

DCAA Compliance Requires Better Processes and Flexible Tools

‘Documentation Traceability’ Can Build Confidence in Audits

The need for reliable, accessible and traceable data that reconciles internal billing information with federal contracts, and with annual estimates of expenses, is of critical importance to federal government contractors who do business with the Department of Defense (DoD).

By far the largest hurdle for small to midsized government contractors to overcome is the requirement to provide excruciating detail about the direct, indirect and overhead expenses associated with every item billed to the government in fulfillment of specific contract awards.

Government contractors must capture all costs associated with goods and services sold to federal agencies and departments, and back up those amounts with supporting accounting records. “When you think about the flow of any business, there are at least ten systems that touch on an organization’s accounting system, and all are impacted by federal regulatory oversight,” said Mary Karen Wills, a partner leading government contract consulting for Argy, Wiltse & Robinson, P.C. “Integrated time-keeping and billing systems, for example, are critical to show how many hours or portions of hours are spent on each government contract or project.”

As the federal government has moved to larger procurements, some with thousands of task orders, contractors must treat each task order as a separate contract or project, so they can maintain detailed cost information down to the task order level. This explains why government contractors require more sophisticated accounting systems and support than most businesses in the private sector, Wills explained.

Ultimately, billing fidelity is crucial to a government contractor’s success, as invoices are reviewed by the agency customer, government contract officers and auditors. Inaccurate or non-conforming bills cause delays in payment processing, as each party must agree to a remedy. Accurate and timely billing also aids in business development because Requests for Proposals (RFPs) always ask for “Citations of Past Performance” and contract officers will review a government contractor’s billing history before awarding new contracts. This presents a great opportunity for forward-thinking contractors to capitalize on financial management solutions that integrate with pursuit management solutions. Empowered program managers can not only see financial past performance but the level of effort required to secure the contract and relevant competitor win/loss tracking.

To comply with the regulations regarding proper financial management, government contractors must satisfy the Defense Contract Audit Agency (DCAA), which is responsible for performing all audits for the DoD, and for providing accounting and financial advisory services to DoD components responsible for procurement and contract administration. DCAA also provides contract audit services for many other government agencies as well.

Rich Marksberry, a Tatum, LLC Financial Leadership Partner has implemented and managed the Microsoft Dynamics SL solution at numerous government contractors. “Looking upon DCAA as a partner, and not as an opponent, is more important now than ever,” Marksberry said. “The audits performed by DCAA are a requirement and integral part of the contract you are working to deliver. Understanding the DCAA auditor’s mission and their requirements, and working to make their tasks easier and more efficient will improve your internal company systems.” According to Marksberry, “An integrated time and expense system that controls changes and secures information from manipulation in accordance with DCAA guidelines allows the company and their auditors to save time and to concentrate on more significant contractual compliance issues.”

DCAA conducts annual audits, and requires government contractors to submit Incurred Cost Proposals each

year, which are contractor forecasts of the indirect, fringe, overhead, general and administrative expenses, material and handling costs for the coming year. "Each year, we factor in all of these costs, as a percentage of our direct costs, along with a fee for our services," said Bill Maxwell, Vice President of Finance and Accounting and Controller for CALIBRE, an Alexandria, Va.-based government contractor.

However, although the federal government allows contractors to recover more than simply direct costs, this doesn't mean they can cut corners on those annual Incurred Cost Proposal estimates. Each contractor must prove to DCAA that all indirect costs are in compliance with the Federal Acquisition Regulation (FAR). The FAR stipulates which indirect costs can be recovered, and which costs are not allowed (including entertainment-related costs, for example) to be billed to the U.S. government. "For each contract, we must verify all projects are charged the same level of indirect expenses, on a consistent basis," said Maxwell.

Meanwhile, DCAA also conducts surprise Floor Check Audits, as often as twice a year. These are designed to ensure a government contractor's employees are charging timesheets appropriately. DCAA wants to ensure, for example, that contracting employees are charging for their services daily, not once a month. In a typical floor check audit, DCAA officials may talk to 20 employees and look at 100 or more time sheets to make sure labor costs are reported accurately and in a timely fashion. DCAA will also look for certified documentation when hours reported are later modified to be in full compliance. The system must capture the reason why a timesheet changed and the changes must be approved by a supervisor.

In addition, there are contract-specific audits that may occur, either pre- or post-award, or at any time the government agency customer or contract officer decides a further investigation is warranted. The DCAA also performs a series of periodic audits of accounting systems called Adequacy of Accounting Systems audits, which are considered audits of a contractor's financial capabilities. Once a government contractor achieves a minimum revenue threshold of \$250 million, the organization must submit to this audit, approximately every three to five years, to prove it can allocate costs, document expenses and support more complex government contracting allocations. "Determining costs, adequately defining indirect pools and base costs as well as fringe and overhead expenses are all required to ensure government funds are spent appropriately and are apportioned properly to the correct contracts," said Amy Shortell, a former

DCAA auditor, currently serving as a senior manager for Argy, Wiltse & Robinson's

government contract consulting group. An overhead rate, for example, incorporates the total cost of supporting operations to include fringe costs and the cost of offices, technology, HVAC and any other charges in support of daily operations. The fringe rate, meanwhile, includes cost benefits for a contractor's employees, such as medical insurance or personal vacation time.

Carl Sweetnam, Managing Partner, Black Ink, LLC, has implemented cost accounting solutions at government contractors for over two decades. He said that corporate finance leadership needs to have a strong grasp of the cost principles that are specified in FAR Part 31, "Contract Cost Principles and Procedures." Sweetnam said, "If you have a good understanding of these principles, you can design any accounting system to be DCAA compliant. However, without the labor components that the accounting solutions geared for government contractors, such as Microsoft Dynamics SL, have built in, the task to meet DCAA's requirements are labor intensive, costly and prone to error. More importantly, time sensitive information is not readily available to key management creating decision lag."

Two areas of utmost importance for government contractors to ensure audit success are 1) the ability to provide effective and 2) easy-to-access reports and the need for internal controls to ensure reliance on the reports. Sweetnam said project accounting solutions designed specifically for government contractors need to provide reports that meet the minimum reporting period of the FAR and provide real time information to effectively manage the business operations. Program management needs the ability to manage the projects without being burdened to compile data. The contractors also need to have strong internal controls and standard operating procedures (SOP) that marry the business requirements with the FAR cost principles on a consistent and equitable basis. The more reliance an auditor has on the internal controls, the less testing is required.

No Silver Bullet

Government contractors have found there's no 'silver bullet' solution certified to guarantee compliance with DCAA's regulatory audits. Instead, contractors must invest in the proper processes and reporting tools to help them achieve and maintain compliance with DCAA's various financial audits. When it comes to compliance, DCAA auditors most want to see a 'traceability of documentation,' according to Lawrence Mocniak, CFO

for Phoenix International, an engineering services company in the underwater recovery business. For instance, he explained, “Is it possible to trace a billed amount to a Purchase Order, or requisition? Has the amount been properly charged to the correct contract or project?”

Phoenix International’s underwater recovery business involves many variables that cause job costs to fluctuate. Every project requires a unique team of specialists, each with different pay rates. Recruiting highly skilled contractors, transportation to and from the site, renting additional equipment, and time spent on the job also adds to the complexity of project-accounting processes. The government contractor has been successful in audits since implementing Microsoft Dynamics SL financial management platform two years ago. “Since there’s no such thing as a ‘government-certified’ accounting system, we’ve found that the key to successful compliance revolves around proper processes and flexible tools that allow us to trace documents through the process from award to billing. That’s what makes an accounting system acceptable to auditors,” he explained.

Tatum’s Marksberry has seen firsthand how Microsoft Dynamics SL dramatically helps government contractors as it relates to their auditing challenges. “What used to be tracing a transaction to its supporting documents has become a system supported drill-down task. Flexibility in reporting against the captured base data allows the auditor to drill down to track all of the costs. Set up properly, it allows the auditor to quickly see and test that the cost segregation and classification is proper whether they are testing the general ledger, an incurred cost submission, or the basis for a forward pricing schedule.”

“The DCAA is the go-to agency to complete audit requirements for agencies beyond the Department of Defense,” said Marksberry. “The result is that DCAA is being stretched thin, and we see their audit scheduling being pushed out more and more. We also see implementation of a pass/fail ranking for accounting system compliance. As the Federal Government ramps up hiring under the current administration this may come under control.”

Rule #1, Fail No Audits

Phoenix previously relied on an outsourced accounting firm that used QuickBooks. This method offered little real-time visibility into financial data and only limited data analysis. Because visibility and data analysis capabilities fell short of compliance standards set by the DCAA, Phoenix faced slow and painful government audits. Since implementing Microsoft Dynamics, Phoenix International has been able to pass DCAA system audits

with ease. “Our last system audit was painless, and the auditor was very impressed with our setup. Auditors found the ease of accessing documentation via an image-scanning capability valuable in tracing transactions through the life cycle of the accounting system,” Mocniak explained.

Providing accurate, detailed information in a format that satisfies the DCAA’s requirements for each individual audit is crucial. If a government contractor were to fail an audit, the organization could lose the ability to directly bill the federal government for goods and services rendered. Instead, the contractor would be required to send invoices to the DCAA, which would review every line of each invoice, at its own pace, delaying payment from a typical 30/60 days, to six months or more. That would have a dramatic impact on cash flow, Maxwell said, “making it nearly impossible to maintain operations and meet payroll, much less invest in the business, without an influx of cash over that period of time.”

Equally important, if a government contractor is unable to achieve approval for its accounting system, the organization simply won’t win contract awards. To win business, Argy, Wiltse & Robinson officials assert that achieving Adequacy of Accounting System compliance is key. The DCAA’s Form 1408 delineates the attributes of an adequate accounting system to include the need for accurate timekeeping, general ledger, labor distribution and project-based accounting components, among other elements.

As government contracts have evolved over the years from manufacturing or product-based to more services-oriented awards, Shortell maintains that small to mid-sized contractors have been expected to incorporate elements of earned value management (EVM), which was added to DoD’s accounting regulation requirements in 2007. As a result, government contracts of \$250 million or more require contractors to provide a global view of program and project management to ensure that all direct and indirect costs are reimbursed.

In Search of Ease of Use and Integration

For all of these reasons, government contracting organizations are increasingly turning away from basic accounting software or services, instead seeking broader and integrated enterprise resource planning (ERP) and document management solutions, such as those offered by Microsoft.

A strong financial management platform can provide government contractors with clear visibility into all costs

associated with each contract, to help them anticipate indirect rates and manage accounts. “At the end of each year, a government contractor should be able to walk away with no money left on table, or worse, a requirement to return funds to the government because earlier estimates were not accurate,” Maxwell explained.

Using older, less capable or inflexible accounting systems makes performing accurate estimates a crap shoot. “If the first goal of government contracting is NOT to fail an audit, the second goal would be to gain authorization to

direct bill, to gain greater control over the organization’s finances,” said Maxwell.

The last thing contractors want is for a government agency to reassess the value of a contract award based on poor operational estimates, which is a sign the contractor is not in control of daily expenses.

After studying the DCAA audit requirements and seeing that government contractors were being underserved in terms of financial management, Microsoft stepped into

A Closer Look at CALIBRE

CALIBRE, Alexandria, Va., is an employee-owned management and technology services company with more than 550 employees and \$100 million in revenue, primarily from contracting with the DoD. Because DoD contracting requires compliance with specialized accounting rules and procedures, CALIBRE previously used Deltek GCS Premier, an accounting and financial management system designed to comply with requirements of the DCAA.

In 2004, the company decided it needed more from its financial management platform, including support for a large geographical footprint, more flexible reporting and a greater ability to analyze data, while ensuring compliance with DCAA regulations. The Deltek system was built on a proprietary database and provided only a limited number of preconfigured reports. Because the Deltek system didn’t easily integrate with CALIBRE’s other Windows and Microsoft Office applications, the contractor was also forced to rely on redundant data entry into multiple systems, creating additional work and introducing the potential for errors.

CALIBRE decided to implement Microsoft Dynamics as a foundation for managing its government contracting business. The success of a flexibly priced government contract depends on the contractor’s ability to document its allocation of overhead, general and administrative expenses and demonstrate those allocations to a DCAA auditor each year. With 115 project managers working on as many as 300 projects a year, the company now depends on Microsoft Dynamics to accurately and reliably allocate its costs, according to DoD regulations.

William Barkovic, Vice President and CTO of CALIBRE recognized executives and managers have differing needs for this information on daily operations. “With Microsoft Dynamics, our controller can see the data from a general ledger perspective and answer questions like, ‘What’s our overall revenue? Are we profitable?’ Meanwhile, our project managers can see the same data from a project view and answer questions like, ‘Are we on schedule? Are we delivering against the plan we developed?’”

“With the Microsoft platform, we knew everything was going to follow the Microsoft Office system model of being totally integrated. We can enter data into the system one time, and everyone who needs that data can use it,” he added.

The open architecture of Microsoft Dynamics solution also enables CALIBRE to connect its project management and financial systems to third-party line-of-business systems. The company can provide government customers with regular reports, and even the annual audits are more manageable. With a compound annual growth rate of more than 18 percent for the last several years, the company has nearly doubled its headcount and overall revenue since switching to Microsoft Dynamics. Remarkably, however, it has achieved this growth while adding only one person to the accounting department. “That’s how powerful and efficient our system is,” Barkovic explained.

Another strength of Dynamics is the ability to perform multi-company or multi-divisional reporting. CALIBRE has acquired a number of companies over the last few years and Microsoft Dynamics readily accommodated those additional financial reporting requirements.

the market in 2001. Although the software giant initially acquired companies to get started, Microsoft's commitment to the market is evident from its investment of more than \$1 billion a year in its ERP systems. Today, Microsoft offers a suite of ERP products that allow contractors to manage both commercial and public sector businesses using a single system, rather than relying on dual accounting systems. Modern business solutions must be integrated, adaptable and work well with the Microsoft® Office suite of applications to streamline processes across a government contractor's entire business.

As government contractors strive to integrate data, simplify processes and speed the advancement of the nation's defense infrastructure, they need flexibility, visibility and scalability. In fact, the need for integration with other systems has never been more important. It's becoming more common for government contractors to frequently synchronize data between ERP and Microsoft® Office Project Server 2007 for resource scheduling and project time reporting. Other government contractors synchronize ERP with Microsoft Dynamics® CRM to turn awarded pursuits into contracts in the financials. Finally, a "must have" on the horizon is document-sharing and collaboration through Microsoft® Office SharePoint® Server, which enables contractors to better collaborate and communicate across internal divisions, or with external government customers.

A Proven Solution

Customers have found Microsoft Dynamics' SL solution is fully FAR, CAS and DCAA compliant. They claim

Dynamics excels because contractors can easily prepare reports, so that when auditors show up for a surprise floor check, "we have the information readily in hand, in the required format, to show precisely where our numbers come from," Maxwell explained.

CALIBRE implemented the Microsoft Dynamics SL ERP product, which provides an automated, robust, repeatable, integrated system that can calculate indirect rates from month to month, and apply those costs to keep the controller informed about variances as they occur. This solution is critical to CALIBRE's success. "When we manage our rates properly, auditors gain confidence that we are calculating, applying and submitting rates in a consistent and reliable manner," Maxwell explained. In addition, the Microsoft solution easily integrates with other systems so CALIBRE can, for example, add 25 new employees overnight, as required by a contract or new business opportunity.

Microsoft is also open about its data dictionary, or list of fields for all databases, and what they represent. This wasn't possible on the old accounting platform CALIBRE used. Instead, Microsoft Dynamics SL makes it easy to replicate reports, as required by auditors. For CALIBRE, an open architecture and ease of customization clearly sets Microsoft apart from the competition. "The ability to customize data entry screens makes it easy to identify information and build reports based on business or government auditing requirements as they arise," said William Barkovic, Vice President and CTO of CALIBRE.