

EXPERT ANALYSIS

2017 NDAA's Impact on Audits and Cost Accounting Standards

By Peter B. Hutt II, Esq., Jason N. Workmaster, Esq., and Justin T. Golart, Esq.
Covington & Burling

Section 820 of the National Defense Authorization Act for Fiscal Year 2017, Pub. L. No. 114-238, 130 Stat. 2000 (NDAA), makes three significant changes to the federal government's future method of conducting audits and implementation of Cost Accounting Standards (CAS).

First, it empowers contractors to avoid Defense Contract Audit Agency (DCAA) audits by employing private auditors to audit their indirect rates. Second, it provides new requirements intended to reinvigorate the federal government's existing CAS Board.

Finally, it creates a new and independent Defense Cost Accounting Standards (DCAS) Board to implement the Cost Accounting Standards across the Department of Defense (DoD). All of these provisions are due to take effect on October 1, 2018.

AUTHORIZATION OF COMMERCIAL AUDITS

Section 820(b)(1) of the NDAA authorizes defense contractors to present commercial auditors' findings concerning indirect costs to the DCAA, which must accept them without performing additional audits so long as the commercial auditor used "relevant commercial accounting standards (such as Generally Accepted Accounting Principles [(GAAP)]) and relevant commercial auditing standards established by the commercial auditing industry for the relevant accounting period."

The law provides an exception that the DCAA can elect to audit indirect costs of contractors or business units with a "predominance of cost-type contracts," even if a commercial audit is presented. Notwithstanding the exception, this development could be of great significance, and may enable contractors to accelerate the audit process and reduce the risk of protracted and inaccurate indirect costs audits performed by the DCAA.

The NDAA, however, does not expressly resolve the question of how CAS relates (if at all) to the "relevant commercial accounting [and auditing] standards" upon which commercial auditors will now be entitled to rely.

AMENDMENT TO CAS STATUTE

Although Section 820 is titled "Defense Cost Accounting Standards," its first order of business is to amend the existing CAS Board's implementing statute, 41 U.S.C. § 1501. *Id.* at § 820(a).

Perhaps most importantly, the CAS Board is directed to "ensure that the cost accounting standards used by Federal contractors rely, to the maximum extent practicable, on commercial standards and accounting practices and systems." *Id.* at § 820(a)(1)(C).

The NDAA directs the CAS Board to meet at least once per quarter, publish a notice of each meeting and the meeting's agenda in the Federal Register, and report annually to congressional committees regarding how it has conformed the federal Cost Accounting Standards to GAAP and minimized the burden on contractors. *Id.*



The law provides an exception allowing the DCAA to audit the indirect costs of contractors with a predominance of cost-type contracts even if a commercial audit has been presented.

The statute also mandates the appointment of an executive secretary to the CAS Board, and requires the Board to meet annually to analyze whether any pending litigation over the Cost Accounting Standards suggests the need for greater clarity.

Finally, the statute significantly increases the value of contracts eligible for waiver from CAS requirements, from the current \$15 million to \$100 million. *Id.* at § 820(a)(2).

These changes to the CAS Board statute clearly reflect Congressional judgment that the CAS Board should become much more active than it has been in recent years, and that the Board's primary emphasis should be on conforming the Cost Accounting Standards to GAAP, so as to provide greater clarity for contractors.

CREATION OF DEFENSE CAS BOARD

The newly-created Defense Cost Accounting Standards (DCAS) Board is given three duties: (1) reviewing the Cost Accounting Standards and recommending changes to the CAS Board; (2) implementing the Cost Accounting Standards to achieve uniformity and consistency across DoD contracts; and (3) developing standards to ensure that commercial operations performed by DoD employees adhere to the Cost Accounting Standards or to GAAP. *Id.*

The seven-member DCAS Board will be located within the Office of the Secretary of Defense and consist of DoD's Chief Financial Officer (or designee), who will serve as chair, and six representatives selected by the Secretary of Defense — three from the private sector and three from within DoD. All members must have experience in contract pricing, finance, or cost accounting.

Additional membership requirements for private sector representatives are rigid: of the three, one must represent a "nontraditional defense contractor" and another must represent a public accounting firm. *Id.*

Therefore, at any given time the DCAS Board will contain at most one representative of a "traditional defense contractor." The only restriction placed on membership from within DoD is that a member may not continue to serve on the DCAS Board if he or she ceases to be a DoD employee. *Id.*

The statutory mandate for the DCAS Board leaves many open questions. How will the duties of the DCAS Board mesh with those of the CAS Board? What role will the DCAS Board take in "implementing" the Cost Accounting Standards with respect to DoD contracts? Will differences emerge between the implementation of Cost Accounting Standards on DoD contracts and other agency contracts?

Answers to these questions are unlikely to emerge before October 2018 when the DCAS Board is up and running.



Peter B. Hutt II (L) is a partner in the Washington office of **Covington & Burling**, where he represents clients in the full range of government contract matters, including audits, investigations and litigation concerning the Cost Accounting Standards, cost allowability and the False Claims Act. He can be reached at phuttjr@cov.com. **Jason N. Workmaster** (C) is of counsel in the firm's Washington office and represents clients in a broad range of government contracts-related matters, including contract disputes, FCA cases and disputes arising from audit findings regarding the CAS and cost issues. He can be reached at jworkmaster@cov.com. **Justin T. Golart** (R) is an associate in the firm's government contracts practice group in Washington. He can be reached at jpgolart@cov.com. A version of this expert analysis was first published March 8 in Covington's Inside Government Contracts blog. Republished with permission.