



Getting Your Incurred Cost Proposal for FYE 12/31/2012 in Order – Starting NOW

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

For many government contractors, the 2012 financial and cost accounting fiscal year (FY) ended December 31, and the six month regulatory clock is now ticking for the submission of an adequate incurred cost proposal (ICP). Contractors with reimbursable or flexibly-priced government contracts which include payment clauses (FAR 52.216-7) requiring final indirect rate settlement have until June 30, 2013 to produce an adequate ICP, unless the contractor submits an extension request that is approved by an Administrative Contracting Officer (ACO).

A significant number of all submitted ICPs will be deemed inadequate by DCAA, tacitly concurred with by the ACO, and returned for “correction”, and a more than nominal percentage of contractors will require an extension although some will not recognize that they cannot meet the June 30 deadline until June 29th. Thus two major hurdles immediately present themselves to all contractors in getting their ICPs queued up for a government audit, or if deemed low risk by a DCAA review, entering a sampling pool for potential audit selection or more importantly to the contractor, acceptance without audit.

If you already know you cannot possibly have a FY 2012 ICP ready by June 30th because of issues within or beyond your control, you should now submit a request for ICP extension including the “exceptional circumstances”, precipitating the extension. The payment provisions in FAR 52.216-7(d)(2)(ii) makes it clear that an explanation of such circumstances must be made to the ACO, or a request for extension can be denied without further discussion. Regulations do not define exceptional circumstances; thus deferring to the ACO in coordination with the auditors to ascertain if a contractor’s rationale is reasonable. Although these are not defined per se, “exceptional circumstances” are those ordinarily beyond a company’s control, and may include events such as unexpected loss of critical accounting staff, destruction of records via fire, weather event, etc., or simply a contractor acknowledgement that the company is new to the government way of doing things. Lame excuses or childish whining will not work and will only make your company look stupid: examples, “we didn’t have a qualified staff”, “we

THIS ISSUE:

- ❖ Getting Your Incurred Cost Proposal for FYE 12/31/2012 in Order – Starting NOW
- ❖ DCAA Access to Internal Audits: The Siege Continues
- ❖ Sequestration: Latest Scoop & Impact on Contractors
- ❖ Training Opportunities
 - ❖ Claims & Terminations Webinar - [REGISTER HERE](#)

have a qualified staff”, “we were too busy working on bid proposals”, “time just got away from us”, “the guard dog ate the computer”, or “our CFO is in prison”. An “exceptional circumstance” which could have reasonably been overcome (e.g., could have engaged outside personnel to assist with ICP) will likely be greeted with ACO frustration and, at worst, unilateral determination of final indirect rates by the government.

If on the other hand you are supremely confident that you can meet the required submission deadline, now is the time to begin planning for preparing the FY 2012 ICP. Assigning responsibilities to staff and milestones for completion is the first step, followed by identification of risks that could hinder the timely completion of the ICP. Dilemmas that frequently plague contractors, which must be overcome before populating an ICP, include known lapses in supporting expense transaction data, improper posting of direct costs to contract ledgers (which will require revisiting), known billing errors which will require adjustment for accurate ICP display (Sch. I of ICP), and resolving costs held in suspense for any number of reasons.

Although final year-end closing may not have taken place, your accounting gurus should nonetheless pull a preliminary trial balance and calculate unadjusted final rates; begin populating ICP schedules with information that does not require cost adjustments such as Sch. J (subcontract info) and accounting changes & decisions (Sch. M); determine that the accounting treatment of costs incurred, in which final rates are will be displayed, are symmetrical to the accounting practices used to calculate 2012 provisional billing rates, and; evaluate sensitive expense accounts one more time for evidence of transactions at risk.

As you assemble the data into an excruciatingly attractive ICP, the lead preparer should utilize the DCAA ICP adequacy checklist, “GUIDE FOR DETERMINING ADEQUACY OF CONTRACTOR INCURRED COST PROPOSAL”, as a benchmark for assessing not only content but also organization of the ICP. Be aware that DCAA auditors often supplement the published DCAA adequacy checklist by adding other personal preferences for ICP organization or insisting that other data be provided which are clearly unnecessary as a condition for adequacy under DCAA policy. What too often happens is that the inability of the contractor to

predict auditor’s nonsensical and peculiar expectations outside the DCAA policy-determined adequacy parameters will nonetheless yield an audit assertion of inadequacy” with ACO concurrence (or more accurately, ACO ambivalence).

Nevertheless, our message to government contractors: NOW is the time to outline ICP preparation procedures and responsibilities, work on known problem 2012 accounting and/or cost transaction issues, and lay out the schedules and templates that will require population. NOW, not later, will reduce the risk of errors and permit a satisfactory time buffer before submission allowing for sufficient review and corrections/adjustments.

DCAA Access to Internal Audits: The Siege Continues

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

In what is rapidly becoming a losing battle (for contractors), government actions continue to pressure government contractors to release internal audits to government auditors (DCAA). The latest action is Section 832 of the 2013 NDAA (National Defense Appropriations Act) which has the title of *DOD Access To, Use Of and Safeguarding and Protections for Contractor Internal Audit Reports*. Section 832 is somewhat innocuous to the extent that it requires nothing of defense contractors, but does require DCAA to revise its guidance on access to defense contractor internal audit reports to include certain documentation:

1. Written determination that access is necessary to complete required evaluations of contractor business systems,
2. A copy of the DCAA request to the contractor, and
3. A record of the response from the contractor including the contractor’s rationale or justification if access to requested reports was not granted.

We suspect that items 1 and 2 will become standardized wording or templates to go along with another superficial requirement, that DCAA’s guidance “must also have safeguards to ensure that contractor internal audit reports cannot be used by DCAA for any other purpose other than

evaluating the efficacy of contractor internal controls and the reliability of contractor business systems”.

Section 832 goes on to paraphrase government auditing standards that “contractor internal audit reports may be considered in determining whether or not a contractor has a sound system of internal controls, but shall not be the sole basis for such determination”. Finally, Section 832 also requires a GAO follow-up review and report.

Although the 2013 NDAA does not overtly compel a contractor to provide internal audits to DCAA, the 2013 NDAA taken in conjunction with the final DFARS Business Systems rule (February 2012) all but seals the fate of those DOD contractors subject to the DFARS Business Systems’ Rule. Specifically, the final DFARS rule modified criterion #8 for an acceptable accounting system to now require “management reviews or internal audits of the system to ensure compliance with the contractor’s established practices”. Noting that DCAA audits will expect contractor documentation which demonstrates compliance with each of the applicable criterion, it will be risking an almost automatic DFARS Business Systems deficiency and a 5% withhold if a contractor does not perform and provide to DCAA business systems internal audits or management reviews.

Of some note, the DFARS Business Systems Rule as well as the 2013 NDAA reference to business systems would seem to limit the government’s interest in contractor internal audits to relatively large defense contractors (i.e. subject to CAS because the DFARS withholding contract clause only applies to reimbursable CAS covered contracts). This seemingly narrow application or interest is coincidentally supported by an August 2012 DCAA audit policy (12-PPS-019) wherein DCAA field offices are only required to track internal audit requests served on “major contractors” (those with annual auditable dollars of \$120 million or more). DCAA’s policy makes reference to non-major contractors, but almost as an afterthought and certainly with no emphasis on anyone other than large defense contractors.

As some may recall, the government lost the battle for access to contractor internal audits in 1988 in *United States v Newport News Shipbuilding and Dry Dock Co.*, 862 F .2d 464 wherein the decision concluded that the work product of the internal auditors was not “cost verification data”. Years later (late 2011) the GAO issued a report which was critical of DCAA’s

failure to request contractor internal audits with the implications that DCAA could reduce its audit scope through reliance on the internal audits. As discussed in our August 2012 newsletter, DCAA, reacting to the DOD-IG report and perhaps anticipating Congressional interest in the matter, issued an audit policy (12-PPS-019) which requires field auditors to request relevant contractor internal audit reports and to log and track those requests for “major” contractors (Editor’s comment: DCAA’s existing policy largely pre-empted the requirements imposed by the 2013 NDAA; hence, DCAA will only need to make very minor revisions to comply with the specific requirements of Section 832 of the 2013 NDAA).

Notwithstanding the long-standing Newport News case, the issue of access to contractor internal audit reports seems to be anti-climactic based upon the fact that many contractors already provide some form of access. The access (which has been granted) may be limited to read only access of the internal audit reports, it may or may not involve access to internal audit work papers or to the internal auditors themselves, but in any case, this issue has largely evolved well beyond the 1988 Newport News issue wherein DCAA was denied any access to any internal audit reports. There may be major contractors who do not allow DCAA access to internal audits and those contractors can expect (or continue to expect) demands from DCAA for access to internal audits along with renewed threats of a DCAA subpoena demanding internal audits; last served on Newport News in 1988, but now being mentioned in DCAA’s 2012 audit policy 12-PPS-019.

For those with an optimistic view of life as a defense contractor, the GAO and now the Congressional interest in DCAA access to internal audits may provide pressures on DCAA to actually consider reliance on the work of contractor internal audits. This has been noticeably missing even before the 1988 Newport News case and it continues today as DCAA will not commit to rely on contractor internal audits and even if DCAA states that it is placing some reliance on internal audits, such reliance has no measureable impact on the DCAA audit scope (as if DCAA pre-determines the audit hours with or without the contractor internal audit). Unfortunately the biggest obstacle hindering DCAA reliance on internal audits remains DCAA’s ultra-conservative interpretation of government auditing standards concerning reliance on the work of others; specifically DCAA CAM 4-1000 (Contract Audit Manual) which implicates significant testing and documentation of the professional competence, independence

and objectivity of the internal auditors and along with work product, all consistent with standards adopted by the Institute of Internal Auditors.

Prior to 2009 (when DCAA was relatively efficient in performing audits), it had been more time consuming for DCAA to document its reliance on the work of others than it was to complete the audit without considering such reliance. As DCAA audits have grown exponentially in scope and breadth (requiring 10-times the hours to complete, current audits compared to audits completed prior to 2009), there may finally be some return on investment within DCAA's documenting reliance on the internal audit reports. At least in theory, everyone gains if DCAA actually relies on internal audit reports and such reliance actually reduces the DCAA audit hours as well as the contractor hours to support DCAA audits. All of the external attention (GAO and 2013 NDAA) to DCAA access to defense contractor internal audits may yield some positive results which would not have occurred had DCAA been left to demand internal audits, not for reliance but for "audit leads".

That said, absolutely no defense contractor should place any reliance on the 2013 NDAA Section 832 wording that DCAA audit policies "must ensure that contractor internal audit reports cannot be used by DCAA for any other purpose other than evaluating the efficacy of contractor internal controls". Just like any other document released to DCAA, once it's released to DCAA, the contractor has little or no control over DCAA's use or misuse of that document in terms of potential business systems issues, cost allowability issues, referral to investigative agencies, or as experienced by one contractor, DCAA second-guessing the contractor's compliance with the standards of the IIA or Institute of Internal Auditors (as if DCAA is qualified to determine compliance with IIA standards). Unfortunately, contractors cannot naively trust DCAA auditors to "do the right" thing because "the right thing" is all a matter of perspective.

Sequestration: Latest Scoop & Impact on Contractors

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

Much has been written over the past few weeks by news commentators, economic experts, and bloggers on the likelihood of a federal spending sequestration event which would result in huge government spending cuts, and the impact that draconian federal budget constraints will have on the government contracting community.

Although no expert can accurately predict if the event will occur nor specifically project how sequestration will play out, one thing seems to be for sure: the decision to extend the deadline for a legislative and executive branch compromise (spending cuts and tax increases) from January 2 to March 1 has convinced many observers that sequestration is now more likely to occur, one which could have a significant impact on government fiscal year 2013 spending, particularly the Department of Defense's funding.

Should sequestration take hold on March 1, 2013, government contractors can expect a number of possible or probable government procurement initiatives to take place to reduce spending. The initiatives and impact on contractors should be nothing new to the informed government contractor, given the barrage of cautions and warnings that have been published in news articles over the past weeks.

The Office of Management and Budget (OMB) has called for all federal agencies to plan for federal employee furloughs, hiring freezes, and early retirement incentives, which will reduce services available by government procurement agencies to government contractors, or at a minimum, slow the award, administration, and close-out of government contracts. More precisely, contract awards, payments to contractors, funding adjustments, problem resolution, etc. could be delayed; further, responsiveness to contractor inquiries, issues, and problem resolution will not be timely. The most onerous impact of limited government procurement services to government contractors include restricted contractor cash flow and threats to business sustainment if delays occur in payments for services, contract awards,

processing increased contract funding, or prompt resolution of issues involving withholds applied to contractor invoices.

Given the government's belief that cost plus and T&M contracts are risky by their very nature, expect to see a move to more FFP contract awards to reduce contract risk to the government. And, cost reduction initiatives may include partial or complete contract terminations, or more likely existing contract scope reductions via a contract change clause since terminations precipitate contractor entitlement of more expenses incidental to that action. Where contractors currently have a number of cost reimbursable contracts, be aware that the incremental funding contract clauses allow the government to discontinue further funding even if the originally anticipated contract work is not completed. For contractors with "task order" contracts, the most likely outcome is simply a reduction in the number of future task orders as necessary to reduce overall government obligations.

Other possible outcomes of sequestration include downsizing of key programs, more expedient resolution of outstanding claims with government contractors (better to pay now than later), continued pressure on DCAA and DCMA in their cost recovery plan, and shifting of spending to lower cost initiatives. We believe that DOD government contractors are likely to take the biggest hit as a result of sequestration, should that possibility become reality.

Government spending cuts, in whatever magnitude or form, will for many contractors necessitate due diligence to mitigate the adverse effects of sequestration. A few risk mitigation actions that contractors should consider or reconsider, as already exhaustively delineated in previous news articles, include:

- Determine if a shift in business development toward commercial (non-government) opportunities is in order; if your company currently maintains a competitive posture in the commercial market, now may be the time to divert selling effort toward those customers.
- Evaluate existing financial and operational policies and practices to determine if processes most frequently evaluated by the government are in good shape; in a presumably more competitive government market, maintaining compliant and acceptable business systems will improve your chances for future contract awards. Consider internal compliance

reviews of business systems (accounting, property management, quality control, procurement, etc.) to identify and correct inefficient and/or non-compliant systems.

- Review cost and revenue budgets to ascertain where spending cuts can be achieved, and revise those budgets for purposes of bidding on future work; as painful as it may be, loss of contract work may require human resource adjustments including consolidating job responsibilities, furloughs, or layoffs.
- Maintain continuous contact with existing government customers, purpose of which is gauging the likelihood of contract scope reductions, reduction in funding, withholding of prospective contract awards currently in bidding stages, terminations, and any delays in payment of services. Contractors should also determine the extent in which government procurement communication may be limited in the future whereby contract performance could be impaired.
- Reassess your existing subcontracting policy and ascertain if existing subcontracted work could be brought back in-house.

In light of the continuing but expanding uncertainties of the federal budget, every contractor should be or should become knowledgeable of your rights for cost recovery should contract work be terminated, reduced or restructured (e.g., teaming arrangement), and get familiar with compliant practices in filing equitable adjustment or termination proposals.

Training Opportunities

2013 Redstone Government Consulting Sponsored Seminar Schedule

February 7, 2013 – Claims and Terminations
WEBINAR – [REGISTER HERE](#)

March 7, 2013 – DFARS Business Systems
WEBINAR

March 20, 2013 – Government Audits
Huntsville, AL



March 21, 2013 – Cost & Price Estimating Strategies
Huntsville, AL

March 26, 2013 – Contractor Purchasing System Review (CPSR)
WEBINAR

April 8, 2013 – Pre- & Post-Award Contractor Accounting Systems
WEBINAR

April 25, 2013 – Incurred Cost Submission – Adequacy Requirements & Prep
WEBINAR

May 21, 2013 – Incurred Cost Submissions (ICS)
Huntsville, AL

May 22, 2013 – Incurred Cost Audits & Issue Resolution
Huntsville, AL

June 11, 2013 – Incurred Cost Submission – Adequacy Requirements & Prep
WEBINAR

2012 Federal Publications Sponsored Seminar Schedule

February 12-13, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Arlington, VA

February 21-22, 2013 – Accounting Compliance for Government Contractors
Arlington, VA

April 10-11, 2013 – Accounting Compliance for Government Contractors
Orlando, FL

May 7-9, 2013 – The Masters Institute in Government Contract Costs
San Diego, CA

May 14-15, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Las Vegas, NV

July 8-9, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Hilton Head, SC

August 5-6, 2013 – Accounting Compliance for Government Contractors
Washington, DC

August 7-8, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Washington, DC

August 7-9, 2013 – The Masters Institute in Government Contract Costs
Washington, DC

October 9-10, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Orlando, FL

October 21-22, 2013 – Accounting Compliance for Government Contractors
Arlington, VA

December 4-5, 2013 – Accounting Compliance for Government Contractors
Las Vegas, NV

Instructors

- Mike Steen
- Darryl Walker
- Scott Butler
- Courtney Edmonson
- Cyndi Dunn
- Wayne Murdock
- Asa Gilliland
- David Fletcher

Go to www.fedpubseminars.com and click on the Government Contracts tab.

Specialized Training

Redstone Government Consulting, Inc. will develop and provide specialized Government contracts compliance training for client / contractor audiences. Topics on which we can provide training include estimating systems, FAR Part 31 Cost Principles, TINA and defective pricing, cost accounting system requirements, and basics of Cost Accounting Standards, just to name a few. If you have an interest in training, with educational needs specific to your company, please contact Ms. Lori Beth Miller at lmiller@redstonegci.com, or at 800-416-1946.



Redstone Government Consulting, Inc. is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: www.learningmarket.org.

About Redstone Government Consulting, Inc.

Our Company's Mission Statement: RGCI enables contractors doing business with the U.S. government to comply with the complex and challenging procurement regulatory provisions and contract requirements by providing superior cost, pricing, accounting, and contracts administration consulting expertise to clients expeditiously, efficiently, and within customer expectations. Our consulting expertise and experience is unparalleled in understanding unique challenges of government contractors, our operating procedures are crafted and monitored to ensure rock-solid compliance, and our company's charter and implementing policies are designed to continuously meet needs of clients while fostering a long-term partnership with each client through pro-active communication with our clients

In achieving government contractor goals, all consulting services are planned and executed utilizing a quality control system to ensure client objectives and goals are fully understood; the right mix of experts with the proper experience are assigned to the requested task; clients are kept abreast of work progress; continuous communication is maintained during the engagement; work is managed and reviewed during the engagement; deliverables are consistent with and tailored to the original agreed-to scope of work, and; follow-up communication to determine the effectiveness of solutions and guidance provided by our experts.



REDSTONE
Government Consulting

Formerly Beason & Nalley Government Compliance Group

Redstone Government Consulting, Inc.

Huntsville, AL
101 Monroe Street
Huntsville, AL 35801
T: 256.533.1720
Toll Free: 1.800.416.1946

Email: info@redstonegci.com
On the web: www.redstonegci.com