

NATIONAL CONTRACT MANAGEMENT ASSOCIATION

# Government Contract Accounting Compliance: Current and Emerging Challenges

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Candor. Insight. Results.

April 11, 2012

12:00-1:30PM Eastern



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## Discussion Topics

### Topics

1. Proposed DFARS Adequacy Checklist for Contract Proposals
2. Allowable Cost and Payment Clause Update – new ICP Adequacy Checklist
3. DCAA Audit Statistics
4. DCAA Access to Contractor Internal Audits – GAO Report
5. Significant CAS Board Final Rules
6. Reasonableness of Compensation Costs (recent ABSCA case) & Pay Cap Application to All Employees
7. DCMA Business Systems Policy and Process



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## Proposed DFARS Rule - Adequacy Checklist for Contract Proposals

### Background

- December 2, 2011: objective is to ensure that offerors submit thorough, accurate, and complete proposals –
  - Proposes an adequacy checklist for proposals in response to solicitations that require submission of certified cost or pricing data
  - Born from a joint industry and Air Force initiative in 2010 to develop a proposal adequacy checklist for certain Air Force RFPs above the cost or pricing data threshold
  - Purportedly supports DoD's Better Buying Power initiative
  - To be used at Contracting Officers discretion, however proposed rule says "contracting officer should include..." Much stronger language than "may."
  - Checklist summarizes pre-existing FAR requirements, with a couple exceptions
  - Due date for comments was January 31, 2012
- Proposal Adequacy Checklist Includes –
  - Forty-seven separate checklist items
  - Requires either 1) a cross-reference to the proposal page number supporting the submission item, or 2) an explanation as to why that submission item is not included



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## Proposed DFARS Rule - Adequacy Checklist for Contract Proposals

### Implications /Considerations

- Increased time and effort for -
  - Contractors to complete the checklist?
  - Government to check the checklist?
- Supports DoD's Better Buying Power initiative?
  - Does the checklist really "reduce non-productive processes and bureaucracy"?
- DOD Guidance vs. RFP Requirement
  - Proposed rule is duplicative of FAR requirements already in place (specifically Table 15-2 under FAR 15.408)
  - Contradicts certain parts of the Air Force proposal checklist
  - No doubt, a helpful tool for the Government and contractors, but...
  - ...may be better issued under DoD's Procedures, Guidance and Information (PGI) as opposed to an additional regulatory requirement
- What happens if checklist is completed incorrectly?
  - Potential new false claim risk?



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## Allowable Cost and Payment Clause Update

### Background

- June 2011: FAR 52.216-7 expanded to include –
  - Requires what was once a recommendation to use DCAA's ICE Model
    - Identifies 15 required schedules for an adequate Incurred Cost Proposal (ICP)
    - Contains 15 additional items that are not required for an adequate proposal, but may be required during the audit process
  - New requirement for contractor to update billings on all contracts to reflect final settled rates within 60 days after settlement – 52.216-7(d)(v)
  - Additional statement that prime contractor is responsible for settling subcontractor amounts and rates included in a completion invoice
    - How?
  - Effective June 30, 2011
- November 4, 2011 – DCAA issued a revised Adequacy Checklist for Incurred Cost Proposals
  - Effective for all major incurred cost audits established on or after October 1, 2011



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## Allowable Cost and Payment Clause Update

### Implications /Considerations

- Now FAR is clear re: what an adequate incurred cost proposal must include
  - Could use DCAA (i.e., ICE Model) guidance previously
  - Rule change adds clarity but is also more restrictive/less flexible
- DCAA will likely apply new rules to unaudited incurred cost proposals submitted in prior years (i.e., pre 2011)
- DCAA adequacy checklist oversteps FAR requirements
  - Explanatory notes for all adjustments
  - Cost schedule for all intermediate cost pools
  - Listing of all subcontracts for flexibly priced contracts for which the contractor is a prime and/or upper-tier subcontractor
    - Opposed to not listing fixed price subcontracts
  - Reconciling direct labor totals between various schedules (i.e., Schedules G and L)



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## DCAA Audit Statistics

### Background

- Section 805 of FY12 NDAA requires DCAA to prepare an annual report to Congress by March 30 for the preceding GFY
- Reports must be made available to public within 60 days
- Reports shall include, at a minimum –
  - Description of significant problems, abuses, and *deficiencies* encountered during contractor audits
  - Statistical tables showing:
    - Audit reports completed and *pending*
    - Priority given to each type of audit
    - Length of time taken for each type of audit
    - Dollar value of *questioned* costs (separately identifying the value of “unsupported” costs)
    - Number and types of audits *pending* for a period longer than *DCAA guidance allows*
  - Recommendations of actions or resources needed to improve the audit process
  - Any other matters of importance to the DCAA Director



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## DCAA Audit Statistics

### Historical Trends – DCAA Budget Estimates to DOD Comptroller

Number of Completed DCAA Audits											
Completed Audits	FY 01	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11
Incurring Costs and Special Audits	30,373	27,746	28,316	26,480	26,360	23,697	22,519	19,956	12,826	5,166	3,886
Price Proposals	8,874	9,447	9,829	10,299	9,673	9,015	8,182	8,113	7,004	5,590	2,599
Cost Accounting Standards	2,689	2,322	2,353	2,340	2,426	2,413	2,648	1,927	1,292	916	874
Defective Pricing	721	627	615	586	562	485	452	356	154	59	31
<b>Total Audits</b>	<b>42,657</b>	<b>40,142</b>	<b>41,113</b>	<b>39,705</b>	<b>39,021</b>	<b>35,610</b>	<b>33,801</b>	<b>30,352</b>	<b>21,276</b>	<b>11,731</b>	<b>7,390</b>

GAO Report 7/22/08, 10 months into FY08

Number of Workyears											
Workyears	FY 01	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11
Incurring Cost and Special Audits	2,110	2,016	2,027	2,033	2,061	2,043	2,098	2,104	1,935	1,765	1,955
Price Proposal	622	640	669	698	690	706	724	779	993	1,307	1,220
Cost Accounting Standards	107	107	102	96	99	99	100	100	120	160	212
Defecting Pricing	98	89	86	83	87	81	76	83	51	33	39
Other Direct Audit Effort	651	658	642	628	611	580	560	533	550	669	716
<b>Total Direct Workyears</b>	<b>3,588</b>	<b>3,510</b>	<b>3,526</b>	<b>3,538</b>	<b>3,548</b>	<b>3,509</b>	<b>3,558</b>	<b>3,599</b>	<b>3,649</b>	<b>3,934</b>	<b>4,142</b>

Number of Audits Per Workyear											
Audits per workyear	FY 01	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11
Incurring Cost and Special Audits	14.4	13.8	14.0	13.0	12.8	11.6	10.7	9.5	6.6	2.9	2.0
Price Proposal	14.3	14.8	14.7	14.8	14.0	12.8	11.3	10.4	7.1	4.3	2.1
Cost Accounting Standards	25.1	21.7	23.1	24.4	24.5	24.4	26.5	19.3	10.8	5.7	4.1
Defecting Pricing	7.4	7.0	7.2	7.1	6.5	6.0	5.9	4.3	3.0	1.8	0.8
Other Direct Audit Effort											
<b>Total Audits Per Workyear*</b>	<b>14.5</b>	<b>14.1</b>	<b>14.3</b>	<b>13.6</b>	<b>13.3</b>	<b>12.2</b>	<b>11.3</b>	<b>9.9</b>	<b>6.9</b>	<b>3.6</b>	<b>2.2</b>

\* Total Audits Per Workyear excludes workyears recorded as "Other Direct Audit Effort"



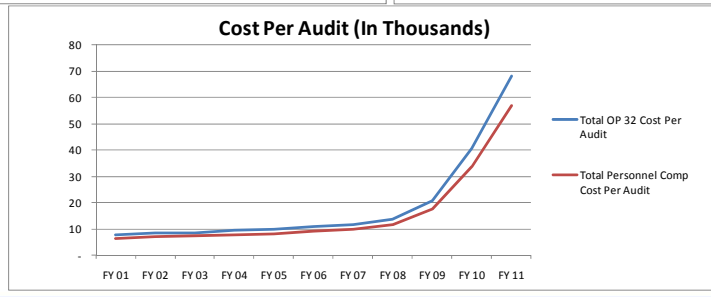
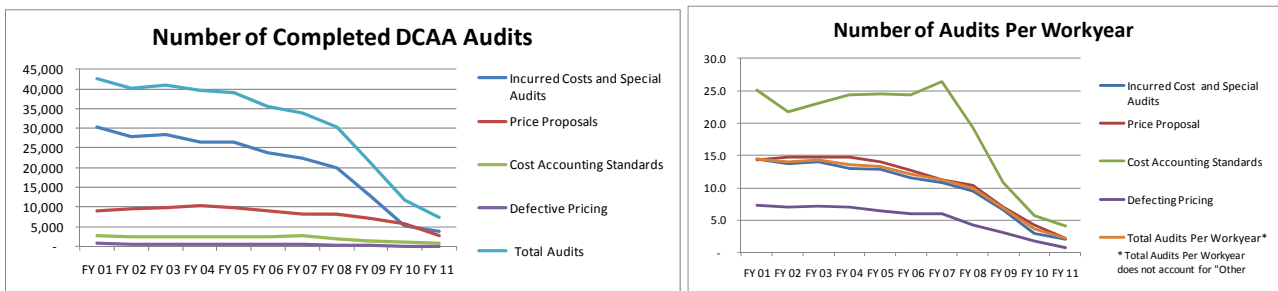
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# DCAA Audit Statistics

## Historical Trends – DCAA Budget Estimates to DOD Comptroller



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## GAO Report – Access to Contractor Internal Audit Reports (Dec. 2011)

### Background

- GAO reviewed the internal audit departments of seven major defense contractors, five large and two small, for –
  - Adherence to internal audit standards (e.g., independence, proficiency, audit planning)
  - The extent to which the internal audit reports address defense contract management internal controls
  - DCAA's ability to examine internal audits and use information from these audits
- GAO Findings –
  - The internal audit departments generally adhered to Institute of Internal Auditor standards
  - 520 of 1,125 internal audits reviewed, from 2008 and 2009, related to the defense contract control environment and one or more areas reviewed by DCAA
  - Court decisions have held that DCAA does not have power to demand access to IA reports, but it may demand access to materials relevant to its audit responsibilities
- GAO recommends DCAA take steps to facilitate access to internal audits and assess periodically whether other actions are needed



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## GAO Report – Access to Contractor Internal Audit Reports (Dec. 2011)

### Implications /Considerations

- Bet on increased DCAA requests of internal audit reports
  - Could lead to increased disputes between contractor and DCAA (potential subpoenas)
- Court cases favor the contractor
- Catch-22 for contractors
  - Granting full access may lead to DCAA fishing and more compliance issues
  - Limiting or denying access may be viewed as significant deficiency in control environment (under guise that DCAA cannot assess operating effectiveness of Internal Audit Dept)
- Decrease in government contract related internal audits?
  - Discourages contractors from using internal audit to provide meaningful reports
- Have a plan
  - Full access, view and copy, view only, or deny access
  - Ensure DCAA documents the report requested and their justification (i.e., what they expect to obtain from the review and the link to a current or upcoming DCAA audit)



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## Significant CAS Board Final Rules

### Background

- Pension Harmonization Rule (CAS 412&413)
  - Pension Protection Act of 2006 required all companies (including gov't contractors) to accelerate (increase) contributions to underfunded defined benefit pension plans
  - PPA cash contributions would significantly exceed pension cost determined under CAS 412 & 413
  - PPA required CAS Board to "harmonize" CAS 412&413 with PPA by January 1, 2011
  - Final Rule issued on December 27, 2011, effective February 27, 2012, implementation starting the first cost accounting period after June 30, 2012
- Elimination of CAS "overseas exemption" (9903.201-1(b)(14))
  - Former exemption: contracts and subcontracts to be executed and performed entirely outside the United States
  - CASB April 23, 2009 RFI: FY09 NDAA required CASB to assess whether the Government would benefit from making CAS applicable to contracts exempted under (b)(14)
  - Industry, DCMA and DCAA urged CASB to retain exemption
  - CASB October 20, 2010 NPRM: proposal to eliminate the (b)(14) exemption
  - CASB August 10, 2011 Final Rule: eliminate the (b)(14) exemption



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## Significant CAS Board Final Rules

### Implications /Considerations

- Pension Harmonization
  - Allows contractors to recoup increased costs associated with pension funding in accordance with PPA
  - Post-PPA, pre-CAS harmonization cost differential recoverable over 5 year transition period
  - Applicable upon award of first full CAS covered contract after effective date
  - Equitable adjustments applicable to CAS covered contracts awarded prior to effective date; contracts awarded after effective date must be priced using new CAS 412/413 rules
- Elimination of Overseas Exemption
  - Most acute impact will be on foreign concern subcontractors (must follow CAS 401&402)
  - Increased administrative burden and costs of compliance (contrary to Efficiency Initiative)
  - Reduced competition by foreign concerns
  - Increased procurement lead time
  - Increased audit risk and noncompliance liability
  - New barrier to aerospace and defense exports (contrary to Administration Policy)
  - Frustrates US policy to stimulate foreign economic development



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## Contractor Compensation Caps & ASBCA Reasonableness Determination

### Background

- Section 803 of FY2012 NDAA extends the compensation cap (currently \$693,951) to “any contractor employee” –
  - Shall be implemented in the FAR within 180 days; but no regulations yet
  - Applies to costs of compensation incurred after January 1, 2012
  - Secretary of Defense may establish an exception for “scientists and engineers...to ensure that the Department of Defense has continued access to needed skills and capabilities”
  - Still much political ambition within Congress to lower the cap amount
- January 18<sup>th</sup>, 2012 Armed Services Board of Contract Appeals (ASBCA) decision says DCAA’s method for calculating reasonableness of executive compensation costs is “fatally flawed”
  - Ruled in favor of J.F. Taylor, Inc. appeal of questioned executive compensation costs
  - DCAA did not (could not?) support its “10 percent range of reasonableness” criteria within its method for determining reasonable compensation costs
  - DCAA did not consider/account for the data dispersion in its sample



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## Contractor Compensation Caps & ASBCA Reasonableness Determination

### Implications /Considerations

- Compensation cap extension to all contractor employees
  - Additional unallowable costs for all contractors with employees receiving compensation over the cap beyond the 5 highest paid senior executives
  - Increased contractor effort to ensure it removes all costs over the cap
  - Increased disclosure risk – must contractors now disclose compensation for every employee?
  - Future change/extension to Schedule T (currently optional) of Incurred Cost Proposal entitled Executive Compensation Information
- ASBCA ruling on reasonable compensation costs
  - Government has until May 17, 2012 to appeal
  - If no appeal or if decision stands, DCAA must revise its method for evaluating reasonableness of executive compensation
  - DCAA's version of "more reasonable" has no basis (10% range from the median)
  - Contractors should challenge the results of recent DCAA executive compensation reviews
  - Reasonableness determination is in addition to the compensation cap listed above



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## DCMA Business System Policy

### Background

- Issued January 2012 ([guidebook.dcma.mil/308/index.cfm](http://guidebook.dcma.mil/308/index.cfm))
- Purpose: ensure Contracting Officers take appropriate and timely actions regarding deficiencies in contractor business systems
- Response to industry fear of inconsistent application of DFARS business systems clauses
  - Requires coordination of CACO, DACO, and ACOs when network exists
  - Rejection of advice from functional specialist of auditor is subject to Board of Review
  - Final determination to disapprove a contractor's business system is subject to Contractor Business Systems Review Panel. Board will review:
    - Functional specialist and/or audit report
    - Contractor's response to CO's initial determination
    - Final determination notice



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## DCMA Business System Policy

### Implications /Considerations

- Legacy “deficiencies” can result in system disapproval and withholds without a new audit
- Withholds targeted for contracts >\$50m, but threshold will be lower for contractors with smaller contracts
- Withholding regime allows for lesser withhold % depending on contractor CAPs, but...
- ...reductions to withhold % are prospective only
- Withholds can be released even if significant deficiencies continue:
  - When contract subject to performance-based or progress payments is complete and necessary closeout actions are complete
  - If withholds are against a contract with funds due to cancel



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# QUESTIONS?



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**End**

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