

Defending the Contractor:

Ensuring DCAA Compliance
with Time and Expense Software

SAGE TIMESHEET



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Introduction: Executive Summary

Government contractors know that profits and future opportunities depend on a favorable review by the Defense Contract Audit Agency (DCAA). As an agency of the Department of Defense (DoD), the DCAA has the authority to audit policies, processes, and control systems that impact the accuracy of contract billing. Contractors with inaccurate or incomplete records can find themselves subjected to withholding of government payments, potential fines and penalties, and even lost contracts.

In 1986, changes to the False Claims Act made it easier for whistleblowers to bring suit against government contractors. When the government joins these lawsuits, the DCAA often assists in investigation and auditing to prepare the government's case. Penalties are steep and an increasing number of suits are filed annually. In recent years, the government has received larger awards or settlements as a result of these lawsuits.

In order to ensure compliance with DCAA regulations, it is imperative that contractors develop a consistent process for recording and tracking time and billing expenses. Labor costs usually represent a large, if not majority share of total contract value. When faced with DCAA audits, contractors greatly benefit from timekeeping software that ensures accurate project time and expense records. These automated solutions can also quickly produce reports useful to auditors.

History and Mission of the DCAA

The DCAA was formed by the Secretary of Defense in 1965 to perform all contract audits for the DoD. Reporting to the Under Secretary of Defense, the DCAA attempts to assure the government that work performed by contractors for the Defense department, and occasionally other agencies, is correctly billed and accounted. DCAA concentrates its efforts on auditing and reviewing the following areas:¹

1. Internal control systems
2. Management policies
3. Accuracy and reasonableness of cost representations
4. Adequacy and reliability of records and accounting systems
5. Financial capability
6. Contractor compliance with contractual provisions having accounting or financial significance, such as Cost Principles, the "Cost Accounting Standards Clause" and clauses pertaining to the Truth in Negotiations Act

For defense contracting firms, there's a strong likelihood that a significant interaction with the DCAA will occur. All DoD contractors are subject to DCAA audits that include a review of compensation, cost accounting, internal controls, and financial systems.² DCAA audited more than 10,000 pricing proposals last year alone. Each year, the agency reports the number of audits conducted as well as the associated net savings:

FY 2003: \$160.9 billion in government contracts were audited with approximately \$2.2 billion saved.

FY 2004: \$148.2 billion worth of pricing proposals were audited with approximately \$2.1 billion in net savings.³

A quick review of the numbers above reveals that contractors owe more than \$2 billion back to the DoD every year. Put another way, the DCAA recoups approximately 1.5% of the total contract amounts they audit. And, the DCAA is not likely to back down anytime soon—in FY 2004, the return on taxpayer investment was \$5 in savings for each dollar spent for agency operations.

¹Information for Contractors," *DCAA Publication 7641.90*, p. 10.

²David Gold, "Doing business as a government contractor – Special Report: HR and the Government," *HR Magazine*, May 1994.

³DCAA website, www.dcaa.mil.

How Does the DCAA Audit Contracts?

The DCAA provides two primary services to ensure proper use of government funds. First, it advises government procurement personnel in the negotiation stages of new contracts. Second, it audits and reviews ongoing contracts, including contractor billing procedures and internal controls, to ascertain if the DoD has been overcharged.⁴

The level of DCAA involvement depends largely on the structure of the contract. DCAA focuses on providing assistance in the proposal stage of a firm-fixed price contract. The agency typically audits flexibly priced contracts after expenses are incurred and submitted.

The DCAA complies with the standards of the American Institute of Certified Public Accountants (AICPA) which are fully incorporated into DCAA auditing procedures.⁵ Auditors follow the policies and procedures outlined in the DCAA Contract Audit Manual (CAM), a lengthy document updated and reprinted twice per year, in January and July. Contractors can obtain a full copy of the CAM at the DCAA website, www.dcaa.mil.

What are the Consequences of Non-Compliance With DCAA Regulations?

Serious consequences exist for contractors who do not keep adequate records to satisfy a DCAA audit. Often, when irregularities appear during an audit, the DCAA recommends withholding a portion of the payment for the contract until its investigation is completed. Assuming the auditors determine that all of the contractor's charges were justified, the contractor receives the remainder of payment on the contract, but cash flow in the interim can be disrupted by such withholdings.

If the DCAA auditors find substantial problems with billing, a defense contractor may lose the contract, or be removed from consideration for future contracts. Additionally the contractor would not receive payment for any items deemed overcharges and may be required to return payments already received as well as pay penalties or fines. Potentially even more damaging, a lawsuit could be filed against the contractor under the False Claims Act.

The False Claims Act, enacted in 1863 and revised in 1986, allows whistleblowers to file suit against a corporation that contracts with the government on the basis that the whistleblower, known as a "relator," has knowledge that the contractor has submitted false claims for payment.⁶ It is not necessary for the whistleblower to have direct evidence or first-hand knowledge of wrong-doing. They can report any information they've learned from other people or sources. These civil actions, known as Qui Tam lawsuits, can be joined by the government and bring the full investigative power of government agencies such as DCAA and the Department of Justice to bear against government contractors.⁷

The penalties for violating the False Claims Act can have devastating effects on a company – sometimes driving the contractor out of business. For each false claim (and a single Qui Tam lawsuit might allege hundreds or thousands for a single contractor) the contractor must pay three times the amount of the government's losses, plus a fine of \$5,000–\$10,000. The whistleblower is entitled to a reward of 15–30% of the money recovered by the government. In FY 2004, whistleblowers received \$108 million in rewards from Qui Tam cases filed under the False Claims Act.⁸

Finally, even accurately recorded and billed expenses must be timely submitted in order for contractors to receive full compensation. The DCAA regulations require contractors to submit a final indirect cost proposal no later than six months after the close of the contractor's fiscal year. Failure to do so may result in a 20% decrease assessed to all costs associated with the contract.⁹

⁴"Information for Contractors," *DCAA Publication 7641.90*, p. 10.

⁵"Information for Contractors," *DCAA Publication 7641.90*, p. 10.

⁶Glenn V. Whitaker and Victor A. Walton Jr., "Beware the whistleblower," *Vorys, Sater, Seymour and Pease LLP website*, www.vssp.com/CW/Articles/articles801.asp, reprinted with permission from *SBN Magazine*.

⁷Phillips & Cohen, LLP, "False Claims Act: How it works," www.allaboutquitam.org/fca_how.shtml.

⁸Phillips & Cohen, LLP, "Qui tam statistics, 1986-2004," www.allaboutquitam.org/fca_how.shtml.

⁹Cherry, Bekaert & Holland, "Defense Contract Audit Agency (DCAA)," *Government Contracts*, Winter 2003, p. 4.

Labor Costs and Compliance with DCAA Standards

The best defense in a DCAA audit is a reliable accounting system and impeccable records of time and expenses associated with the contract. Glenn V. Whitaker, an attorney specializing in defending government contractors in false claims litigation, suggests that corporate compliance programs can help deflect potential litigation and greatly aid in government investigations.

In an interview for *The Metropolitan Corporate Counsel*, Whitaker explains, "It's clear that a compliance program is essential in this day of Sarbanes-Oxley and increased emphasis on corporate wrongdoing. In fact, the Department of Justice has recently taken the position that the absence of a compliance program or an ineffective compliance program satisfies the scienter requirements of the False Claims Act."¹⁰

According to the DCAA Contract Audit Manual, labor costs generally represent the largest component of costs associated with a government contract. And unlike other types of costs, timekeeping is at the sole discretion of the contractor, without external records such as purchase orders or receipts to verify time spent on a contract. It is therefore not surprising that both timekeeping systems and individual records receive intense scrutiny during the DCAA audit process.

When DCAA auditors assess a contractor's procedures to determine the risk that errors in billing can occur, they review eight requirements:¹¹

1. Effective method to monitor the integrity of the timekeeping system
2. Employee awareness training to be sure that employees know how to properly record their time
3. Procedures for authorizations/approvals of labor costs
4. Effective procedures to ensure time is recorded accurately and that any changes are "documented, authorized and approved"
5. Effective labor distribution to "assure proper recording of labor costs to cost objectives"
6. Labor cost accounting procedures to make certain that labor costs charged to the government are in compliance with Cost Accounting Standards, generally accepted accounting principles and the terms of the contract
7. Effective payroll procedures that ensure the proper pay rates are applied
8. Proper documentation for labor transfers and adjustments

Well-designed time and billing software systems help ensure that contractors are prepared to demonstrate effective procedures and accurate records to meet the requirements above. These solutions offer increased security, better auditing of changes, and the quick generation of reports to support contractor compliance during an audit.

Sage TimeSheet Aids in Compliance with DCAA Regulations

Sage TimeSheet is designed to help contractors comply with DCAA's stringent expectations for tracking labor costs and expenses. By eliminating time-consuming and inaccurate manual timekeeping, Sage TimeSheet enables contractors to easily track employee time by project with the security and accuracy demanded by the DCAA.

Password security and a log-on/log-out audit trail in Sage TimeSheet maintain the integrity of timekeeping records. The audit trail also tracks the "who, what, and when" for all status changes and approvals, putting critical audit data at management's fingertips to quickly and easily produce reports for DCAA field auditors.

Sage TimeSheet tracks labor costs against objectives using descriptive features that allow time tracking by project as well as by task against a defined overall budget. Up to nine levels of detail associated with each time entry provide exceptional insight into labor distribution.

¹⁰Glenn V. Whitaker, "Confronting *Qui Tam*: Defending The Corporation In False Claims Act Litigation," *The Metropolitan Corporate Counsel*, Volume 12, No. 9, September 2004.

¹¹Defense Contract Audit Agency, *DCAA Contract Audit Manual*, 5-902, June 2, 2005.

Sage TimeSheet also helps contractors ensure that payroll is properly calculated, prepared, and authorized. Extensive pay rule functionality is included in Sage TimeSheet and timekeeping data easily transfers to external payroll applications.

Finally, the efficiency and accuracy of timekeeping software must be supported by full staff awareness and participation. Sage Software provides end-user training classes to quickly bring all employees up to speed on timekeeping procedures. Contractors can choose between training delivered onsite by Sage TimeSheet experts, or convenient, affordable Web-based delivery.

Sage TimeSheet Takes the Worry out of Government Reporting Compliance Helping you Avoid Costly Penalties and Lost Revenue

DCAA Timekeeping Requirements*

1. Monitor the integrity of the Labor/Timekeeping system
2. Create employee awareness about the importance of proper time charging
3. Accumulate and record labor costs to objectives ‘
4. Accurately record labor hours and assure that corrections are documented, authorized, and approved
5. Distribute labor to assure the proper recording of labor costs to cost objectives
6. Account for labor costs to assure that labor charges to the government are in compliance with Cost Accounting Standard and contract terms/clauses
7. Prepare payroll to assure independent preparation of payroll and that pay rates are appropriately authorized and accurate
8. Assure that labor transfers and adjustments are documented and approved

Sage TimeSheet Meets These and More

1. Secure passwords/NT Authentication and an audit trail of logins/logouts
2. End user training classes available both onsite and in a Web-based format
3. Time tracking by task against a defined overall budget
4. Multi-level configurable approval processes, and a reportable audit trail of all changes and approval
5. Tracking of employee time against up to 9 levels of details and detail reporting of labor distribution
6. Defined rates to employees and the ability to override for specific task-based rates, with all changes captured in the audit trail
7. Extensive pay rule functionality built in, and ability to transfer to external payroll applications
8. Time entry and modification records backed by an audit trail

Conclusion

The DoD enjoys a long, productive relationship with many government contractors. Fiscal accountability to U.S. taxpayers requires the DoD to assure that contractors record accurate time and expenses when submitting contract bills. When a DCAA audit occurs, contractors with solid systems in place for tracking and reporting labor costs are best prepared to cooperate and comply. Sage TimeSheet provides detailed, accurate records and comprehensive reports that constitute a contractor's best defense against lost compensation, fines, lawsuits, or loss of future contract awards.

About Sage Software

Sage Software supports the needs, challenges and dreams of nearly 2.8 million small and mid-sized business customers in North America through easy-to-use, scalable, and customizable software and services.

Sage Software is a subsidiary of The Sage Group plc, a leading global supplier of accounting and business management software solutions and related products and services for small and mid-sized businesses. Formed in 1981, Sage was floated on the London Stock Exchange in 1989 and the Group now has 5.5 million customers and employs over 13,900 people worldwide.

For more information, please visit the Web site at www.sagetimesheet.com or call **866-271-6055**.

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