



Government

A magnifying glass and a pen are positioned in the top left corner of the page. The background is a light-colored document with a grid of numbers, some of which are highlighted in blue. The numbers are arranged in rows and columns, with some numbers being larger than others. The overall theme is financial or accounting.

WORKING WITH Government Auditors

By **Gregory A. Garrett** and
Thomas Reynolds

**A review of various practices contractors
can follow to ease the tension often associated
with the DCAA audit process.**



Contractor audits are an inevitable way of life for most organizations providing goods or services to the U.S. federal government, depending upon the nature of the goods and services and the type of contracts involved. How contractors approach and manage these audits plays a vital role in their ability to compete, perform, and win new contracts within the government contracting arena.

Government contractors are most likely to encounter auditors from the Defense Contract Audit Agency (DCAA); however, contractors may also encounter auditors from the Inspector General office, Government Accountability Office, and other similar agencies. Although audits are inherently time consuming, cumbersome, and resource draining, through adequate preparation and development of a professional rapport with the auditors, a contractor can significantly reduce the stress level associated with these audits.

This article will first highlight important steps contractors can take to prepare for anticipated DCAA audits. After establishing this foundation, the remainder of the article will focus specifically on the contractor's relationship and interaction with the auditors.

Pre-Audit Collaboration and Cooperation

Prior to discussing steps that a contractor can take before commencement of an audit, it is essential to qualify what generally

constitutes a successful audit from the contractor's perspective. Although audits vary greatly in size and scope, an audit is generally considered successful if it yields no significant findings that will ultimately impact a contractor's overall operations or profitability.¹ To satisfy this objective, building a strong rapport with government auditors during the initial stages of an audit can establish the tone and relationship that will permeate throughout the entire audit. Consequently, contractors should strive to establish credibility early on in the audit process while avoiding actions that can potentially damage their credibility. The most effective method for building a strong relationship with the government auditors is to anticipate future audits and plan accordingly.

One of the most important questions for contractors to contemplate is what types of audits DCAA is likely to perform. For example, a large contractor with a significant number of high-profile, cost-reimbursable contracts with the Department of Defense can anticipate extensive audits of its cost-

related data and records during and after contract performance (i.e., “incurred cost audits”). Conversely, a relatively small contractor with primarily firm-fixed-price contracts will be subject to fewer audits; most of which will likely take place during the proposal stage.

After determining which areas of their business are most likely to be audited, contractors should begin planning for the audit by reviewing DCAA audit work programs. These audit programs, which cover a wide variety of key audit areas, are used by the auditors during fieldwork and are accessible via the DCAA’s website at www.dcaa.mil/standard-guidance.htm. These work programs detail each step of the audit, including the primary audit objectives, control environment, risk assessment, policies and procedures review, and actual testing steps. More specifically, given the detail included in these work programs, contractors can brief personnel who are most likely to be impacted by the audit on the necessary steps to take both before and during the audit to help ensure the audit proceeds in a smooth manner. The contractor can also perform self-reviews in advance of the DCAA audit to ensure that all necessary operations, control activities, etc. are being performed adequately. In summary, by reviewing the relevant work programs in advance, a contractor can better align its preparation efforts to match the anticipated requests and focus areas of the actual audit.

To supplement the review of the audit work programs, contractors should also review relevant sections of the *DCAA Contract Audit Manual (DCAM)*,² which provides technical audit guidance, audit techniques, audit standards, and technical policies and procedures to be followed by DCAA personnel in the execution of its audit mission. Similar to the audit work programs, reviewing the *DCAM* sections relevant to the pending audit will enable the contractor to align its resources to match the anticipated needs of the auditors. For example, section 5-1302, “Purchasing and Subcontracting System Reviews,” discusses when contractor purchasing system reviews are likely to be performed. By reviewing this section in coordination with the audit work programs

previously discussed, a contractor should develop a better awareness of when a purchasing system audit is likely to be conducted, as well as the areas that the auditors will focus on during the audit. The *DCAM* also provides guidance to the auditors in areas such as notification of visits to contractor facilities and access to contractor records. Obtaining an understanding of this guidance will help the contractor better manage and coordinate expectations with DCAA.

In addition to obtaining an understanding of DCAA audit objectives and standard testing procedures, contractors should also review previous audits to gain greater insight into key focus areas. More specifically, if DCAA presented any findings in a particular area during a previous audit, it will most likely review the same area again to ensure contractor compliance. After identifying potential areas of focus, a contractor can perform self-reviews of these areas to ensure remediation efforts are being implemented properly and allocate necessary resources to ensure compliance prior to the commencement of the audit.

One of the most effective means for a contractor to limit the number and frequency of DCAA audits performed is to ensure that it has developed a robust internal control system. If DCAA is satisfied that the internal control structure provides reasonable assurance that the underlying contract-related accounting data is accurate, it will significantly limit the substantive audit procedures performed. To effectively communicate a strong internal control framework, a contractor should document its internal control structure and processes through the use of narratives, flowcharts, and matrices. In coordination with the internal control structure, the contractor should also establish and maintain a robust set of policies and procedures relating to key focus areas (e.g., labor charging, cost estimating, purchasing, billing, etc.). Demonstrating to DCAA that internal controls are in place and operating effectively to ensure financial representations are reliable, assets are safeguarded, and operational efficiency is achieved will significantly reduce the stress level later in the audit process.³

Prior to arriving at a contractor’s site to begin performing audit testing procedures, DCAA will generally provide a list of records/documents that it would like the contractor to make available at the beginning of the audit. Providing records and documents will be discussed in more extensive detail during the next section, but contractors should generally make requested documents and records available to the auditors in a timely manner, provided that the request is relevant and reasonable. One of the most important documents for a contractor to have ready for the auditors’ review is a copy of its policies and procedures relevant to the focus area(s) of the audit. For example, if DCAA is going to be performing an audit of a contractor’s labor charging system, the contractor should make its labor charging policies and procedures manual available to the auditors. DCAA is also likely to perform testing to ensure the policies and procedures are being followed precisely; therefore, contractors should perform advance self-testing to ensure employees are adhering to established policies.

In summary, DCAA generally does not perform unannounced audits, and usually provides contractors with adequate preparation time. It is essential that contractors properly utilize this time to anticipate audit requests, gather appropriate documents, perform self-reviews to remedy any potential areas of concern, coordinate internal resources to ensure they understand their roles and responsibilities during the audit process, and take the necessary steps to develop a professional relationship with the auditors. Developing a strong rapport with the auditors prior to their arrival on-site to begin fieldwork will lead to a more productive audit and a less stressful environment for both the contractor and auditors.

Working with On-Site DCAA Auditors

Prior to arrival on-site, the auditors are required to provide a notice to the contractors that they will be performing a site visit.⁴ This will enable the contractor to ensure that necessary resources are made available to assist during the audit process. Although there are

many facets to ensuring the audit proceeds in a smooth manner, two of the most important measures are scheduling meetings at appropriate intervals and satisfying relevant audit requests in a timely manner.

DCAA auditors will often spend a significant amount of time at contractor facilities. The amount of time spent at a contractor's facilities will generally vary directly in proportion to the number, dollar amount, and complexity of federal contracts that a particular contractor has been awarded.

Further, depending on the number, size, and complexity of the federal contracts, DCAA auditors may either perform site visit audits (i.e., commuting to the contractor offices from their branch offices) or establish a resident office at the contractor's site for the duration of the audit. DCAM 1-502.3, "Establishment of Resident Offices," provides guidance on establishing resident offices at contractor locations:

- a) A resident office is defined as a DCAA field office located at a con-

tractor's facility for the purpose of performing the contract audit workload at the contractor.

(...)

- c) Resident offices are usually established at principal locations of major defense contractors. The main criteria for establishing a resident office are whether the audit workload at the contractor is of a continuing nature and is sufficient in significance, complexity, and volume to warrant a full-time staff large enough to require a resident audit manager and clerical staff.
- d) A resident office has the important advantage of enabling auditors assigned to the contractor location on a continuing basis to develop a comprehensive understanding of the contractor's operations and basic management policies and practices in relation to government contracting. This understanding enables more efficient audits of major contractors and more timely and effective audit advice on these contractors to procurement and contract administration activities.⁵

After determining the extent of the auditors' presence on-site, the contractor can tailor its preparation efforts and focus accordingly.

Entrance and Interim Meetings

Before the auditors arrive on-site to begin audit fieldwork, it is essential for a contractor to hold an entrance meeting with the auditors. If multiple reviews are being performed, an entrance meeting or conference should be held prior to each review. One of the most important aspects of this review is to introduce the audit liaison(s) to DCAA. The audit liaison serves as the point-of-contact for the contractor to help satisfy DCAA's document requests throughout the audit process. The entrance meeting will also enable the contractor to better



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understand the scope and timing of the audit. After obtaining an understanding of the scope and timing, the contractor will be in a better position to align appropriate resources to specific audit areas. Other key topical areas that should be addressed during the entrance meeting include:

- Any changes in scope or timing should be communicated immediately.
- Problems encountered while conducting the audit should also be communicated in a timely manner.
- Scheduling of bi-weekly meetings (or other similar, agreed-upon timeframe) to discuss the current status and progress of the audits. These meetings can also be utilized to discuss anticipated progress over the next few weeks, or in the time period before the next meeting.⁶

In addition to the entrance conference held prior to the initiation of field work, contractors should also schedule periodic interim conferences with the auditors. These meetings will enable the contractor to discuss any audit findings with the auditors and will alleviate potential “surprises” at the conclusion of the audit. Although there is not a prescribed timeframe for when or how often these meetings should be held, discretion should be used based on the complexity and general progress of the audit. During these meetings, contractors should determine the following:

- What the auditors accomplished subsequent to the previous meeting,
- What they plan to accomplish during the next interim period, and
- If there are any changes in timing with respect to the anticipated completion date.

If there are any changes in the fieldwork timeframe, the auditors should provide an explanation during these meetings.⁷ Ultimately, the interim conferences are the contractor’s primary opportunities to influence the audit. Contractors should take advantage of these meetings to establish a

regular and effective line of communication with the auditors.

In connection with these meetings, contractors should appoint an individual to document discussions held in the entrance meeting and any subsequent meetings. Maintaining documentation of scope and timing discussions can often prove to be invaluable when debates arise regarding a change in the timing or scope of the audit.

Access to Contractor Records

Regardless of the nature of the audit or whether DCAA establishes a resident office on-site, one of the most contentious areas of any audit involves access to contractor records. Although access to records clauses included in the *Federal Acquisition Regulation (FAR)* are inserted into nearly all negotiated contracts, contractors and auditors often disagree over exactly what documents must be provided. Therefore, it is vital for contractors to understand the regulatory guidance regarding access to records, as well as any specific contractual terms. Given this context, this section will focus on standard contractual clauses, contractor rights and responsibilities, and practices contractors can implement to facilitate the process.

FAR 52.215-2, “Audits and Records—Negotiation,” includes the clause that serves as the auditor’s primary authority to access contractor records. Specifically, DCAM 1-504.1 states that this clause “must be inserted in all negotiated contracts, except those 1) not exceeding the simplified acquisition threshold; 2) for commercial items; or 3) for utility services.” A few of the most relevant sections of FAR 52.215-2 state:

- a) **Examination of costs.** If this is a cost-reimbursement, incentive, time-and-materials, labor-hour, or price-redeterminable contract, or any combination of these, the contractor shall maintain and the contracting officer, or an authorized representative of the contracting officer, shall have the right to examine and audit



all records or other evidence sufficient to reflect properly all costs claimed to have been incurred or anticipated to be incurred directly or indirectly in performance of this contract. This right of examination shall include inspection at all reasonable times of the contractor’s plants, or parts of them, engaged in performing the contract.

(...)

- e) **Reports.** If the contractor is required to furnish cost, funding, or performance reports, the contracting officer, or an authorized representative of the contracting officer, shall have the right to examine and audit the supporting records and materials for the purpose of evaluating 1) the effectiveness of the contractor’s policies and procedures to produce data compatible with the objectives of these reports, and 2) the data reported.
- f) **Availability.** The contractor shall make available at its office at all reasonable times the records, materials, and other evidence described in paragraphs (a), (b), (c), (d), and (e) of this clause for examination, audit, or reproduction until three years after final payment under this contractor or for any shorter period specified in Subpart 4.7, “Contractor Records Retention,” of the [FAR], or for any longer period required by statute or by other clauses of this contract...

DCAM 1-504.1 also provides a good summary of this requirement, as well as further clarification of what constitutes *contractor records*:

- a)This clause provides the contracting officer's representative with the authority to examine and audit contractors' books, records, documents, and other evidence and accounting procedures and practices, regardless of form (e.g., machine readable media such as disk, tape, etc.) or type (e.g., databases, application software, database management software, utilities, etc.), sufficient to reflect properly all costs claimed to have been incurred or anticipated to be incurred in performing cost-reimbursement, incentive, time-and-material, labor-hour, or price-redeterminable contracts.
- b) In addition to access to specific cost records, *access to records* refers to contractor policies, procedures, systems, management reports, personnel, minutes of its board of directors meetings, charter and bylaws, and any other information source which affects and reflects the incurrence, control, and allocation of costs to contracts.

In addition to providing clarifying guidance regarding what constitutes *contractor records*, DCAM 1-504.1 also explains why gaining access to contractor records is necessary to complete an adequate audit:

- c) Adequate audits are possible only when all existing evidence which pertains to the representations, claims, or proposals under audit is available to the auditor. A contractor's failure to make all pertinent records available to the auditor when needed leads to audit reports that contain qualified or adverse opinions, and may result in more difficult negotiations and delay in the contract award or settlement.

However, DCAM 1-504.1(d) also makes it clear that auditors do not have "free reign" to all contractor records and systems. It states that an auditor's responsibility includes making the determination of the *specific* records that are required to adequately complete the audit. It further states that "auditors must adhere to generally accepted government auditing standards (GAGAS) in determining what comprises competent, relevant, and sufficient evidential matter." Finally, this section of the *DCAM* also states

that auditors should use sound judgment and contemplate the audit objective, risk, and acceptable error when selecting records to review.

Equally important to understanding the regulations governing records that auditors can request is developing an understanding of how auditors request these records. DCAM 1-504.3(a) provides some of the most valuable language for a contractor regarding audit requests:



Records should first be verbally requested during the FAO's [field audit office] normal course of business with the contractor. The auditor should be ready to discuss the basis for the request with the contractor. *DCAM* or other agency guidelines should not be cited as the reason for requesting a record in lieu of explaining the underlying need.

In addition to this guidance, *DCAM* 1-504 also sheds some light on other key aspects of the document request process, including, but not limited to, the following:

- DCAA will generally accommodate a contractor's desires to have requests in writing, but will resist their desire to have *all* requests in writing, as that may hinder audit progress.
- DCAA auditors should make specific requests, rather than general requests.
- Unusual or extensive requests should be made in writing.
- If the contractor supplies original records, auditors should return them as soon as feasible.
- Original documents should not be removed from the contractor's facility without obtaining appropriate approvals.

Clearly, reviewing contractor records, documents, and files is a necessary part of any DCAA audit. The *DCAM* guidance outlines DCAA's right to review contractor records, but also goes the extra mile to ensure that contractor rights are protected and that audit authority is not abused. Given this framework for obtaining access to records, contractors also have responsibilities and expectations for providing the auditors with the requested documents.

A contractor should be fully aware of its rights with respect to DCAA audit requests. In addition to the regulations previously discussed, it is also vital for a contractor to review any specific contractual terms guiding access to records during an audit. The principle practice for contractors to follow is to provide auditors with access to perti-

nent records in a timely manner, but if the request goes beyond the scope of the audit, the contractor has the right to question the request. However, when questioning the request, the contractor should refer to relevant regulations and contractual terms rather than questioning the request simply based on emotion or inconvenience.⁸

As mentioned previously, one of the first steps a contractor should take after becoming aware of an impending DCAA audit is to appoint a liaison who will work with the auditors to coordinate the audit requests. Depending on the size of the company, it may also be prudent to create a management team to help address audit requests and questions. The liaison, or a member of the management team (if more practical), should maintain a list or repository of all DCAA requests.⁹ The liaison should also review the request list to ensure that the turnaround times are reasonable. The request list should be updated whenever a document is provided and should be monitored periodically to ensure all documents are being provided to DCAA in a timely manner. Another important responsibility of the liaison is to maintain and monitor a list of requested interviews. It is also advisable that the liaison be present at each interview to ensure that the interviewee is the appropriate individual to be responding to the questions posed by the auditor.¹⁰

One of the most effective ways to facilitate the audit liaison's job is to ask that data requests and interrogatories be put into writing. Based on the guidance previously discussed, while it is not advisable for a contractor to respond only to requests in writing, it is reasonable to ask DCAA to furnish its requests in writing whenever feasible. This will enable the contractor to organize and prioritize the requests and remit the documents to DCAA in a timely manner. If DCAA has a complex or out-of-the-ordinary request, a contractor should always ask for the request to be put in writing to ensure that there are no uncertainties regarding the exact nature of the record or document that DCAA is requesting.

After it has been determined that an audit request is reasonable and that the contrac-

tor has no additional clarification questions, the contractor should provide access to the records or documents in an organized and systematic manner. To accomplish this, the contractor should review all documents or data before providing them to the auditors. This will ensure only the appropriate documents are being provided and that documents beyond the scope of the audit are not provided. Equally important, the documents and data should be provided in an easy and understandable format. If the auditors cannot understand the documents, or the documents are provided in a disorganized format, this will slow down the progress of the audit and lead to an abundance of follow-up questions to which the contractor must respond. During this process, it is not recommended to allow DCAA auditors to pull files from contractor systems or to re-file documents upon completion of their review.¹¹

In addition to providing documents in an organized and systematic manner, contractors should also seek to provide all relevant documents within the timeframe requested by the auditors. Although their presence onsite may disrupt a contractor's normal course of business, the sooner documents are provided, the quicker the auditors will be able to complete their fieldwork. If delays are anticipated when providing documents, the contractor should immediately discuss the cause of these delays with the auditors to avoid any unwanted "surprises." This underscores the importance of holding an entrance meeting and interim meetings to ensure that the initial timeframe is reasonable.

The denial of access to contractor records is a serious offense that DCAA will not take lightly. *DCAM* 1-504.4 outlines actions and inactions constituting a denial of access, which include, but are not limited to, the following:

- a) Contractor refusal to provide access to any requested record including (i) support for unclaimed costs excluded under CAS 405 or (ii) records maintained in an electronic or optical format (even if paper copies are available).

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- b) Unreasonable delays by contractor representatives in permitting the audit commencement or in providing access to needed data or personnel...
- c) Restrictions on reproduction of necessary supporting evidential matter.
- d) Partial or complete denial of access to internal audit data or other management reports on contractor operations.
- e) Denial of access to the contractor's database...
- f) Chronic failure of contractor personnel to comply with agreed-to dates for furnishing data.
- g) Assertion of attorney-client privilege or attorney work product rule...

DCAM 1-504.5 recommends that auditors attempt to resolve denial of access issues at the lowest DCAA level possible. If reasonable efforts to do so prove to be ineffective, dispute resolution procedures will be followed.

Audit Wrap-Up

At the conclusion of an audit, an exit conference should be scheduled for the contractors and auditors to meet to discuss the results of the audit. Any findings or conditions identified during the audit will be discussed in further detail during this meeting. However, assuming the contractor is proactive in scheduling interim meetings throughout the process, there should not be any “surprises” during the exit conference. Also upon conclusion of the audit(s), the contractor should obtain copies of all relevant audit reports.

During the audit, if it is determined that any audit follow-up is required, the contractor should ensure that the auditors clearly define the nature and timing of the additional procedures. Requests to review additional documents or speak with contractor personnel should also be clearly communicated. It is also imperative for the contractor to ensure that its expectations regarding remediation efforts are consistent with the auditors' expectations.

At this stage of the process, the contractor prepares its response in which it either concurs or disagrees with each of the conditions (if any). It is advisable for a contractor to challenge any findings or conditions prior to them being put into writing (i.e., in the final audit report).

If after evaluating relevant regulations the contractor concurs with DCAA's position, it should withdraw the cost, concur with the finding, and maintain its integrity and credibility throughout the process. However, if a dispute arises, the contractor should ensure it grounds its rebuttal in regulations and avoids any unnecessary histrionics. To accomplish this, the contractor should first try to gain an understanding of the auditor's point of view by researching relevant regulations, reading the audit work program, and reading the related sections of the *DCAM*. Second, the contractor should ensure that all relevant facts and circumstances are understood and that the auditor understands these same facts and circumstances. If necessary, the contractor should elevate the issue internally to the relevant party (i.e., controller, general counsel, etc.). After evaluating the relevant regulations, if the contractor still maintains its position, it should begin building its argument. The argument should be focused primarily on regulations and the *DCAM*, and legal precedents should be used sparingly. Moreover, the contractor should prepare a rebuttal supported by proper documentation. This rebuttal should include additional facts and circumstances that the auditor may not have been aware of that strengthen the contractor's position. At the same time, the contractor should maintain a grounded, professional tone while avoiding “attacking” the auditor.

Conclusion and Recommendations

This article has presented several tools and proven best practices that contractors should employ to limit the inherent stress associated with DCAA and other government agency audits. This article has also focused on positive actions contractors can take prior to the commencement of audit field work, during audit field work, and in connection with audit wrap-up and exit conferences. Several of the specific best practices suggested include:

- Properly preparing for an audit,
- Providing the auditors with access to records in a timely manner,

- Scheduling periodic meetings, and
- Maintaining a professional relationship with the auditors.

In addition to these proven best practices, contemplating the following high-level “do’s” and “don’ts” will also enable contractors to effectively manage their relationships with governments auditors:

Do's

- The audit relationship should be carefully managed. Further, the contractor should always strive to develop a rapport with the auditors, and at a minimum, should always treat the auditor with respect.
- Contractors should take a long-term view of the relationship. Most importantly, contractors should focus on building credibility one step at a time while always maintaining the highest level of professionalism.
- Contractors should focus on taking a systematic, organized approach to the audit process. This is especially important given that auditors take a systematic, organized approach to conducting the audit.
- Be prepared. By adequately preparing for the audit, a contractor can significantly reduce the level of stress associated with the audit process.

Don'ts

- Refusing to provide access to any requested record with relevance to the audit scope.
- Creating unreasonable delays in scheduling the entrance conference.
- Creating unreasonable delays in providing access to needed data and/or personnel.
- Restricting reproduction of necessary evidential matter.

- Consistently failing to comply with agreed-upon dates for furnishing data.
- Developing an adversarial approach with the auditors.

Although this list of Do’s and Don’ts is not all-inclusive, it provides a basic set of guidelines that contractors should follow in their efforts to establish a professional relationship with the auditors. Establishing a professional relationship can prove to be instrumental in determining whether the audit proceeds in a smooth manner or whether it becomes excessively time-consuming, overly adversarial, and cumbersome for both the auditors and the contractor. **CM**

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Note: This article is a modified extract from the new book *Government Contract Audits & Compliance*, by Gregory A. Garrett (Chicago: CCH-Wolters Kluwer Law & Business, 2010).

ENDNOTES

1. See *Surviving a DCAA Audit* (Johnstown, PA: TD Government Solutions, February 16, 2010).
2. All DCAM sections referenced herein are available at www.dcaa.mil/cam.htm.
3. See *Preparing for a DCAA Audit* (Vienna, VA: Holbrook & Kellogg Inc., 1992): vi, vii.
4. As per DCAM 1-503.2.
5. DCAM 1-502.3.
6. See *Preparing for a DCAA Audit*, at note 3.
7. *Ibid.*
8. *Ibid.*, at vi.
9. See *Surviving a DCAA Audit*, at note 1.
10. *Ibid.*
11. See *Preparing for a DCAA Audit*, at note 3: vii.

