

## Recommendation 7: Provide flexibility to contracting officers and auditors to use audit and advisory services when appropriate.

### Problem

Contracting officers too often request a specific service from either DCAA or DCMA without consulting internal technical specialists about the best way to meet their needs. In addition, DCAA auditors and DCMA technical specialists perform their most accustomed services without adapting their services to contracting officers' specific situations and needs. Contracting officers currently use the term *audit* in a way that conflates audit and advisory activities in their functional requests to DCAA for a wide-ranging set of technical activities.

### Background

Contracting officers require input from outside advisors to make sound business decisions in the public best interest. Contracting officers express they do not believe auditors can or will tailor their services to meet contracting officer needs, especially in the preaward area relating to cost and pricing services.<sup>1</sup> At one stakeholder meeting, the Section 809 Panel asked a group of acquisition professionals about the specific insights DCAA provides contracting officers, and whether an *audit* is required to obtain such information. Several stakeholders stated trained and experienced contracting officers should be able to decide whether a proposed cost is fair and reasonable. Contracting officers feel they must request an audit anyway, however, because of certain dollar thresholds and to avoid criticism later.<sup>2</sup> Audits inappropriately requested by contracting officers or provided by DCAA delay the acquisition process and decrease their utility. It is imperative for the appropriate engagement (audit/advisory) to be performed by the most qualified compliance professional with the required expertise and skills to ensure contracting officer needs are met.

### Findings

Today, contract auditors perform an attestation examination for virtually all contract audit services provided.<sup>3</sup> These attestation examinations "consist of obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter is based on (or in conformity with) the criteria in all material respects or the assertion is presented (or fairly stated), in all material respects, based on the criteria."<sup>4</sup> This type of engagement can be too restrictive or irrelevant for many contract cost or price evaluation circumstances for which contracting officers look to auditors for advice, guidance, and recommendations on how to proceed.

Using an attestation examination engagement to help contracting officers develop a negotiation position illustrates this point. In an attestation examination engagement, the auditor may only attest to whether a contractor's cost estimates comply with established audit criteria (e.g., FAR and any contractor cost assumptions within the proposal). In this type of engagement, the auditor many times does not perform the work required to provide needed advice and guidance to the contracting officer

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<sup>1</sup> Data collection interviews conducted from August – November 2017 by Section 809 Panel Team 4: Barriers to Entry.

<sup>2</sup> Ibid.

<sup>3</sup> "Services," Defense Contract Audit Agency, accessed November 17, 2017, <http://www.dcaa.mil/Home/Services?title=Services>.

<sup>4</sup> GAO, *Government Auditing Standards, 2011 Revision, GAO-12-331G*, 16, accessed November 17, 2017, <http://www.gao.gov/assets/590/587281.pdf>.

beyond a statement indicating whether a contractor's proposed costs are compliant with established criteria (e.g., determining the root cause of any noncompliance incidents). This practice falls short of what contracting officers require to develop a negotiation position. Contracting officers need to know whether costs are compliant, and if not, then they need advice on how best to proceed based on audit findings.

## Conclusions

*Subrecommendation 7a: Prior to requesting field pricing/audit assistance, contracting officers should consider other available internal resources and tailor their request for assistance to the maximum extent possible.*

Contracting officers should use internal resources to understand if, and specifically where, field pricing support is required. With the help of internal resources, contracting officer requests for field pricing assistance should be tailored to the maximum extent possible—requesting only what is needed and nothing more. Over-reliance on outside support, and unnecessarily broad requests, overtax the compliance workforce and add bureaucracy to the already slow acquisition process.

Requests for field pricing support, by default, become requests to DCAA for proposal audits. A group of contracting officers told the Section 809 Panel they believe many of the questions DCAA asked later in the audit process are the same things a contracting officer could have asked earlier on. These contracting officers see value in DCAA's services, but not at the current expense of how long it takes in many situations.<sup>5</sup> At a separate meeting, another stakeholder told the Section 809 Panel that "DCAA is not in the fair and reasonable business," implying that other resources may be better suited for proposal support.<sup>6</sup> By dedicating resources to build pricing expertise, DoD could cultivate a growing culture of self-reliance and attempt to rebuild organic pricing capability at the agency level that was lost during the 1990 DoD downsizing, rather than automatically request DCAA support.

There is precedent for this model. After Congress prohibited DCAA from performing other agency audits, non-DoD agencies relying on DCAA for contract audit and oversight were forced to look elsewhere.<sup>7</sup> As one of the biggest non-DoD users of cost-type contracts, NASA was affected greatly by this congressional prohibition, and responded by creating a DCAA-like internal organization within NASA. After outsourcing contract audit support for 40 years, NASA was able to identify efficiencies after taking ownership of all responsibilities, and NASA officials consider the transition to internal auditing a success.<sup>8</sup>

Previously, when NASA relied on DCAA for audit proposal support, the agency lacked the ability to dictate what DCAA reviewed and how. Today, NASA contracting officers tailor proposal analysis requests to their internal support. NASA has invested heavily in internal cost and price analysis capabilities by developing cadres of subject matter experts, acknowledging that audits may not always be needed for purposes of proposed cost and price evaluation. One NASA official told the Section 809

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<sup>5</sup> Data collection interviews conducted from August – November 2017 by Section 809 Panel Team 4: Barriers to Entry.

<sup>6</sup> Ibid.

<sup>7</sup> FY 2016 NDAA, Pub. L. No. 114-92, § 893, 129 Stat. 952 (2015).

<sup>8</sup> Data collection interviews with NASA officials conducted August 28, 2017 by Section 809 Panel Team 4: Barriers to Entry.

Panel this approach has changed the culture from defaulting to calling DCAA first, to asking “what do I have within NASA to do this?” As a result of the efficiencies and insight gained from taking back ownership of proposal audits from DCAA, NASA has no intent to go back to DCAA.<sup>9</sup>

### *Subrecommendation 7b: Define the term audit.*

The term audit is not defined in the FAR, contributing to confusion surrounding contracting officers’ precise needs when requesting support services. Certain elements of FAR require an audit when other forms of reviews may be more appropriate to meet contracting officer needs and responsibilities. The level of assurance contracting officers need should dictate the service required, not the other way around. The terms audit and audits should be defined through DoDD 5105.36, which will filter into FAR Part 2 and DCAM to bring consistency to a term that is often over and inappropriately used.

Definition of audit:

*A systematic examination, performed in accordance with Generally Accepted Government Auditing Standards (GAGAS), for the purpose of rendering professional opinions and conclusions that provide assurance to one or more third-parties regarding the reasonableness of an individual’s or organization’s representations or performance relative to established, objective standards or criteria..*

All instances in which the FAR currently requires an audit should be evaluated against the definition set forth above and incorporated into FAR Part 2. Such an evaluation would produce three possible outcomes:

- Keep the word audit.
- Supplement the word audit with the phrase advisory services (e.g., contracting officers will request an audit or advisory services).
- Supplant audit with advisory services.

The net result of this process would not be to preclude audits. Rather, it would provide flexibility, so DCAA can provide contracting officers the appropriate service for the level of assurance required. For example, FAR 42.101 directs contract auditors to perform “analysis of the contractor’s financial and accounting records or other related data.”<sup>10</sup> The current FAR language provides for a variety of different services depending on the circumstances—not solely a GAGAS audit.

### *Subrecommendation 7c: DCAA should use the full range of audit and nonaudit services available.*

In almost every situation for which DCAA provides an audit level of assurance to contracting officers, DCAA auditors perform an attestation examination engagement regardless of the contracting officer’s needs.<sup>11</sup> Contract auditors should perform services other than attestation engagement based on the requirements of contracting officers as appropriate. If the audit objectives overlap with different types

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<sup>9</sup> NASA officials, interview conducted August 28, 2017 by Section 809 Panel Team 4: Barriers to Entry.

<sup>10</sup> Contract audit responsibilities, FAR 42.101.

<sup>11</sup> “Services,” Defense Contract Audit Agency, accessed November 17, 2017, <http://www.dcaa.mil/Home/Services?title=Services>.

of audit services, contract auditors should evaluate the needs of contracting officers to determine which engagement type is best suited. DCAA should encourage its contract auditors to review the needs of contracting officers to determine the audit or advisory service most appropriate to the objectives of contracting officers.

According to GAGAS, the types of engagements auditors may use include those listed in Table 2-3 below:

**Table 2-3. Types of GAGAS Audits and Attestation Engagements<sup>12</sup>**

Service Type	Description
Financial Audits	Financial audits provide an independent assessment of whether an entity's reported financial information (e.g., financial condition, results, and use of resources) is presented fairly in accordance with recognized criteria. Financial audits performed in accordance with GAGAS include financial statement audits and other related financial audits.
Attestation Examination Engagement	Attestation examination engagement consists of obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter is based on (or in conformity with) the criteria in all material respects or the assertion is presented (or fairly stated), in all material respects, based on the criteria.
Attestation Review Engagement	Consists of sufficient testing to express a conclusion about whether any information came to the auditors' attention on the basis of the work performed that indicates the subject matter is not based on (or not in conformity with) the criteria or the assertion is not presented (or not fairly stated) in all material respects based on the criteria. Auditors should not perform review-level work for reporting on internal control or compliance with provisions of laws and regulations.
Attestation Agreed-Upon Procedures	Agreed-upon procedures consist of auditors performing specific procedures on the subject matter and issuing a report of findings based on the agreed-upon procedures. In an agreed-upon procedures engagement, the auditor does not express an opinion or conclusion, but only reports on agreed-upon procedures in the form of procedures and findings related to the specific procedures applied.
Performance Audits	Performance audits are defined as audits that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. The term <i>program</i> is used in GAGAS to include government entities, organizations, programs, activities, and functions.

<sup>12</sup> GAO, *Government Auditing Standards, 2011 Revision*, GAO-12-331G, 14-17, accessed November 17, 2017, <http://www.gao.gov/assets/590/587281.pdf>.

***Subrecommendation 7d: Direct a review of the roles of DCAA and DCMA to ensure appropriate alignment and eliminate redundancies.***

A group of contracting officers told Section 809 Panel staff “the distinction between DCMA and DCAA is not always clear—they sometimes look at the same thing.”<sup>13</sup> One contracting officer suggested there needs to be more collaboration and communication between DCAA and DCMA and that “If you align the priorities, the agencies can work together to achieve overarching desired results faster.”<sup>14</sup>

Given the continued scrutiny around audit requirements, it is critical that DoD use its oversight resources as efficiently as possible. The professional skills of auditors should not be inappropriately used to perform nonaudit work if it can be effectively performed in other ways or by other organizations. For example, the DCMA Cost and Pricing Center and DCMA’s Integrated Cost Analysis Teams (ICATs) are already able to assist with business and technical proposal pricing support for the contracting officer and acquisition team.<sup>15</sup> It is possible that some functions performed in DCAA could be accomplished by the DCMA Pricing Center to include the ICATs.

The Chief Management Officer (CMO) should direct a review of the work performed by DCAA and DCMA to identify services that are redundant between the two agencies and then to take targeted action to improve contract audit and advisory services. The connection between audit work and nonaudit work has benefits associated with the knowledge gained from each and that knowledge supports some of the other process controls. Real opportunities exist, however, to consider how the work of DCAA and DCMA could be more complementary and avoid the current inclination to use audits to solve every problem. In support of moving forward with IPAs and driving down DCAA work backlog, this review by DoD should be a priority and completed within 180 days, but either way prior to execution of the IPA contracts as recommended in Recommendation 9.

## **Implementation**

### ***Legislative Branch***

- Require in statute that DoD CMO will direct USD(A&S) and the Comptroller to conduct a joint review of the DCAA and DCMA contract compliance mission requirements for the purpose of determining if there are functions performed in either DCAA or DCMA that would be more appropriately aligned in the other Agency. The review shall be complete within 180 days of assignment and prior to execution of the IPA contracts as recommended in Recommendation 9. The review will include appropriate statutory or regulatory language as needed to execute any recommendations emerging from the review.

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<sup>13</sup> Data collection interviews conducted from August – November 2017 by Section 809 Panel Team 4: Barriers to Entry.

<sup>14</sup> Ibid.

<sup>15</sup> DoD Memorandum from USD(AT&L), *Integrated Cost Analysis Team Support to Major Proposals*, accessed November 17, 2017, [https://www.acq.osd.mil/dpap/policy/policyvault/D\\_DP\\_Signed\\_ICAT\\_Memo\\_Oct\\_2014.pdf](https://www.acq.osd.mil/dpap/policy/policyvault/D_DP_Signed_ICAT_Memo_Oct_2014.pdf).

### ***Executive Branch***

- Amend FAR 15.404-2(a)(1) and PGI 215.404-2 to ensure contracting officers fully understand and clarify their needs prior to requesting outside support.
- Define the term *audit* in DoDD 5105.36, FAR Part 2, and the DCAM. Use the definition to determine if an *audit* is the appropriate activity in all instances where FAR and DFARS currently require an *audit*.
- Modify DoDD 5105.36 to encourage DCAA to consider different types of audit engagements where and when appropriate.

### ***Implications for Other Agencies***

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

- Add words to the effect of the following to DoDD 5105.36:

Establish and maintain indefinite delivery, indefinite quantity contracts with qualified Independent Public Accounting (IPA) firms. DCAA will use IPAs to meet statutory time limits for contract audit and oversight services.

(1) IDIQ contracts will require that IPAs:

- (a) Make work papers available to DCAA and GAO upon request.
- (b) Be responsible for their own peer reviews. Failure to pass a peer review may subject the IPA to a default termination of its contract.

(2) As part of administering IPA contracts, DCAA will:

- (a) Maintain copies of all accepted work products from IPAs and other professional services firms (whether retained by the agencies or contractors) to maintain a complete oversight record for each contractor.
- (b) Ensure the end-user of deliverables (e.g., administrative contracting officer) is named the contracting officer technical representative (COTR) in all task order awards; responsible for accepting the work of IPAs.
- (c) Honor contracting officer requests to use IPAs, but remain responsible for determining the nature and scope of work to be performed with each respective contracting officer.
  - a. DCAA has not been able to complete the work within timeframes needed by contracting officers.
- (d) Honor contractor's request to retain IPAs (where the contract privity is between the contractor and IPA) as an allowable expense if:
  - a. DCAA has not been able to complete the work within timeframes needed by contracting officers.
  - b. DCAA has not been able to issue a task order to complete the work.

Recommendations 6, 7, 8, and 12





## **LEGISLATIVE PROVISIONS — 809 PANEL STATUTORY RECOMMENDATIONS RELATING TO CONTRACTOR AUDITS**

**[NOTE: The draft legislative text below is followed by a “Sections Affected” display, showing the text of each provision of law affected by the draft legislative text below.]**

### **1 TITLE II—CONTRACTOR AUDITING**

Sec. 201. Time limits for Defense Contract Audit Agency review of certain contractor submissions and contractor compliance.

Sec. 202. Peer review of Defense Contract Audit Agency.

Sec. 203. Defense Contract Audit Agency annual report.

Sec. 204. Review of roles of Defense Contract Audit Agency and Defense Contract Management Agency.

### **2 SEC. 201. TIME LIMITS FOR DEFENSE CONTRACT AUDIT AGENCY REVIEW OF 3 CERTAIN CONTRACTOR SUBMISSIONS AND CONTRACTOR 4 COMPLIANCE.**

5 (a) TIME LIMITS.—

6 (1) IN GENERAL.—Chapter 137 of title 10, United States Code, is amended by  
7 inserting after section 2313b the following new section:

8 **“§ 2313c. DCAA review of contractor submissions and contractor compliance: time limits**

9 “(a) TIME LIMITS FOR DCAA REVIEW.—The Secretary of Defense shall require the  
10 Director of the Defense Contract Audit Agency (in this section referred to as ‘DCAA’) to  
11 prescribe procedures to ensure that DCAA, upon receipt of a contractor submission, or of a  
12 request from a contracting officer, that is specified in a table in subsection (b), completes the  
13 DCAA review within the time limit specified in the table or, in the case of a review requested by  
14 a contracting officer, within any shorter time limit agreed to by DCAA at the time of the request

1 from the contracting officer (and subject to any extension authorized pursuant to subsection (c)).  
 2 The time limits in subsection (b) shall take effect on October 1, 2019.

3 “(b) TIME LIMITS.—

4 “(1) ON-DEMAND ACTIVITIES.—The following time limits shall apply under the  
 5 procedures prescribed under subsection (a):

<b>Matter for DCAA review</b>	<b>DCAA time limit</b>
Contractor submission of pre-award cost proposal	90 days from date of contracting officer request for review
Contractor submission of invoices for direct contract costs	90 days from date of contracting officer request for review
Any other contractor submission in connection with awarding, administering, or terminating a particular contract	180 days from date of contracting officer request for review

6 “(2) PREDICTABLE ACTIVITIES.—The following time limits shall apply under the  
 7 procedures prescribed under subsection (a):

<b>Matter for DCAA review</b>	<b>DCAA time limit</b>
Contractor submission of forward pricing rate proposal	90 days from date of contracting officer request for review
Contractor submission of provisional billing rate proposal	30 days from date of receipt of the contractor submission
Contractor submission of Cost Accounting Standards (CAS) disclosure statement	If the contracting officer requests DCAA review of the adequacy of the CAS disclosure statement, 60 days from date of contracting officer request for review

Contractor submission of cost accounting practice changes referred to as a General Dollar Magnitude (GDM) proposal	90 days from date of contracting officer request for review
Contractor submission of cost accounting practice changes referred to as a Detailed Cost Impact (DCI) proposal	180 days from date of contracting officer request for review
Contractor compliance with Cost Accounting Standards in accordance with the contractor's CAS disclosure statement	90 days from date of contracting officer request for review
Contractor compliance with an individual Cost Accounting Standard	90 days from date of contracting officer request for review

1 “(c) EXTENSIONS.—

2 “(1) AUTHORITY FOR EXTENSIONS.—The procedures prescribed under subsection  
3 (a) shall provide that a contracting officer may grant an extension of a time limit under  
4 this section (whether the applicable time limit is prescribed under subsection (b) or was  
5 agreed to by DCAA at the time of the request from the contracting office). Those  
6 procedures shall require that any such extension be recorded separately from the original  
7 time limit.

8 “(2) TYPES OF EXTENSIONS.—Any such extension shall be categorized as one of  
9 the following:

10 “(A) Contracting officer change.

11 “(B) DCAA request.

12 “(C) Contractor request or contractor caused.

13 “(3) REQUIREMENT AS TO CONTRACTOR REQUESTED OR CAUSED EXTENSIONS.—An  
14 extension may not be categorized as having been requested or caused by a contractor

1 unless the contractor is informed that the extension will be so categorized. If the  
2 contractor disagrees with that categorization, the contracting officer shall record such  
3 disagreement.”.

4 (2) CLERICAL AMENDMENT.—The table of sections at the beginning of such  
5 chapter is amended by inserting after the item relating to section 2313b the following new  
6 item:

“2313c. DCAA review of contractor submissions and contractor compliance: time limits.”.

7 (b) TIMELINESS OF INCURRED COST AUDITS.—

8 (1) CONSISTENCY WITH NEW SECTION 2313C.—Subsection (g) of section 2313b of  
9 title 10, United States Code, is amended—

10 (A) by striking paragraph (2);

11 (B) by redesignating paragraph (3) as paragraph (2) and in that  
12 paragraph—

13 (i) by striking “qualified” both places it appears; and

14 (ii) by striking “on or after the date of the enactment of this  
15 section” and inserting “after December 11, 2017.”;

16 (C) by redesignating paragraph (4) as paragraph (3) and in that  
17 paragraph—

18 (i) by striking “paragraph (5)” and inserting “paragraph (4)”; and

19 (ii) by striking “qualified”; and

20 (D) by redesignating paragraph (5) as paragraph (4) and in that  
21 paragraph—

22 (i) by striking “The Under Secretary of Defense (Comptroller) may  
23 waive the requirements of paragraph (4) on a case-by-case basis” and

1 inserting “(A) The contracting officer (or an official within the contracting  
2 activity senior to the contracting officer) may grant an extension of the  
3 time limit under paragraph (2) for issuance of audit findings for an  
4 incurred cost submission and may waive the requirements of paragraph (3)  
5 with respect to the period of any such extension. Any such extension and  
6 waiver may only be made on a case-by-case basis and only”;

7 (ii) by designating the sentence beginning “The Director of” as  
8 subparagraph (B) and in that subparagraph—

9 (I) by inserting “for any fiscal year” after “of this title”; and

10 (II) by inserting “under this paragraph during such fiscal  
11 year” after “waivers issued”; and

12 (iii) by adding at the end the following new subparagraphs:

13 “(C) The provisions of section 2313c(c) of this title shall apply to an extension granted  
14 under this paragraph.

15 “(4) A time limit under this subsection for issuance of audit findings for an incurred cost  
16 submission does not apply in a case in which the contractor requests a multiyear audit and the  
17 contracting officer (or an official within the contracting activity senior to the contracting officer)  
18 approves.”.

19 (b) CONFORMING AND TECHNICAL AMENDMENTS.—Such section is further amended—

20 (1) in subsection (b)(1)—

21 (A) in subparagraph (B), by striking “a qualified incurred” and inserting  
22 “an incurred”; and

23 (B) in subparagraph (E)—

1 (i) by redesignating clauses (A) and (B) as clauses (i) and (ii),  
2 respectively;

3 (ii) by striking “a qualified incurred” in clause (i) (as so  
4 redesignated) and inserting “an incurred”; and

5 (iii) by striking “more than 12 months before the date of the  
6 enactment of this section” and inserting “before December 12, 2016”; and

7 (2) in subsection (i)—

8 (A) by striking paragraph (6); and

9 (B) by redesignating paragraph (7) as paragraph (6).

10 **SEC. 202. PEER REVIEW OF DEFENSE CONTRACT AUDIT AGENCY.**

11 (a) REMOVAL OF DCAA PEER REVIEWS FROM DOD IG. —Section 8(c)(10) of the  
12 Inspector General Act of 1978 (5 U.S.C. App) is amended by inserting before the period at the  
13 end the following: “, except that this paragraph does not apply to the Defense Contract Audit  
14 Agency”.

15 (b) REQUIREMENT FOR DCAA PEER REVIEW BY COMMERCIAL AUDITOR.—Section  
16 2313b(e) of title 10, United States Code, is amended—

17 (1) by redesignating paragraph (2) as paragraph (3);

18 (2) by designating the second sentence of paragraph (1) as paragraph (2) ; and

19 (3) in paragraph (2), as so designated, by inserting before “Such peer review” the

20 following: “The Secretary of Defense shall provide for periodic peer review of the

21 Defense Contract Audit Agency by a commercial auditor.”.

22 **SEC. 203. DEFENSE CONTRACT AUDIT AGENCY ANNUAL REPORT.**

1 (a) REVISIONS TO REPORT ELEMENTS.—Subsection (a) of section 2313a of title 10, United  
2 States Code, is amended—

3 (1) in paragraph (1), by striking “significant” and all that follows and inserting  
4 “the regulatory requirements that create compliance difficulties for contractors, including  
5 an analysis of how those regulatory requirements affect contractors of different sizes and  
6 industries;”;

7 (2) in paragraph (2)—

8 (A) by striking subparagraphs (A) through (E) and inserting the following:

9 “(A) the total number of new audit or advisory engagements, by type (pre-  
10 award, incurred cost, other post-award, and business system), with time limits  
11 expiring during the fiscal year that were completed or were awaiting completion,  
12 as compared to total audit and advisory engagements completed or awaiting  
13 completion during the year;

14 “(B) on-time performance relative to time limits for each type of audit or  
15 advisory engagement (shown separately for the Defense Contract Audit Agency  
16 and qualified private auditors retained by the agency);

17 “(C) the time limit (expressed in days) for each type of audit or advisory  
18 engagement, along with the shortest period, longest period, and average period of  
19 actual performance (shown separately for the Defense Contract Audit Agency and  
20 qualified private auditors retained by the agency);

21 “(D) for pre-award audits and advisory engagements of contractor costs,  
22 sustained costs as a total number and as a percentage of total questioned costs,  
23 where questioned costs are expressed as the impact on negotiable contract costs



1 (shown separately for the Defense Contract Audit Agency and qualified private  
2 auditors retained by the agency);

3 “(E) for post-award audits and advisory engagements of contractor costs,  
4 the questioned costs accepted by the contracting officers and contractors as a total  
5 number and as a percentage of total questioned costs, where questioned costs are  
6 expressed as the impact on reimbursable contract (shown separately for the  
7 Defense Contract Audit Agency and qualified private auditors retained by the  
8 agency);” and

9 (B) in subparagraph (H)—

10 (i) by inserting “post-award” after “dollar value of”; and

11 (ii) by striking “submission” and inserting “proposal”;

12 (3) by redesignating paragraphs (3), (4), (5), (6), and (7) as paragraphs (4), (5),  
13 (6), (7), and (9), respectively;

14 (4) by inserting after paragraph (2) the following new paragraph (3):

15 “(3) A summary of the reasons for the difference between questioned and  
16 sustained costs shown in the statistical tables under paragraph (2).”;

17 (5) in paragraph (4) (as redesignated by paragraph (3) of this subsection), by  
18 striking “needed to improve the audit process;” and inserting “needed by the Defense  
19 Contract Audit Agency to improve the audit process or that would enhance compliance  
20 with regulatory requirements.”;

21 (6) in paragraph (7) (as redesignated by paragraph (3) of this subsection), by  
22 striking “more effective use of audit resources;” and inserting “contract compliance and

1 professional development of the Defense Contract Audit Agency workforce (shown  
2 separately for collaborative outreach actions and other outreach actions).”; and

3 (7) by inserting after paragraph (7) (as redesignated by paragraph (3) of this  
4 subsection) the following new paragraph:

5 “(8) A statistically representative survey of contracting officers from Department  
6 of Defense buying commands, the Defense Contract Management Agency, and small and  
7 large business representatives from industry to measure the timeliness and effectiveness  
8 of audit and advisory services provided (shown separately for the Defense Contract Audit  
9 Agency and qualified private auditors retained by the Defense Contract Audit Agency).”.

10 (b) CONFORMING AMENDMENTS.—Subsection (a) of such section is further amended—

11 (1) in the matter preceding paragraph (1), by striking “shall include, at a  
12 minimum—“ and inserting “shall include the following.”;

13 (2) by capitalizing the first letter following the paragraph designation in each of  
14 paragraphs (1), (2), (4), (5), (6), (7), and (9); and

15 (3) by striking the semicolon at the end of each of paragraphs (1), (2), (5), and (6)  
16 and inserting a period.

17 (c) DEFINITIONS.—Subsection (d)(1) of such section is amended by striking “qualified  
18 incurred cost submission” and inserting “qualified private auditor”.

19 (d) EFFECTIVE DATE.—The amendments made by this section shall take effect on  
20 October 1, 2020.

21 **SEC. 204. REVIEW OF ROLES OF DEFENSE CONTRACT AUDIT AGENCY AND**  
22 **DEFENSE CONTRACT MANAGEMENT AGENCY.**

1 (a) REVIEW.—The Secretary of Defense, acting through the Chief Management Officer of  
2 the Department of Defense, shall direct the Under Secretary of Defense for Acquisition and  
3 Sustainment and the Under Secretary of Defense (Comptroller) to conduct a joint review of the  
4 functions of the Defense Contract Management Agency and the Defense Contract Audit Agency  
5 to determine whether there are functions being performed by either Agency that could more  
6 appropriately be performed by the other Agency. The review shall consider the extent to which  
7 redundancies exist between the two Agencies and how best to align the functions and workload  
8 of the two Agencies to best serve the acquisition community.

9 (b) REPORT.—The Under Secretaries shall submit to the Secretary of Defense a report  
10 with the results of the review under subsection (a) not later than 180 days after the date of the  
11 enactment of this Act. The report shall include a draft of any statutory or regulatory change  
12 needed to implement recommendations of the review.

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## SECTIONS AFFECTED BY THE PROPOSAL

[The material below shows changes proposed to be made by the proposal to the text of existing statutes. Matter proposed to be deleted is shown in ~~stricken through~~ text; matter proposed to be inserted is shown in *bold italic*. (Where an amendment in the proposal would add a full new section to existing law, the text of that proposed new section is NOT set forth below since it is set out in full in the legislative text above.)]

[NOTE: Text shown as current law incorporates amendments made by the FY2018 NDAA, Public Law 115-91, enacted Dec. 12, 2017]

### Section 8 of the Inspector General Act of 1978

#### SEC. 8. ADDITIONAL PROVISIONS WITH RESPECT TO THE INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE.

(a) No member of the Armed Forces, active or reserve, shall be appointed Inspector General of the Department of Defense.

(b)(1) Notwithstanding the last two sentences of section 3(a), the Inspector General shall be under the authority, direction, and control of the Secretary of Defense with respect to audits or investigations, or the issuance of subpoenas, which require access to information concerning—

- (A) sensitive operational plans;
- (B) intelligence matters;
- (C) counterintelligence matters;
- (D) ongoing criminal investigations by other administrative units of the Department of Defense related to national security; or
- (E) other matters the disclosure of which would constitute a serious threat to national security.

(2) With respect to the information described in paragraph (1) the Secretary of Defense may prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation, from accessing information described in paragraph (1), or from issuing any subpoena, after the Inspector General has decided to initiate, carry out or complete such audit or investigation, access such information, or to issue such subpoena, if the Secretary determines that such prohibition is necessary to preserve the national security interests of the United States.

(3) If the Secretary of Defense exercises any power under paragraph (1) or (2), the Inspector General shall submit a statement concerning such exercise within thirty days to the Committees on Armed Services and Governmental Affairs of the Senate and the Committee on Armed Services and the Committee on Government Reform and Oversight of the House of Representatives and to other appropriate committees or subcommittees of the Congress.

(4) The Secretary shall, within thirty days after submission of a statement under paragraph (3), transmit a statement of the reasons for the exercise of power under paragraph (1) or (2) to the congressional committees specified in paragraph (3) and to other appropriate committees or subcommittees.

(c) In addition to the other duties and responsibilities specified in this Act, the Inspector General of the Department of Defense shall—

- (1) be the principal adviser to the Secretary of Defense for matters relating to the prevention and detection of fraud, waste, and abuse in the programs and operations of the Department;
- (2) initiate, conduct, and supervise such audits and investigations in the Department of Defense (including the military departments) as the Inspector General considers appropriate;
- (3) provide policy direction for audits and investigations relating to fraud, waste, and abuse and program effectiveness;
- (4) investigate fraud, waste, and abuse uncovered as a result of other contract and internal audits, as the Inspector General considers appropriate;
- (5) develop policy, monitor and evaluate program performance, and provide guidance with respect to all Department activities relating to criminal investigation programs;
- (6) monitor and evaluate the adherence of Department auditors to internal audit, contract audit, and internal review principles, policies, and procedures;

(7) develop policy, evaluate program performance, and monitor actions taken by all components of the Department in response to contract audits, internal audits, internal review reports, and audits conducted by the Comptroller General of the United States;

(8) request assistance as needed from other audit, inspection, and investigative units of the Department of Defense (including military departments);

(9) give particular regard to the activities of the internal audit, inspection, and investigative units of the military departments with a view toward avoiding duplication and insuring effective coordination and cooperation; and

(10) conduct, or approve arrangements for the conduct of, external peer reviews of Department of Defense audit agencies in accordance with and in such frequency as provided by Government auditing standards as established by the Comptroller General of the United States, *except that this paragraph does not apply to the Defense Contract Audit Agency.*

(d) \*\*\*

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## Title 10, United States Code

### § 2313a. [current law shown as in effect on October 1, 2018] Defense Contract Audit Agency: annual report

(a) REQUIRED REPORT.—The Director of the Defense Contract Audit Agency shall prepare an annual report of the activities of the Agency during the previous fiscal year. The report shall include, ~~at a minimum~~—*the following*:

(1) ~~[a] A description of significant problems, abuses, and deficiencies encountered during the conduct of contractor audits~~ *the regulatory requirements that create compliance difficulties for contractors, including an analysis of how those regulatory requirements affect contractors of different sizes and industries*[:].

(2) ~~[s] Statistical tables showing—~~

~~(A) the total number and dollar value of audit reports completed and pending, set forth separately by type of audit;~~

~~(B) the priority given to each type of audit;~~

~~(C) the length of time taken for each type of audit, both from the date of receipt of a qualified incurred cost submission and from the date the audit begins;~~

~~(D) the sustained questioned costs, set forth separately by type of audit, both as a total value and as a percentage of the total questioned costs for the audit;~~

~~(E) the total number and dollar value of incurred cost audits completed, and the method by which such incurred cost audits were completed;~~

*(A) the total number of new audit or advisory engagements, by type (pre-award, incurred cost, other post-award, and business system), with time limits expiring during the fiscal year that were completed or were awaiting completion, as compared to total audit and advisory engagements completed or awaiting completion during the year;*

*(B) on-time performance relative to time limits for each type of audit or advisory engagement (shown separately for the Defense Contract Audit Agency and qualified private auditors retained by the agency);*

*(C) the time limit (expressed in days) for each type of audit or advisory engagement, along with the shortest period, longest period, and average period of actual performance (shown separately for the Defense Contract Audit Agency and qualified private auditors retained by the agency);*

*(D) for pre-award audits and advisory engagements of contractor costs, sustained costs as a total number and as a percentage of total questioned costs, where questioned costs are expressed as the impact on negotiable contract costs (shown separately for the Defense Contract Audit Agency and qualified private auditors retained by the agency);*

*(E) for post-award audits and advisory engagements of contractor costs, the questioned costs accepted by the contracting officers and contractors as a total number and as a percentage of total questioned costs, where questioned costs are expressed as the impact on reimbursable contract (shown separately for the Defense Contract Audit Agency and qualified private auditors retained by the agency);*

(F) the aggregate cost of performing audits, set forth separately by type of audit;

(G) the ratio of sustained questioned costs to the aggregate costs of performing audits, set forth separately by type of audit; and

(H) the total number and dollar value of *post-award* audits that are pending for a period longer than one year as of the end of the fiscal year covered by the report, and the fiscal year in which the qualified ~~submission~~ *proposal* was received, set forth separately by type of audit[;] .

*(3) A summary of the reasons for the difference between questioned and sustained costs shown in the statistical tables under paragraph (2).*

~~(3)~~(4) [a] A summary of any recommendations of actions or resources needed by *the Defense Contract Audit Agency* to improve the audit process *or that would enhance compliance with regulatory requirements*[;] .

~~(4)~~ (5) [a] A summary, set forth separately by dollar amount and percentage, of indirect costs for independent research and development incurred by contractors in the previous fiscal year[;] .

~~(5)~~ (6) [a] A summary, set forth separately by dollar amount and percentage, of indirect costs for bid and proposal costs incurred by contractors in the previous fiscal year[;] .

~~(6)~~ (7) [a] A description of outreach actions toward industry to promote ~~more~~ *effective use of audit resources; contract compliance and professional development of the Defense Contract Audit Agency workforce (shown separately for collaborative outreach actions and other outreach actions).*

(8) *A statistically representative survey of contracting officers from Department of Defense buying commands and the Defense Contract Management Agency and representatives of small and large businesses to measure the timeliness and effectiveness of audit and advisory services provided by the Defense Contract Audit*

*Agency (shown separately for the Defense Contract Audit Agency and qualified private auditors retained by the agency).*

(7) (9) [a] Any other matters the Director considers appropriate.

(b) SUBMISSION OF ANNUAL REPORT.—Not later than March 30 of each year, the Director shall submit to the congressional defense committees the report required by subsection (a).

(c) PUBLIC AVAILABILITY.—Not later than 60 days after the submission of an annual report to the congressional defense committees under subsection (b), the Director shall make the report available on the publicly available website of the Agency or such other publicly available website as the Director considers appropriate.

(d) DEFINITIONS.—

(1) The terms “incurred cost audit” and “~~qualified incurred cost submission~~ *qualified private auditor*” have the meaning given those terms in section 2313b of this title.

(2) The term “sustained questioned costs” means questioned costs that were recovered by the Federal Government as a result of contract negotiations related to such questioned costs.

### § 2313b. Performance of incurred cost audits

(a) COMPLIANCE WITH STANDARDS OF RISK AND MATERIALITY.—Not later than October 1, 2020, the Secretary of Defense shall comply with commercially accepted standards of risk and materiality in the performance of each incurred cost audit of costs associated with a contract of the Department of Defense.

(b) CONDITIONS FOR THE USE OF QUALIFIED AUDITORS TO PERFORM INCURRED COST AUDITS.—(1) To support the need of the Department of Defense for timely and effective incurred cost audits, and to ensure that the Defense Contract Audit Agency is able to allocate resources to higher-risk and more complex audits, the Secretary of Defense shall use qualified private auditors to perform a sufficient number of incurred cost audits of contracts of the Department of Defense to—

(A) eliminate, by October 1, 2020, any backlog of incurred cost audits of the Defense Contract Audit Agency;

(B) ensure that incurred cost audits are completed not later than one year after the date of receipt of ~~a qualified an~~ incurred cost submission;

(C) maintain an appropriate mix of Government and private sector capacity to meet the current and future needs of the Department of Defense for the performance of incurred cost audits;

(D) ensure that qualified private auditors perform incurred cost audits on an ongoing basis to improve the efficiency and effectiveness of the performance of incurred cost audits; and

(E) limit multiyear auditing to ensure that multiyear auditing is conducted only—

(A) (i) to address outstanding incurred cost audits for which ~~a qualified an~~ incurred cost submission was submitted to the Defense Contract Audit Agency

~~more than 12 months before the date of the enactment of this section~~ *before December 12, 2016*; or

(B) *(ii)* when the contractor being audited submits a written request, including a justification for the use of multiyear auditing, to the Under Secretary of Defense (Comptroller).

(2) The Secretary of Defense shall consult with Federal agencies that have awarded contracts or task orders to qualified private auditors to ensure that the Department of Defense is using, as appropriate, best practices relating to contracting with qualified private auditors.

(3) The Secretary of Defense shall ensure that a qualified private auditor performing an incurred cost audit under this section—

(A) has no conflict of interest in performing such an audit, as defined by generally accepted government auditing standards;

(B) possesses the necessary independence to perform such an audit, as defined by generally accepted government auditing standards;

(C) signs a nondisclosure agreement, as appropriate, to protect proprietary or nonpublic data;

(D) accesses and uses proprietary or nonpublic data furnished to the qualified private auditor only for the purposes stated in the contract;

(E) takes all reasonable steps to protect proprietary and nonpublic data furnished during the audit; and

(F) does not use proprietary or nonpublic data provided to the qualified private auditor under the authority of this section to compete for Government or nongovernment contracts.

(c) PROCEDURES FOR THE USE OF QUALIFIED PRIVATE AUDITORS.—(1) Not later than October 1, 2018, the Secretary of Defense shall submit to the congressional defense committees a plan to implement the requirements of subsection (b). Such plan shall include, at a minimum—

(A) a description of the incurred cost audits that the Secretary determines are appropriate to be conducted by qualified private auditors, including the approximate number and dollar value of such incurred cost audits;

(B) an estimate of the number and dollar value of incurred cost audits to be conducted by qualified private auditors for each of the fiscal years 2019 through 2025 necessary to meet the requirements of subsection (b); and

(C) all other elements of an acquisition plan as required by the Federal Acquisition Regulation.

(2) Not later than April 1, 2019, the Secretary of Defense or a Federal department or agency authorized by the Secretary shall award a contract or issue a task order under an existing contract to two or more qualified private auditors to perform incurred cost audits of costs associated with contracts of the Department of Defense. The Defense Contract Management Agency or a contract administration office of a military department shall use a contract or a task order awarded or issued pursuant to this paragraph for the performance of an incurred cost audit, if doing so will assist the Secretary in meeting the requirements in subsection (b).

(3) To improve the quality of incurred cost audits and reduce duplication of performance of such audits, the Secretary of Defense may provide a qualified private auditor with information on past or ongoing audit results or other relevant information on the entities the qualified private auditor is auditing.



(4) The Secretary of Defense shall consider the results of an incurred cost audit performed under this section without regard to whether the Defense Contract Audit Agency or a qualified private auditor performed the audit.

(5) The contracting officer for a contract that is the subject of an incurred cost audit shall have the sole discretion to determine what action should be taken based on an audit finding on direct costs of the contract.

(d) QUALIFIED PRIVATE AUDITOR REQUIREMENTS.—(1) A qualified private auditor awarded a contract or issued a task order under subsection (c)(2) shall conduct an incurred cost audit in accordance with the generally accepted government auditing standards.

(2) A qualified private auditor awarded a contract or issued a task order under subsection (c)(2) shall develop and maintain complete and accurate working papers on each incurred cost audit. All working papers and reports on the incurred cost audit prepared by such qualified private auditor shall be the property of the Department of Defense, except that the qualified private auditor may retain a complete copy of all working papers to support such reports made pursuant to this section.

(3) A breach of contract by a qualified private auditor with respect to use of proprietary or nonpublic data may subject the qualified private auditor to—

(A) criminal, civil, administrative, and contractual actions for penalties, damages, and other appropriate remedies by the United States; and

(B) civil actions for damages and other appropriate remedies by the contractor or subcontractor whose data are affected by the breach.

(e) PEER REVIEW.—(1) Effective October 1, 2022, the Defense Contract Audit Agency may issue unqualified audit findings for an incurred cost audit only if the Defense Contract Audit Agency is peer reviewed by a commercial auditor and passes such peer review.

(2) ***The Secretary of Defense shall provide for periodic peer review of the Defense Contract Audit Agency by a commercial auditor.*** Such peer review shall be conducted in accordance with the peer review requirements of generally accepted government auditing standards, including the requirements related to frequency of peer reviews, and shall be deemed to meet the requirements of the Defense Contract Audit Agency for a peer review under such standards.

(2) (3) Not later than October 1, 2019, the Secretary of Defense shall provide to the Committees on Armed Services of the Senate and the House of Representatives an update on the process of securing a commercial auditor to perform the peer review referred to in paragraph (1).

(f) NUMERIC MATERIALITY STANDARDS FOR INCURRED COST AUDITS.—(1) Not later than October 1, 2020, the Department of Defense shall implement numeric materiality standards for incurred cost audits to be used by auditors that are consistent with commercially accepted standards of risk and materiality.

(2) Not later than October 1, 2019, the Secretary of Defense shall submit to the congressional defense committees a report containing proposed numeric materiality standards required under paragraph (1). In developing such standards, the Secretary shall consult with commercial auditors that conduct incurred cost audits, the advisory panel authorized under section 809 of the National Defense Authorization Act for Fiscal Year 2016 (Public Law 114-92; 129 Stat. 889), and other governmental and nongovernmental entities with relevant expertise.

(g) **TIMELINESS OF INCURRED COST AUDITS.**—(1) The Secretary of Defense shall ensure that all incurred cost audits performed by qualified private auditors or the Defense Contract Audit Agency are performed in a timely manner.

~~(2) The Secretary of Defense shall notify a contractor of the Department of Defense within 60 days after receipt of an incurred cost submission from the contractor whether the submission is a qualified incurred cost submission.~~

~~(3) (2)~~ With respect to **qualified** incurred cost submissions received ~~on or after the date of the enactment of this section~~ *after December 11, 2017*, audit findings shall be issued for an incurred cost audit not later than one year after the date of receipt of such **qualified** incurred cost submission.

~~(4) (3)~~ Not later than October 1, 2020, and subject to paragraph ~~(5) (4)~~, if audit findings are not issued within one year after the date of receipt of a **qualified** incurred cost submission, the audit shall be considered to be complete and no additional audit work shall be conducted.

~~(5) (4)(A) The Under Secretary of Defense (Comptroller)~~ *The contracting officer (or an official within the contracting activity senior to the contracting officer) may grant an extension of the time limit under paragraph (2) for issuance of audit findings for an incurred cost submission and may waive the requirements of paragraph (4) (3) with respect to the period of any such extension. Any such extension and waiver may only be made on a case-by-case basis and only if the Director of the Defense Contract Audit Agency submits a written request.*

*(B) The Director of the Defense Contract Audit Agency shall include in the report required under section 2313a of this title for any fiscal year the total number of waivers issued under this paragraph during such fiscal year and the reasons for issuing each such waiver.*

*(C) The provisions of section 2313c(c) of this title shall apply to an extension granted under this paragraph.*

*(5) A time limit under this subsection for issuance of audit findings for an incurred cost submission does not apply in a case in which the contractor requests a multiyear audit and the contracting officer (or an official within the contracting activity senior to the contracting officer) approves.*

(h) **REVIEW OF AUDIT PERFORMANCE.**—Not later than April 1, 2025, the Comptroller General of the United States shall submit to the congressional defense committees a report that evaluates for the period beginning on October 1, 2019, and ending on August 31, 2023—

(1) the timeliness, individual cost, and quality of incurred cost audits, set forth separately by incurred cost audits performed by the Defense Contract Audit Agency and by qualified private auditors;

(2) the cost to contractors of the Department of Defense for incurred cost audits, set forth separately by incurred cost audits performed by the Defense Contract Audit Agency and by qualified private auditors;

(3) the effect, if any, on other types of audits conducted by the Defense Contract Audit Agency that results from incurred cost audits conducted by qualified private auditors; and

(4) the capability and capacity of qualified private auditors to conduct incurred cost audits for the Department of Defense.

(i) **DEFINITIONS.**—In this section:

(1) The term “commercial auditor” means a private entity engaged in the business of performing audits.

(2) The term “incurred cost audit” means an audit of charges to the Government by a contractor under a flexibly priced contract.

(3) The term “flexibly priced contract” has the meaning given the term “flexibly-priced contracts and subcontracts” in part 30 of the Federal Acquisition Regulation (section 30.001 of title 48, Code of Federal Regulations).

(4) The term “generally accepted government auditing standards” means the generally accepted government auditing standards of the Comptroller General of the United States.

(5) The term “numeric materiality standard” means a dollar amount of misstatements, including omissions, contained in an incurred cost audit that would be material if the misstatements, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the Government made on the basis of the incurred cost audit.

~~(6) The term “qualified incurred cost submission” means a submission by a contractor of costs incurred under a flexibly priced contract that has been qualified by the Department of Defense as sufficient to conduct an incurred cost audit.~~

(7) (6) The term “qualified private auditor” means a commercial auditor—

(A) that performs audits in accordance with generally accepted government auditing standards; and

(B) that has received a passing peer review rating, as defined by generally accepted government auditing standards.

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