

CLIENT ALERT

Fasten Your Seatbelts -- Bumpy Road Ahead

Jan.07.2009

In two memoranda distributed as internal guidance to auditors on December 19, 2008 ([08-PAS-42](#) and [08-PAS-43](#)), DCAA has announced its intention to take an aggressive position on two perennial audit issues.

- "Denial of Access to Records." In Guidance 08-PAS-42(R), auditors are instructed to require that contractors provide "timely" access to supporting records requested by DCAA, with timeliness defined in many cases as the same day. Ignoring the provisions of the standard Audit clauses limiting the Government's audit rights to contractor "records," "support" is defined in the guidance to include "access to personnel" in addition to documents and other data. The guidance directs auditors generally to obtain support information "directly from the person responsible for the information," rather than from a "liaison" designated by the contractor. Auditors are required to report failure to provide "support" in a timely way as a "denial of access" to records, to consider issuing a subpoena for the supporting data (either directly or through the DOD Inspector General), to follow other published guidance about suspending payment (generally using a Form 1 to recommend suspension), and to consider whether an internal control deficiency exists (see the bullet below). While the assertion of an audit right to contact individual contractor employees directly is likely to be the most controversial element of this policy, it also seems inevitable that at least some auditors will rely on the guidance to take precipitous action when a contractor is unable to produce supporting records instantly in response to a request from DCAA or contests the scope or relevance of DCAA requests. The guidance is clearly intended to encourage DCAA's increasingly common practice of issuing Form 1s to attempt to suspend payment to contractors, a process almost never used for 30 years after the passage of the Contract Disputes Act in 1976.
- Adequacy of the Contractor's Internal Control System. In Guidance 08-PAS-043(R), auditors are instructed to report any "material internal control" weakness identified in an audit. The guidance states that since DCAA only performs internal control audits that are material to Government contract costs, a finding of an internal control deficiency by DCAA will generally have a material impact on Government contract costs and should result in a report finding that there is a "material deficiency" that renders the contractor's "system" inadequate. The guidance suggests that it is not necessary to identify any actual questioned costs in order to make a finding of a "material" deficiency, citing as an example the possibility that inadequacies identified by DCAA in controls related to ethics and integrity may be material even though the finding involves no identified actual cost impact. Although not specifically mentioned in the guidance, audit reports asserting that a system is inadequate could result in problems under FAR 16.301-3, which requires as a prerequisite to awarding any cost reimbursement contract that contractor's accounting systems be "adequate for determining costs applicable to the contract."

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.