

Co-written by:

Jim Rogers
Market Vice President,
GovCon

Rich Wilkinson
GovCon Consultant

Survival of The Fittest – What You Need to Know About The New DCAA Rules

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The Rules – and the Game Have Changed

In July of 2008, the Government Accounting Office (GAO) issued a report that cited the Defense Contract Audit Agency (DCAA) for a lack of independence in their audits of Government contractors. In response, DCAA has made sweeping changes to its audit policies and the guidance letters that control how its auditors carry out their duties.

One of the “Audit Guidance” memos issued in December, 2008, effected major policy changes with respect to opinions issued by the Agency on contractors’ internal control systems:

- DCAA will no longer report “deficient in part” opinions – a system review may ONLY result in a finding of either “wholly adequate” or “inadequate”
- Audit reports may no longer include suggestions for improvement in the contractor’s internal control systems
- When a system is found to be inadequate, the auditor is required to recommend to the Administrative Contracting Officer (ACO) that payments be suspended on affected contracts.

The language of the memo also considerably expanded the definition of “significant deficiency/material weakness” to include “failure to accomplish any control objective... even when the control objective doesn’t have a direct relationship to charging costs to Government contracts.” The memo went on to say that a “contractor’s failure to accomplish any applicable control objective should be reported as a significant deficiency/material weakness” and that “any significant deficiencies/ material weaknesses will result in an opinion that the system is inadequate.”

[Click here for the full O8-PAS-043\(R\) memo.](#)

The Brave New World of Government Contracting

Whether you are a “major contractor” by DCAA’s definition (the firms for which this particular memo was intended) or a small business, DCAA’s attitude has changed and the new environment is anything but collegial. In an address by Agency Director, April Stephenson, to the Professional Services Council in February, 2009, she referred to the new environment as a “Brave New World.” It was clear from her remarks that the Agency no longer includes helping contractors get or stay compliant as part of its mission. She said “It’s back to basics” for DCAA and by that and her other remarks she clearly implied that the Agency would perform audits, write opinions and nothing else.

It hasn’t always been that way.

Every business has to accept some degree of risk. But where does your organization fall?

History of the DCAA

DCAA was formed in 1965, under the purview of the Secretary of Defense, to conduct all contract audits for the Department of Defense (DoD) and provide contract audit services to other U.S. agencies on a reimbursable basis. Organizations doing business with the federal government must comply with a number of DCAA requirements to qualify for and keep the contracts they win, but the Agency has historically had a cooperative attitude toward helping contractors with compliance. They also have always had a very finely tuned sense of what was “material” and what was not. Some critics have even criticized DCAA for their approach, considering it to be “soft.”

In the past, contractors could continue with current contracts even after an audit found minor deficiencies in their systems, receiving what the agency referred to as an “inadequate in part” opinion in the report. Such reports typically allowed the contractor time to correct the deficiencies and the Agency would perform a follow-up review at the next audit. Auditors would often offer suggestions as to the specific steps needed to fix the deficiencies.

The New DCAA

The “Audit Guidance” memo signaled the end of “inadequate in part” opinions. It also effectively ended the practice of making suggestions for improvement. These are just a few of the changes in DCAA’s “Brave New World.”

Three other significant audit guidance memos were issued the same week as the initial memo. One sets new standards for time to respond to requests for records by the Agency and requires auditors to report requests not fulfilled within seven days to Agency headquarters for issuance of a subpoena.

[Click here to read memo 08-PAS-042\(R\).](#)

Another creates a new requirement for full reconciliation of interim public vouchers to contractors accounting records as part of the payment review cycle, not in the Incurred Cost Submission as in the past. Another requires auditors to “self initiate” a limited scope audit of internal controls when an internal controls deficiency is identified as part of another review (a billing system review, for example, or a timekeeping system review, etc.).

[Click here to read memo 08-PAS-041\(R\).](#)

These are major changes. Taken together, they will have a major impact. And, they are likely to be just the beginning of changes that will further affect the way DCAA’s interacts with contractors.

Of the guidance memo’s issued so far, the one on Internal Controls is causing the most concern. Not only does DCAA indulge in some circular logic to justify the materiality issues, but the remedy specified for a determination of inadequacy is a suspension of payments.

Potential Suspension of Payments

With the tightening of the credit markets, even a short suspension of payments could have a devastating or fatal effect for all but the largest contractors – the only ones with enough cash to operate while payments are withheld. For everyone else, it can mean failure. Frozen credit. Insolvency. And it’s inevitable this will happen to someone as a direct result of this change.

Every business has to accept some degree of risk. But where does your organization fall? If you have prior “inadequate in part” opinions in your DCAA file, you’re at higher risk, even if they were minor. Is your system built on a solid foundation of software solutions that the DCAA understands and trusts? Or would an internal controls review at your firm reveal even one failure to accomplish an internal control objective and, therefore, a “failing grade?” Can you afford to have payments suspended for 30 days? 60 days? Indefinitely?

Whether you are a “major contractor” by DCAA’s definition... or a small business, DCAA’s attitude has changed and the new environment is anything but collegial.

Deltek: Audit-Ready Solutions for Government Contractors of Any Size

Contractors with systems built on generic software tools with extensive workarounds, especially small to medium firms using popular software like QuickBooks, are at risk – serious risk. And some of them won’t survive. Those firms with cost accounting and internal control systems that DCAA understands and trusts stand a better chance of catching deficiencies early, and achieving a “passing grade.” Deltek offers those trusted systems. **DCAA knows Deltek, and more firms that are contracting with the Federal government use Deltek than any of our competitors’ solutions combined.** We can help spot and correct deficiencies before they become cash flow-freezing problems.

An accounting system is much more than just software tools, but only purpose-built solutions like Deltek Costpoint and Deltek GCS Premier provide the functionality to enable, support and enforce the internal controls a government contractor requires. More than 2,500 Government contractors trust their internal control environments to a Deltek software solution including 92% of the top 100. To take it a step further, Deltek offers AppGRC (Governance, Risk & Compliance) for Costpoint – providing continuous, automated monitoring of key Costpoint data and the most comprehensive audit trail available.

Deltek Costpoint was designed specifically for the needs of government contractors in other areas as well – from segregation of duties to SOX reporting to unlimited cost allocation pools and tiers. And when the year is over, Costpoint provides the most robust reporting available, and it is tailored explicitly to the requirements of the Incurred Cost Submission.

Real-World Benefits

The real-world benefit of Deltek’s solutions for government contractors is that DCAA auditors see and audit the internal control environments of Deltek’s GovCon clients more often than those of all other software companies combined. They understand how Deltek solutions implement internal controls. They trust those environments and as a result, Deltek clients approach their audits with confidence.

Are you willing to bet the future of your company on the results of your next audit? If you have a generic accounting system supplemented by workarounds and manual processes you may be exposed. Find out more about Deltek solutions and what they can do for you, today. Call (800) 456-2009, visit our website at www.deltek.com or [e-mail info@deltek.com](mailto:info@deltek.com) for more information today.

World Headquarters:

United States

13880 Dulles Corner Lane
Herndon, VA 20171
800.456.2009

Regional Headquarters:

United Kingdom

1 Warwick Row
London
SW1E 5ER
+44 (0) 20 7518-5010

Denmark

Vordingborggade 18-22
DK - 2100 Copenhagen Ø
+45 35 27 79 00

Australia

6th floor
182 Victoria Square
Adelaide
South Australia 5000
+61 8 8112 1200

deltek.com

info@deltek.com

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