REDSTONE Government Consulting
Formerly Beason & Nalley Government Compliance Group

Government Contract INSIGHTS
A MONTHLY PUBLICATION FOR GOVERNMENT CONTRACTORS

Volume 43 SEPTEMBER 2014

DCAA "In the News"

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

In the past month, DCAA has been in the government contracting news in the context of multiple DOD-IG (Inspector General) Reports as well as a potentially devastating FTCA action (Federal Torts Claims Act) initiated by KBR (Kellogg Brown & Root Services). Starting with the FTCA action, a brief discussion of DCAA "In the News".

Kellogg Brown & Root Services (KBR) v United States of America

In its FTCA complaint, KBR alleges that DCAA committed gross professional negligence when DCAA issued an audit report in August 2007 asserting that KBR had billed approximately $99.6 million in unallowable costs for PSCs (Private Security Contractors). KBR is now asserting that DCAA's audit report was demonstrably false and that DCAA performed the audit in a negligent manner. Further and of far greater potential damage to DCAA, KBR asserts that the particular audit is only one example of a larger pattern of professional malpractice to which KBR and other defense contractors have been subjected by DCAA.

In supporting its FTCA complaint, KBR introduces evidence specific to that particular audit as well as evidence which more broadly applies; in particular GAO reports in 2008 and 2009 which concluded that DCAA consistently failed to comply with government auditing standards (GAGAS) notwithstanding the fact that DCAA's reports stated that the audit and the reporting were in accordance with GAGAS. Subsequent to the GAO reports, DCAA did begin to include one qualifier which pertained to the lack of a "peer review" of DCAA's quality controls (see the related article: DOD-IG "Approved with Deficiencies" peer review of DCAA). In terms of evidence specific to the particular DCAA audit, KBR draws from information obtained from the ASBCA case wherein KBR prevailed on the allowability of the PSC costs ($44 million which has not yet been paid by the government).

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It should be noted, that the ASBCA case was resolved after the government voluntarily dismissed its FCA (False Claims Act) case one day before the government was required to start producing relevant documents under the court's schedule. Moreover, the ASBCA case (and the litigation process, including discovery and depositions) provided KBR with the evidence which is critical in establishing negligence. Specifically, without the ability to compel disclosure of DCAA work papers and to depose DCAA auditors, it would be impossible to determine for any given audit if DCAA complied with GAGAS or if DCAA committed professional negligence.

With respect to DCAA's audit specific negligence alleged by KBR, the complaint asserts that both DCAA and the Army contracting agency were acting amid persistent political pressures with intentions to pander to an investigating Congressional Committee. In actions which were coincidental to an Army appearance before the HCGR (House Committee on Government Oversight and Reform), an Army Contracting Officer directed DCAA to issue a DCAA Form 1 suspending $19.7 million for PSC costs purportedly prohibited by a contractual clause. Subsequently, KBR provided 17 to 20 binders documenting KBR's use of PSCs and subsequently DCAA "audited" that documentation. DCAA ultimately reported unallowable costs based entirely upon a subcontractor's estimate of PSC costs as 12.xx% of total subcontract costs.

Potentially more damaging to DCAA, its auditor, supervisor and field office manager confirmed that DCAA failed to perform all mandatory steps required by professional auditing standards because the Army had already determined the PSC costs to be unallowable. Perhaps most damaging to DCAA is that the auditor undertook the audit as a "clerical assignment", not necessarily in the scope of any audit (in spite of the fact that one or more audit reports were ultimately issued which asserted that an audit had been performed in accordance with government auditing standards).

There are significantly more details in the KBR complaint including those which highlight the fact that the amounts disallowed were a constantly moving target and that these amounts were never based upon an audit performed in accordance with GAGAS. Similarly, the government's FCA actions were not only voluntarily dismissed in 2012, but the FCA was wholly unfounded given that KBR had notified the government on numerous occasions that the circumstances in Iraq had necessitated the use of PSCs (a fact well-established in the ASBCA case which included a memorable quotation from an Army official that "You could not swing a dead cat, without hitting a private security guard".)

It remains to be seen if KBR's FTCA complaint will succeed in terms of KBR's ability to recover $10,514,116.35 in damages (professional and internal administrative costs to defend itself in the FCA and Contract Disputes actions). Historically, at least one government contractor GD (General Dynamics) succeeded in pursuing an FTCA which concluded that DCAA had committed professional negligence; however, GD never recovered any of the $24.1 million in alleged damages (for a discussion of that case and the FTCA, one should go the website of McKenna, Long and Aldridge or the following link: http://www.mckennalong.com/media/site_files/1835_DCAA%20Malpractice-Recovery%20of%20Damages.pdf.

Should KBR succeed, its success could be a pre-cursor to a flood of similar actions, particularly those wherein it can be established that DCAA failed to comply with government auditing standards which could include DCAA's failure to properly supervise auditors along with documentation implicating DCAA's failure to independently and objectively perform any given audit. Although we do not want to offer specifics, we have reason to believe that DCAA auditors have been anything but objective in terms of approaching audits with pre-determined opinions influenced by DCAA's contorted view of its role in protecting the taxpayer. Translated, DCAA auditors, supervisors, field office managers, regional and headquarters management ignore contractual terms and conditions (i.e. FAR) and/or selectively apply FAR to yield "cost questioned" which are unsustainable. Further, in spite of having its methods for benchmarking contractor compensation successfully challenged in published ASBCA decisions, that DCAA deploys the exact same benchmarking for contractors including one of the contractors which was the subject of an ASBCA decision (reference to ASBCA decisions related to compensation reasonableness under FAR 31.205-6(b)).

Perhaps obvious, the government contractor community will be closely following the KBR FTCA while most likely looking back at their experiences with DCAA to determine if this could be the opportunity to pursue similar FTCA actions. However

and not as obvious, there is a distinct possibility that the FTCA will not be successful based upon legal/jurisdictional issues such as those which were successfully introduced by the government in previously published and unpublished FTCA contractor complaints against DCAA.

DOD-IG Peer Review of DCAA

In a long delayed review and report, the DOD-IG concluded that DCAA's System of Quality Control supports a "Pass with Deficiencies" overall opinion. The DOD-IG report dated August 21, 2014, identified a number of issues, including errors or lack of sufficient documentation with 11 of 92 audits and that an additional three audits reported conclusions which were not supported by engagement documentation. However, the DOD-IG inexplicably determined that those three reports were not impacted by the lack of documentation, based upon interviews and additional information outside the engagement documentation.

For anyone familiar with DCAA audits of contractor business systems and/or claimed costs, DCAA rarely if ever gives a contractor credit for "undocumented" explanations and/or clarifications provided during the audit and DCAA virtually never accepts any of these verbal explanations or even additional written explanations once DCAA has drafted its audit report. In fact, DCAA field auditors will predictably discount anything other than contemporaneously prepared documentation; translated, after-the-fact contractor documentation and/or explanations don't count as relevant evidentiary matter in the context of a DCAA audit of contractor assertions. It is somewhat ironic that DCAA appears to have verbally convinced the DOD-IG to soften its opinion (pass with deficiencies) when DCAA's engagement documentation (audit working papers supporting its audits of government contractors) would have supported a "failed" peer review. To an informed observer, this appears to be a pre-determined opinion which is wholly incongruent with respect to the details contained in the DOD-IG report; in particular, the lengthy and somewhat "ugly" details concerning the 11 files which lacked sufficient documentation.

Perhaps the greatest irony within the DOD-IG review and report and the GAO criteria for GAGAS compliance (government audit agency systems of quality control) is that the government has three opinions wherein the difference between failure and pass with deficiency is that the former is evidenced by a "significant deficiency" and the latter by a "deficiency". In contrast, outcomes of DCAA government contractor business systems' audits are limited to only two opinions, pass or fail wherein failure (or disapproval) is based upon a noncompliance with one or more criterion. Although DCAA purportedly only reports "significant deficiencies", the reality is that virtually any deficiency observed by DCAA is categorized as significant even though there is no demonstrable harm to the government (i.e., the audit opinion is based solely upon "risk" of harm).

In our opinion, the DOD-IG review contrasted with audits of contractor business systems constitutes one of the most obvious examples of a double standard wherein contractors are held to much higher standards than are the government agencies responsible for oversight of those government contractors, but no one said that life is fair.

DOD-IG Review of Selected DCAA Audits

The IG report dated September 8, 2014 (18 days after the IG "peer review" report) covered 16 DCAA audits and audit reports and the IG report concluded that 13 of 16 audits had one or more significant inadequacies (although the IG never explains why it uses "inadequacies" instead of what has become the more widely used "deficiencies"). The 13 deficiencies involved a number of issues in terms of non-compliance with government auditing standards (GAGAS) along with five forward pricing (bid proposal) audits wherein DCAA failed in terms of obtaining and/or auditing "cost or pricing data".

It is incredulous that the DOD-IG would issue this particular report within 18 days of issuing a "passed with deficiencies" opinion of DCAA's system of quality control (see the preceding article) because the later IG report absolutely reinforces questions concerning the validity of the peer review opinion. Of particular note, the results reported on September 8 were available to the DOD-IG before it issued its August 21, 2014 peer review report/opinion. As discussed above, the facts reported in the peer review report/opinion suggest that a "pass with deficiencies" was benevolent if not ignoring the facts; however, "pass with deficiencies" is simply indefensible when coupled with results of the September 8, 2014 IG report.

Over and above our concerns with the implications of the combined IG reports, we take particular note of two sets of facts reported by the IG in its September 8, 2014 report. First,

DCAA duplicated reporting cost questioned to the tune of $6,128,000 dollars; a fact which is potentially just the "tip of the iceberg" and one which suggests that DCAA may have materially misstated its audit results in its Annual Reports to Congress (available on DCAA's website). Second, one of the audits associated with the duplicated reporting of cost questioned also involved an inexcusable continuum of start-stops and auditor assignments/reassignments caused by frequent changes to "higher priority" audits leading to failures by the "last auditor" to properly retain previous and superseded working papers. For any large contractor subjected to DCAA audits, the latter issue/circumstance is not an anomaly, but the modus-operandi for DCAA for years.

"If" the DOD-IG follows auditing protocol, it will consider the risks exposed by its review of the 16 audits and it will expand its reviews of DCAA to focus on DCAA's duplicate reporting (of questioned costs?) as well as DCAA's grossly inefficient practices of costly and ineffective "start-stop-restart" audits. Perhaps the IG will do just that, but don't hold your breath.

DCAA Issues FY 2015 Audit Staff Allocation Plan

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

Government contractors will likely see little change in the DCAA (Defense Contract Audit Agency) audit priorities for Government Fiscal Year (GFY) 2015 versus GFY2014 based on DCAA's August 2014 staffing allocation plan, as audits of bid proposals, incurred cost proposals, and reimbursable contract invoices will continue to remain in the forefront. In formulating or more accurately reconfirming existing priorities, and defining the number of audit personnel required for GFY 2015, DCAA estimates that it will have the resources to pay for 4,982 work years, which is a slight increase over its planned work years for GFY 2014. The agency's GFY 2015 goals for utilization of its audit staff are set forth in memo 14-OWD-031(R).

Top priorities for FY 2015, shown in the staffing allocation memo, follow:

- Demand audits which are those specifically requested by a government agency. Examples include forward pricing actions (bid proposals, Forward Pricing Rate Proposals (FPRPs), terminations, and pre-award accounting system audits;
- Incurred cost audits (aka the "backlog");
- CASB Disclosure Statement compliance audits;
- High-risk, time-sensitive labor and material reviews; real-time audits of labor and material charges to determine existence and allocability of those costs when they are first incurred, often referred to as MAAR 6 (labor)and 13 (materials) audits. The MAAR procedures are a major component of DCAA's incurred cost proposal audits;
- Contractor billing reviews to include provisional billing rates, and pre- and post-payment reviews, and;
- Other areas of audit focus considered high-risk.

DCAA continues its struggle to reduce its backlog of aged incurred cost proposals (ICP) and enable government agencies to closeout old contracts. The agency's GFY 2015 objectives include completing ICP audits for contractor fiscal year (CFY) 2008 and earlier years (with a focus on previously identified "priority" ICPs), most of CFY 2009, and a portion of CFY 2010. DCAA will continue to utilize Virtual Incurred Cost audit teams and sampling techniques for auditing or more frequently not auditing proposals deemed low risk. The staff allocation memo requires auditors to assess CFY 2008 and earlier ICPs for Statute of Limitation issues, ostensibly before continuing carryover, or initiating, ICP audits for those years.

The plan also includes resources for the testing of paid vouchers submitted by contractors which have not been "visited" during the past three years, a process which will be phased in over a three-year period.

And because auditors are finding it impossible to validate the use and/or existence of reimbursable contract labor and material costs in the year in which an incurred cost proposal audit is performed (years after the costs were actually incurred), DCAA plans to ramp up its time-sensitive MAARS 6 and 13 audits. Agency guidance issued in July 2013 sets forth alternate procedures for testing labor and materials after those costs are incurred; therein the agency appears to tacitly agree that attempting to validate the existence and allocability of labor and material costs years after they are incurred is often an impossible task. The GFY 2015 staffing plan hopes to

remedy that situation with added resources dedicated to testing labor and material charges on a real-time basis.

The plan also places CAS compliance audits as a low priority unless considered a DCMA priority. However, CASB Disclosure Statement compliance audits will presumably be accomplished upon request in situations where an adequate and compliant CAS DS is a requirement explicitly stated as a condition of contract award.

Business systems audits are largely on hold, and defective pricing audits are limited to "high profit" contracts identified by DPAP. DCAA will confine business systems audits to billing, control environment, and accounting system in-process audits at pilot sites (if continuation is deemed useful), and the completion of Material Management and Accounting System (MMAS) audits at selected contractors. The DCAA staffing plan states that there are insufficient resources to program new business systems audits; however, until a proposed rule is finalized, which if approved, would place the responsibility for three categories of business systems audits with the contractor, DCAA will not go forward in dedicating staffing resources for accomplishing those audits.

Executive Order Possible Restricting Contract Awards to Inverted Government Contractors

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

President Obama may soon issue an executive order to restrict contract awards to certain corporations who reincorporate overseas, the purpose of which is to dodge payment of U.S. income taxes. Such companies are termed "inverted corporations", and a proposed House bill identified as "The No Contracts for Corporate Deserters Act" (H.E. 5278) is currently moving through the legislative process. However, the White House is under pressure from both Senate and House legislators to issue an executive order in advance of passage of any legislation which would block certain "treacherous" corporations from receiving contract awards. Passage of such legislation could take months to be implemented, that is, if the legislation makes it through House and Senate, and it is therefore likely that Obama will soon go forward with an order implementing the HR bill criteria and penalties.

Current laws and FAR provision prohibit use of obligated federal monies for contracts with any contractor deemed an inverted domestic corporation; one existing legal criteria for determining inverted corporation classification is a company with 80 percent of the stock of the new entity held by former shareholders. The new pending legislation would lower that threshold to 50 per cent.

Some observers are confident that issuance of an executive order restricting inverted domestic corporations from future contract awards is just days away because the alternative, which is passage of the proposed bill, is tenuous, and the authors of that bill are Democratic legislators attempting to introduce and pass legislation in a "house divided".

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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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