

Prime Insights Webinar: Quarterly Compliance Update



Update – 2021 Government Contract Compliance



TODAY'S SPEAKER:

Brian Gallagher

Director

Capital Edge Consulting, Inc.

Brian Gallagher has over 15 years of experience providing professional support to government contractors and government agencies in the areas of compliance, accounting and training. His experience includes providing assistance with drafting and implementing processes, policies and procedures for Contractor Business Systems as well as performing Business System compliance reviews. His experience extends to also include developing incurred cost submissions, CAS Disclosure Statements, related cost impact models and developing Forward Pricing Rates, supporting clients through DCAA Audits, while monitoring and supporting compliance with the FAR, DFARS, and CAS.

Excerpts and Trends from DCAA Reports to Congress (2018 – 2020)

- Trends in audit results
- Staffing and resources
- Areas of audit focus

Current Audit Environment

- DCAA audit priorities
- Business system audit updates
- COVID-19 impacts

Strategies for managing audits

- Managing audits in remote environments
- Considerations for audits by independent public accounting (IPA) firms
- Responding to audit findings

Agenda



Excerpts from DCAA Reports to Congress

- 2020 Report to Congress released March 31, 2021
- DCAA summarizes audit efforts for reporting metrics
- ROI indicates DCAA's perceived value in performing certain audits
- Forward Pricing continues to be priority with lowest reported time to complete audits and highest ROI

Table 2 –Net Savings and ROI by Audit Type

	Net Savings	Aggregate Cost of Performing Audits based on Percentage of Direct Audit Hours	Return On Investment (Net Savings /Aggregate Cost)
Forward pricing	\$2,929,970,000	\$113,040,000	\$25.92
Incurred Cost	\$307,093,000	\$230,812,000	\$1.33
Claims and Terminations	\$185,278,000	\$38,122,000	\$4.86
Systems, CAS & TIN	\$46,375,000	\$283,829,000	\$0.16*

* This figure is low as audits in this category provide long term value to the government without providing direct savings, e.g. CAS and business systems.

Excerpts and Trends from DCAA Reports to Congress

Areas of Audit Focus



Excerpts from DCAA Reports to Congress

- Sustention rates indicative of Cognizant Agency Officials concurrence with audit findings
- Incurred cost continues to represent lowest sustention rates, while Forward Pricing sustention rates drop below 60% (62.5% in 2019, 61.6% in 2018)

Table 3 – Sustention by Amount and Percentage of Audit Exceptions

Audit Type	Audit Exceptions	Exceptions Sustained	Percent Sustained
Forward Pricing	\$6,266,858,000	\$3,734,288,000	59.6%
Incurred Cost	\$1,161,178,000	\$350,945,000	30.2%
Claims and Terminations	\$238,402,000	\$183,189,000	76.8%
Systems, CAS & TIN	\$12,699,000	\$8,240,000	64.9%
Total	\$7,679,137,000	\$4,276,662,000	55.7%

Excerpts and Trends from DCAA Reports to Congress

Trends in Audit Results



DCAA Staffing Trends

- Decrease in number of auditors continues from FY18
 - 2018 – 4,148 auditors (23% CPAs)
 - 2019 – 3,994 auditors (22% CPAs)
 - 2020 – 3,843 auditors (21% CPAs)
- Despite reduction in audit professionals, Average Elapsed Days of audits continued decline
 - Forward Pricing – 82 days
 - Incurred Cost – 110 days
 - Claims and Terminations – 84 days
 - System, CAS & TIN – 230 days

Excerpts and Trends from DCAA Reports to Congress

- Staffing and Resources



Excerpts from DCAA Reports to Congress

- 36% reduction in incurred cost reports from FY19
- 46% increase in Systems, CAS & TIN reports from FY19

Table 4 – FY 2020 Audit Reports Completed and Dollars Examined

Audit Type	Reports	Dollars Examined	Audit Exceptions
Forward Pricing	719	\$185,262,581,000	\$6,892,049,000
Incurred Cost	710	\$145,804,743,000	\$917,622,000
Claims and Terminations	964	\$3,250,862,000	\$495,481,000
Systems, CAS & TIN	437	\$30,978,226,000	\$268,642,000
Total	2,830	\$365,296,412,000	\$8,573,794,000

Excerpts and Trends from DCAA Reports to Congress

Areas of Audit Focus



Implementation of 2018 NDAA Requirements:

- Contracting with Independent Public Accounting (IPA) Firms
 - DCAA contracted out 100 audits to IPA firms in FY20
- Completing incurred cost audits within 1 year of receipt of adequate submission
 - Accomplished in 2020 and 2019, a year ahead of required deadline

Audit Initiatives

- 7/19/19 MRD Audit Guidance on Using Materiality in Incurred Cost Audits
 - First utilized in conducting 2020 audits
 - Associated changes to parameters for risk-based sampling and testing procedures
- 6/15/21 MRD 21-PAS-004(R) Audit Alert on Reporting Material Noncompliances and Scope Limitations

Current Audit Environment

- DCAA Audit Priorities



Trends in Business System Audits

- Since 2017 DCAA Report to Congress, Business system audits stated as priority “providing long term value to the Government without providing direct savings”
- DCAA audit responsibilities for Accounting, Estimating, and Material Management Accounting Systems (MMAS) had taken backseat to ICS Backlog priorities prior to FY19
- 46% increase in business system, CAS, and Truth in Negotiations audits for FY20 over FY19
- Revised audit programs most recently updated June and July 2020 for Estimating and Accounting Systems, respectively

Current Audit Environment

- Business System Audits



Trends in Accounting System Audits

- Updated audit programs include revisions to risk assessment and audit procedures as well as changes to the various subsystems
- Subsystems as identified by separate sections of audit program are as follows:
 - Control Environment
 - Billing
 - Labor Accounting
 - General Accounting
 - Material Accounting
 - Indirect Cost
 - Other Direct Cost (ODC)
 - Pre-Production Cost and Follow-on Contracts
- General IT no longer separate subsystem, general understanding required in preliminary risk assessment
- Compensation included with limited audit steps under Labor Accounting Compliance

Current Audit Environment

- Business System Audits



Business System Audit Structure and Timing

- Preliminary Risk Assessments typically include the following:
 - Entrance conference
 - Preliminary data requests (written narratives, descriptions of controls)
 - Business system walkthroughs (contractor presentations of business system processes, controls, identification of key personnel, manual and automated systems, etc.)
 - System Demonstrations (DCAA observation of significant processes)
- Data requests and reviews of policies and procedures significantly front-loaded as part of Preliminary Risk Assessment

Current Audit Environment

- What to Expect from Business System Audits



Business System Audit Structure and Timing

- Requests for contractor provided written narrative varying in complexity and format, with the most significant following the audit program closely while requesting detailed documentation of **Key Controls**
- Contractor experiences vary relative to period subject to testing (lookback of proposals or transactions ranging from one year to three months, and in some cases concurrent testing of controls in conjunction with ongoing audits of proposals, incurred cost, etc.)
- Expect timeframe for completion of audit to likely exceed one year from notification letter to issuance of final audit report

Current Audit Environment

- What to Expect from Business System Audits



Remote Audit Changes

- 2020 Report to Congress described leveraging “professional relationships with contractors to obtain and maintain direct access to contractor systems and data while we both were working remotely...this is a best practice which hopefully will continue.”
- Implemented Contractor Submission Portal
 - Phased in approach for electronic submission of incurred cost proposals, avoiding issues of file size limitation through e mail transmission
 - Automatic notification validating receipt
 - Centralized storage with version control and simple process for withdrawing and resubmitting

Current Audit Environment

- COVID-19 Impacts



COVID-19 Impacts

- REVISED 20-PIC-006(R) Revised Audit Alert on Coronavirus Legislation and Regulations issued 4/23/21
 - FAQs addressing treatment of CARES act provisions in incurred cost and forward pricing
 - “credit should apply to contract costs in the same manner in which the PPP loan funds were originally spent by the contractor.”
 - Loans not yet forgiven are liabilities on the balance sheet, even if contractor is expecting loan forgiveness
- Expect additional audit focus from DCAA as PPP loans receive additional scrutiny due to fraud concerns

Current Audit Environment

- COVID-19 Impacts



Challenges Experienced in Supporting Remote Audits

- Coordination of internal resources to meet audit requests and objectives
 - Difficulties aligning schedules with technological limitations of contractors and DCAA audit teams can make direct system access a tempting alternative
- Managing points of contact between auditors and key personnel
 - Risks of aligning audit objectives with appropriate personnel, and risk of managing audit scope
- Reduced contact with auditors and the risk of auditor misunderstanding elevating to audit findings

Strategies for Managing Audits

- Managing Audits in Remote Environments



Challenges Experienced in Supporting Audits by IPA Firms

- Experience of audit personnel with FAR, DFARS, CAS requirements may be limited
- Lack of prior experience and understanding of contractor processes, procedures, and prior audit results
- Potential for increased findings due to lack of willingness or understanding in performing alternative procedures, when appropriate
- Auditing to a budget decreases incentive to address questions with contractor on a timely basis

Strategies for Managing Audits

- Considerations for Audits by Independent Public Accounting (IPA) Firms



Strategies for Managing Audits

- While the challenges may vary, the recommended strategies are the same
- Be proactive in understanding the criteria under audit and the scope of the audit
 - Self-assessment and corrective action prior to the audit addresses monitoring requirements
- Clear documentation of controls and processes alleviates many concerns of risk assessment and should reduce the amount of testing requiring additional support by contractor personnel
- Be proactive in communicating with auditors to confirm understanding and clarify questions before they elevate to findings of the audit
- Know your true audience
 - Regardless of who performs the audit, your Contracting Officer makes final determinations on findings

Strategies for Managing Audits



Responding to Audit Findings

- Draft audit reports are provided to contractors prior to finalization to incorporate contractor reactions to findings
- While some auditors may provide extremely short timeframes for responses, contractors may defer their responses as part of the final audit report and provide directly to the Contracting Officer
- Know your regulations and don't take for granted that findings are accurate
- Additional documentation and artifacts can be provided to the Contracting Officer in support of written reactions to findings
- Understand materiality as to whether the findings represent material weakness (currently "Significant deficiency" in DFARS) in drafting response

Strategies for Managing Audits

- Responding to Audit Findings



Thank You!



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