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The Perfect Storm - Discussion of Changes to DCAA Guidance Related to Internal Control Audits

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Over the past year and a half, the Defense Contract Audit Agency ("DCAA") has issued several guidance memoranda to its staff pertaining to business systems audits. Business systems include accounting systems, purchasing, estimating, billing and six other major areas. This guidance has resulted in a change in scope of DCAA audits, a change in direction related to internal control audits and an increased significance of limited scope audits. Collectively, the various guidance memos have resulted in a number of potential implications to Federal Government Contractors.

Concurrent to the DCAA's guidance memos, changes have been proposed to the Defense Federal Acquisition Regulation Supplement ("DFARS") that could potentially overhaul the business systems controls landscape. Contractors should be aware of the current audit environment related to business systems. This article summarizes these recent DCAA guidance memos related to business systems and the ramifications of the new audit guidance on Federal Government Contractors.

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Summer of Opportunity - M&A Activity Heating Up Following Cooler Market Temperatures

Marc Marlin - Kipps DeSanto

The weather is warm, the sun is shining, the beverages are cold. Life is good. Suddenly, the sky darkens as clouds roll in. The wind picks up speed and the seemingly therapeutic cadence of the ocean waves begin to crash with a newfound anger. In a blink, raindrops attack the sand, sending vacationers scattering. Amidst the drama, watches the seasoned surfer. Confident this storm too shall pass, he calmly waxes his board, eyeing the waves, and eagerly waiting for what's next.



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AGENCY SPOTLIGHT



The government and defense contracting environment circa 2008 - 2009 has similarities to that unexpected rain shower we've all likely experienced. Few see it coming, others don't want to believe, and select folks always seem prepared to adapt their plans and embrace it. A myriad of market changes and new challenges have emerged over the past few years, including but not exclusive to the Obama Administration's anti-contractor sentiment, complex economic and budgetary pressures, capital markets conservatism, and paused M&A markets in the wake of broader domestic and international economic instability. However, the ripples are settling and a new dawn of opportunities has arisen, shaping the next chapter for the government and defense contracting community. These characteristics embody focus, M&A as a preferred tool to reposition and flourish, transparency, and renewed access to capital.

[Full Article](#)

Growing Emphasis on Information Technology in Mergers and Acquisitions

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Information technology systems - the computer software, hardware, networks and databases to that collect, store, process, transmit, and retrieve information - have become the lifeblood of most businesses today. Legal risks associated with the information technology (IT) systems of businesses have become significant, and are likely to continue to grow. The heavy reliance on IT systems in the business world, coupled with the expanding amounts of regulation and standards addressing IT issues, have turned IT diligence and representations and warranties relating to information technology into important considerations in M&A transactions. What started with regulatory efforts in discrete business sectors, has expanded to touch in some way or another virtually all business sectors - with no indication of slowing its reach.

[Full Article](#)

Proposed Business Systems Rule Changes

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On January 15, 2010, the Department of Defense ("DOD") Defense Acquisition Regulations (DAR) Council submitted proposed rule changes to the Defense Federal Acquisition Regulation Supplement (DFARS) entitled Business Systems - Definition and Administration (DFARS Case 2009-D038), proposing changes to what is currently defined as Contractor Business Systems. In the proposed rule, the DOD states that the changes were proposed in an effort "to improve the effectiveness of DOD oversight of Contractor Business Systems." If accepted, the proposed changes would drastically alter the landscape of Contractor Business System environments.

The DAR Council has received numerous public comments voicing concerns over the proposed rule. Despite this fact, months have passed without any revisions or any indication that public hearings will be held related to the rule.

Defense Contract Management Agency (DCMA)

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DCMA Background

The Defense Contract Management Agency (DCMA) is a component of the Department of Defense (DoD). The DCMA role helps to ensure that DoD and other Federal entities have supplies and services delivered on time, at projected cost, and meet all performance requirements. Before contract award, DCMA provides those entities with advice regarding solicitation; identifies potential risks, selects award winners, and assists with developing contracts.

After contract award, the DCMA monitors contractors' performance and management systems to ensure that cost, product performance, and delivery schedules are in compliance with terms and conditions of contracts. Agency data as of the end of June 2010 states there are 19,186 Contractors and 328,915 active contracts under DCMA's purview.

Agency Realignment

Charlie Williams, Jr., Defense Contract Management Agency Director, recently announced that the DCMA finalized its tactical structure by aligning three primary Contract Management offices (CMOs) in the East, Central and West regions. Headquarters is located in the East region. The DCMA also established international CMOs in Europe, Middle East Asia, Iraq, Afghanistan and Pacific Asia.

For its first regional commanders, the DCMA appointed Air Force Col. Aaron Clark, Army Col. Jeffrey Gabbert and Navy Capt. Sidney Kim. The DCMA's new structure has a five phase rollout and will target completion by the end of the year. Additionally, DCMA announced the appointment of Marie Greening for the Chief Operations Officer (COO), a newly created position under the Agency's regionally aligned organizational structure.

Cost and Pricing Center

The current backlog of unnegotiated Forward Pricing Rate Agreements nationwide has resulted in additional contractor effort and resources and delays in contract awards and audit report findings. In response to these issues, the DCMA established a Cost and Pricing Center. The DCMA is planning to establish Cost and Pricing branches

This article discusses business systems (both as currently defined by regulations and as they would be defined under the proposed rule changes), the proposed rule changes, and implications of the proposed rule changes to Government Contractors.

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- [Contracting Officers Withholds](#)
- [OFPP Sets Executive Compensation Cap for FY 2010 and Beyond](#)
- [FAR to implement the Federal Awardee Performance and Integrity Information Systems \(FAPIIS\)](#)
- [DFARS - issued that requires any loss, theft, damage, or destruction \(LTDD\) of government property](#)
- [DCAA Issues New Guidance to its Auditors pertaining to Reporting on Forward Pricing Rates in Pricing Proposals](#)
- [Aligning FAR with Cost Accounting Standards](#)
- [Aligning FAR with CAS 412 and 415 - ESOP Clarification](#)

at all CMOs as part of the realignment and hire 30 Chiefs and recruit business and technical staff. The establishment of the Cost and Pricing Center will enable the DCMA to better handle complex cost issues consistently across major contract sites. The DCMA is rebuilding its cost and pricing capability with additional training and improved relations with the Defense Contract Audit Agency (DCAA) by reconciling issues at the tactical level.

DCMA and DCAA Emphasis on EVM and CPSR Audits

The impetus behind the DCMA/DCAA focus on Earned Value Systems (EVM) and Contractor Purchasing Systems (CPSR) appears to stem from the following:

DCAA Director Fitzgerald at the hearing of the "Commission on Wartime Contracting in Iraq and Afghanistan (CWC)", on July 26, 2010 stated, "With respect to the three LOGCAP IV performance contractors, DCAA has reported all the estimating systems as inadequate and cited their estimating practices as being deficient for ensuring fair and reasonable subcontract prices." Additionally, "DCAA has performed contractors' purchasing system reviews (CPSRs) for the Defense Contract Management Agency (DCMA) Administrative Contracting Officer (ACO) at all of the three LOGCAP IV performance contractors and has found each system to be inadequate." Director Fitzgerald also stated, "During our review of prime contractor billings and incurred cost audits, DCAA has identified situations where the prime contractor has not awarded its fixed-price subcontracts based on fair and reasonable prices leading to unreasonable or unallowable costs being paid by the Government." Historically, DCAA has provided assistance to the DCMA functional specialists with the purchasing system reviews, EVM and Property audits under the auspices of the cognizant contract administration office. While DCAA may identify deficiencies, the system adequacy determination is vested in the cognizant ACO. DCMA has increased staffing to accommodate the new focus.