



# FY 2018 NDAA UPDATE

House Section 874 (Engrossed)

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## FY 2018 NDAA - House Section 874 (Engrossed)

The House version of the National Defense Authorization Act (NDAA) for fiscal year 2018 contains a provision (Section 874) to repeal contractors' ability to utilize commercial auditors for purposes of auditing their annual incurred cost proposals. Specifically, Section 874 of the 2018 NDAA would strike in its entirety subsection (f) of Section 820 of the 2017 NDAA previously passed by Congress and signed by the President.

Subsection (f) states:

*“(f) Section 820 Auditing Requirements.--(1) Notwithstanding any other provision of law, contractors with the Department of Defense may present, and the Defense Contract Audit Agency shall accept without performing additional audits, a summary of audit findings prepared by a commercial auditor if--*

*“(A) the auditor previously performed an audit of the allowability, measurement, assignment to accounting periods, and allocation of indirect costs of the contractor; and*

*“(B) such audit was performed using relevant commercial accounting standards (such as Generally Accepted Accounting Principles) and relevant commercial auditing standards established by the commercial auditing industry for the relevant accounting period.*

*“(2) The Defense Contract Audit Agency may audit direct costs of Department of Defense cost contracts and shall rely on commercial audits of indirect costs without performing additional audits, except that in the case of companies or business units that have a predominance of cost-type contracts as a percentage of sales, the Defense Contract Audit Agency may audit both direct and indirect costs.”.*

Section 820 of the 2017 NDAA is simply the law formed by the Act. No implementing regulations, proposed rules, public comments or other industry experience is currently available to allow an objective assessment of the effectiveness of accomplishing the intent of Section 820. Therefore, it doesn't appear prudent to repeal this provision prior to its implementation, or, at a minimum, the issuance of applicable proposed rules and review of corresponding public comments.

Section 874 was added to the 2018 HASC NDAA (Engrossed) version on July 14th subsequent to publishing the July 6th version and Report by House Committee:

Floor # 058, Rules # 368 offered by Mr. Conaway of Texas (R). Revised Repeals subsection 190(f) of title 10, United States Code, to ensure a consistent approach is used to determine when qualified private auditors should conduct incurred cost audits for Department of Defense contracts. Floor action, EB3 Adopted, Voice Vote.

## FY 2018 NDAA - House Section 874 (Cont.)

It is unfortunate that Section 874 strikes the third-party auditing of incurred cost proposals to the detriment of the DoD. Section 820 was set to take effect on October 1, 2018, whereas Section 802 of the FY 2018 NDAA will not take effect until October 1, 2019. There is no benefit of audit consistency, audit oversight or reduction of incurred cost audit backlog realized by striking Section 820:

- Section 874 would remove an important reform added in the FY 2017 NDAA, a reform that allowed predominantly commercial companies to rely on third party auditors for their incurred cost audits.
- Section 874 unfortunately strips away the common-sense authority allowing predominantly commercial contractors to use third party auditors to opine on their incurred cost proposals. Section 802 of the FY 2018 NDAA does not add back this ability of commercial contractors to engage third party auditors in opining on and clearing the incurred cost backlog. This would represent a serious expansion of unnecessary bureaucratic requirements imposed on commercial contractors compared to existing law – just at a time when the Pentagon professes a desire to do more business with commercial companies.
- Section 802 is not inconsistent with Section 820. Section 802 as reported by the HASC would build upon the provisions of Section 820, allowing the Defense Contract Management Agency to now rely on audits from qualified public auditors for those companies not covered by the FY 2017 provision.
- By repealing Section 820, DCAA resources are constrained with smaller commercial contractors and audits that would otherwise allow DCAA to focus on larger contractors and forward pricing audits where they declare higher value returns.

The implementing regulation for Section 802 will take time to develop. Valuable knowledge and experience would be gained from Section 820 incurred cost audits in defining the criteria for which DoD will outsource audits and conduct oversight. There has not been any outreach, public comment period or input from the AICPA on implementing Section 820. We believe it is premature to strike this FY 2017 NDAA provision prior to evaluating its effectiveness in reducing incurred cost audit backlog and increasing the quality and efficiency of audits performed by the DoD.

Further, implementing regulation for Section 820 as contemplated by the 114th Congress would facilitate public comment, industry association and AICPA participation in crafting regulation for Section 802. We recommend elimination of Section 874 of the FY 2018 NDAA during the reconciliation process.



## FY 2018 NDAA - House Section 874 (Cont.)

Industry associations have drafted language and position papers seeking to dissuade the politicians from furthering this initiative to eliminate the Section 820, subsection (f) language noted above through the 2018 NDAA. However, with focus on the budget and major weapons programs, Section 874 and its negative impact may be overlooked. Contractors and interested parties may want to support these initiatives as effective implementation of the intent of the 2017 NDAA Section 820 could be beneficial to both government and industry. We would urge those who desire to retain Section 820 as written and strike the House Section 874 to contact a Member of the reconciliation committee and express their views:

### Senate:

- McCain
- Inhofe
- Wicker
- Fischer
- Cotton
- Rounds
- Ernst
- Tillis
- Sullivan
- Perdue
- Cruz
- Graham
- Sasse
- Strange
- Reed
- Nelson
- McCaskill
- Shaheen
- Gillibrand
- Blumenthal
- Donnelly
- Hirono
- Kaine
- King
- Heinrich

### House:

Committee on Armed Services for consideration of the House bill and the Senate amendment, and modifications committed to conference:

- Thornberry
- Wilson (SC)
- LoBiondo
- Bishop (UT)
- Turner
- Rogers (AL)
- Franks (AZ)
- Brady (PA)
- Davis (CA)
- Langevin
- Larsen (WA)
- Shuster
- Conaway
- Lamborn
- Wittman
- Coffman
- Hartzler
- Scott
- Austin
- Cook
- Stefanik
- Knight
- Bacon
- Smith (WA)
- Cooper
- Bordallo
- Courtney
- Tsongas
- Garamendi
- Speier
- Veasey
- Gabbard



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