REDSTONE Government Consulting

Government Contract INSIGHTS

A MONTHLY PUBLICATION FOR GOVERNMENT CONTRACTORS

Volume 46

DECEMBER 2014

NASA OIG Recommends Outsourcing Contract Audits To Compensate for Risks Attributed to the Lack of DCAA Audits

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

In its report, No. IG-15-010, December 17, 2014, the NASA OIG (Office of Inspector General) found that "NASA is at increased risk of paying unallowable, unreasonable and unallocable costs and of losing the opportunity to recoup improper costs because Agency contracting officers rely too heavily on DCAA's incurred cost audit process." The OIG report notes the level at which NASA utilizes cost type contracts and the impact of DCAA's untimely audit support, in particular the fact that DCAA's overall incurred cost backlog has grown to six years with more than 19,000 incurred cost proposals awaiting audit including 1,153 which relate to NASA contracts. The reference to six years is of particular interest, because NASA and other government agencies generally have six years to recover any unallowable costs (reference to FAR 33.206, *Initiation of a claim*). Further, the OIG refers to DCAA's 2012 policy change wherein DCAA implemented a low risk universe incurred cost audit sampling plan wherein the majority of contractor incurred cost proposals (ICPs) are written-off without any audit. In the opinion of the NASA OIG, DCAA's policy is simply too risky; hence, one of the OIG recommendations is a change in the NASA FAR supplement to allow independent public accounting firms to provide "supplemental" coverage for NASA contracts. Similarly, the OIG recommended that NASA develop its own risk based sampling methodology for increasing audit oversight of incurred cost proposals that do not meet DCAA's parameter's for review. Additionally, the OIG recommended triennial reviews of contractor compensation on service contracts with a potential value in excess of $500,000.

THIS ISSUE:

It should come as no surprise that the NASA OIG has become one more government agency which has either embraced or recommended embracing a policy of outsourcing contract audits. DCAA's inability to timely and/or predictably accomplish contract audits began in 2009 in the wake of GAO and Congressional criticisms concerning the sufficiency of DCAA's audits. More specifically, that DCAA's audits failed to comply with government auditing standards (GAGAS) which was cause for alarm for Congress and the Senate, notably Senator McCaskill who was ultimately responsible for the removal of DCAA's (then) Director in 2009. In the wake of these criticisms, DCAA's ability to timely complete audits simply disintegrated as evidenced by the number of audit reports issued in 2008 (and prior years) versus the number issued in 2009 and later years. In 2008 and prior years, DCAA had been issuing (annually) in excess of 40,000 audit reports, that number fell to 21,300 in 2009 and only 6,300 in 2013. Oddly enough, DCAA's output declined in spite of the fact that its auditor staffing levels increased from approximately 3,600 in 2008 to approximately 4,400 in 2013. DCAA's inability to complete audits and to issue audit reports was particularly notable with respect to incurred cost audits (audits of contractor ICPs) as evidenced by the fact that the number issued plummeted from in excess of 8,000 in 2008 to 349 in 2011. Since DCAA implemented its low risk sampling plan in 2012, DCAA has closed significantly more of the incurred cost backlog by closing ICPs with rate agreement letters sans an audit.

The NASA OIG recommendation that NASA change its procurement policies to open the door to independent public accounting (IPA) firms may be at odds with the current administration's disdain for outsourcing inherently government functions; however, it is by no means unprecedented to the extent that the DOE (Department of Energy) engaged an IPA in 2011 to "supplement" DCAA's contract audits. DOE acknowledged this during a February 2011 Senate Subcommittee hearing which included statements that DOE's OIG monitors the work of contractors' internal auditors to ensure that the internal auditors' work can be relied upon (coincidentally as noted in our November 2014 Government Contract Insights, DCAA insists that it cannot rely upon the work of contractor internal auditors). DOE also acknowledged that outsourced contract audits were more expensive than DCAA audits (on an hourly rate basis $150/hour versus $114/hour); however, per the DOE spokesperson, "the use of an (outsourced) contract auditor has proven very successful and DOE expects to increase its use of contract audit services".

In a less visible fashion, at least one other civilian agency (Department of Homeland Security) has "supplemented" DCAA's contract audit services by acquiring GAGAS audit services from audit firms with services offered through the GSA Schedule. Other agencies have embraced IPAs as evidenced by incurred cost audit reports issued by IPAs (for DHHS, Department of Health and Human Services) wherein the reports covered multiple years (in some cases five years) and the audit scope and duration were obviously influenced by budgets and due dates. In fact, during the IPA audit, the IPA auditor made it absolutely clear to the government contractor that the audit had a limited duration and a limited number of IPA hours (noticeably missing from DCAA audits as a by-product of DCAA auditors asserting that their ability to protect the taxpayers had been unfavorably impacted by artificial constraints in the form of budgets and due dates).

And finally, even DoD (Department of Defense) is moving towards IPAs to supplement DCAA audits in the context of a proposed DFARS (Defense FAR Supplement) rule on contractor business systems. The proposed rule, published in the Federal Register on July 15, 2014, would involve IPA audits of three of the six contractor business systems (accounting, estimating and MMAS) as a means of "supplementing" DCAA's audit coverage of contractor business systems. However, the DFARS proposed rule is significantly different than other supplemental contract audit services because the DFARS rule would still involve DCAA in terms of evaluating the independence of the IPA and the sufficiency of the IPA's audit (a point of consternation within many public comments to the proposed rule). It remains to be seen if a final DFARS rule will retain the requirement for IPA audits, but the fact that DoD is now contemplating the use of IPAs would seem to reaffirm the use of IPAs in place of DCAA on a very broad scale. However, there is one subtle difference between DoD and civilian agencies (e.g. NASA); the DFARS proposed rule would not involve any direct DoD procurement of IPA contract audit services because those services would be procured by DoD contractors. Although DoD has yet to acknowledge it, their strategy implicates an assumption that DoD would not necessarily foot the entire bill for the IPA services because DoD implicitly expects the cost to be buried in contractor overhead or G&A in which case a contractor's entire business base would absorb the costs.

Unfortunately for civilian agencies, if they also have contracts with the DoD contractor, a civilian agency could be funding its own IPA audits as well as absorbing some amount of the IPA audits specifically for the DFARS business system.

As more contract audits are outsourced (i.e. DCAA audit services are displaced by those performed by IPAs), one can expect a resurrection of the debate concerning the need for a FCAA (Federal Contract Audit Agency) independent of any particular department. That debate has been around for at least 20 years and in fact was the focus of the February 2011 Senate Hearings at a time when DCAA's inability to timely complete audits was "front and center". Since it wasn't pursued then, it remains to be seen if or when it will ever be pursued other than in the purely political context of a Legislative proposal which would remove DCAA from DoD if DoD is unable to generate auditable financial statements by the end of FY2016.

Although one could expound on the many reasons for replacing DCAA with a FCAA, one should never forget that an FCAA may or may not be any improvement over DCAA as long as government auditors and audit agencies are subject to audits by other government auditors or audit agencies (e.g. GAO or OIG).

CAS 418 Litigation: Government Loses Again

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

Earlier this month, the Federal Circuit reaffirmed a US CoFC (Court of Federal Claims) decision concerning CAS 418 compliance. The Government appealed the CoFC decision which had disagreed with the Government's assertion that Sikorsky Aircraft Corporation's material overhead cost, allocated to cost objectives (contracts) using a direct labor base, was not in compliance with CAS 418-50(e). In its appeal, the Government continued to assert that CAS 418.50(e) did not apply and that CAS 418.50(d) was the applicable regulation. At the heart of this issue was the question of the components of the material overhead pool, in particular did the pool include material amounts of management and supervision, in which case 418.50(d) would have been the appropriate regulation wherein Sikorsky would have been compelled to use material dollars as the allocation base.

In continuing its challenge, the Government asserted that Sikorsky's material overhead pool included amounts for management and supervision which were more than de minimus; hence, material in amount. In both decisions, the courts' rejected the Government interpretation and concluded that Sikorsky's pool/base/rate was compliant with CAS 418 (by implication, more than de minimus is not necessarily material in amount)

Although the focus of the litigation was the somewhat academic debate concerning an appropriate base for a material overhead pool; the reason for the issue was the very significant difference in allocable cost to government CAS covered contracts. Although the quantum was never debated (because the Government failed to proof that Sikorsky's practice was non-compliant), the Government alleged that there was an impact of $80 million. As is the case with many Government challenges to cost allocation methods, the government's issue is developed around the cost impact as opposed to an in-depth analysis of the methods vis-à-vis the regulations. Hence, the Government, particularly DCAA auditors, all-too-often attempt to develop the basis for their assertions to support a pre-determined objective of reducing costs allocable to Government contracts. In the minority of these cases, the Government has shown that a contractor method (pool/base) is non-compliant and in any case, the Sikorsky decisions are a reminder that cost allocability can be challenged before, during or after-the-fact. Most unfortunate, even when the Government fails to prove its case, nothing precludes the Government (DCAA) from launching its next challenge on its next target.

DOJ Statistics on Fraud Recoveries for FY2014

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

In late November 2014 the DOJ (Department of Justice) published its FCA (False Claims Act) recoveries from civil cases for the Government FY (Fiscal Year) ending September

30, 2014. In its media release, the DOJ highlighted the dollar amount which was $5.69 billion and the first time its annual recoveries exceeded $5 billion. The DOJ also highlighted the fact that whistleblower lawsuits exceeded 700 for the second consecutive year. Whistleblower lawsuits are more accurately "Qui Tams" wherein the whistleblower sues on behalf of the US Government and as shown in DOJ statistics, approximately 55 percent of the settlements' amounts resulted from actions initiated by a whistleblower (this percentage decreased in FY2014 due to the disproportionately large number of FCA settlements, $3.1 billion, involving financial institutions associated with the 2008 housing and mortgage crisis).

The DOJ media release also continues to self-proclaim the success of the DOJ from January 2009 until now (the Obama years), noting recoveries of $22.75 billion which is more than one-half of the total FCA recoveries since the Act was amended 28 years ago. The DOJ continues to overlook the fact that any given FCA recovery is a function of years of investigative activity and that many FCA recoveries in 2009-2014 were merely the resolution of actions which began well before January 2009. The DOJ media release continues with its self-aggrandizement by noting that the sustained success results from its continuous commitment to "remain vigilant in identifying those who would unlawfully obtain money from the federal fisc". This statement is somewhat inconsistent with the facts given that the primary sources for FCA actions are whistleblowers and not DOJ or any other government source such as government auditors or investigators. In fact, with respect to settlement in 2014, the whistleblowers collectively received $435 million and more recently, a single whistleblower was awarded $57 million related to his assistance with respect to a $16.65 billion settlement involving Bank of America and DOJ.

Whistleblowers are and will remain a key component in terms of identifying and reporting contract fraud (although no one publishes any data concerning the number of whistleblower complaints versus the number which proved to be valid complaints or allegations). Additionally, whistleblowers continue to be protected by laws and regulations which prohibit retaliation including a July 2014 change to FAR 31.205-47(c) which makes unallowable certain legal costs related to whistleblower retaliation. Notwithstanding whistleblower protections which would apply to an employee, of passing interest, a recent Sixth Circuit decision did not extend any pre-employment protections to an applicant with a history of FCA claims. Based upon that decision, neither the anti-retaliation provisions of the FCA or the anti-retaliation provisions of Title VII of the 1964 Civil Rights Act apply to a job applicant (however, based upon legislative trends, such an anti-retaliation measure is merely a matter of time).

We Have Moved! Redstone Government Consulting, Inc. Opens New Office in Huntsville, AL

Redstone Government Consulting, Inc. (RGCI) is pleased to announce the grand opening of our new office location in Huntsville, AL. Our new location at 4240 Balmoral Drive SW is conveniently located to both Redstone Arsenal and Cummings Research Park, and offers additional office space as well as dedicated training facilities. Our growth over the past 3-years has been a direct result of our clients continued support of Redstone Government Consulting and our commitment to providing those clients best in industry and cost effective government compliance support. We wish to extend our sincere gratitude to all of our clients who have worked with our staff since the early 90s as our group grew from a small part of a public accounting firm to a new company and recognized industry leader in government compliance consulting.

REDSTONE Government Consulting

Our first training class in the new facility was hosted this past week and we will be hosting additional training and an open house and ribbon cutting in the next few weeks. We look forward to seeing many of you at these upcoming events.

Training Opportunities

2015 Redstone Government Consulting Sponsored Seminar Schedule

January 15, 2015 – Government Contractor Challenges in 2015
WEBINAR –**REGISTER HERE**

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.

2015 Federal Publications Sponsored Seminar Schedule

April 7-8, 2015 – Accounting Compliance for Government Contractors
Denver, CO

April 7-8, 2015 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
San Diego, CA

May 5-7, 2015 – The Masters Institute in Government Contract Costs
La Jolla, CA

June 2-3, 2015 – Accounting Compliance for Government Contractors
Arlington, VA

July 20-21, 2015 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Hilton Head Island, SC

July 21-23, 2015 – The Masters Institute in Government Contract Costs
Hilton Head Island, SC

August 18-20, 2015 – The Masters Institute in Government Contract Costs
Sterling, VA

August 20-21, 2015 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Sterling, VA

October 5-6, 2015 – Accounting Compliance for Government Contractors
Arlington, VA

Instructors:

- Mike Steen
- Scott Butler
- Cyndi Dunn
- Asa Gilliland
- Darryl Walker
- Courtney Edmonson
- Cheryl Anderson
- Robert Eldridge

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

Blog Articles Posted to our Website

White House Memo Acknowledges Procurement Process Needs Transformation
Posted by Darryl Walker on Tues, Dec 11, 2014 – Read More

The Good Old Days?
Posted by Cheryl Anderson on Tues, Dec 2, 2014 – Read More

Continuing DCAA Inconsistency and Compliance Failures Related to Company Internal Audit Report Requests!
Posted by Robert Eldridge on Thur, Nov 20, 2014 – Read More

Republican Control of Congress – Should Contractors Rejoice?
Posted by Robert Eldridge on Tue, Nov 11, 2014 – Read More

REDSTONE Government Consulting

The Top 4 Halloween Costumes At the Annual Government Halloween Ball
Posted by Michael Steen on Tue, Nov 4, 2014 – Read More

Commercial Item Pricing and DOD's Vision of "Fair Pricing"
Posted by Michael Steen on Wed, Sept 3, 2014 – Read More

DFARS Business Systems: A First-hand Perspective
Posted by Glenn Behrends on Mon, Aug 18, 2014 – Read More

Update: The New Contractor Purchasing System Reviews (CPSR)
Posted by Wayne Murdock on Wed, Aug 13, 2014 – Read More

For More Blog Articles: http://info.redstonegci.com/blog

Whitepapers Posted to our Website

The Audit World's Biggest Myths
A Whitepaper by Wayne Murdock – Read More

Government Contracting and Uncompensated Overtime
A Whitepaper by Wayne Murdock – Read More

DCAA Rejection of Incurred Cost Proposals
A Whitepaper by Michael Steen – Read More

For More Whitepapers:
http://www.redstonegci.com/resources/white-papers

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.

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 Moses at lmoses@redstonegci.com, or at 256-704-9811.

REDSTONE Government Consulting

Redstone Government Consulting, Inc.

NEW ADDRESS
Huntsville, AL
4240 Balmoral Drive SW, Suite 400
Huntsville, AL 35802
T: 256.704.9800

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

