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GAO Report on Capping DOD Contractor Salaries: Huge Increases in Unallowable Wages & DOD Cost Savings

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

The Government Accountability Office (GAO) released a report on the impact of potentially lowering the current annual government contractor employee wage ceilings, which are reimbursed under government contracts, to the annual salaries for either the President's ($400,00) or Vice-President's salary of ($230,700)--the obvious outcome of the analysis: a potential huge reduction in DOD payouts to government contractors. The analysis was a requirement of the FY 2013 National Defense Authorization Act with the primary task of comparing average wages for contractor employees to pre-determined benchmark salary levels for the two White House senior executives, and to the existing FAR regulatory salary ceilings for fiscal years 2010, 2011, and 2012 (the 2011 salary ceiling remains the cap for 2012 and beyond because the government has conveniently withheld any increases notwithstanding the fact that the process had been an annual process).

The GAO reviewed compensation data provided by 27 government contractors for these three fiscal years, and matched annual wages for contractor employees to each of the proposed wage ceilings, e.g., President and Vice-President's salaries. The report noted that fewer than 200 employees in any one of the three fiscal years were paid compensation costs that exceeded existing regulatory ceilings (for FY 2012, ceiling is $763,029); however when using the lower ceilings as caps, e.g., President and Vice-President's salaries, the numbers of employees with annual compensation exceeding the salary of the President increased to over 500 and to over 3,000 employees if wage ceilings had been the same as the Vice-President' salary.

THIS ISSUE:

The GAO estimated that the annual unallowable contractor compensation for the selected 27 contractors would have risen from $80 million (existing regulatory ceilings) to $180 million if the ceiling benchmark were that of the President, and $440 million if the Vice-President's salary reflected the statutory ceiling.

Reactions from the Office of Management and Budget (OMB) and Congressional leaders were predictable and reinforced the government's position that regulatory contractor wage caps require reform because increases in those ceilings since 1998 have far out-paced general employment cost inflationary trends. Moreover, lawmakers remain outraged that allowable government contractor salaries are above those of the government's chief executives even if those government contractor wages are reasonable when compared to private sector wage levels and compliant with other relevant parts of FAR Part 31 Cost Principles.

After release of the GAO report, several U.S. Senators indicated support for proposed legislation, identified as the 2013 Commonsense Contractor Compensation Act, which would cap allowable contractor salaries to the Vice-President's salary; those caps would be applicable to all government contractors (DOD and civilian agencies) and to all contractor employees, rather than the top five executives of a contractor. Senator Barbara Boxer stated, "This stunning GAO report shows that thousands of government contractors are raking in taxpayer-funded-salaries that are significantly more than what the vice president of the United States and members of president's cabinet make". Charles Grassley mimicked other Congressional representatives whom support lowering of allowable contractor wage ceilings, stating "the direct taxpayer-funded salaries of contractors government-wide clearly need to be contained…" Reading between the lines, our U.S. government representatives and the White House leadership believe that the private sector commercial market place, of which government contractors are participants, should be discarded in establishing reasonable and allowable salaries for government contractors and supplanted with salary benchmarks equal to public sector executives.

Government contractor and private sector industry leaders pushed back, calling the GAO analysis "lacking in both context and depth". In its report, GAO did include industry associations' and contractor's responses to establishing wage benchmarks below those of a competitive market place. Contractor representatives stated that in order to be competitive in hiring and retaining highly talented employees, contractors must be prepared to offer market place wages. If the ability of contractors to recover a large amount of incurred employee wages via reimbursements under government contracts is strangled by unreasonably low and artificially established regulatory caps equal to that of the public sector, company cash flow may be restricted, profitability significantly affected, and risk of losing qualified personnel increased.

GAO's comparative analysis of President/Vice-President wages to compensation paid to contractor is inherently flawed in that an "apples to apples" analysis was not utilized. The annual contractor salaries the GAO obtained from the selected government contractors apparently included all compensation components as defined by FAR, e.g., wages, salary, bonuses, deferred compensation, and employer contributions to defined contribution pension plans. On the other hand, the Vice-President's and President's salaries that were used as a baseline to determine gaps between government executive and contractor salaries do not include other benefits provided to the President and Vice-President. These "other benefits" include immeasurable amounts for lifetime security, taxpayer paid meals, travel and personal support, a pension plan second to none (payout as a function of years of service), and almost unlimited deferred compensation as a direct result of having been the Government's Chief Executive or Deputy Chief Executive.

DCAA Fiscal Year (FY) 2012 Report to Congress

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

DCAA recently posted its second Annual (FY 2012) Report to Congress including a number of informational items as stipulated in 10 U.S.C. 2313a. As with its first Annual Report to Congress (FY2011), DCAA highlights its accomplishments, takes credit for protecting the taxpayer and makes its case for additional regulations which would purportedly eliminate "significant deficiencies" in the audit process as if every significant deficiency impeding DCAA's quest for the perfect,

high quality GAGAS (Government Auditing Standards) audit is related to some external obstacle, recalcitrant contractors or the absence of regulations shifting more and more responsibility to contractors.

In this case, "responsibility" is code for regulations which require absolute standardized structure forcing contractor assertions to all look alike, thus making it easier for the average auditor to appear to audit contractor representations instead of adequately training auditors on the fine art of understanding and auditing a specific contractor's assertions. In the view of this experienced auditor, DCAA continues to pursue "form over substance" to complement its audit strategy of "form over substance". Undoubtedly DCAA has a valid mission to protect our (taxpayer) collective investment in the procurement process; however, it is increasingly difficult to determine if and how DCAA is protecting the taxpayer because DCAA's Annual Report to Congress is primarily focused on protecting DCAA.

For anyone reading DCAA's annual reports, including Congress, it should be noted that these annual reports are significantly different than corporate annual reports because DCAA's annual reports are not subject to any authoritative reporting standards. Translated, nothing requires DCAA's Report to Congress to adhere to consistency standards or to avoid misleading misrepresentations of results.

Additionally, DCAA's Annual Report to Congress is unaudited, which further casts doubts upon the reliability of the report notwithstanding the fact that DCAA would undoubtedly stand-by its results, at least until an independent and unbiased critical assessment reported the following:

- DCAA continues to present and highlight a graphical depiction of its cost questioned as a percentage of dollars examined over a period of years beginning with 2002. That graphical representation shows that beginning in 2009, DCAA has dramatically increased its relative percentage of cost questioned (coincidentally the year in which DCAA's current Director assumed that role). In 2002 that percentage was 2.3 percent and it never exceeded 4 percent until 2009 when it was 6.8 percent and thus far topped-out at 9.3 percent in FY2011. In reporting its "success", DCAA fails to fully disclose that the percentages for any given fiscal year are based upon a very different audit mix and that different audits yield significantly different relative percentages of cost questioned. In particular, beginning in 2009, DCAA has all but abandoned incurred cost audits in favor of bid proposal audits and the latter have a higher relative payback; approximately eight-to-one in comparison to incurred costs. In the years 2008 and before, incurred cost audits constituted a much larger percentage of DCAA's overall audit mix; hence, the years 2008 and prior would have a much lower relative percentage of cost questioned. The absence of any reporting standards facilitates this misleading but allegedly comparative chart and apparently none of the recipients of the report are all that interested in comparative data which actually reflects consistency in reporting.
- DCAA reports cost questioned data and trends without reporting the end results; specifically, DCAA does not and will not volunteer trends in sustention rates. Sustention rates represent the net effect after the contracting officer resolves (dispositions) the DCAA advisory reports. Using the limited amount of information contained in the DCAA Annual Report to Congress, one can estimate that DCAA's sustention rate is approximately 30 percent (for every dollar questioned by DCAA, a contracting officer actually sustains 30 cents in dispositioning the audit recommendation). Historically, prior to the new DCAA which prides itself on absolute compliance with Government Auditing Standards and protecting the taxpayer, DCAA was sustaining between 65 and 70 percent of cost questioned. One could attribute the dramatic decline in sustention rates to i) DCAA audits which disregard government contract regulations in favor of maximizing cost questioned based upon unsustainable interpretations of those regulations or ii) the failure of Contracting Officers to uphold DCAA's valid recommendations. Noting that DCAA has also embarked on a policy of referring Contracting Officers (who do not sustain DCAA audit recommendations) to investigative agencies and that the Contracting Officers must first clear internal review boards before not sustaining DCAA, we believe that DCAA's dismal sustention rate reflects a DCAA policy of questioning costs with little regard to the contract regulations. This is reflected in a recent situation wherein the auditor's basis for his/her

assertions with respect to challenging cost allowability: "I will know it when I see it" (an auditor explaining his/her regulatory basis for asserting that contractor documentation was not adequate and disallowing the incurred costs although the contractor had substantial documentation and an adequate accounting system).

- DCAA's Annual Report includes a discussion of "pending audits" for which DCAA is required by 10 U.S.C. 2313a to provide an assessment of audits pending for a period longer than allowed pursuant to guidance of the DCAA. Conveniently, DCAA never actually mentions any DCAA guidance and also explains that its management information system does not separate audits into a "pending" category. By implication, even if DCAA had guidance concerning timely audits, DCAA would be unable to report on any untimely, pending audits. DCAA then provides an example of a "pending" audit by reference to the annual requirement for an adequate annual incurred cost submission awaiting final DCAA action. DCAA's "example" is a FY2008 incurred cost submission received in FY2012 as if that example is representative. DCAA's example misrepresents reality by failing to report that a contractor FY 2008 incurred cost submission is actually due six months into FY2009 (June 30, 2009 for a calendar year ending December 31, 2008) and a very high percentage of contractor FY2008 submissions were received on or before June 30, 2009. One has to question why DCAA would pick this "example" other than to imply that contractor incurred cost submissions are delinquent and that like everything else, untimely DCAA audits are never caused by DCAA failings, but are attributable to contractor failures to provide adequate assertions (proposals).
- DCAA does (reluctantly) report its elapsed days for completing various categories of audits; notably DCAA "only" took 1,184 days (on average) to complete incurred cost audits measured from the date of receipt of an adequate indirect cost rate proposal to the audit report issuance date. Once again, DCAA fails to report the "rest of the story", in this case, that hundreds of contractor indirect cost rate proposals were rejected as inadequate long after these were initially submitted and deemed adequate by DCAA. That strategy conveniently restarted the elapsed day clock for hundreds of indirect cost rate proposals and significantly understated the true elapsed days measured against the date of receipt of the initial contractor proposals. DCAA's strategy of rejecting indirect cost rate proposals is based upon highly subjective criteria which are unsupported by the regulations until May 31, 2011, when the FAR was changed in terms of defining an adequate indirect cost rate proposal. As well established in government contracts, a FAR change is not retroactive; however, that minor issue has not prevented DCAA from wholesale rejections of contractor indirect cost rate proposals for inane reasons, but apparently consistent with management direction to reject contractor indirect cost rate proposals to maintain the ruse that untimely contract audits are "the contractor's fault". Certainly the frequency of DCAA rejections of contractor ICPs is such that the strategy is not that of a "rogue" auditor. DCAA also reports elapsed days for other types of audits and notably DCAA fails to volunteer any comparative data which would show that forward pricing (bid proposal) audits take 110 days compared to 30 days (FY2012 compared to FY2008 and prior). The 110 days is most likely understated because DCAA also utilizes its proposal adequacy checklist to "manage" the start date (date it receives an adequate bid proposal).
- DCAA reports significant deficiencies and recommended actions to improve the audit process and not surprisingly, the first deficiency is the adequacy of contractor forward pricing proposals (deficiencies are always attributable to contractors). DCAA prides itself on the fact that it proposed and the DAR Council bought the idea that this significant deficiency will magically disappear if contractors complete a proposal adequacy checklist (eerily similar to DCAA's proposal adequacy checklist although DCAA has yet to update its checklist to match "official checklist"—but DCAA is not known for rushing into anything). Unfortunately the actions of the DAR Council give credibility to DCAA's assertions as if contractor forward pricing proposals can be standardized to the point of a one size fits all adequacy checklist. In fact, the checklist is conceptually absurd to the extent it contains a number of mutually exclusive items (all items listed

on the checklist are to be included in a bid proposal cost volume or the contractor has to explain why an item is not provided—"not applicable" is not an acceptable answer even though it is the answer in many cases where items are mutually exclusive).

- DCAA asserts that in order to perform high quality audits, DCAA must obtain sufficient evidence to provide a reasonable basis for the conclusions expressed in the audit report specifically, that includes access to records including internal audit reports, online data, and contractor employees. Apparently DCAA has not consistently performed high quality audits because DCAA has not routinely requested contractor internal audits and contractors rarely provide DCAA with "online data" (unfettered access to accounting, purchasing, or personnel records). In fact, for purposes of an audit opinion on contractor assertions, no auditing standard requires access to internal audits, online data or to contractor personnel. Moreover, in spite of not having access (or not having requested such access) DCAA has issued unqualified audit reports for years. Either DCAA's "must have" access to records (or people) list is a misrepresentation or DCAA has been failing to perform high quality audits forever (including 2009 and beyond when the current Director assumed the role). In spite of DCAA's insistence that DCAA must have access to contractor employees, no regulation supports that other than in very limited circumstances including access to contractor employees charging labor to commercial T&M (Time & Material) contracts (FAR 52.212-4) or in the even more limited circumstance of cooperating with a government audit under a mandatory disclosure (FAR 52.203-13).

  In summarizing its position regarding access to employees, DCAA "strongly believes that having access to contractor employees is critical to ensure the high level of assurance required by GAGAS" (for the record, GAGAS requires reasonable assurance just like other auditing standards). DCAA further explains that some contractors have argued that DCAA's access to records does not include access to contractor employees; therefore DCAA believes that a change to FAR is necessary to ensure DCAA's timely access to employees. It appears that contractors are not only right (that DCAA's access does not extend to contractor employees), but DCAA is tacitly acknowledging that these "arguing contractors" are in fact consistent with the regulations.

  Oddly enough, DCAA's insistence that it must have access to contractor employees is in direct contradiction with DCAA's unwillingness to consider contractor employees as a source for after-the-fact explanations of contractor expenses. In cases where DCAA asserts that contemporaneous documentation insufficiently supports an incurred cost, DCAA discounts employee statements (further explanation) as non-contemporaneous; hence, unreliable corroborating evidence. If employee statements cannot be relied upon as corroborating evidence, we are not sure why DCAA insists that it must have access to contractor employees (other than as one more excuse blaming contractors for DCAA's untimely audits).

In summarizing DCAA's FY 2012 Activities, DCAA makes note of the $4.2 billion in net savings as a clear indication that rigorous testing of contractor data in accordance with GAGAS provides significant returns for the taxpayer. This statement begs the question: "Whatever happened to rigorous testing of contractor data in accordance with contract terms and conditions (FAR)?"

Legislation Introduced to Automatically Debar Contractors Guilty of Crimes and Delinquent in Income Tax Payments

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

Legislation issued as a standalone bill as well as an amendment to the House approved 2013 spending bills for certain contracts would allow the government to automatically debar government contractors convicted of fraud or other crimes, or contractors who are delinquent in paying federal income taxes although no final resolution with the IRS has been reached.

The automatic debarment process, a product of the growing U.S. legislator perception of rampant fraud, waste and abuse among government contractors, will, without further appeal or due process, debar contractors who were within the past three years convicted of a crime or were subjected to a civil judgment regarding:

- Criminal fraud or another criminal offense related to award, attempting to obtain an award, or performance of any federal, state, or local contract;
- Violation of federal and state antitrust laws specific to proposal submissions/offers;
- False statements, theft, forgery, intentional destruction of records, tax evasion, taking possession of stolen property, or any federal crime tax laws

The bill, submitted by Rep. Alan Grayson, also includes the government's right to debar contractors who are delinquent in payment of income taxes totaling $3,000, even if the contractor has disputed the IRS claim and an appeal process is still in play (but not yet resolved) three years after the contractor first received an IRS notification of delinquent income taxes.

Automatic disbarment due to an IRS assertion of delinquent income taxes requires no final court determination or mutually agreed settlement between contractor and the government as with other statutory violations. Under the proposed automatic disbarment legislation, contractors who dispute delinquent income tax assertions by the IRS are therefore presumed guilty if by the end of the three year period after IRS notification there is still no conclusion to the dispute by court order. Those contractors, under the new debarment provision, would be unable to receive any federal contracts or subcontracts although they may be later found not liable for unpaid government taxes.

Proponents of the legislation, as well as certain government spending watch-dog groups, are delighted with the legislation, to include the provision of unilateral debarment of companies charged, but not convicted, of IRS statute violations. Alan Grayson, sponsor of the standalone bill, stated that these amendments "will help protect American taxpayers and prevent corporations from profiting from criminal activity".

Critics of the proposed legislation point out that the new bill is obviously duplicative of provisions already found in the Federal Acquisition Regulations (FAR) that provide suspension and debarment procedures and remedies when contractors are convicted of violating certain federal, state, and local laws.

The proposed provisions allowing the government to unilaterally and without due process to potentially shut-down government contractors still in litigation with the IRS for alleged delinquent tax payments has been termed as "outrageous" and lacking sensibility by a number of professional organizations. Those private sector support organizations agree that common-sense acquisition regulations are needed to that in contractors whom are obviously violating statutes that result in government overpayments to those companies. One observer termed the Grayson amendment as built upon the growing tide-swell of an unfounded perception that a majority of government contractors charge the government (and "taxpayers") unreasonable and overstated costs in performance of contracts.

With respect to delinquent taxes, it is ironic that certain Congress-persons have no qualms in going after contractors with alleged tax payments due of $3,000; however, certain Congress-persons continue to block attempts to impose similar laws on allegedly tax-delinquent government employees. In the case of the latter, Congress asserts that mandatory termination might be inappropriate if the government employee ultimately prevails against the alleged tax delinquency. No one said that Congress is logical or consistent.

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August 7-8, 2013 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
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August 7-9, 2013 – The Masters Institute in Government Contract Costs
Washington, DC

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Orlando, FL

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

December 4-5, 2013 – Accounting Compliance for Government Contractors
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Instructors

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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.

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