Recommendation 71: Adopt a professional practice guide to support the contract audit practice of DoD and the independent public accountants DoD may use to meet its contract audit needs, and direct DoD to establish a working group to maintain and update the guide.

Problem
DCAA provides professional services and skilled advice to DoD contracting officers. With the introduction of independent public accountants (IPAs) into these oversight functions, the quality and consistency of advice contracting officers receive will depend on the quality and consistency of how oversight professionals interpret and apply foundational standards that guide their work.

Background
Although professional standards are common in the auditing profession, none of them have been developed or interpreted for the unique purpose of federal government contract oversight. DCAA’s Contract Audit Manual provides a good foundation, but it lacks the collaborative inputs, perspectives, and interpretations of knowledgeable professionals outside DCAA and the government. This point is important because IPAs and other qualified professional services firms are playing an increasingly important role in the government’s oversight of federal government contractors.

Discussion
Because professional standards generally establish principles rather than rules, they are subject to interpretation. DoD’s oversight professionals will benefit from a uniform, collaborative interpretation of certain professional standards as they apply to government contract oversight. Without a professional practice guide (PPG), contracting officers will be underserved and likely confused by inevitable inconsistencies among audit and advisory reports issued by DCAA, DCMA, and IPAs. Professional standards of importance that require a collaborative interpretation on how to apply the standards in the contract oversight environment include (among many others) materiality, risk, internal controls, independence, objectivity, sufficient evidence, and reliance on the work of others.

Conclusions
The Section 809 Panel’s Volume 1 Report concluded that a PPG would be beneficial and supplemental to existing guidance for professionals involved in the business of government contract auditing. As written by the Section 809 Panel, the PPG (see Attachment 6-1) provides information on how to interpret and apply specific auditing concepts for government contract audits to assist government auditors, private-sector auditors, contracting officers, and other stakeholders involved in the audit process. Although these concepts are established in auditing literature, the PPG focuses on how the concepts can be applied for the unique purpose of federal government contract oversight. A working group of subject-matter experts in contract auditing developed the guide for the panel. The team included members from key stakeholder communities, including Section 809 Panel representatives, DCAA, GAO, AICPA, DCMA, and industry. Members of the team worked collaboratively to consider and address concerns that have been raised by Congress and others.

The PPG provides the requisite guidance to address Congress’s direction to the Section 809 Panel in the FY 2018 NDAA, Section 803, with respect to numeric materiality. The PPG sets forth clear materiality
guidelines that help oversight professionals plan their work and provide the information contracting officers need to make reasonable business decisions. What may be material to a particular business decision will be influenced by a variety of qualitative and quantitative considerations, recognizing that the contracting officer’s role is to manage DoD’s risk, rather than avoid it. The cost of DoD’s oversight, including adverse effects on the timeliness of decision making, must be balanced with expected benefits of that oversight. The Cost Accounting Standards (CAS) Board’s administrative regulations establish a variety of qualitative materiality considerations appropriate for and applicable to any business decision affecting contract costs/prices.

Besides materiality, the PPG addresses an internal controls framework for audits of contractor accounting systems. As discussed below, adoption of the internal controls framework for review of accounting systems requires amendments to statute and the DFARs, and the Section 809 Panel provides the appropriate language in support of the amendments.

In the Section 809 Panel’s Volume 1 Report, Recommendation 14 provided for DCAA to incentivize contractor compliance and manage risk efficiently through robust risk assessment. The PPG provides a risk model that should be employed by DCAA. Although, DCAA has historically used a risk-based approach to determine which contractors are subject to incurred cost audits, as part of the PPG working group, DCAA has embraced an expanded risk model to include additional risk factors that further refine and improve the process.

The Volume 1 Report noted that DCAA plays an important role within DoD’s system of acquisition internal controls. When these controls are operating effectively and efficiently, they provide DoD reasonable assurance that contract prices and cost reimbursements are free of material unallowable costs. This concept, established by the COSO Internal Control Framework and incorporated into GAO’s Standards for Internal Control in the Federal Government (i.e., Green Book), is fully compatible with the FAR guiding principle of shifting focus from risk avoidance to risk management. To accomplish the desired outcome of both the federal government’s internal control framework and the FAR’s Guiding Principles, it is important to recognize DCAA’s role in developing and embracing the enhanced risk model.

Implementation

**Legislative Branch**

- Direct DoD to adopt the PPG as guidance in support of DoD’s contract audit practice and the practice of IPAs that the Department may use in support of its contract audit needs. In adopting the PPG, the Congress should ensure that DoD establishes a collaborative process for future maintenance of the guide to include changes to the guide. Specifically, direct the Secretary of Defense to charter a PPG working group (PPGWG), chaired by DCAA/DCMA for the purpose of ensuring the same collaborative process is used for changes to the guide as was established by the Section 809 Panel. As part of this direction, the PPG does not take the place of federal regulations or auditing standards. Direct the Secretary of Defense to charter a working group similar to the Section 809 Panel, that is exempt from FACA, although the proceedings and decisions of the panel would be posted on the DCAA website.
Executive Branch

- Adopt the PPG as guidance in support of DoD’s contract audit practice and the practice of IPAs that the Department may use in support of its contract audit needs. In doing so, the Secretary of Defense should charter a PPGWG, chaired by DCAA/DCMA for the purpose of ensuring the same collaborative process is used for changes to the guide as was established by the Section 809 Panel. The process should ensure that the PPG stays current with changes in the practice and that changes to the guide are considered collaboratively by a group of experts in the field of contract auditing. Specifically, the Section 809 Panel recommends the following approach to long-term support of the PPG.

  - The Secretary of Defense should charter a PPGWG with five permanent representatives:
    - A representative of the DCAA appointed by the Director of DCAA.
    - A representative of the DCMA appointed by the Director of DCMA.
    - A representative of the U.S. GAO appointed by the Comptroller General of the United States.
    - A representative of industry nominated by CODSIA and agreed on by a majority of the representatives from DCAA, DCMA, and GAO.
    - A representative from the American Institute of Certified Public Accountants and agreed on by a majority of the representatives from DCAA, DCMA, and GAO.

  - Rotate the committee chair position biennially between DCAA and DCMA. The chair is responsible for scheduling and recording proceedings and decisions made by working group members. The committee members do not have terms but changes to membership on the committee should be re-assessed by the collective members on an annual basis. The appointees from the DCAA, DCMA, GAO, and AICPA will be automatically removed from the working group should they leave their organizations. The working group will meet not less than semi-annually and otherwise as determined necessary by the members of the committee. The working group shall have an indefinite termination date.

  - Administer the PPG at DCAA as follows:
    - Self-initiate minor revisions due to spelling and grammatical errors.
    - Make substantive changes as agreed on by a majority of the PPG working group members.
    - Maintain the most recent version of the PPG on the DCAA public website.

  - Adopt substantive revisions based on a majority vote of working group members. Substantive revisions are defined as changes to the guides meaning, adding new context to existing concepts in the guide or adding or deleting information in the guide.

Implications for Other Agencies

- There are no cross-agency implications for this recommendation.