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ASBCA Case No. 57795: Flowers, Parties and Unified Jazz Ensemble = Unallowable Entertainment

By Michael E. Steen, CPA, Technical Director at Redstone Government Consulting, Inc.

In its October 4, 2012 decision, the ASBCA agreed on all counts with the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA) finding that incurred and billed Thomas Associates, Inc. entertainment and other costs were expressly unallowable and therefore subject to penalties without qualification. In ASBCA case 57795, the counts or issues involved five indirect cost items as well as the application of FAR 42.709-1(a)(1), penalties for expressly unallowable costs on contracts subject to the allowable cost and payment clause, FAR 52.216-7. Although this case may have facts and circumstances which are not identical to the facts and circumstances applicable to other contractors, ASBCA No. 57795 still provides some universal lessons for all contractors subject to DCAA audits of indirect cost rate proposals.

The five issues before the ASBCA involved two sub-issues; one, the distinction between allowable employee morale and welfare costs (FAR 31.205-13) and unallowable entertainment costs (FAR 31.205-14) and secondly, an issue of unallowable rental costs involving a related party (common control) lease (FAR 31.205-36(b)(3)). The following is a brief description of each sub-issue, noting that in all cases the DCAA/DCMA interpretation prevailed, all costs were deemed expressly unallowable and the contractor was ultimately responsible for penalties based upon expressly unallowable amounts allocated to cost-plus fixed fee contracts.

- Pintail Point Club including a corporate deluxe membership (privileges to five contractor executives) encompassing sporting clay shooting instructions, tournaments and fishing trips. ASBCA rejected contractor assertion that these costs were to improve employee morale, fitness and teamwork (editor's note: apparently fishing and/or clay shooting doesn't really contribute to health and fitness).

THIS ISSUE:

- Unified jazz ensemble, a separate expense during an official corporate event and considered expressly unallowable entertainment by the ASBCA (editor's note: other costs associated with the corporate event were apparently not questioned by DCAA).
- Flowers for employees (births, illness, death, weddings) were considered by the ASBCA to be a "cost free gesture to employees…nothing more than a gift which is expressly unallowable under FAR 31.205-14": (editor's note: this is particularly disconcerting because many consider these expenses to be allowable employee morale and welfare at the very least subject to interpretation and certainly not "expressly unallowable").
- Office rent involving real property owned by the owner of the contractor and/or owned by a related party for which the ASBCA concluded this was sufficient to establish common control in which case allowable rent is limited to constructive cost of ownership. The contractor asserted that the rent was well below comparable commercial rents/leases; unfortunately this "market comparison" has no relevance in determining allowable or unallowable costs under FAR 31.205-36(b)(3).
- Christmas party which was after a corporate meeting and per the contractor, the party also served as a banquet to recognize employees. Unfortunately, the contractor had previously lost an identical issue before the ASBCA; hence, the contractor was dead on arrival in disputing the same issue (the issue previously decided against the contractor applied to the 2005 Christmas party, the recent ASBCA case involved the same party, but in 2004). In the current decision, the ASBCA noted that the party included 26 hours of activities and at most, the corporate meeting involved 2 of those 26 hours and the majority of the attendees were not contractor employees.

Regarding the application of the FAR 42.709 penalties for claiming expressly unallowable costs (as allowable) within a certified indirect cost rate proposal, the contractor argued that the penalties should be waived because it was a novice contractor which has now learned the regulations and government expectations. Unfortunately as the ASBCA stated, there is no provision for waiving the penalties for new contractors (editor's note: in fact there is absolutely no concept of a "learner's permit" for government contractors, no one should engage in government contracting without knowing the regulations and risks, and never assume that the government has a "sensitive or benevolent" side when dealing with government contractors).

As previously stated, the facts and circumstances in ASBCA No. 57795 maybe somewhat unique, but the ASBCA decisions have very unfavorable implications to any contractor trying to distinguish between allowable employee morale/welfare costs and unallowable entertainment. As it relates to flowers for employees, it doesn't matter that this is a common practice across Corporate America, apparently the ASBCA expects the contractor to i) not claim these costs or ii) give the flowers to the employee, but then reduce the employee's pay to offset the cost.

DCAA: Re-writing FAR 4.703 within DCAA Audit Policy on Scanning Records

By Michael E. Steen, CPA, Technical Director at Redstone Government Consulting, Inc.

DCAA has apparently assumed sole authority for writing or re-writing the FAR (Federal Acquisition Regulations), in this case as it relates to "Transfer of Records from Hard Copy to Computer Medium" or more succinctly, records scanning as defined in FAR 4.703(d). The actual requirements in FAR are limited to three very basic criteria:

- Scanned records must preserve accurate images including signatures and other graphic images,
- Effective indexing system to permit timely and convenient access to imaged records,
- Original records retained for one year after imaging to permit periodic validation of the imaging system.

In stark contrast to the actual regulations, DCAA's CAM (Contract Audit Manual) refers to FAR 4.703(d) which was effective February 27, 1995 inclusive of the following "requirements"--the listing which follows is only a partial extraction of DCAA's list which is an egregious misrepresentation of the actual requirements of the FAR; moreover, it totally defies all logic that DCAA's long list of "FAR 4.703(d) requirements" never existed anywhere until DCAA magically and unilaterally authored them within DCAA's internal contract audit manual.

- Records retention FAR 4.7 requirements must be satisfied,
- An audit trail describing the data transfer,
- A transfer process which includes all relevant notes and worksheets necessary for reconstructing or understanding the records (this also includes back-up procedures),
- Adequate internal control including segregation of duties particularly between those responsible for maintaining the General Ledger and those responsible for the transfer process,
- A procedure prohibiting records destruction during the implementation phase until it can be shown that the system is actually providing acceptable copies,
- An acceptable system of continuing surveillance over the transfer system; this includes periodic comparisons and internal audits,
- Adequate procedures for periodic internal and external audit,
- Adequate procedures for labeling and storing the computer medium; these should meet the minimum standards prescribed by the National Archives and Records Administration (NARA),
- Adequate procedures for random sampling and testing of all records as prescribed by NARA,
- Procedures for retrieval of retained records at the time of audit including provisions for government access to the computer resources (terminals, printers, etc.).

Unfortunately, this is but one example of DCAA's implied declaration of independence from anything actually stated in FAR notwithstanding that government contracts include FAR clauses and not DCAA's preference for what these clauses should state. Perhaps the most egregious aspects of DCAA's contract audit manual is to include a totally misleading introductory paragraph which states without qualification that FAR 4.703(d) permits the contractor to retain the records in any medium or combination of media **if the following requirements** are met—and DCAA's version of requirements is a list of 17 requirements whereas the real deal (FAR 4.703(d)) only lists three very basic requirements.

It is noteworthy that in the mid-1990s, on multiple occasions DCAA authored audit policies which were at odds with the actual regulations and at the time, the Director for DDP (which is now DPAP, Defense Procurement Acquisition Policy), publicly embarrassed DCAA by directing DCAA to withdraw those audit policies. Apparently DPAP no longer has any interest in re-directing DCAA regardless of DCAA's wayward interpretations of the regulations. Equally apparent and more disconcerting, no one in DPAP or DOD cares that DCAA's wayward interpretations are resulting in unnecessary administrative costs (for costs to change contractor systems to accommodate DCAA's non-regulatory based demands) as well as the costs of contract disputes which will ultimately be decided based upon the regulations and not DCAA's re-interpretation of those regulations.

Until someone with authority re-directs DCAA, they will continue with their unofficial motto: "We prefer to believe what we prefer to be true". DCAA seemingly reinforces its unofficial "we believe" motto with its interpretation of auditor independence (reference to government auditing standards) as independent of the actual contract terms and conditions.

Tightening Allowable Contractor Employee Wages: The Debate Continues

By Darryl L. Walker, CPA, CFE, CGFM, Technical Director at Redstone Government Consulting, Inc.

Pressure continues to mount for Congress to adopt the Senate language in a bill that would place an annual $230,700 cap on individual contractor employee wages that could be claimed for reimbursement within certain DOD government contracts.

Adopting that ceiling would constitute a $532,329 reduction in the existing regulatory annual compensation ceiling ($763,029); moreover, the reduced cap would apply to every contractor employee, a continuation of the change effected with the 2012 DOD Appropriations Act (for DOD contracts, this cap is no longer limited to the top five employees in management positions as currently stipulated in FAR 31.205-6(p)).

Heads of notable national labor unions and leaders of public interest groups sent an October 18 letter to the Senate and House Armed Services Committee chairpersons urging

lawmakers to adopt that annual wage ceiling as currently delineated in the National Defense Authorization Act of 2013.

Making their case that contractor employees are being paid too much money and therefore bilking the American public, the letter's authors state that "it is fiscally irresponsible to allow private contractors to charge escalating and exorbitant rates to the government". The assertion of "escalating" and "exorbitant" is supported by purported increases in contractor employee wages that have outpaced inflation by 53%, while military personnel received only a nominal increase this year, and federal civilian employee wages frozen.

The letter notes "fiscal responsibility and fairness" is required when faced with budget cuts and sequestration, and the authors invoke a commonly unsupported notion that "compensation levels over $230,000 are not required to find and retain a talented work force" (the unsupported example given: many Nobel Laureates conducting research at government labs work at salaries well below $200K). The letter also states that the President and U.S. Senators make far less money than government contractor employees, so why should those employees, whose salaries are paid for by the government, be any higher (editor's comment: we could have a field-day challenging the actual value derived from those in public office, particularly those incapable of dealing with the deficit, but we won't). The letter summarizes the authors' obvious irritation with Congressional inaction to lower the compensation cap via a concluding statement coated with hyperbole: "It is grossly unfair to expect working people to pay for the inflated salaries for defense contractor employees".

Fueling the frustration of federal labor union leaders with demands to lower allowable contractor employee wage ceilings is a recent study released by the Federal Salary Council which disclosed that "federal employees earn 34.6 percent less pay on average than their private sector peers". That survey contradicts other federal-to-private-sector wage evaluations, specifically by the Cato Institute and Heritage Foundation, which historically concluded that federal employees garner higher paid salaries than private sector personnel in the same job positions, notably professionals in the Information Technology business.

The Senate Armed Services Committee approved a plan to cap reimbursement by the DOD at the $230,700 per contractor employee amount in June 2012, the amount of which was based on the existing annual salary for the Vice-President; however the Senate version has stalled in the House of Representatives, and until the House and Senate can negotiate an agreement, no change to contractor employee wage ceilings will take place.

DOD IG Finds Pentagon Not Following Own Guidance in Tracking Sole-Source Contracts

By Darryl L. Walker, CPA, CFE, CGFM, Technical Director at Redstone Government Consulting, Inc.

A Department of Defense Inspector General (DOD IG) office October 4, 2012 report asserts that the DOD is not adequately following its internal parameters and monitoring policies in awarding contracts on a competitive basis when only receiving a single-source bid. By not following its internal policies, the DOD IG contends that the Pentagon does not encourage adequate competition which significantly diminishes savings to the general public in contract award values.

The IG reviewed a sample 237 contract awards, modifications to contacts, Broad Agency Agreements (BAA) and Small Business Innovation Research (SBIR) awards, totaling almost $2 billion, with the objective of determining if DOD agencies followed award criteria when placing an award with a single bidder after having released a solicitation with the expectation of several competitive bids. The Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics (OUSD [AT&L]) provided several memorandums in the past two years to procurement activities that essentially required a more thorough analysis of single bids in response to a competitive solicitation before making the award to the sole bidder. Guidance focused on analyzing risk of the single offer, performing adequate price analysis, requesting cost information as needed, and re-soliciting the bid if necessary. DFARS was amended in June 2012 to add contracting analysis parameters for awarding a single bid in response to a competitive solicitation.

DOD IG's principal findings include:

- Inadequate identification of certain contracts in the Federal Procurement Data

System-Next Generation (FPDS-NG) as single-bid awards;
- Failing to classify BAA and SBIR awards in the FPDS-NG Effective Competition Report as having effective competition;
- Not following the single-bid guidance for certain single-bid contracts
- Insufficient plans to increase competition; and
- Lack of monitoring of certain contract modifications to determine if they exceeded the three-year limitation on awarding contract modifications.

Summary recommendations for ensuring awards to single-bidders, under a competitive solicitation, are adequately vetted by contracting officers via current parameters, include:

- Director, DPAP should routinely and thoroughly review the Services' Competition Advocates competition reports;
- Services' Competition Advocates should prepare guidelines to closely monitor implementation and execution of single-bid guidance; develop a plan to increase competition in their competition plans and 3-year period of performance plans; and monitor the accuracy of contracting officers' FPDS-NG information.
- Services' Competition Advocates should prepare a plan related to the length of contract modifications and improve the DOD Effective Competition Report.

Notably missing from the DOD-IG report is any analysis to confirm that adherence to the DOD policy would actually yield any tangible savings which simply confirms that the DOD-IG charter does not include dispelling myths and assumptions.

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Instructors

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