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DCAA Issues Guidance Clarifying Allowable Health Benefits & Travel Per Diem

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

In two separate March 2013 guidance memorandums, the Defense Contract Audit Agency (DCAA) officially (and finally) retracted its previous position on defining ineligible dependent healthcare costs as expressly unallowable, and clarified the intent of FAR 31.205-46 in determining allowability of claimed per diem amounts.

In August 2009 guidance to auditors, DCAA asserted that costs for ineligible dependent healthcare benefits are "expressly" unallowable per FAR 31.205-6(m), and therefore subject to the penalties provisions (FAR 42.709) if such costs were included in certified indirect cost rate proposals. That guidance also encouraged auditors to determine if contractor internal controls were sufficient to identify the unallowable costs, and if not, issue reports citing the absence of controls to capture such unallowable costs as systemic deficiency in addition to a separate CAS 405 non-compliance report if applicable. A follow-up DCAA February 2011 memo reminded auditors to request "cost impact proposals" from those contractors with contracts subject to the administrative CAS provisions (FAR 52.230-6) identifying the impact of the non-compliance on CAS covered contracts.

In a February 2012 memo to DCAA and the Defense Contract Management Agency (DCMA), the Director, Defense Pricing (DDP) provided its regulatory take on ineligible dependent health care costs, and agreed with DCAA that those costs would be unreasonable under FAR 31.201-3 and therefore in violation of the FAR 31.205-6(m); however the DDP effectively removed ineligible dependent health care benefits from the "expressly unallowable" category by stating that DOD would not pursue application of FAR 42.709 penalties on those costs.

THIS ISSUE:

Thirteen months after DPAP's memo, DCAA's March 2013 memo (13-PAC-004(R)) finally admitted that its previous guidance was inaccurate by stating that "these unallowable costs are not expressly unallowable" and not subject to penalties. In remedying the impact of its flawed guidance issued two and one-half years before, DCAA has instructed its auditors to supplement/revise any previously issued reports or documents which inappropriately deemed ineligible dependent healthcare benefits as expressly unallowable (and subject to penalties) with verbiage correcting or reversing its prior audit position, and re-issuing those revised documents to applicable government users/customers. Moreover, DCAA field offices must disclose to contracting officers who previously received CAS 405 non-compliance reports, issued as a consequence of identifying unallowable dependent healthcare benefits costs, the nature of the subsequently acquired data (e.g., DDP January 17, 2012 memo correcting DCAA's assertion of "expressly unallowable") and the effect such inaccurate information has on the prior DCAA reported non-compliance assertions.

The second DCAA March 2013 instruction clarifies the FAR 31.205-46(a)(2) regulatory intent for determining if contractor claimed per diem costs (consisting of two components—lodging and meals & incidentals (M&I)) are within the allowable applicable government travel regulations' per diem ceilings. Although the government travel regulations identify a ceiling for two distinct per diem components (lodging separate from M&I), government contractors are subject to only one ceiling, which is total lodging plus M&I. This means that the contractor daily per diem amounts would be questioned only if the total lodging plus M&I (single amount) exceeded the total ceiling (combination of lodging plus M&I) stipulated within the applicable government travel regulations. The memo calls attention to DCAA's own guidance (Contract Audit Manual 7-1002.3c(2)) which states that contractors are held to a single (combined) daily maximum per diem rate.

The per diem guidance was obviously released because auditors frequently measure allowability of per diem by separating contractor lodging and M&I costs and comparing those individual components to the individual per diem amounts identified in respective government travel regulations. The auditors' misapplication of the daily per diem ceilings regulatory intent, during reviews of contractor cost claims, has often resulted in overstated questioned costs as well as assertions of contractor systemic internal controls deficiencies. The auditor's flawed conclusions, whether delivered to the contractors during informal exit meetings or formally reported to government customers have created unnecessary and costly contractor administrative effort in responding to corresponding reported audit findings, not to mention, contractually incorrect Administrative Contracting Officer (ACO) decisions because the ACO relied on DCAA's flawed application of FAR. Contractors which formerly were acquiesced and accepted the incorrect outcomes of per diem reviews without question should take notice of this DCAA memo: it is clear that, without question, auditors are to cease and desist from determining allowable per diem via individual component comparison to travel regulatory ceilings.

The DCAA audit policy concerning per diems and the distinctions between FAR 31.205-46 and Government Travel Regulations (JTR/FTR) also serves as a reminder that FAR 31.205-46(a)(4) clearly states that with respect to incorporating the JTR/FTR, "only the maximum per diem rates, the definitions of lodging, meals and incidental expenses, and the regulatory coverage dealing with special or unusual situations are incorporated herein". Hence, contractors should not necessarily accommodate DCAA auditor DCAA assertions based upon other provisions in the JTR/FTR (expressly not incorporated into FAR as stated in 31.205-46(a(4)).

DOD Issues Final DFARS Proposal Adequacy Checklist

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

In spite of numerous public comments suggesting that a DOD Proposal Adequacy Checklist was a non-value added document in an already expensive proposal preparation process, the wise and all-knowing DAR Council issued its final rule on March 28, 2013 to incorporate a Proposal Adequacy Checklist for proposals which require certified cost or pricing data. The 12 page Proposal Adequacy Checklist is quite similar to the pre-existing DCAA proposal adequacy checklist although the DFARS checklist has eliminated a few of DCAA's items (tacitly confirming that DCAA routinely overstates

anything actually required or invoked by the relevant regulation, in this case FAR 15.408).

The checklist will be incorporated into DFARS 215.408 along with an associated solicitation provision at 252.215-7009 "to ensure that offerors take responsibility for submitting thorough, accurate and complete proposals" (Editor's comment: apparently submitting current, accurate and complete proposals as certified using FAR 15.406-2 isn't quite good enough for DOD which requires "thorough" proposals instead of "current" proposals—as if "thorough" is defined anywhere in any regulation).

The final DFARS rule noted that fifteen respondents submitted "public comments" and with rare exception, most of the public comments were summarily dismissed with the DAR Council responses that: "it (Proposal Adequacy Checklist) aims to achieve cost savings by improving initial proposal submissions from contractors" and the provision "intends to increase uniformity across DOD, minimize local variations, and thereby decrease proposal preparation costs". In furtherance of its predetermination to incorporate an adequacy checklist which is eerily similar to DCAA's checklist, the DAR Council states that this provision results from a long history of incomplete proposals resulting in "rework and lost time", by implication accepting DCAA's assertions that contractor bid proposals are typically inadequate when initially submitted. Of course no one, including the DAR Council, has ever validated DCAA's assertions nor the fact that DCAA's view of proposal adequacy is highly subjective and a self-serving strategy for blaming contractors for DCAA's inability to timely complete even high priority bid proposal audits. DCAA's invention of adequacy checklists has served one primary purpose which is to mask DCAA's failings (inability to timely audit) and to its credit, DCAA has done an outstanding job of convincing DOD and Congress/GAO that "it's always the contractor's fault".

The absurdity of the checklist or at least the grossly overstated value of the checklist is self-evident in one particular public comment and DAR Council response:

Comment: The checklist will improve efficiency on both sides of the contract and that DOD will save time because they will have all the answers they need to determine which contractor is best for the Government.

Response: This comment accurately expresses the goals of this rule.

Apparently neither the commenter nor the DAR Council is the least bit familiar with FAR Part 15 and the requirements for and/or the exemptions from certified cost or pricing data; in particular that adequate competition will likely negate the requirement for certified cost or pricing data which would also negate the applicability of the Proposal Adequacy Checklist. Certainly, "Determining the best contractor for the Government" implicates adequate competition; hence, an exemption from certified cost or pricing data. Based upon that point of reference, it is apparent that the authors of the regulation don't actually understand FAR Part 15; hence, we can't think of any process which would be of any less value than to have someone author a regulation even though they apparently don't have any familiarity with the underlying regulations which invoke certified cost or pricing data. To paraphrase an old cliché: "Why confuse the rule making process by using someone (rule-writer) who actually understands the rule in actual application.

In any case, with or without the prerequisite knowledge of FAR provisions which invoke certified cost or pricing data, the new rule defies all logic that the DAR Council would have endorsed the over-simplistic public comment that a checklist will "have all the answers they need to determine which contractor is best for the Government".

Although we would like to find some redeeming value in the proposal adequacy checklist, there are none unless it's the fact that it is optional; specifically, contracting officers should (vs. shall) include 252.242-7009, Proposal Adequacy Checklist (noting that the DAR Council specifically rejected a public comment/recommendation to make it mandatory). Fortunately, it is also optional for prime contractors to require subcontractors to complete the same "invaluable" checklist. There is simply no value in a generic proposal adequacy checklist whose stated objective is to increase uniformity across DOD and to decrease local variations as if every DOD solicitation is the same. In that context, DFARs 252.242-7009 makes no reference to solicitation specific requirements, and therein the DAR Council rejected public comments suggesting that solicitation specific criteria displace the generic criteria. In this particular rejection of a valid, logical public comment, the DAR council is ignoring long-standing practices by competent procurement agencies to provide more specific instructions

and formats to minimize subjective and non-value added interpretations of generic FAR or DFARS requirements. Once again, the DAR Council seems to be operating without any benefit of any practical knowledge or relevant facts which unfortunately facilitates the issuance of a DFARS requirement with absolutely no value other than "form over substance".

A final observation and blatant example of "form over substance", the checklist requires an explanation for any checklist item not provided giving a "thumbs down" to a public comment/recommendation that the form add "not applicable" as an acceptable response/column heading. Even though several checklist items are frequently going to be not applicable, apparently it won't be as simple as checking not applicable. Just one example, item 32 which is solely related to price revisions/redeterminations which will most frequently be "not applicable"; the offeror must "provide an explanation" which would most likely state not applicable because this is not a price revision/redetermination; clearly "form over substance".

There are checklists which have some value such as pre-flight checklists and observations by pilots; conversely, there are checklists which purely "paper the file". The Proposal Adequacy Checklist is the latter and it will predictably not improve the bid proposal process, but if DCAA is involved, it will result in extraneous debates as to the sufficiency/accuracy of the checklist. The DAR Council did reject a public comment suggesting penalties for a contractor failing to properly complete the checklist, stating that the checklist is a tool.

Editor's comment: We did not list or discuss the items in the checklist assuming that many DOD contractors would already be familiar with the criteria within the checklist given the similarity of the pre-existing DCAA Proposal Adequacy Checklist with the DFARS Proposal Adequacy Checklist with (which can be obtained by accessing the https://www.federalregister.gov and search on DFARS 252.215-7009).

Contractor Agrees to Reimburse Employees for Back-Wages after Cited SCA Violation

Contractor Dilemma: Are Back-pay Amounts Allowable?

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

An investigation conducted by the U.S. Department of Labor's (DOL) Wage and Hour Division for compliance with the McNamara-O'Hara Service Contract Act (SCA) and the Contract Work Hours and Safety Standards Act (CWHSSA) revealed that CH, Inc. violated the provisions of these two statutes by underpaying 35 employees $268,899 in fringe benefits and overtime which, under the statutes, those employees were entitled/required to receive.

The DOL March 28th press release which disclosed the Wage and Hour Division (WHD) investigation outcome noted that the contractor failed to pay SCA stipulated fringe benefits of up to $3.59 per hour to part-time employees; application of SCA fringe payment applies to all employees and does not distinguish among temporary, part-time, or full time employees. The WHD also found that CH, Inc. did not accurately reimburse employees for overtime worked within the CWHSSA guidelines.

Contractors with awards subject to the SCA are required to compensate service employees no less than prevailing labor classification wage rates and fringe amounts "prevailing in the locality" in which those employees perform services for an SCA contract, the minimum wage rates of which are often tied to the "Wage Determination Guidelines" schedules, or rates found in a predecessor's collective bargaining agreement. Further, the CWHSSA, applicable to federal service contracts and certain construction contracts over $100,000, requires payment of overtime equal to one and one-half of basic hourly rates for all hours worked in excess of 40 hours during a work week.

CH, Inc. agreed to pay the back wages to the employees for services performed, ostensibly in the form of retroactive adjustments to prior period salaries, and a question arises among contractors whether back wages, in this scenario, are

allowable under the FAR 31.205-6 "Compensation" cost principle.

Back-pay is expressly *unallowable* under FAR 31.205-6(h), with an exception pertinent to the CH, Inc. scenario: if back wages are owed as required by a "negotiated settlement, order, or court decree", and the underpayment is clearly tied to "actual work performed", back pay is clearly an allowable expense.

Given that a government agency (DOL), through an investigative process, rendered the contractor in violation of two federal statutes (and implementing contract clauses), moreover having calculated specific underpaid wage amounts directly linked to the violation, any contractor facing this scenario should be able to support back wages as an allowable expense billable to the applicable government contract(s) under which those employees worked. Although the DOL press release does not expressly note in what context a settlement was reached between CH, Inc. and the DOL, it is obvious that an agreement was executed between the two parties requiring the contractor to pay the back wages to retroactively comply with the applicable statutes and contract provisions.

Government auditors and procurement officials, however, may differ in application of the FAR 31.205-6(h) criteria when back wages are allowable, whether arising from a federal investigation with a clear mandate to retroactively restore affected contractor employees, or from a self-initiated contractor internal review the outcome of which is retroactive pay adjustments to employees (as a matter of complying with federal regulations) without a negotiated settlement, order or court decree.

Government auditors and procurement officials have not traditionally recognized any back wages as allowable unless there is documented "negotiated settlement, order, or court decree", which implicitly suggests that a government or employee initiated evaluation and/or litigation process must have been in play preceding a written mandate for payment of back-wages. Hence, contractor self-disclosure of wage underpayments whereby contractors voluntarily restore employees' salaries will not fulfill the FAR 31.205-6(h) contractual requirements for allowable back-pay unless evidence of a documented settlement, order or court decree can be produced.

COFC Denies Gov't Claim for $80 Mil due to CAS Noncompliance, Affirms Gov't Filing within Statute of Limitations

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

The Court of Federal Claims (COFC) dismissed a Government claim (under the Contract Disputes Act) mandating that Sikorsky Aircraft Corporation pay $80 million resulting from an alleged CAS 418 non-compliance. In that same March 27, 2013 ruling, however, the court dismissed Sikorsky's initial assertion that the government claim was not submitted within six years after the accrual of the claim which is required under the Statute of Limitations (FAR 33.206).

The government claim first arose from a DCAA audit of a change in cost accounting practice effective in January 1999 in which Sikorsky changed its allocation base for a materials overhead pool from a direct materials costs base to a direct labor costs base. DCAA issued a report in July 1999 which concluded that the contractor did not comply with CAS 418 because the revised allocation base did not reflect an appropriate base for assigning pool costs to government contracts. However, a February 2000 cost calculation quantifying the impact of the noncompliance was deemed "beneficial to the government", and the auditor confirmed that shift in costs were only "possibly" (not for sure) due to the non-compliance. Thus the issue was dropped until another audit was conducted beginning in August 2002, with field work concluded in December 2003 and a report issued in October 2004 which revived the CAS 418 non-compliance. The contracting officer evaluated the non-compliance cost impact occurring from 1999 to 2005 and issued in March 2007 a notice of "potential non-compliance", with a final decision in December 2008 and an $80 million government claim against Sikorsky.

Sikorsky argued that the "accrual of the claim", the point in time at which the government had reasonable grounds to know of a potential violation, was February 2000, the date the first CAS 418 non-compliance cost impact was presented to the government. Because the time span between the contracting officer's decision, December 2008, and the Sikorsky February 2000 cost impact calculation, had

surpassed the six-year period limitation for filing a claim, Sikorsky argued that the government had lost its opportunity to seek a claim. The Court disagreed, stating that December 2003, the approximate time frame the auditor concluded its second CAS 418 examination and defined a cost impact for the contractor's fiscal year 2003, was the earliest point at which the government had actual or constructive knowledge of a CAS violation, thus a claim accrual—more precisely, until the auditor had gathered and assimilated updated information in the second audit confirming an adverse impact to the government, no claim had accrued. Because the December 2008 contracting office claim was presented within six years from December 2003 (point in time which the court deemed an accrual of claim existed), the government had met the Statute of Limitations requirement for a contracting officer final written decision within six years of the accrual date.

Having concluded that the government met the six year time restriction in filing a claim, the court reviewed that government's assertion that the direct labor dollars allocation base for a material overhead pool contravened CAS 418. The government's case and the court's decision centered on CAS 418-50(d) and (e) allocation base guidelines The regulations state that when an indirect cost pool contains a "material amount of costs of management or supervision of activities involving direct labor or direct materials", the allocation base should represent the activity being managed, (one example being material cost base); on the other hand if a pool does not include material amounts for these management activities, the regulation provides that a resource consumption method is to be used, with a three tier selection process including, in order of preference: (I) a base reflecting resource consumption of the activities of the pool, (2) measurement of output, and lastly a (3) surrogate base that "varies in proportion to the services received" by the cost objectives to which the pool costs are allocated. DCAA asserted that the pool contained "material" amounts of management activities, thus a base of the activity managed (materials) was appropriate and required.

The court disagreed, finding that the overhead pool did not contain significant costs for management of direct labor and materials, therefore permitting the use of a "surrogate" base, the third alternative stipulated in CAS 418-50 (e) because the first two alternatives were not practical. The court noted that a clear correlation between direct labor and material overhead costs exists (based on examination of 2003 through 2005 trend analyses), and therefore concluded that the direct labor cost base, which varied in proportion to the material overhead services rendered, represented a suitable "surrogate" allocation base compliant with the CAS 418 allocation parameters.

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