

Understanding DCAA Compliance

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Introduction

One of the most important aspects of becoming a government contractor is complying with a welter of federal rules and regulations. From the Federal Acquisition Regulation (FAR) to the Generally Accepted Government Auditing Standards (GAGAS), contractors are expected to know—and comply with—all of them.

A key aspect of compliance for contractors is creating business systems that are compliant with the Defense Contract Audit Agency (DCAA), which performs contract audits for the Defense Department and many other agencies.

Over the years, the DCAA's role has changed, and it's important for government contractors to understand the agency's impact on the industry.

This white paper addresses some aspects of what's known as DCAA compliance, and how contractors can reduce risk by avoiding and preparing for audits.

What the DCAA Does

It is in the government's best interests—on ethical, practical and political levels—to ensure that funds are spent properly. One of the ways it ensures that contractors spend money appropriately is through audits. These audits are meant to determine whether contract costs are allowable, allocable and reasonable.

The DCAA performs contract auditing for the Department of Defense (DOD) and certain other federal agencies. The scope of the DCAA's influence is significant. That's because the DCAA provides definitive recommendations to contracting officers that affect negotiations with nearly 7,500 contractors in a typical year. Contracting officers are then better able to negotiate prices and settle contracts for services and supplies using DCAA recommendations.

The DCAA has no direct role in determining which companies are awarded defense contracts; instead, it provides recommendations to the government officials who first select contractors to perform government-funded work and then negotiate prices accordingly for the products and services offered. The DCAA audits only contractors; it has no internal audit responsibilities for the DOD.

In government fiscal year 2012, the DCAA examined over \$150 billion in defense contractor costs and issued over 6,700 audit reports. These reports recommended \$12.4 billion in cost reductions.

These reductions are good news for taxpayers, but also mean that contractors are being increasingly scrutinized.

According to the agency's [fiscal 2012 report to Congress \[PDF\]](#), the DCAA helped contracting officials achieve \$4.2 billion in documented savings

Increasing Risk of Audits for Contractors

Deltek asked government contractors to tell us which audits they have undergone over the past two years. More surprising than the types of audits firms had experienced, was the sheer number of audits altogether.

Three out of four contractors reported being audited by a federal agency during 2011 and 2012. What's more, small businesses were equally as susceptible to auditing as large businesses.

Source: Deltek Clarity GovCon Industry Study, 2013

Audit Reports Completed by the DCAA in Fiscal 2012

Type of Audit Report	Number of Audit Reports	Dollar Value of Questioned Costs (Millions)*	Dollar Value of Unsupported Costs (Millions)**	Average Time to Completion (Days)
Forward Pricing	1,811	\$9,859	\$17,605	110
Special Audits	1,937	\$831	N/A**	217
Incurred Cost	1,795	\$1,538	N/A**	1,184
Other Audits	1,173	\$173	N/A**	384
Total	6,716	\$12,401	\$17,605	N/A

* Questioned Costs are costs that the auditor considers not acceptable for negotiating, a reasonable contract price or not acceptable for reimbursement under existing contracts.

** Unsupported Costs denote instances where the contractor has not provided specific evidence or documentation to support assertions related to the cost of future work. Unsupported costs are not applicable in the case of incurred cost audits, special audits and other audits, because the contractor is not making a claim about the cost of future work.

Any potential cost discrepancies identified by the DCAA in the case of incurred cost audits, special audits and other audits are classified as "questioned costs", where the contractor has not provided adequate documentation to support a claim about the actual costs the contractor has incurred.

to the government. Based on these savings, the return on taxpayers' investment in the DCAA was approximately \$6.70 for each dollar invested.

In fiscal 2012, the DCAA issued 1,811 forward pricing reports and identified over \$9.8 billion in cost discrepancies.

Types of DCAA Audits

The DCAA performs a number of types of audits, including forward pricing, special audits, incurred cost, pre-award and other audits.

Contracting officers may also request an independent financial opinion on specific elements of a contract, in addition to an assessment of compliance with specific acquisition regulations or contract terms, a contractor's business system, and the like. The DCAA typically categorizes these types of requests as "special" or "other" audits.

Forward Pricing

Forward pricing audits are generally completed before contract award. The DCAA evaluates a contractor's estimate of how much it will cost the contractor to provide goods or services to the government.

Special Audits

Special audits can be conducted before or after contract award. Most of the reports in this category are issued in response to requests from contracting officers. In these instances, the contracting officers need an independent financial opinion on specific elements of a contract or on a contractor's accounting business system in order for the contract work to proceed—making special audits a high priority.

In fiscal 2012, the DCAA issued 1,937 special reports and identified \$831 million in questioned costs.

Incurred Cost

Incurred cost audits determine the accuracy of a contractor's annual allowable cost representations. When a contract price is not fixed, the DCAA conducts an incurred cost audit after contract award to determine the accuracy of contractor cost representations.

In fiscal 2012, the DCAA issued 1,795 incurred cost reports (covering 2,735 incurred cost years) and identified \$1.5 billion in questioned costs.

Pre-Award Surveys

Many small businesses are affected by DCAA Standard Form (SF) 1408 pre-award surveys. The major objectives of this audit are to:

- Gain an understanding of the contractor's accounting system
- Complete the SF 1408 form, Preaward Survey of Prospective Contractor Accounting System
- Form an opinion as to whether the contractor's system design is acceptable for the award of a government contract

Contractors that are audited must be able to demonstrate their accounting system to the auditor and implement it before incurring any costs on a contract.

The SF-1408 focuses on a number of areas, including:

- Generally accepted accounting principles
- Cost allocations, indirect and unallowable costs
- Timekeeping system
- Labor distribution
- Billings (e.g., progress payments, public vouchers)
- Accounting system in operation

Other Audits

Other audits primarily consist of audits performed after contract award, and can be requested by a contracting officer or initiated by the DCAA.

The DCAA typically initiates this type of audit when there is high risk, such as where the contractor has inadequate business systems.

In fiscal 2012, the DCAA issued 1,173 other audits and identified \$173 million in questioned costs.

DCAA Compliance 101

The phrase "DCAA compliance" is used widely in the contracting industry, but the agency does not actually certify contractors as "compliant."

Being DCAA compliant means following the agency's recommendations and guidance so that you remain compliant with federal law and are prepared for audits.

DCAA audits are driven by the rules outlined in the FAR, GAGAS and CAS, discussed below.

The primary method of tracking where government money goes is by accounting processes, so it is particularly important that contractors perform scrupulous accounting. Here are the four areas where contractors need to be compliant with DCAA standards:

Federal Acquisition Regulation

The FAR gives federal agencies overarching guidance on audits. FAR Subpart 42 includes this guidance, relevant to contractors: For most contractors, the cognizant federal agency is the one with the largest dollar amount of negotiated contracts, including options. However, contracting officers may request an audit directly from an audit agency.

Generally Accepted Government Auditing Standards

The GAGAS are a set of standards that ensure audit conclusions are well supported by evidence. They provide a framework for conducting high-quality audits with competence, integrity, objectivity and independence. These standards are used by auditors of government entities, entities that receive government awards and audit organizations performing GAGAS audits.

Cost Accounting Standards

Many DOD contractors (with a complex set of exceptions) must comply with the CAS, which are meant to create consistency in pricing and accounting practices.

“We looked at several large and small accounting systems, and found that for our needs and our budget, Deltek First Essentials offered the best overall solution focusing on government-compliant functionality and reporting.”

*Michael Repper,
Director of Finance for
Edvance Research*

To comply, contractors must also accumulate costs by contract to determine their allowability per government regulations. Costs by contract must be classified as either direct or indirect costs. There are also a number of unallowable costs that cannot be charged to federal contracts.

To meet these standards, an accounting system must be standardized and able to separate accounting functions such as timekeeping and accounts payable. It must also be able to address the needs of each type of contract in which the business participates.

Timekeeping and Labor Charging System Requirements

Contractors must also establish timekeeping procedures and use an automated timekeeping system. Employees working for a contractor must understand that they are personally responsible for:

- Recording their time on a daily basis
- Correctly distributing time to cost objective
- Signing the timecard at the end of each work period

Careless or improper timecard preparation may lead to disciplinary actions under company policies, as well as applicable federal statutes.

Unlike other costs, labor is not supported by external documentation or physical evidence to provide an independent check. This means contractors must emphasize to employees that they are responsible for accurately recording time charges and changes.

Consequences of Noncompliance

Every contractor is responsible for remaining compliant with all the government rules and regulations that apply. Misconduct could be exposed by a whistleblower, audit, investigation, Freedom of Information Act (FOIA) request or other means.

The consequences of illegal and unethical conduct or noncompliance can include suspension, debarment, voided or terminated contracts, listing in the Excluded Parties List System (EPLS) and criminal and civil penalties.

Civil and Criminal Penalties

Civil penalties for noncompliance are determined per violation, per invoice. The government can recoup \$5,500 to \$11,000, and the contractor runs the risk of paying the government up to three times the damage.

Criminal penalties are much more serious—up to five years imprisonment for whoever signed the certificate of cost and pricing data.

“It was too cumbersome to work through the University’s accounting and reporting systems. The recordkeeping requirements for government contracts have their own unique characteristics.”

“We knew when we broke away, we would need to substantially improve our ability to document research, track contracts and provide detailed cost accounting and reporting.”

*Terry Rapoch,
President, Wright State
Applied Research
Corporation and Chief
Technologist,
Wright State Research
Institute*

Debarment

Debarment is one of the most serious punishments the federal government can impose on a contractor. A contractor can be debarred for committing fraud in obtaining or performing a contract, violating antitrust laws or a number of other offenses.

A debarment from one agency has government-wide effects. Solicitation bids and proposals from debarred contractors cannot be considered, unless the agency head determines a compelling reason to do so in writing.

Voided or Terminated Contracts

The FAR gives agencies the ability to void and rescind contracts for which:

- There has been a final conviction for bribery, conflict of interest, disclosure or receipt of contractor bid or proposal information
- There has been a final conviction of source selection information in exchange for either a thing of value or to give anyone competitive advantage.
- There has been agency head determination of any of the above.

Get Compliant with Deltek First

Deltek First meets FAR and CAS standards and is fully compliant with DCAA requirements. Deltek First provides internal controls that install rigid checks and balances across your financial and project business processes, including the creation of audit trails.

Deltek’s solutions also include many of the Incurred Cost Submission (ICS) schedules necessary for ICS reporting, eliminating the need for manual creation of these reports.

Deltek First offers everything a small government contractor needs in order to:

- Pursue that first government contract
- Expand targets and cover all contract types (e.g., time and materials, cost-plus)
- Provide confidence to prime contractors as a subcontractor
- Address operational complexity through growth

To learn more about Deltek First and its ability to keep government contractors DCAA compliant, visit <http://bit.ly/11xc4tV>.

[Notes](#)

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