.

For example, Schedule I ("Schedule of cumulative direct and indirect costs claimed and billed by contract and subcontract") is used by DCAA in the preparation of the Cumulative Allowable Cost Worksheet (CACWS). Its creation of Schedule I has nothing to do with claimed costs nor does it have anything to do with calculating indirect cost rates. If it weren't for the necessity of preparing a CACWS, it would not need to be done. Historically it was an internal DCAA working paper that was a data source of the CACWS. After the 2001 FAR changes it became a mandatory Schedule that contractors needed to prepare and submit in the exact required format mandated by DCAA, a format that was designed to provide data into the CACWS. Similarly, Schedule J is simply a listing of awarded subcontracts so that DCAA can request assist audits. Schedule O simply identifies contracts that might be closed-out, if DCAA could ever get around to finishing the 10100 audit. Those three Schedules add zero value to the contractor but DCAA demands the contractor prepare them.

If the contractor declines to take on the auditors' workload, then its proposal to establish final billing rates is determined to be inadequate for audit by DCAA (even though the FAR expressly reserves the right to determine adequacy to the DCMA Administrative Contracting Officer) and the contractor has no right of appeal. Actually, the consequences for a refusal to do the auditors' work are worse than a simple finding of "inadequate for audit."

If DCAA judges that the contractor cannot remedy the alleged deficiencies in its final billing rate proposal within 30 days then it will send the DCMA Administrative Contracting Officer a memo recommending decrements to the proposed direct and indirect costs. What happens after that is solely the responsibility of the ACO, since (as we [told readers](#)) DCAA will close out its audit assignment and drop the proposal from its backlog. In other words, DCAA will wash its hands of the matter and negotiating final billing rates will then become DCMA's problem.

Moreover, if DCAA judges that a contractor cannot (or is unwilling to) submit an "adequate" final billing rate proposal (as defined by DCAA), then the auditors have the option of issuing a deficiency report and recommending that the contractor's accounting system be determined to be inadequate for cost-reimbursement contracting. Not only would that determination lead to a massive erosion of competitive position, but it might well lead to an imposition of payment withholds under the DFARS Business System administration regime. The person who makes

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the final call and prepares the Board of Review package is the ACO and (once again) not the DCAA auditor making the finding. (Naturally, if the finding is not sustained by the Contracting Officer or the Board of Review, then there are no consequences for the DCAA auditor or his/her supervisory auditor or his/her Branch Manager. Nobody ever puts a letter of reprimand in their personnel files for issuing bogus findings that waste the time of the DCMA Contracting Officers and/or the DCMA Review Boards. That's a feedback loop that does not seem to exist. So much for accountability; but perhaps we digress.)

There's more to discuss.

There are some tasks that DCMA has taken from DCAA for itself, apparently because DCAA cannot or will not issue a timely audit report that would actually be of value to a Contracting Officer. The most apparent of these is the review of a contractor's CASB Disclosure Statement for adequacy. This review used to be DCAA's bread and butter; now, it's a review performed by the DCMA Contracting Officer and staff. Similarly, DCMA now issues Forward Pricing Rate Recommendations (FPRRs) without waiting 90 or 120 or 180 days for an official DCAA audit report that will express an opinion on the mathematical accuracy of the contractor's estimate of direct and indirect costs it will record over the next year or two or five. (Let's be clear. DCAA has little if any ability to actually express a supported conclusion on the contractor's forecast of sales and cost of sales and SG&A costs, which is fundamentally a crystal ball-based educated guess as to what the future holds. Guess what? DCAA's guess about the contractor's future is going to be significantly less educated than the contractor's guess. But that disparity doesn't keep DCAA from "questioning" forecasted costs and then reporting those questioned costs as some kind of taxpayer savings that justifies next year's operating budget. *Oops!* Perhaps we digressed once again. Let's wrap this up, shall we?)

At this point we've discussed how DCAA has shifted its former workload over to DCMA, and how DCAA has shifted its former workload onto the contractors. (Did we mention how much pressure is on contractors these days to lower their indirect expenses? It's tough to do that when you're taking on additional workload.) And we've discussed how DCMA has voluntarily taken on some of the former DCAA workload, in what seems to be an effort to move the ball forward despite DCAA's inability to play in the game.

The last item we will discuss is going to be how the Department of Defense is preparing to shift a *huge* piece of DCAA's workload over to the contractors. It's called DFARS Case 2012-D042. Now we confess we haven't seen the proposed DFARS revision. According to the open DFARS [Open Cases Report](#) (dated 4/26/2014) the rule is at OIRA for review. (OIRA = Office of Information and Regulatory Affairs, for those who don't follow Federal rulemaking.) The

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Open Cases Report simply says of the proposed DFARS revision: "Revises business systems clauses to include contractor reporting and documentation requirements regarding contractor compliance with DFARS business systems criteria." Now, that sounds rather benign (unless you know the propensity for the rulemakers to hide their true intentions behind benign-sounding phrases). But according to Adam Eastridge, writing in the March 2014 edition of West's Government Contract Costs, Pricing & Accounting Report, hidden within that proposed rule will be a key policy shift that increases contractor workload. Mr. Eastridge wrote-

The proposed DFARS rule ... clearly has the potential to create additional inefficiencies in both the Government and the contracting industry. The proposed rule would require contractors to pay CPA firms to audit and opine on their business systems. ... [Under the proposed rule] DCAA will no longer be responsible for auditing business systems ... DCMA may view the proposed rule as beneficial because it transfers the responsibility for business system audits away from DCAA. *Excluding DCAA from the process to allow quicker and timely decisions is clearly DCMA's preference, as illustrated in the recent DCMA FPRP guidance.*

[Emphasis in original.]

Again, we have not seen the DFARS revisions (because they haven't been published yet), but Mr. Eastridge clearly has seen a draft. If his summary of the proposed change is accurate, then DOD will once again be shifting the workload from its own staff to the staffs of its contractors. But of course the contractors will not have to hire any new personnel; they will simply hire outside CPA firms to do the work. Sure it will cost money, but it's free money because it's not coming out of DOD's budget. Where is that money coming from? Contractors' prices, is where.

Consequently, it's likely that contractors are going to be required to spend more of their limited indirect funds to pay for external CPAs to review their business systems, a review that will be mandated by DOD and paid for through increased prices for goods and services.

This is but the latest example of how DCAA has reduced its workload. But remember, readers, this workload shift has been happening at the same time as DCAA has been adding additional staff. DCAA has been reducing the workload of its auditors and asking them to do less, while at the same time hiring more staff.

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Yes, you read that correctly. *DCAA is working hard to do less with more, with the official blessing of Pentagon leadership.*

Given the foregoing, we have to ask whether DOD and the taxpayers need DCAA anymore. What is the purpose of an ever-growing audit agency that no longer performs a significant piece of the workload for which it was responsible only a few short years ago? What is the purpose of an audit agency when its own customers prefer to do the work themselves or to push it to others? What is the purpose of an audit agency when its reports lack meaningful value in the eye of its customers?

If DCAA were a commercial audit firm-the kind of audit firm that DOD wants to now audit contractor business systems-then it would be going out of business. Instead, DCAA keeps on hiring. For what purpose? We don't know.

We are reminded of Norm Augustine's musing on the ever-expanding role of the auditor. He wrote:

Auditors, reviewers, inspectors, and other forms of overseers perform a truly important role, but that role can be beneficial only when applied *constructively* and with considerable moderation. The prevailing trend would suggest the existence of an explosion in the overseer business, with an ominous threat approaching that there will soon be no one left for the auditors to audit. When this day of an infinite watcher-to-worker ratio arrives, it will presumably be necessary to focus audits on the mistakes which would have been made had in fact there been anyone doing anything.

[Emphasis in original.]

This blog has existed for more than five years now. In that time we've discussed many different topics. But no topic has been more prevalent, or more popular, than the discussions about DCAA and its evolving role in the defense acquisition process. This website has documented the fall of DCAA and we think that fall will continue. We don't know what DCAA is going to do with its ever-growing audit staff but, obviously, it will not be performing many audits or Disclosure Statement reviews or contractor business system reviews in the future.

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We don't relish the following statement, because we personally know many DCAA auditors and (for the most part) we like and respect those we work with. But the truth is that the DOD audit agency is working hard to put itself out of business and we think it's time to let that happen.

It's time to put DCAA out of business completely.