

Recommendation 72: Replace 18 system criteria from DFARS 252.242-7006, Accounting System Administration, with an internal control audit to assess the adequacy of contractors' accounting systems based on seven system criteria.

Problem

DoD is not obtaining timely assurance that internal controls for defense contractors' accounting systems are properly designed and functioning.¹ Ensuring effective internal controls is one of the most efficient ways to protect the government's interest, reduce risk, and improve performance.

Background

Accounting business systems make up much of the business systems in DoD's Contractor Business Analysis Repository (CBAR). In addition to being the most prevalent contractor system, it is a critical system for ensuring the government's interests are protected when doing business through flexibly priced contracts.

FAR 16.301-3, Limitations, recognizes the criticality of the accounting system by requiring contractors to maintain an adequate accounting system for determining cost applicable to contracts awarded on the basis of cost. In addition, FAR subpart 32.5, Progress Payments Based on Costs, and FAR 32.503, Post Award Matters, contain multiple provisions requiring an adequate accounting system and controls. Even prospective contractors wanting to do business with the federal government must have the necessary accounting and operational control structure to be deemed responsible in accordance with FAR 9.104-1, General Standards.

To do business with the government, contractors must demonstrate capability to meet the requirements outlined in the Standard Form 1408, Pre-Award Survey of a Prospective Contractor Accounting System. This preaward system review should not be confused with the reviews required by the DFARS Business System rule that tests the design and capability of the system, as well as whether controls are in place and functioning properly.

Discussion

In its *Volume 1 Report*, the Section 809 Panel recommended that DoD replace the system criteria in DFARS 252.242-7006, Accounting System Administration, with an internal control audit to assess the adequacy of contractors' accounting systems. The panel chartered a working group to develop a PPG and asked the working group to review and refine the panel's previously recommended accounting system criteria and the internal controls framework for assessment of contractor accounting systems.

Conclusions

As recommended in the Section 809 Panel's original recommendation in its *Volume 1 Report*, DoD should embrace an internal control framework for accounting system audits and has refined the framework necessary to implement the recommendation. An internal control audit framework based on a body of professional standards developed to address SOX 404(b) serves as a foundation to help

¹ DCAA, email to Section 809 Panel Staff, December 18, 2017. The email indicated that DCAA completed eight accounting system audits in FY 2016.

meet the government's objectives to obtain assurance that contractors have effective internal controls for their business systems. Starting with this framework eliminates the need to develop uniquely defined criteria and terminology, which in turn reduces the time needed to make this framework operational.

Using the private-sector-established internal control audit framework will resolve a consistent complaint expressed in Section 809 Panel meetings with stakeholders that the DFARS accounting system criteria were not objective and measurable because of the current terminology used in the business system rule. Internal control audits should be performed as the basis for assessing the adequacy of defense contractors' accounting systems because these audits provide the following:

- An engagement framework used in the private sector that is well established and understood.
- More useful and relevant information to the acquisition team, contracting officer, and contractor.
- Clear and objective criteria for accounting system requirements.

The framework's standards and criteria also satisfy the requirement at Section 893 (a) of the FY 2017 NDAA to develop "clear and specific business system requirements that are identifiable and made publicly available."²

Implementation

Legislative Branch

- There are no statutory changes required for this recommendation.

Executive Branch

- Amend the DFARS to replace the system criteria from DFARS 252.242-7006, Accounting System Administration, with an internal control audit framework to assess the adequacy of contractors' accounting systems. The envisioned internal control audits will focus on assessing the key controls that ensure government objectives are being met. Auditors' conclusions on the effectiveness of the key controls are essential information for contracting officers and contractors to evaluate whether the government's interests are adequately protected. Specifically, auditors will evaluate whether key internal controls are in place and operating to provide reasonable assurance of the following:
 - Direct costs and indirect costs are classified in accordance with contract terms, FAR, Cost Accounting Standards (CAS) and other regulations, as applicable.
 - Direct costs are identified and accumulated by contract in accordance with contract terms, FAR, CAS and other regulations, as applicable.

² Section 893 of FY 2017 NDAA, Pub. L. No. 114-AS328 (2016).

- Methods are established to accumulate and allocate indirect costs to contracts in accordance with contract terms, FAR, CAS and other regulations, as applicable.
- General ledger control accounts accurately reflect all transactions recorded in subsidiary ledgers and/or other information systems that either integrate or interface with the general ledger including, but not limited to, timekeeping, labor cost distribution, fixed assets, accounts payable, project costs, and inventory.
- Adjustments to the general ledger, subsidiary ledgers, or other information systems bearing on the determination of contract costs (e.g. adjusting journal entries, reclassification journal entries, cost transfers, etc.) are done for reasons that do not violate contract terms, FAR, CAS, and other regulations, as applicable.
- Identification and treatment of unallowable costs are accomplished in accordance with contract terms, FAR, CAS, and other regulations, as applicable.
- Billings are prepared in accordance with contract terms, FAR, CAS, and other regulations, as applicable.

Implications for Other Agencies

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

RECOMMENDED REPORT LANGUAGE

SEC. ____. CONTRACT AUDIT PRACTICE.

This section would amend Section 893 of the Ike Skelton National Defense Authorization Act for Fiscal Year 2011 (Public Law 111-383; 10 U.S.C. 2302 note) by replacing “significant deficiency” with the term “material weakness.” The committee notes that the proposed revised definition will better align review and approval of contractor business systems with generally accepted commercial and government auditing standards.

This section also would mandate the adoption of the Professional Practice Guide prepared by acquisition advisory panel, established under section 809 of the National Defense Authorization Act for Fiscal Year 2016 (Public Law 114-92). This section would require the Department of Defense to phase-in use of such practice guide within six-months after date of enactment and that the audit workforce would be properly trained regarding use of the Guide. This section would further establish a collaborative working group of subject matter experts, within and outside the government, in order to keep the Guide current with evolving audit practices.

1 **SEC. __. CONTRACT AUDIT PRACTICE.**

2 (a) REVISION TO STANDARDS FOR CONTRACTOR BUSINESS SYSTEMS.—Section 893 of the
3 Ike Skelton National Defense Authorization Act for Fiscal Year 2011 (Public Law 111-383; 10
4 U.S.C. 2302 note) is amended—

5 (1) by striking “significant deficiency” in subsections (b)(4), (b)(5), and (h)(3)
6 and inserting “material weakness”; and

7 (2) by striking paragraph (4) of subsection (h) and inserting the following:

8 “(4)(A) The term ‘material weakness’ means a deficiency, or combination of
9 deficiencies, in internal control over risks related to Government contract compliances or
10 other shortcomings in the system, such that there is a reasonable possibility that a
11 material noncompliance will not be prevented, or detected and corrected, on a timely
12 basis.

13 “(B) For purposes of subparagraph (A), a reasonable possibility of an event shall
14 be considered to exist when the likelihood of the event occurring is—

15 “(i) reasonably possible (meaning that the chance of the event occurring is
16 more than remote but less than likely); or

17 “(ii) probable.”.

18 (b) IMPLEMENTATION OF PROFESSIONAL PRACTICE GUIDE PREPARED BY SECTION 809
19 PANEL.—

20 (1) IN GENERAL.—The Secretary of Defense shall adopt the audit practice guide
21 described in paragraph (2) for use as guidance in support of the contract audit practice of
22 the Department of Defense and of the practice of any independent private auditor that the

1 Department may use in support of its contract audit needs. The guide is supplemental to,
2 and does not supersede, regulations and auditing standards applicable to contract audits.

3 (2) PROFESSIONAL PRACTICE GUIDE.—The guide referred to in paragraph (1) is the
4 Professional Practice Guide set forth in Attachment [X] of Volume III of the Report of
5 the Section 809 Panel, dated January 15, 2019.

6 (3) DEADLINE.—Adoption and phase-in of the Professional Practice Guide in
7 accordance with paragraph (1) shall be carried out not later than the end of the six-month
8 period beginning on the date of the enactment of this Act. In adopting the guide, the
9 Secretary shall ensure that the audit workforce is properly informed and trained as to the
10 intent and expected use of the guide.

11 (c) WORKING GROUP FOR FUTURE CHANGES.—

12 (1) FINDING.—Congress finds that future changes to the Professional Practice
13 Guide adopted pursuant to subsection (b) should be made through a collaborative process
14 involving subject matter experts from a variety of relevant backgrounds who have
15 expertise in the field of auditing, accounting, or both, similar to the process by which the
16 guide was developed by the Section 809 Panel.

17 (2) WORKING GROUP.—The Secretary of Defense shall establish a working group
18 composed of representatives of the Defense Contract Audit Agency and the Defense
19 Contract Management Agency and representatives of other organizations from within the
20 Government and outside the Government with expertise in auditing, accounting, or both.

21 (3) FUNCTION.—The working group shall ensure that the professional practice
22 guide for contract audit practice adopted pursuant to subsection (a) stays current with
23 changes in audit practice. The working group may adopt such changes to the guide as the

1 working group determines are appropriate for the purpose stated in the preceding
2 sentence or as otherwise determined appropriate by the working group, and any changes
3 adopted by the working group shall be made a part of the guide.

4 (4) ACTIVITIES TO BE COLLABORATIVE.—The activities of the working group shall
5 be conducted so that proposed changes to the guide are considered collaboratively. As
6 part of the collaborative process, the working group shall seek information from other
7 public and private sector stakeholders as needed to facilitate any proposed changes.

8 (5) PUBLICATION.—Any revision to the guide that is adopted by the working
9 group and the proceedings of the working group shall be posted on the website of the
10 Defense Contract Audit Agency.

11 (6) FEDERAL ADVISORY COMMITTEE ACT EXEMPTION.—The working group shall
12 be exempt from the Federal Advisory Committee Act.

13 (d) SECTION 809 PANEL.—In this section, the term “Section 809 Panel” means the panel
14 established by the Secretary of Defense pursuant to section 809 of the National Defense
15 Authorization Act for Fiscal Year 2016 (Public Law 114-92), as amended by section 863(d) of
16 the National Defense Authorization Act for Fiscal Year 2017 (P. L. 114-328) and sections 803(c)
17 and 883 of the National Defense Authorization Act for Fiscal Year 2018 (P. L. 115-91).