

# **DCAA Price Proposal Audits**



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# Defense Contract Audit Agency Mission Statement

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The DCAA, **while serving the public interest as its primary customer**, shall perform all necessary contract audits for the Department of Defense and provide accounting and financial advisory services regarding contracts and subcontracts to all DoD components responsible for procurement and contract administration. These services shall be provided in connection with negotiation, administration, and settlement of contracts and subcontracts **to ensure taxpayer dollars are spent on fair and reasonable contract prices**. DCAA shall provide contract audit services to other Federal agencies, as appropriate.



# About Proposal Audits

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- ❑ Because of the significant dollars and the risk of overstatement, we conduct proposal audits as examinations under GAGAS.
- ❑ An examination provides a high level of assurance and consists of obtaining sufficient appropriate evidence to express an opinion on the contractor's proposal and supporting historical data.
- ❑ Objectives: Determine –
  - Adequacy of cost or pricing data/info other than cost or pricing data (FAR 15)
  - Compliance with FAR 31 and CAS of the proposed amounts as well as the underlying estimates and supporting contractor books and records



# About GAGAS

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- ❑ GAGAS 1.03 Purpose and Applicability-
    - Provides a framework for conducting high quality government audits with competence, integrity, objectivity, and independence
    - Contains requirements and guidance to assist auditors in objectively acquiring and evaluating **sufficient, appropriate evidence**
  - ❑ High quality GAGAS compliant audits support better decision making and oversight
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# Audit Process

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- ❑ Proposal Adequacy Assessment
- ❑ Materiality and Risk Assessment
- ❑ Substantive Procedures to test for FAR & CAS compliance of:
  - Labor rates and hours
  - Direct Material
  - Subcontracts
  - Indirect expenses



# Proposal Adequacy Assessment

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## □ Proposal Walk-through

- Assess proposal adequacy and understand the basis of estimate

## □ Importance of Proposal Adequacy Assessment

- Reduces effort needed for audit of proposal (more efficient use of audit resources)
- Facilitates timely audit services
- Facilitates contract negotiations
- Ensures compliance with Contracting Officer's requirements as stated in the RFP and FAR 15-408, Table 15-2



# Proposal Adequacy Assessment – Top Reasons for Inadequate Proposals

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- ❑ Supporting data for individual cost elements do not reconcile to total cost estimates
- ❑ Proposal did not reflect anticipated cost accounting changes that directly impact the pricing of the proposal
- ❑ Lack of detailed Basis of Estimate (BOE)
- ❑ Consolidated Bill of Material (BOM) not provided with proposal
- ❑ Inadequate support for Subcontract cost



# Proposal Adequacy Assessment – Top Reasons for Inadequate Proposals

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## □ Indirect Rates

- No budgetary or trend data to support the rates
- Proposed rates were outdated
- Proposed rates were different than the period of contract performance

## □ Labor

- No Basis of Estimate (BOE) for rates and/or hours
  - Labor rates not time phased for the period of performance
  - Labor rates not based on period of performance
  - No support or trend data for escalation factors on direct labor
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# Materiality & Risk Assessment

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- ❑ The assessment considers factors such as:
  - Materiality and sensitivity (Proposal Value, Contract Type, etc.)
  - Prior audit experience with the contractor
  - Auditor's understanding of internal controls
  - Inherent risk in specific proposal elements
  
- ❑ Document rationale for selecting areas for (substantive) testing



# Audit Procedures

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- ❑ Substantive Procedures include:
  - Observation and Inquiry
  - Analytical procedures (e.g., trend and regression analysis).
  - Detailed testing (e.g., review of supporting data for a specific proposed amount)



# Audit Procedures

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- ❑ Prospective costs are often based on both **historical data** (e.g., hours charged to previous contracts) and **other evidence** about expected future costs (e.g., forecasted sales)
  - Substantive procedures must be applied to both
  - Detailed testing procedures may include statistical sampling or judgmental selection



# Audit Procedures

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- ❑ A standard audit program is tailored to fit the unique risk and materiality of the proposal under audit
- ❑ Overall plan for the audit and types of books, records, and other data needed to conduct the audit are discussed at the entrance conference
- ❑ Factual matters are discussed with the contractor throughout the audit and at an exit conference



# Audit Procedures

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## □ Labor Rates

- Document basis of proposed rates
- Determine consistent with disclosed practices (CAS 401/CAS 402 - FAR 31.202/31.203(a))
- Evaluate development methodology of proposed rates
- Evaluate the proposed base labor rates by tracing to payroll data
- Evaluate the proposed escalation factors



# Audit Procedures

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- ❑ Labor Hours
  - Document basis of proposed hours
  - Evaluate development method of proposed hours
  - Determine the suitability of historical data for making estimates (i.e., accurate, reliable, and representative)
  - Ensure the historical data is in reasonable compliance with FAR Part 31 and, if applicable, CAS.
  - Determine consistent with disclosed practices (CAS 401/CAS 402 - FAR 31.202/31.203(a)).
  - Perform analytical procedures to determine if the proposed estimating method has yielded reasonably accurate estimates
  - If appropriate, apply QM techniques, such as improvement curves, trend or regression analysis techniques
  - Compare experienced labor mix with proposed labor mix



# Audit Procedures

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- ❑ Direct Material
  - Document basis of proposed direct material
  - Determine consistent with disclosed practices (CAS 401/CAS 402 - FAR 31.202/31.203(a))
  - Evaluate the support for any additive factors (e.g., scrap)
  - Ensure the historical data is in reasonable compliance with FAR Part 31 and, if applicable, CAS
  - Trace a representative sample of proposed quantities to supporting documents (e.g., RFP, engineering drawings, etc.)
  - Test a representative sample of proposed unit prices considering: discounts, potential quote decrements, parts in current inventory, adequate competition, etc.
  - Evaluate significant make or buy decisions
  - Evaluate proposed escalation



# Audit Procedures

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## □ Subcontracts

- Verify that the proposed subcontracts were priced in compliance with FAR 15 (i.e., a fair and reasonable price and the best value is obtained)
- When cost or pricing data are required/submitted by the subcontractor, determine the adequacy of the contractor's cost and price analysis
- If any analyses have not been completed, determine the contractor's completion schedule
- Determine whether an assist audit is necessary
- Evaluate significant make or buy decisions



# Audit Procedures

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- ❑ Indirect Rates
  - Document basis of proposed rates
  - Determine if consistent with disclosed practices (CAS 401/CAS 402 - FAR 31.202/31.203(a))
  - Verify that the period for the proposed rates coincides with the contractor's fiscal year
  - Compare proposed rates to prior year(s) rates and YTD experience and analyze major variances
  - Trace a selection of proposed pool and base amounts to the underlying budgetary data
  - Determine the suitability of budgetary data (i.e., current, accurate, reliable, and representative)
  - Verify the proposed rates properly reflect anticipated changes to future operations
  - Verify that the estimates exclude unallowable expenses (FAR 31) and the deletions are reasonably in line with history



# Audit Procedures

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- ❑ Indirect Rates (continued)
  - Review selected significant or high risk expense accounts in the pools to evaluate the reasonableness of specific estimates
  - Determine that the bases are appropriate for allocating the indirect expenses and in accordance with established or disclosed practices (CAS 403, 410, 418, and 420, if applicable)
  - Evaluate the proposed allocation base amounts and determine whether they reasonably reflect obtaining additional work including the impact of the subject proposal
  - If historical data is used as basis, perform substantive audit procedures to ensure the historical data is in reasonable compliance with FAR Part 31 and, if applicable, CAS
  - Evaluate the reasonableness of the proposed rates using regression analysis when appropriate



# Unique Value of the Audit

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- ❑ The Price Analyst, adhering to the Contract Pricing Reference Guide (Volume 3- Cost Analysis), may perform many of the procedures discussed.

**However, the Auditor, with access to the contractor's books and financial records, can evaluate the validity of historical data and other supporting records.**

- ❑ Typically, contractors use historical costs to justify proposed costs. DCAA is able to assess compliance of historical cost and thus compliance (and consistency) of related prospective costs in a price proposal.



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# Discussion