

# DCAA: the Good, the Bad and the Ugly

**The good news** – As a result of a number of small businesses having problems with DCAA a formal NDIA (National Defense Industry Association – [www.ndia.org](http://www.ndia.org))/ SBTC (Small Business Technology Council – [www.sbtc.org](http://www.sbtc.org)) Joint Committee on DCAA was formed earlier this year. The purpose of this joint committee is to work with DCAA HQ to identify, clearly define and develop solutions for broad based problems small business DOD contractors are having with DCAA. This committee has met three times this year with DCAA HQ and is scheduled to meet again in early December. Results are very preliminary; however the dialog has been positive. There is clearly communicated interest within the highest levels of DCAA HQ to solve the identified broad based problems and a commitment from Pat Fitzgerald, Executive Director of DCAA, to meet quarterly with this joint committee. ReliAscent has a member on this joint committee.

**Now the bad news** -- DCAA is a large bureaucratic organization with a culture of distrust toward small businesses. Most small businesses are started by people with technical expertise and, in general, limited business experience, especially as a contractor to the Department of Defense. As a result, unless the small business engages

experts (like ReliAscent) to properly maintain their accounting, contract management and other infrastructure aspects of their business they frequently are ill prepared for a rigorous audit and review of their procedures. The auditor sees a person (or small business) with limited business knowledge making mistakes in the way they keep their books, the way they charge their time and not adhering to proper and documented procedures (if any are documented). The auditor will often view this lack of attention to the business as attempts to “game the system”, “take advantage of taxpayers” or in rare instances “appear to be fraudulent in their business practices”. Rarely are any of these perceptions by DCAA auditors accurate as most small businesses just lack the proper knowledge and are just doing things the way they think makes sense, not realizing the unintended consequences of their honest actions. The result is a bad and occasionally confrontational relationship with DCAA auditors.

**And of course, there is the ugly** – DCAA has for a number of years allowed incurred cost audits to be placed on hold. Many small business contractors are just now having their 2005, 2006 or 2007 incurred cost proposals audited. In addition, DCAA is increasing their detailed audit work by selecting larger samples to examine, requiring more detailed support for claimed costs and in some cases being what might appear as unreasonable in their



expectation a business would have documents stored somewhere for expenses incurred six to eight years earlier, not just copies or electronic versions but original documents. We have heard examples where the DCAA auditor repeatedly asked (over a period of weeks) for an original receipt for \$1.47. In another case the auditor wanted to meet a former employee who had left employment years earlier, presumably to ascertain the paycheck and time card were prepared by a “real person.”

But for every “ugly” story, there are many “good” stories as well...

During meetings with DCAA HQ the joint committee has been repeatedly told that small businesses should escalate their concerns if not being adequately addressed to supervisors, then to branch managers, then regional area managers, then regional area directors and finally to DCAA HQ. We are aware of companies that have taken their issues all the way to DCAA HQ and have gotten favorable responses ultimately. *(continued on back...)*

# Top 5 Accounting Mistakes 1st Time Government Contractors Make

In the highly regulated arena of government contracting, your accounting system will receive its fair share of scrutiny even in the relatively benign environment of fixed-price or time-and-material contracting. Described in terms only accountants can understand, a competent and competitive accounting system will need to be a job cost accounting system – on steroids.

## Mistake #1 - Alphabetic COA.

Many firms just starting out set up their Chart of Accounts (COA) alphabetically. This is a classic tax-focused approach used by most CPAs. This approach will be inadequate for government contract accounting since the government will want to see your direct project costs segregated from your indirect costs, or non-job related expenses. This approach to expense accounting gives the government the ability to calculate and evaluate the ratio of your indirect costs to your direct costs. The cost principles found in the Federal Acquisition Regulations (FAR) provide a framework such that any number of ways can be used to structure and calculate this ration in a manner that maximizes a firm's com-

petitive pricing approach. An alphabetic COA also does not segregate unallowable costs, a critical factor in government contract accounting and billing systems.

## Mistake #2 – Comingling personal and business costs.

While the government is comfortable contracting with any legal entity, including sole-proprietors, there is a tendency with new entities to co-mingle business and personal expenses in the same accounting file. This frustrates the accounting and yields inaccurate financial information. There are also nuances with LLCs concerning how members get compensated and get their compensation recognized as “billable labor” versus a distribution of profits – an unallowable government contract expense.

## Mistake #3 – Poor labor accounting.

Speaking of labor, since labor costs typically dominate what the government pays for, posting labor properly is critical. Timekeeping is the foundation of a solid labor accounting and distribution system. Many new businesses view timekeeping as invasive and resist implementing processes for as long as possible – at their peril. Once that hurdle is dealt with, there are the additional bewildering concepts of accruing and segregating labor properly and accounting for uncompensated overtime.

## Mistake #4 – Not calculating indirect rates.

The focus of job cost accounting is to segregate project costs from “indirect” costs, then calculating the ratio of indirect costs (pool) to direct costs (base). This provides the basis for pricing government solicitations and billing. Measuring and understanding indirect rates is essential to a government contract accounting system and also a powerful tool in measuring profit on a job-by-job basis. Without knowing what your indi-

rect rates are, you're really flying blind.

**Mistake #5 – Ignoring contracting basics.** Understanding your regulatory environment is critical to knowing what's required of your accounting system. Offering strictly commercial off-the-shelf products and services to the government is quite different from performing research and development or building customized widgets. Understanding basic contract types and pricing requirements will help you either avoid unnecessary costs for improving your accounting system or highlight the urgent need for a total overhaul.

*-Contributed by Dave Donley*

## DCAA: the Good, the Bad, and the Ugly (cont. 'd)

Small businesses need to be confident in their positions to be successful with DCAA HQ. An unsupportable position on a questioned cost or issue will only cause frustration. If you have questions on what to do or how to handle a specific situation, senior members of ReliAscent are good sources of advice.

*-Contributed by Russ Farmer, Executive VP, ReliAscent LLC*

## ReliAscent's Growing Video Library

ReliAscent has added a number of videos to our [YouTube Channel](#) for Government Contractors. Topics cover DCAA Audits, Compliant timekeeping and accounting, proposal pricing and other important areas of contracting.

Over the course of 2014, we will be adding new videos every few weeks, on topics like ICP's, Invoicing the Government, and contracting opportunities etc., so come back and visit our website and channel ([and subscribe to our Blog](#)), to stay informed and one step ahead of the government and your competition!

## Upcoming Events

SBIR/STTR dates you need to remember:

- **December 5th:** HHS/NIH SBIR/STTR grants (non-AIDS) close
- **December 20th:** DoD SIBR 2014.1 opens
- **January 22:** DoD SBIR 2014.1 closes
- **January 29th:** NASA SBIR closes
- **January 29th:** NOAA SBIR closes
- **February 4th:** DoE SBIR (R2) closes