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September 15, 2014

Defense Acquisition Regulations System
Attn: Mr. Mark Gomersall
OUSD (AT&L), DPAP (DARS), Room 3B941
3060 Defense Pentagon
Washington, DC 20301-3060

Subject: Defense Federal Acquisition Regulation Supplement; Business Systems Compliance (DFARS Case 2012-D042)
CODSIA Case 07-14

Dear Mr. Gomersall:

On behalf of the undersigned members of the Council of Defense and Space Industry Associations (CODSIA¹), we appreciate the opportunity to submit comments to the Defense Federal Acquisition Regulation Supplement (DFARS) Case 2012-D042 titled Business Systems Compliance and published in the *Federal Register* at Vol. 79, No. 135, pg. 41172 on July 15, 2014 as a proposed rule.

Auditing of government contractors is essential to protect the taxpayer's interests. It ensures that business is transacted ethically, transparently, and in accordance with contractual requirements. The undersigned members of CODSIA strongly support reasonable internal and external audit programs. Our membership represents the nation's largest federal contractors as well as audit firms; thus, CODSIA has both public-spirited and private interests supporting beneficial audit processes. Accordingly, we feel especially well-suited to provide comments on the proposed revisions to the Defense Federal Acquisition Regulation Supplement set out in this case. A summary of CODSIA's comments follow, with greater detail provided in the enclosure.

Basis of the proposed rule. The proposed rule was drafted "in response to a U.S. Government Accountability Office report (GAO-12-83) issued on November 3, 2011."² The relevant section of that report provides:

...because we found consistent delays in the audit time frames for the business systems that require support from [Defense Contract Audit Agency (DCAA)], higher-level attention is needed to mitigate the risk to the government of outdated business system audits. DCAA, because of workforce challenges of its own, is not at present able to fulfill its business system audit responsibilities and is not likely to be in a position to do so in

¹The Council of Defense and Space Industry Associations (CODSIA) was formed in 1964 by industry associations with common interests in federal procurement policy issues at the suggestion of the Department of Defense. CODSIA consists of seven associations – the Aerospace Industries Association (AIA), the American Council of Engineering Companies (ACEC), Information Technology Alliance for the Public Sector (ITAPS), the National Defense Industrial Association (NDIA), the Professional Services Council (PSC), TechAmerica, and the Chamber of Commerce of the United States. CODSIA's member associations represent thousands of government contractors nationwide. The Council acts as an institutional focal point for coordination of its members' positions regarding policies, regulations, directives, and procedures that affect them. A decision by any member association to abstain from participation in a particular case is not necessarily an indication of dissent.

² [Federal Register/Vol.79, No. 135/Tuesday, July 15, 2014/Proposed Rules, 41173](#)

the near term given its other priorities. Thus, the department needs to consider alternative methods to accomplish these critical audits in a timelier manner.³

As a conclusion to its findings, the GAO recommended “that the Secretary of Defense work with [Defense Contract Management Agency (DCMA)] and DCAA to identify and execute options, such as hiring external auditors, to assist in conducting audits of contractor business systems as an interim step until DCAA can build its workforce enough to fulfill this responsibility.”⁴

GAO recommended that DoD contract directly with private Certified Public Accountants (CPAs) for the purposes of temporarily augmenting DCAA’s audit capacity. That approach is far different from the proposed rule, which instead creates an additional layer of audit oversight and cost without either increasing DCAA’s staff capacity or reducing its workload. We recognize the near term advantages of temporarily augmenting DCAA’s staff with private CPAs, and also recognize the cost-efficiencies and process benefits that DoD could foster by allowing government contractors to have their business systems audited by private third party CPAs with risk- and materiality-based oversight.

Regrettably, the proposed rule creates a new and burdensome hybrid audit process involving the use of CPAs that DCAA will continue to oversee which prevents CPA independence. As flawed as the current DCAA processes are, the undersigned CODSIA member associations and their member companies prefer the current DCAA business systems audit processes to the increased burdens created by the proposed rule.

Threshold question. To properly write its final rule, the government must answer a threshold question: is it necessary for DCAA to intervene in contractor business systems audits, or is it not?

The proposed rule fails to place the responsibility for business system audits either exclusively on contractors or exclusively on DCAA. Rather, it takes a hybrid approach where contractors must use private third party CPAs to perform business system audits, while DCAA will still retain review responsibility over the work of fully qualified CPAs. By interjecting DCAA into a corporate audit process, the proposed rule will increase DoD costs without improving efficiency and defeats the purpose motivating the GAO recommendations designed to improve DCAA’s ability to perform its mission.

Therefore, the final rule should reflect one of two distinct approaches:

- (a) DoD should directly contract with private third party CPAs to conduct contractor business systems audits and retain oversight authority over them, or**
- (b) Defense contractors should contract with private third party CPAs and be jointly responsible for business systems audits under a risk-based approach with the Administrative Contracting Officer directly relying on the CPA’s audit strategy and findings.**

³[GAO-12-83, Defense Contract Management Agency: Amid Ongoing Efforts to Rebuild Capacity, Several Factors Present Challenges in Meeting Its Missions, 35.](#)

⁴[Ibid, 36.](#)

In either case, DoD should not use the hybrid approach. CODSIA members do not believe that the act of auditing a contractor's business systems, including identifying significant deficiencies, requires DCAA involvement. Civilian agencies already contract with private CPAs to perform government audits of private companies, and private industry uses independent consulting firms to audit compliance with other governmental and non-governmental business obligations. For example, many contractors undergo extensive business systems testing and audits by independent accountants to comply with Sarbanes-Oxley internal control requirements. If DoD does not believe these control mechanisms will work for contractor business systems audits, it should clearly articulate why that is.

Major concerns. The hybrid approach raises several major concerns explored more fully in the enclosure:

- Increased inefficiency,
- Significant and unnecessary increased government access to internal contractor records, and
- The risks of repeating the worst aspects of the Circular A-133 single audit process.

If the government agrees that the Administrative Contracting Officer should directly rely on the CPA's audit strategy and findings, it should remove DCAA from the review process to the maximum extent possible. If the government believes that DCAA involvement is essential to proper contractor business systems audits, it should withdraw this proposed rule, retain the current business systems audit process, and contract directly with private third party CPAs to temporarily augment DCAA's staff as GAO recommended.

Recommendations. Either way, DoD should consider the following recommendations, explored more fully in the enclosure:

- Expressly state that the associated costs are allowable and allocable for government reimbursement,
- Rely on existing professional standards for CPAs,
- Rely on CPA determinations,
- Rely on existing tools to conduct these audits,
- Realistically estimate the burden on defense contractors,
- Establish specific timelines,
- Establish consistent guidance in collaboration with industry and define "contracting officer," and
- Provide contractors the option of using CPA firms as an alternative to the existing government audit process.

In addition, we offer the following procedural recommendations:

Effective date. To accommodate contractors' changes to their internal business processes, changes to DCMA's business systems approval determination process, and to allow the private audit market to cope with these new demands on its services (including but not limited development of audit criteria and the CPA proposal and selection process), DoD should phase in compliance to ensure the effective date allows sufficient time following the publication of the final rule to accomplish the necessary tasks and offer broad waiver authority to Administrative Contracting Officers once the final rule is issued.

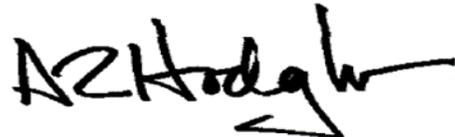
Enhanced rulemaking process. The success or failure of this rule hinges on government collaboration with the private sector. We urge DoD to convene a government-industry working group to establish basic principles that should guide the proposed rule. We sincerely hope that DoD will adopt a collaborative approach more likely to produce a successful, cost-efficient rule when the drafting and review processes are done.

Conclusion. The proposed rule adds an additional layer of auditing without removing an extraneous layer of DCAA review. CODSIA members recommend taking one of the two suggested process approaches to secure the taxpayer's interests without adding significant new costs, and perhaps even reducing costs. We offer our help to implement these recommendations in the final rule.

Sincerely,



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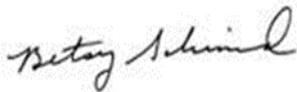
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Enclosure: as stated.

ENCLOSURE

CONCERNS WITH THE PROPOSED RULE'S "HYBRID" APPROACH TO BUSINESS SYSTEMS AUDITING

Increased inefficiency. The proposed rule will lead to increased inefficiency in several ways. First, to the extent that DCAA performs additional audit procedures rather than relies upon the internal reviews and triennial external CPA audits, this rule will result in increased costs to government and industry. Because of DCAA's reluctance to rely upon outsourced audit functions, it is possible and even likely that the increased internal assessments and CPA audits will simply become an intermediate step before a DCAA audit of the audit, potentially increasing costs with no return of timeliness on the investment.

Second, the increased frequency of complete annual internal reviews will have a cost impact. The proposed rule requires the contractor to perform annual internal reviews of its business systems. Historically, this requirement has meant each system would be internally reviewed in its entirety over a three year cycle. Companies reviewed one-third of each system each year and then awaited the DCAA triennial audit. The proposed rule appears to require a complete internal review of each system each year in addition to an external audit every third year. This approach increases the demands of the internal review, and increases associated costs.

Third, the proposed rule increases the number of audits over and above the quantity recommended by GAO in the report upon which the rule is based. In that report, GAO recommended a 4 year time frame for review of both the Accounting and Material Management and Accounting Systems.⁵ Performing audits more frequently than GAO recommended will lead to increased costs.

Access to records. The proposed rule will generate a substantial amount of new paperwork and provides the government with significantly broader access to external audit records. The newly developed processes (which qualify the CPA and its independence, require the CPA's latest peer review report, and pre-review the CPA's audit strategy, field planning considerations, and audit program, including the CPA's review of the contractor's internal controls and previous deficiencies) add up to overly broad and unnecessary access. Under the proposed rule, the government would have access to records never even shared with the contractor under any type of audit.

The proposed rule further provides the contracting officer and DCAA auditor access to all audit work papers of the independent CPA. Because of the opportunity for efficiencies, a contractor would likely choose the CPA already performing their other audits, such as those for Sarbanes-Oxley and financial reporting, so the work papers from the various engagements may have multiple uses. This could result in government access to the auditor's reviews of the contractor's overall business operations, including any non-government aspects of the contractor's business operations, since the independent CPA may not be able to perform the required audit without the consideration of all business, both government and commercial, affecting their scope of audit. The only certain way to avoid the disclosure and access issues raised by the proposed rule is to prevent access to the work papers related to the non-governmental aspects of the contractor's business operations obtained by the independent CPA.

⁵ [GAO-12-83, Defense Contract Management Agency: Amid Ongoing Efforts to Rebuild Capacity, Several Factors Present Challenges in Meeting Its Missions, p. 28.](#)

Otherwise, the audits might need to be performed by an independent CPA firm that does not perform any other audits of a particular contractor and restrict the scope to only those areas of the company to which the contracting officer and DCAA have access. Unfortunately, using multiple CPA firms limits the efficiencies that are possible when auditors are already familiar with a contractor's systems, personnel, processes, and records.

Past as prologue. The best way for CODSIA to predict the success of this proposed rule is to look at similar rules in the past to judge whether those succeeded or failed. Unfortunately, the example of Circular A-133 audits gives little reason for optimism. On the other hand, DCAA has successfully collaborated with industry in the past on material management and accounting system (MMAS) audits by taking a more consultative and less adversarial approach to auditing. Together, the two examples suggest that the proposed rule presents significant new risks of cost and delay for both industry and government unless DoD adopts the changes proposed by CODSIA in this letter.

A-133 audits. The coordinated approach to public and private auditing in this proposed rule is highly similar to an approach that was tried with the introduction of the Single Audit Act of 1984 and the Office of Management and Budget circular A-133 audit process. The A-133 process was designed to be more efficient for non-federal entities by combining multiple audits of individual programs into a single audit, an approach where work shares are negotiated at the beginning of the audit, with results shared between the CPA and DCAA. Feedback from non-profit contractors, CPA firms, and DCAA indicates that the coordinated audit approach has failed. Very few non-profit contractors use a coordinated audit due to DCAA's reluctance to participate. Under the A-133 single audit process, contractors must submit audit results within nine months of the end of their fiscal year. DCAA has no such time constraints and considers these audits a low priority and therefore delays them beyond the statutory due date for the contractor submittal. DCAA has refused to rely on an external CPA's work and ends up testing most of the same business systems, contracts, and costs that the CPA has already audited. Because of this lack of coordination, the "coordinated audit" becomes a redundant audit by the CPA and then by DCAA. The DoD Inspector General has also been critical of DCAA's compliance with Circular A-133 requirements, auditing standards, and even DCAA guidance for these engagements. The proposed rule poses a high likelihood of repeating the bad outcome of the A-133 audit process but on a much larger scale.

MMAS audits. During the late '80s and early '90s, when the "ten common deficiencies" evolved into the ten MMAS standards, DCAA took a more constructive, consultative, and advisory approach to its audits, as compared to the adversarial approach of today. The typical MMAS audit began with a contractor self-assessment performed by an outside consulting or CPA firm of the contractor's choice. The self-assessment work program and transaction test work program were shared with DCAA in advance, and DCAA had the opportunity to make suggestions but rarely did so.

After completion of the field assessment work by the company and its outside consultant, a demonstration of the company's MMAS was provided by the company to DCAA, DCMA, DoD customers, and the ACO. The demonstration was organized on the contents of the MMAS system description required by MMAS Standard 1⁶, and included the transaction test results as well as any findings, recommendations, and associated corrective action plans or completed corrective actions. The demonstration also included MMAS process flow charts and a procedural roadmap. The purpose of the

⁶ A description of MMAS Standard 1 is available at http://www.dcaa.mil/sap/MMAS-Internal_Control_Matrix.pdf

demonstration was to give all interested parties a basis to understand how the company's MMAS intended to operate and how it was actually operating based on transaction test results.

After the MMAS demonstration, DCAA usually performed limited transaction testing to validate the work of the CPA. Where the self-assessment may have performed testing on 20 to 25 samples, DCAA would perform testing on five similar samples. DCAA had the opportunity to review the self-assessment work papers on-site at its convenience, and usually did so. The effort was intended to put and keep the contractor in compliance with MMAS standards, not to prove non-compliance and punish the contractor for it. Those goals are in direct opposition, and they were the difference between success and failure of the MMAS audit process and will mean the difference between success and failure of the proposed rule. To make this rule work, DCAA would have to adopt a constructive, consultative, and advisory approach to business systems auditing and not follow the adversarial approach we find common among its auditors today.

RECOMMENDATIONS FOR A SINGLE AUDITING APPROACH TO CONTRACTOR BUSINESS SYSTEMS

Expressly state that costs are allowable and allocable. To the extent that DoD issues a rule that makes contractor self-assessments and CPA audits mandatory, the rule should also expressly make the contractor's costs for those assessments and CPA audits allowable and allocable.

The proposed rule requires the contracting officer to review the CPA's audit strategy, risk assessment, and audit plan and notify the contractor of any potential issues with their reasonableness because "early notification of potential issues may decrease the likelihood of the contractor incurring unreasonableness costs." But the proposed rule further states that such a review would not constitute the contracting officer's approval. Thus, the proposed rule suggests that if the contractor complies with the proposed rule's requirement to submit the CPA audit strategy, risk assessment, and audit plan for contracting officer review and, hearing nothing from the contracting officer regarding the CPA's plan, the CPA proceeds with its audit and report in order to comply with the proposed rule, the contracting officer could nonetheless deem the contractor's incurred costs as unallowable after the fact by determining that the plan and its associated costs were not "reasonable." Contractors should not be forced to incur the significant costs of compliance and be forced to also bear the risk that the costs could later be found "unreasonable," particularly after the fact, when the rule does not require the contracting officer to approve the CPA's audit strategy, risk assessment, and audit plan beforehand. Furthermore, this process of reviewing the CPA's audit strategy, risk assessment, and audit plan could be perceived as putting the CPA in the position that the CPA firm is no longer independent in accordance with the requirements of Generally Accepted Government Auditing Standards (GAGAS) and the American Institute of Certified Public Accountants (AICPA).

Rely on existing professional standards. DoD should rely on existing professional auditing standards for CPA firms, beginning with auditor independence. GAGAS and the AICPA establish criteria that CPA firms must meet to maintain personal, external, and organizational independence in both fact and appearance. The GAGAS Yellow Book and AICPA rules include "Conceptual Frameworks for Independence" standards that auditors use to evaluate threats to independence. Therefore, the rule must clarify that auditors should follow established professional standards for independence without imposing new requirements.

Further, the rule should rely on professional audit qualifications. Under the proposed rule, contractors must “reasonably ensure that the CPA firm performing the audit is...qualified to perform the audit by obtaining and reviewing...information about key engagement team members regarding professional qualifications and experience...” This requirement appears to exceed normal professional standards. Under both GAGAS and AICPA rules, the staff assigned to perform the audit must collectively possess the adequate professional competence needed to address the audit objective and perform the work. The professional standards require the audit organization’s management to compare the skills needed for the audit to the qualifications of its workforce. The rule should instruct auditors to follow GAGAS and AICPA guidelines as is customary in attestation engagements. The rule should make it clear that customary commercial terms and conditions are acceptable for engaging the services of a CPA firm.

Rely on CPA determinations. To avoid the increased costs of a DCAA audit of the CPA audit, the rule should dispense with the requirement for DCAA to review aspects of the CPA’s audit process. Adding DoD reviews at various points during the audit process creates the potential for delay and needless inefficiency along with redundant costs. Such audits of the audit undermine the basic purpose of the rule itself, which in GAO’s words is to avoid “consistent delays in the audit time frames for the business systems that require support from DCAA.”⁷ The proposed rule should allow the CPA to conduct its audit process in the normal course of an attestation engagement subject to review after the audit work is complete and the report is issued. By following the normal audit process for attestation engagements, the DoD oversight role would be similar to other governing bodies that rely on CPA firms, such as the Securities and Exchange Commission.

CODSIA supports oversight of the procedures used by independent CPAs in performing business systems audits. The oversight process, however, should mirror established oversight processes that are accepted throughout the accounting and auditing profession.

Rely on existing tools. GAO’s original recommendation, “that the Secretary of Defense work with DCMA and DCAA to identify and execute options, such as hiring external auditors, to assist in conducting audits of contractor business systems as an interim step until DCAA can build its workforce enough to fulfill this responsibility,” suggests a process whereby DoD would temporarily correct its own staffing shortfall by contracting with private CPAs directly to do business systems audits on its behalf, rather than on behalf of the contractor. While the proposed rule is a significant deviation from that recommendation, DoD has the tools and could simply adopt GAO’s recommendation rather than establish the new process described in this rule.

Civilian agencies have contracted with and are using independent CPA firms to conduct GAGAS performance audits of government contractors. Many of these CPA firms are on the GSA Schedule, and DoD could acquire their services at competitive rates. The GAGAS performance audits currently solicited by other government agencies and conducted by the independent CPA firms include the business system audits addressed in this proposed rule.

⁷[GAO-12-83, Defense Contract Management Agency: Amid Ongoing Efforts to Rebuild Capacity, Several Factors Present Challenges in Meeting Its Missions, p. 35.](#)

These independent CPA audits supplement other agency audits. The scope of the audit can be tailored to address risk or other concerns raised by an agency before the audit commences. Use of the independent CPA firm would allow DCAA to deploy its limited audit resources in higher priority areas. The CPA firm maintains the audit programs and work papers to support an external peer review required under GAGAS. Agency reliance on the external opinion of the CPA firm's quality control system avoids otherwise duplicative review of the CPA firm, its audit programs, and work papers.

Estimate the burden realistically. DoD's estimate of the annual reporting requirement burden on contractors, 2.87 hours, is significantly understated. To report as required by the proposed rule, the contractor must evaluate their systems' compliance with criteria spread across 12 pages of the *Federal Register*. The reporting burden includes contractors' formal evaluations of their business systems and the preparation of associated documentation. CODSIA estimates that this burden could exceed 200 hours per system per contractor—and some contractors may have multiple business systems for the same basic function across different business units. As stated above, this formal annual reporting requirement adds significant cost burden to the contracting process. If the final rule retains the annual evaluation reporting requirement in order to pass the triennial CPA audit, the significant effort and expense required should be properly identified to prevent the need to repeatedly justify the complicated effort and additional cost involved.

Should DoD insist on an annual report on a contractor's business systems, CODSIA suggests that DoD limit the report to significant or material changes to the contractor's business systems during the preceding year rather than an evaluation of the business systems against all criteria. Such a requirement would allow DCMA to determine whether the risk profile of the contractor had changed enough to warrant an accelerated CPA review.

Establish specific timelines. Should the government insist on an annual assessment, DoD should require its cognizant official to review the report within 30 days and communicate to the contractor whether they must take additional action. The contractor report will be submitted six months after the end of the contractor's fiscal year; an additional month taken by DoD will place the review of the assessment at the seventh month of the contractor's next fiscal year. Any further delay in feedback from DoD will provide only a limited period for the contractor to respond or take corrective action before the next annual period of reporting is completed. The narrow window of remaining time before the end of the next reporting period reinforces the notion that annual reporting is excessive. DCAA recognized this fact when they established their own triennial audit cycle, especially given that internal control design and procedures do not typically change frequently.

In addition, while CODSIA does not support DCAA review of the CPA audit plan, should DoD retain the requirement in the final rule, it must at the very least include a limited window of 14 days to provide feedback on the audit plan before the plan is deemed accepted and associated costs allowable and allocable by default. Having no stated deadline for DCAA feedback impairs a CPA's ability to complete the audit on schedule.

Further, the rule stipulates no timeline for DCMA to evaluate the independent audit report. DCMA should evaluate these reports within 30 days of receiving them to ensure that auditors are available and remain familiar with the audit. Delays greater than a month in duration create inefficiency for the CPA

and the contractor in re-familiarizing themselves with the audit. Again, delays shorten the limited period for the contractor to respond or take corrective action before the next annual self-assessment.

Establish guidance and define “contracting officer.” Troublingly, the proposed rule lacks consistent guidance on business system requirements, leaving open the likelihood of inconsistent and arbitrary audit findings.

To remedy this problem, DoD should adopt objective criteria prior to issuing a final rule. As recommended above, DoD should develop the guidance collaboratively with industry. At a minimum, DoD should establish a formal working group including the AICPA, GAO, DCAA, and CODSIA to develop audit guidance for use by both CPA firms and DCAA.

Further, the proposed rule uses the term “contracting officer” without specifying whether it refers to the Procuring Contracting Officer, Administrative Contracting Officer, or other contracting officers. The final rule should use the term “Administrative Contracting Officer” in place of contracting officer to reduce the potential for confusion. Because current regulation authorizes the Administrative Contracting Officer to waive a full audit in the event of low risk, the final rule should expressly state that such authority remains in place.

Opt in. DoD should allow contractors to opt-in to using CPA firms as an alternative to the existing government audit process. If a contractor chooses to use a CPA firm, DoD should rely on the normal audit process used by the CPA for an attestation engagement. By giving contractors this choice, contractors can weigh the added cost and administrative burden against the potential advantages of a timely audit, efficiencies gained through the use of auditors who are familiar with the contractors’ systems, and other factors. If a contractor decides against obtaining an audit for cost or other reasons, DoD could use DCAA or, if DCAA does not have the capacity, outsource the audits directly to CPA firms.

Further, an opt-in provision would allow contractors who do not meet specific criteria or thresholds for accounting system, estimating system, and MMAS reviews a mechanism by which to have their systems assessed. Often contractors are precluded from responding to specific solicitations because their systems have not been audited by the DCAA. CODSIA recommends that the rule include specific provisions that would allow contractors to present independent CPA examinations as a basis for demonstrating system compliance. Doing so would promote competition.

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