

**NDIA/SBTC Joint DCAA/DCMA Committee
Meeting with DCAA HQ
August 21, 2013**

Attendees:

DCAA -- Joe Garcia, Tom Peters, Carol Sexton, John Shire, Don McKenzie and Chris Andrezze

DCMA via phone -- Joan Sherwood

NDIA/SBTC Joint Committee (SB Committee) -- Russ Farmer (ADA Technologies, Inc.), Heidi Jacobus (Cybernet, Inc.) and Larry Nannis, CPA (Katz Nannis & Solomon PC)

Minutes:

The meeting followed very close to the earlier agreed agenda (attached) with the SB Committee identifying their list of immediate problems that needed to be addressed and resolved (see agenda). There was no voiced disagreement with discussing these items.

DCAA then presented some "background" information and data resulting from their analysis. DCAA reviewed over 6,000 "completed" incurred cost years from effort done in fiscal years 2012 and 2013. A little over 4,000 of the completed incurred cost years were closed based on application of the new low risk procedures. Of the more than 6,000 years, about 600 were for companies with more than \$15M of contracts, and about 5,600 were for companies under \$15M, i.e. small businesses. Of those under \$15M that were audited 22% resulted in questioned costs documented by a formal report being issued by DCAA. In addition, for all audits that included questioned cost, consultant costs were included as part of the questioned cost only 20% of the time.

DCAA also explained the history behind the FAR cost principle on consultants and why the cost principle included such prescriptive language. FAR 31.205-33, Professional and Consultant Costs was significantly changed in the late 1980s in response issues disclosed by a procurement investigation called "Operation Ill Wind". The investigation ultimately resulted in more than 70 convictions, including the convictions of half a dozen major defense contractors, some smaller defense contractors, employees, consultants and about a dozen Government officials.

The issues disclosed by this investigation resulted in significant changes to the FAR cost principle, including major changes to the documentation requirements. FAR 31.205-33(f) contains three specific documentation requirements necessary to permit a determination that the work performed is proper and does not violate law or regulation. These requirements are:

- (1) Details of all agreements (e.g., work requirements, rate of compensation, and nature and amount of other expenses if any) and details of actual services performed;
- (2) Invoices or billings submitted by consultants, including sufficient detail as to the time expended and nature of the actual services provided; and

(3) Consultant work products and related documents, such as trip reports indicating persons visited and subjects discussed, minutes of meetings, and collateral memoranda and reports.

DCAA then outlined two major actions they are taking in the area of consultant costs. First they will be issuing guidance on auditing consultant costs. The guidance will highlight the formal definition of "consultants" as provided in FAR 31.205-33(a). It will then explain how to apply the FAR. It will describe what is needed to comply with the FAR and explain the intent of the FAR. Their observation, with which the SB committee agrees, is that many of the costs SBs include in their general ledger account titled "consultants" are not "consultants" as the specific term is used in the FAR. Many small businesses follow a protocol of identifying all 1099 employees as consultants which reflects compliance with IRS rules. As a result significant cost for "purchased labor", "temporary Labor", etc. has been included by the SBs in their account titled "Consultants". DCAA personnel suggested the appropriate section of the FAR for these "non-consultant" costs would be FAR 31.201-2 [Determining Allowability] and specifically the reasonableness and allocability of the costs as discussed in this FAR section.

Second, DCAA will be holding major training sessions (a 4 day training is planned, one day of which will be dedicated to discussing how to interact with small businesses) with field audit office special assistants for quality (FAQs). Areas including "auditor judgement" (vs. "perfect" documentation) and "alternative audit procedures" to satisfy the essence of the audit step and cost verification will be presented and discussed. Larry Nannis (a CPA with "abundant" DCAA experience with small business government contractors) was asked to participate in this training to provide the SB perspective on some of the issues included in the formal training. The FAQs will then take back a 2 hour training session to the audit offices.

The SB Committee expressed their support and appreciation for the direction and training being planned by DCAA. The inclusion of a member of the SB community (Larry Nannis) is a very positive and valuable addition to both opening/expanding channels of communication and trust.

The meeting then focused on a path forward for select incurred cost (IC) audits (circa 2005, 06 and 07) where audit reports have been issued or the individual contractor has raised concerns. This discussion focused on consultant costs in these years. DCAA HQ will work through Regional and Branch managers to re-evaluate their audit and report, based on the guidance discussed above and the training provided to more effectively utilize "auditor judgement" on each specific contractor problem brought to their attention. DCAA will then discuss their process, actions and results of their re-evaluation with each SB contractor.

Next the meeting focused on IC audits still in process (circa 2006 and later) or not started. DCAA has committed to ensure their planned actions in the area of consultant costs will be incorporated in the audit scopes for these years.

The SB committee continued to express extreme concern about the financial disaster to SBs unless a satisfactory resolution can be achieved. SB committee noted that there were a number of "players" involved in creating this problem and, if necessary,

it might be that all parties (SBs, DCAA, DCMA, GAO and Congress) need to be actively involved in achieving a satisfactory solution.

Don requested the SB committee to communicate to its members to be more "supportively inquisitive" as to the specific request by field auditors. It is not unusual for a company to not have the specific document or report requested by the auditor but once the SB understands what the auditor needs to verify a cost, the SB often has other data or reports that will satisfy the auditor's testing. Only by the SB asking "what is it you are trying to accomplish with this audit step," can a better, more effective result and usually a more favorable result ensue.

A number of the DCAA attendees encouraged the SB committee to communicate to its members the need for them to "escalate" problems to higher levels within DCAA if satisfactory results are not achieved at the auditor or supervisor level. SBs should not shy away from calling the Branch Manager on a problem and if that proves unsatisfactory contact the Regional Audit Manager, then the Regional Director.

Carol Sexton and Russ will work on an agenda for the DCAA panel at the NDIA Small Business Conference to be held September 25, 2013 in Springfield VA. Carol will be one of the panel members and two or three meeting attendees expressed interest in attending the session (not as panellists but as attendees). The SB committee observed the attendance of other DCAA personnel would be quite valuable to the overall process of working together, understanding our various roles, to support our war fighters.

Attachment to Meeting Minutes

DCAA HQ and SBTC/NDIA Joint DCAA/DCMA Committee

Meeting August 21, 2013

Agenda

Meeting Objectives:

- A. Discuss the results of DCAA research on audit coverage of consultant costs.
- B. Agree on the specific problems to be solved.
- C. Discuss path forward to address circa 2006, 2007 Incurred Cost Audit reports already issued
- D. Discuss actions and path forward to address SB concerns for remaining dated (circa 2007, 08, 09, 10 and 11) incurred cost audits
- E. Discuss a preliminary agenda (and DCAA HQ participant) for the NDIA Small Business Conference September 25, 2013

Agenda Topics:

1. The immediate problems from SB prospective are:
 - a. Significant questioned/disallowed costs (consultant costs being one) for “dated” incurred cost proposals that have now been documented in formal DCAA audit reports.
 - b. Similar costs for subsequent years incurred cost proposals (Purgatory years)
 - c. Becoming current on audits of incurred cost proposals for small businesses
 - d. Applying similar audit scopes and internal control criteria to small businesses as expected from major prime contractors.
2. Discussion of significance of questioned/disallowed consultant costs for small businesses
 - a. Briefing on DCAA analysis of incurred cost audits and costs questioned
 - b. DCAA to provide insight on how the FAR cost principle on consultants became so prescriptive.
3. DCAA planned actions:
 - a. New guidance on consultant costs
 - b. New training proposed for field auditors for consultant costs
 - c. Briefing on low risk incurred cost audit process.
4. Discuss path forward to address incurred cost audit reports already issued with disallowed problem costs
5. Discuss path forward to address incurred cost audits in process with potential disallowed problem costs
6. Discuss agenda and format for the NDIA Small Business Conference September 25, 2013