A GovCon's Essential Guide to DCAA Compliance

How the right technology and best practices simplify data management and take the risk and anxiety out of government contract compliance.

Unanet

THE COMPLEX AND CONFUSING WORLD OF DCAA COMPLIANCE

Government contracting is a unique business. There are different job selection criteria, performance expectations, and regulations to follow than in private sector business. Whether it's manufacturing guidance systems for government-owned vehicles, conducting lab tests, or simply transporting essential goods, government contracting is important work — but it's not for everyone.

The federal government has a goal to set aside 27% of contract spend small businesses.[1]

The companies new to the GovCon game or that have recently chosen to pursue work as a contractor will have to contend with a range of challenges private sector organizations don't have to worry about.

That's especially the case when working with the Defense Contract Audit Agency (DCAA), an agency of the United States Department of Defense (DoD) responsible for performing all contract audits for the Department and providing financial and accounting advisory services for contract negotiation, administration and settlement.

GovCons face a litany of new acronyms — FAR, DFAR, ICE, and CAS, among others — that represent critical rules, regulations, or guidelines by which they must abide. Companies will need to deep dive into the nuances of working with DoD, understand not just what each term means but also the minutiae, and they'll need to ensure they have the right processes, procedures, and tools or technologies in place to remain compliant with evolving standards without sacrificing profitability or competitiveness.

This paper will provide an important overview of the audit agency and help GovCon leaders better understand the key audits they'll need to prepare for throughout their organization's relationship with DoD.

Important Acronyms to Know:

- **FAR:** Federal Acquisition Regulations
- **DFAR:** Defense Federal Acquisition Regulation
- **CFR:** Code of Federal Regulations
- **ICE:** Incurred Cost Electronically
- **CAS:** Cost Accounting Standards
- **DCAA:** Defense Contract Auditing Agency
- **DCMA:** Defense Contract Management Agency

[1] Snyder, Daniel. *"Federal Contract Spending Trends: Five Years in Five Charts."* Federalnewsnetwork.com. January 22, 2019.

DCAA 101

For the unacquainted, the Defense Contract Audit Agency is a government agency working under the Department of Defense. The agency is primarily responsible for performing contract and financial audits on behalf of other agencies who acquire and administer contracts for the US Government.

DCAA takes a deep dive into the entire financial and accounting structure of contractors who win bids to work for DoD. But before that, the agency also performs pre-bid audits to ensure bid candidates have the financial stability and capabilities required to actually complete the job, should they be awarded the work.

The audits – both pre-bid and post-selection – use a wide array of standards and guidelines called Generally Accepted Government Auditing Standards (GAGAS), which are created and managed by the Government Accountability Office (GAO). GAGAS apply to both financial and performance audits, and include five general categories:

- Independence: whether an audit is independently of the audited organization

- Due Care/Diligence: that all reasonable investigations were complete prior to entering a contract

- Continuing Professional Education (CPE): A GovCon must provide continuing education opportunities for staff to maintain professional certifications and credentials

- Supervision: whether a GovCon has a single point of contact for audits and financial operations

- Quality Control: whether a GovCon has appropriate systems and controls in place to ensure data quality, accuracy, and transparency

The wide-ranging nature and ambiguity of the audit categories are purposefully designed to enable DCAA to fulfill its charter of ensuring that taxpayers' money is spent responsibly and ethically. Financial audits, in particular, help to assure the validity of costs throughout the acquisition process and help the agency communicate with the government's contracting officer (CO) to make recommendations that have an impact on contract negotiations, including (or especially) what the price of the contract should be.

> One in four GovCons expect their compliance related expenses to increase by more than 5% in the coming year.
>
> Source: *2019 Gauge Report: Industry Roadmap*

FOLLOW THE MONEY: FAR AND CAS

As with most business engagements, government contracts are high-value financial investments. And because the contracts are funded by taxpayer money, government agencies – and the DCAA specifically – will pay close attention to how and where every cent is spent.

That's why GovCons need to become intimately familiar with both the Federal Acquisition Regulation (FAR) standards and Cost Accounting Standards (CAS) to maintain compliance with DoD's standards and better position themselves to win more business.

What is FAR and why should GovCons care?

The Federal Acquisition Regulation (FAR) standards are the primary set of rules governing the manner in which federal government agencies procure products or services. It's designed to create a uniform policy for the entire federal government to help agencies:

- Secure fair pricing

- Improve service quality and timeliness

- Minimize administrative operating costs

- Conduct business with integrity, fairness, and openness

- Fulfill public policy objectives

For GovCons working with or planning to work with DoD, they must demonstrate an ability to comply with the various standards and provisions or show they'll be able to by the time they're awarded the bid. In particular, a GovCon must show its accounting system can differentiate between direct and indirect costs or it will be deemed inadequate for government contracts.

Direct costs are any cost that is specifically identified with a particular final cost objective (FAR 2.101). To determine this, ask if the cost would be incurred even if the specific contact did not exist. Costs may include labor, materials, and other direct cost used to meet the contract's requirements.

Indirect costs are those that cannot easily be allocated discretely to a single project or across a number of projects. These indirect costs could include general accounting, payroll, and procurement expenses or general business travel and facility maintenance and other activities not related to a particular contract.

More importantly, GovCons must strictly adhere to FAR's six categories of standard solicitation provisions along with following stringent data management and security standards. In addition, FAR requires GovCons to disclose any allegations of fraud, conflict of interest, bribery, or gratuity violation in involving an employee or officer of the company in connection with any previous award, performance, or closeout of a Government contract.

Failure to abide by any or all of the standards puts a GovCon at risk of losing a winning bid, having an existing contract canceled or amended, or incurring fines and other financial penalties.

The importance of CAS

CAS is one of the more challenging elements of a GovCon's business. Cost Accounting Standards is a set of 19 rules that help government agencies determine the costs on negotiated contracts. The regulations affect contracts specifically, rather than contractors as a whole.

CAS was created to build consistency in how larger defense contractors and subcontractors manage cost accounting, as well as to establish regulations to require them to disclose in writing their cost accounting practices. Contractors with CAS-covered contracts must monitor their bidding, booking, and billing to ensure each is consistent with their written cost accounting disclosures prior to winning a project.

Changing those practices can incur additional expenses from the required cost impact analysis – how changes in accounting practices may affect the overall cost of a project – and deviation from CAS standards without the analysis may result in fines, additional fees, or other penalties.

AUDIT TYPES: WHAT GOVCONS CAN EXPECT

With CAS and FAR firmly entrenched as the core of DCAA's activities, projecting the potential audits GovCons may face is a little easier. Below are some examples of audits they might be encountered:

COMMON DCAA AUDITS

INCURRED COST
Review of accounting procedures and ensuring costs are reasonable, allocable and allowable.

CAS AUDITS
Determine if policies, procedures, and practices used to estimate, accumulate, and report costs on contracts and subcontracts comply with CAS.

FORWARD PRICING
Review of contractors cost proposals to ensure that contract prices are fair and reasonable.

LABOR FLOOR CHECK
Evaluation of procedures and adherence to them demonstrated through employee Interviews Checking for mis-charging and fraud.

PRE-AWARD / ACCOUNTING SYSTEM
Review to ensure regulations are complied with and the accounting system is reliable with risk minimized A pre-award survey SF1408 Is required.

BUSINESS SYSTEM AUDIT
Examine compliance with the system criteria for an acceptable estimatIng system as prescribed In DEARS 252 215-7002.

What they mean and why they're important

Incurred Cost Submission

The most common audit type, Incurred Cost Submission (ICS) is a financial representation of the work a contractor performed during a specific period and is intended to make sure that claimed actual costs and billed costs match. Many GovCons find it challenging to identify items such as rate structure, direct cost to contracts, and both indirect and unallowable costs. This audit is required for contracts when the contract amount is not fixed and when the contract contains the Allowable and Payment Clause.

Incurred Cost Submissions are the top audit performed by DCAA, with costs over 10K being questioned more often than any previous year.

Source: *2024 Gauge Report: The Government Contractor's Guide to AI Implementation*.
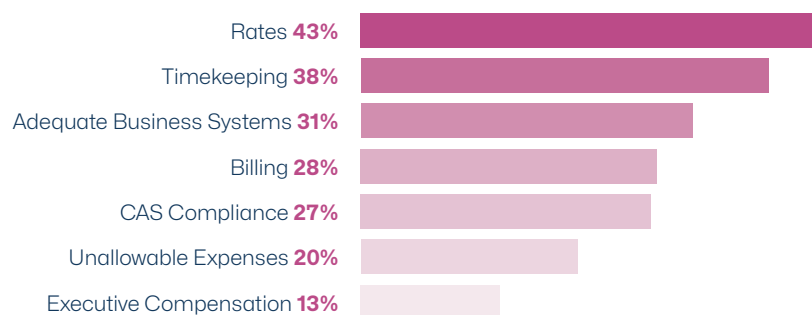
Forward Pricing

Forward pricing audits are conducted on contract proposals related to a specific contract and are usually conducted during the award selection process. Simply, forward pricing audits are conducted on a Forward Pricing Rate Proposal (FPRP), tied to a base year rather than to a specific contract and is aimed at ensuring that DCAA and the contractor agree that future rates are reasonable and realistic for use in bids.

Timekeeping

Timekeeping is the bane of many contractors' existence. But accurate timekeeping is absolutely essential for GovCons, as timekeeping audits are among the most prevalent audits reported year over year and are the only audits performed by DCAA without advanced notice.

In the 21st century, GovCons have few reasons to not have an electronic timekeeping system to accurately represent various aspects of a contract such as project number, task, charge number, and change reasons. The audit is intended to keep GovCons honest and vigilant about the veracity and reliability of employee time records, that employees are at work, and that they're performing in assigned job classifications while charging time to the proper line item.

Rank the following audit challenges from the most to the least significant last year (% Ranked 1st & 2nd Shown)

Challenge	%
Rates	43%
Timekeeping	38%
Adequate Business Systems	31%
Billing	28%
CAS Compliance	27%
Unallowable Expenses	20%
Executive Compensation	13%

Pre-Award Accounting System Audit

Government agencies want to know that the GovCons they're working with have a satisfactory accounting system in place. Accounting System Audits are conducted pre-award and should be considered necessary to win any cost type contract.

Specifically, GovCons should have an accounting that complies with existing laws and regulation, is accessible and provides reliably accurate data, has safeguards against misallocations and mischarges, and allocates contract budgets and charges consistent with billing procedures.

Sample questions from Pre-Award Accounting System Audit:

1. Is the accounting system in accordance with the GAAP?

2. Accounting System provides for:

- Proper segregation of direct and indirect costs
- Method for allocation of indirect costs
- Timekeeping System
- Labor distribution
- Segregation of unallowable costs
- Accumulation of costs under General Ledger Control

3. Accounting System provides financial information

4. Is the accounting designed to have reliable and accurate data?

5. Is the accounting system fully operable?

Business System Audits

In addition to pre-award audits of accounting systems, DCAA may also conduct more general business system audits, intended to help ensure that contractors have all the necessary infrastructure, processes, and procedures in place to properly manage government prime contracts. These audits include accounting systems and processes, along with earned value management (EVM), estimating, material management and accounting (MMAS), property management, and purchasing systems.

Special Audits

Special audits may be requested by contracting offers needing an independent financial opinion about specific portions of a contract. These high priority investigations may be conducted before or after contract award. Special audits conducted after contract award primarily address change requests for part of a contract or agreements that are in some stage of termination. These are complex audits of high-risk contracts that DCAA must carefully evaluate the cost of original contract work from the changed scope of work.

Miscellaneous Audits

DCAA may initiate other audits when there is potential for a high risk of misallocation or mischarging of costs. These miscellaneous audits often focus on a contractor's Cost Accounting Standards Disclosure Statement, compliance with cost accounting standards, assessment of contractor Cost Impact Statements for non-compliances, review of contractor business systems, and contractor compliance with the Truth in Negotiation Act (TINA).

In the high-stakes, high-profile world of government work, contractors can't be caught off-guard by a DCAA request for more information and transparency. Adequate preparation and the right tools, systems, and expertise can help contractors avoid unnecessary and uncomfortable.

UNANET: ADVANCED COMPLIANCE TECHNOLOGY FOR GOVCONS

Many GovCons have traditionally relied on generic ERP systems, accounting software, and spreadsheets to manage their financial records and contract bids. But manually collecting, transporting, and cataloguing financial data is time-consuming and error prone. And failure to meet DCAA's requirements may result in anything from the contractor's billing rates being unilaterally reduced by up to 16%[2] to civil or criminal penalties allowed for under the law.

Unanet is helping GovCons take the uncertainty and anxiety out of DCAA compliance with a purposebuilt suite of software to simplify and streamline compliance activities. Trusted by more than 1,000 government contractors and reviewed by DCAA auditors, Unanet unifies core timekeeping, accounting, and expense management activities into a single platform.

Timekeeping

Unanet's web-based timekeeping software enables GovCons to reliably collect employee hours and statuses for project tracking anytime, from anywhere. The tool also features supporting systems for payroll, invoicing, project accounting, chargeback, and job cost accounting while also providing robust capabilities for auditing. Unanet is recognized as the best government contractor timesheet, complying with DCAA requirements.

Accounting

Unanet's complete Project-Based ERP solution delivers an integrated set of capabilities for real-time project performance, people management, and financials in one application to eliminate the need for reconciling data between different systems. The solution makes it easy for GovCons to effectively and efficiently manage core financial reporting activities like:

- Segregating direct and indirect costs, including by contract line item and units

- Identifying and accumulating direct costs by contract

- Consistently allocating indirect costs to intermediate and final cost objectives

- Charging direct and indirect labor to the final cost objectives

- Routinely posting books for interim determination of costs charged to a contract

- Excluding unallowable costs charged to the government contracts

Expense Reporting

Unanet's Expense Report software helps contractors compile employee travel and materials expenses, along with the related expense authorization requests, from any connected device for maximum efficiency and accuracy. The solution automates expense reporting and follows all government expense reporting guidelines to eliminate administrative effort and increase efficiency.

ACCESS

- Users access only their individual timesheets and/or expense reports
- Users limited to authorized projects/ activities/tasks
- Approvers restricted from editing user's timesheet/ expense reports
- Password security features

WORKFLOW

- Changes to "saved" time captured in audit trail
- Automated approval workflow event process
- Automated timesheet/expense approval audit trail
- User initiated adjustments and approval
- Post submittal and approval review
- Automatic reminder notices

CONTROL

- Time may not be reported in advance
- Comments to describe and substantiate time and/or expenses
- Delinquent time (daily time entry required) report
- Timesheet status report
- Validations to ensure accurate changes
- Weekly overlap time period

CONTRACT SUPPORT

- Pay codes
- General and Project Labor Categories
- Total Time Accounting (Adjusted Cost Rate)
- Assignment reports
- Project performance report
- Project status report
- Teamwork notes collaboration

Government contractors new to the field face a litany of new rules, regulations, and compliance standards that can create headaches and chaos if they're not properly addressed. Unanet replaces outdated, manual contract management practices with automated workflows and unparalleled access to all the reporting (time, people, and expenses), timesheet controls, and contract support they need to remain compliant with stringent DCAA's standards.

Visit **unanet.com/erp-for-govcon/compliance** for more information about simplifying FAR and CAS compliance or call **703.689.9703** for a free demo to see Unanet in action.

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Where Information Means Insight

Unanet serves more than 3600 businesses with its ERP software solutions purpose-built for professional service organizations. Unanet's software helps project-driven organizations reliably plan, track and manage projects, people and financials. Unanet's customer-centric culture means we strive to deliver insights with personal service.

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