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The Senate Threatens DCAA's Budget…and The White House Comes to the Aid of DCAA

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

Although it's not yet final, the 2016 NDAA (National Defense Authorization Act) includes a provision (section 878) that could adversely impact DCAA's funding if DCAA fails to reduce its incurred cost backlog to the equivalent of one year inventory of incurred cost submissions. Specifically, the reduced funding is with respect to reimbursable audits (performed for civilian/non-DOD agencies) which require civilian agencies to reimburse DCAA for an audit performed for the civilian agency or for the pro-rata share of a DCAA audit performed for DOD and civilian agencies (e.g. an audit of an indirect cost rate proposal or ICP involving both DOD and civilian agency contracts). As stated in section 878, if DCAA fails to reduce its backlog by the start of FY2016 (October 1, 2015), DCAA's DOD funding will be reduced dollar for dollar by amounts reimbursed by other agencies. Although the relative amounts of funding are not published, the potential reduction in DCAA's funding would presumably have a significant impact on DCAA's total budget which would translate into a significant reduction in staffing (DCAA's budget is predominantly for salaries and related costs).

In a published statement related to Section 878, DCAA's Deputy Director stated that DCAA has made significant progress in reducing its backlog which stood at 31,000 submissions in 2012, but is now down to 17,600. Noting that DCAA receives about 5,000 submissions annually, the NDAA requirement would implicate the need for DCAA to disposition 12,600 incurred cost submissions by September 30, 2015 (assuming that those received on June 30, 2015 won't be counted against DCAA in determining if DCAA has met the "one year inventory"). In fact, DCAA's Deputy Director stated that an inventory of 5,000 to 10,000 is an ideal backlog which implicitly recognizes that the backlog probably bottoms out on June 29 of each year, followed by an immediate increase of 4,000+ with the June 30 submissions.

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As noted by DCAA's Deputy Director and confirmed by DCAA's 2014 Annual Report to Congress, DCAA has significantly increased the number of ICPs which are closed in any given year, having bottomed-out at 487 in 2011 and increased to 11,101 in 2014. However, DCAA is achieving this dramatic turn-around by closing the majority of the ICPs without an audit (reference to DCAA's low risk universe/sampling plan which has been revised once to increase the number of ICPs which are categorized as low risk with very low probability of audit). While good for contractors who win the lottery (are not randomly selected for audit), DCAA's ever expanding number of ICP's closed without audit has caught the attention of at least one civilian agency, NASA, whose IG expressed concerns that DCAA's risk based approach was too risky (too many dollars are never being audited).

Section 878 of the 2016 NDAA has resulted in one unlikely alliance, the White House coming to the aid of DCAA in the context of a June 2, 2015 SAP (Statement of Administration Policy) wherein the Administration strongly objected to Section 878. The SAP stated that DCAA has already reduced its backlog by 90% (apparently oblivious and/or unconcerned with "how" DCAA has achieved that reduction) and that 878 would result in additional burdens on the "already over-taxed DOD-IG, DCAA auditors and on industry, and would decrease efficiency in DCAA". We are relatively certain that "over-taxed" was not meant to apply to industry and it's all-too-obvious that the White House knows absolutely nothing about DCAA; otherwise they would not assert that DCAA could be any less efficient. Further the SAP states the Section 878 would not lead to the reductions envisioned which is ignoring or oblivious to the fact that DCAA could achieve the reductions envisioned by simply writing-off (closing without audit) even more ICPs (or by rejecting more as inadequate which removes them from DCAA's inventory).

If Section 878 survives in terms of becoming a provision of the 2016 NDAA signed by the President and if DCAA fails to meet the goal of a one year incurred cost backlog, it will result in the end of DCAA's reimbursable audits. There would be absolutely no reason for DCAA to perform any reimbursable audits knowing that every reimbursable audit hour becomes a reduction of audit hours for DOD contract audits. In fact, whether published or unpublished, one would assume that DOD would mandate that DCAA not perform any reimbursable audits. However, even if Section 878 survives, there is a reasonable possibility that DCAA will obtain the goal of having a one year backlog on September 30, 2015. DCAA appears to be defining the backlog in terms of the number of contractor submissions which is vastly different than defining the backlog in terms of the aggregated dollar value of a one year universe. As would be shown if one obtained and analyzed DCAA's 2014 incurred cost closures, the majority are low dollar low risk involving very few audit hours in contrast to relatively few (closed) which were high dollar requiring hundreds if not thousands of audit hours. DCAA's success in closing incurred cost years has been publicized in terms of ICP count which is masking the fact that the unaudited backlog dollars are disproportionately high. This nuance is attributable to the fact that DCAA may be able to close lower dollar ICPs without audit, but the ICPs which remain are for the very large and complex ICPs which will require significant audit resources. In other words, success in reducing the incurred cost backlog could be fleeting at best as DCAA clears low risk ICPs, but leaves itself with a disproportionately high number of high-dollar, complex audits within its inventory of 5,000 -10,000.

Defective Pricing or Worse

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

Note that this article is written based solely upon a Government complaint; hence, without benefit of the contractor rebuttals and certainly without the final disposition of the matter.

In a recent civil action, the government filed a complaint against a large government contractor alleging that the contractor knowingly provided inaccurate, incomplete or non-current cost or pricing data leading to an alleged violation of the TINA clause (Truth in Negotiations Act or as of 2014 with the "positive" codification of FAR, Truthful Cost or Pricing Data). More ominously, the government action is seeking treble damages under the FCA (False Claims Act) based upon allegations of fraud, false claims for payment and false statements made by the contractor in connection with a solicitation, bid proposal and negotiations.

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The Government's action serves as a reminder that hundreds of solicitations, bid proposals and contract negotiations invoke certified cost or pricing data which are subject to FAR 52.215-10; Price Reduction for Defective Certified Cost or Pricing Data. At the point when the contractor and government reach an agreement on price, the contractor will certify that the cost or pricing data is accurate, complete and current which will typically involve an internal "sweep" to obtain and to disclose to the Government (if applicable) more current data and the impact of that data. In the case of the factual allegations within the particular Government complaint, this involved an initial contractor proposal in December 2007, followed by revisions, an undefinitized contract action May 30, 2008 and further pricing updates and price negotiations in September 2008. At the bequest of the Government PCO, the contractor initiated a sweep and updated pricing on September 11, 2008. As the process continued, on September 24, 2008, the contractor informed that Government that the results of the sweep indicated that the price (for the bill of materials) should be increased by $16 million, but that the contractor would forego that increase and honor the (lower price) commitment during negotiations (the $16 million was approximately 1% of total value for the bill of materials).

However, the Government's complaint is alleging that the result of the contractor's sweep was actually a decrease (not an increase) in the bill of materials' price including lower:

- Vendor price quotes ($20 million),
- Prices based upon actual purchase orders or historical information ($1 million),
- Labor rates for fabricated materials/assemblies ($11 million)
- Prices for corrected material requirements ($12 million)

In its claims for relief, the government is seeking damages under the FCA of $5,500 to $11,000 for each allegedly fraudulent claim for payment; in this case the Government asserts there were claims for payment for 26,789 items delivered totally $3.6 billion. Assuming the Government asserts that the 26,789 items represent claims for payment, the FCA damages are no less than $143 million. In addition the Government is seeking an amount for allegedly defective pricing, plus penalties and interest. The Government claim does not state a sum certain for alleged damages (to be determined at trial for which the Government has requested a jury trial).

The Government claim does not state the source for its action, in particular, the United States is the plaintiff (with no reference to a Qui Tam Relator) and there is no reference to a DCAA post-award audit report; hence, it is indeterminable what events or circumstances led the government to pursue this action. During the most recent 18 months reported by the DOD-IG (semi-annual reports to Congress), there have been a total of 27 defective pricing audit reports issued (presumably by DCAA) with total recommended price reductions of $120.7 million. By contrast, during that same period the DOD-IG reports state that there were 1,480 forward pricing audit reports (primarily bid proposals). Clearly, there is an extremely low probability that a pricing action will become the subject of a post-award defective pricing audit; however, the financial exposure (illustrated by the Government's civil claim discussed herein) suggests that compliance with TINA is anything but risk free. No government contractor should cavalierly approach TINA compliance as if the relative absence of DCAA audits displaces the requirement for due diligence on the part of the contractor. Lastly, negotiators for government contractors should engage in full disclosure and never misrepresent the facts; in particular, even if a last minute sweep for more accurate, current or complete data results in a very minor price increase or decrease, the preference is to accurately disclose that amount to the government and let the government decide if the amount is insignificant.

As stated in the opening sentence, this discussion is based solely upon the Government's civil complaint without benefit of the contractor's rebuttal and without the final disposition of the matter.

Miscellaneous News

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

IR&D Back to the Future

DOD has been going down a "Better Buying Power" path, now at BBP 3.0, with re-stated intentions of increasing efficiencies in DOD acquisition primarily to reduce the number of programs

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with significant overruns (i.e. underestimating the cost to produce and sustain a weapons system. However BBP 3.0 also has a provision which is essentially moving in the direction of back to the future in terms of the allowability of IR&D costs (Independent Research and Development). In particular, a provision to "increase the productivity of corporate IR&D"; translated, to address a trend wherein IR&D is spent on developing IP (Intellectual Property) of little or no value to the government. BBP 3.0 includes a requirement (for guidelines) requiring endorsement by an appropriate DOD sponsor and a written report of results obtained through project completion. The latter requirement is an expansion of an existing (January 30, 2012 Federal Register) requirement for certain contractors ("majors" having $10 million or more in IR&D/B&P costs in a year) to annually report IR&D costs, else the costs are unallowable. Contractors who do not meet the reporting threshold are encouraged to report their IR&D projects to provide DOD with visibility into the technical content of contractor IR&D activity. Not so coincidentally, on June 16,2015, the Federal Register included a "correction" to DFARS 231.205-18 which reinstated requirements to: i) determine whether the IR&D/B&P projects are of potential relevance to DOD and ii) provide the results of the determination to the contractor.

In the aggregate, all of these actions are aimed at one thing, reducing the amount of allowable IR&D costs, at least with respect to DOD contracts. For what it's worth, DOD is slowly unraveling acquisition policies (FARA/FASA) in the 1990s which recognized that DOD funding was decreasing; therefore traditionally DOD contractors needed to be encouraged to diversify as a means of retaining or increasing business revenues and more importantly increasing cost allocation bases common to DOD contracts. The objective was to avoid more costly weapons' systems because (without diversification) fixed overhead would be allocated/absorbed by fewer DOD dollars. How soon we forget.

Casinos, Government Employees and the FCPA

Perhaps an odd mix, but of late casinos (and adult entertainment establishments) have been in the news. A DOD-IG report (2015-125) concluded (sort of) that from July 1, 2013 to June 30, 2014, 4,437 transactions amounting to $952.2K were likely government travel cards used for personal use at casinos and 900 additional transactions for $96.6K at adult entertainment establishments. To support its analysis, the DOD-IG reviewed seven non-statistically selected cardholders with 76 transactions valued at $19,643. The DOD-IG concluded that neither the DOD compliance program nor the credit card contractor identified the high-risk transactions and/or failed to coordinate to notify APCs (Agency Program Coordinators) of potentially fraudulent activity or suspension of accounts.

In response to this slightly embarrassing report (which is nothing new in terms of a long history of travel card abuse by a relatively small number of DOD and other agency employees), we now have Senate Bill, "Saving Federal Dollars Through Better Use of Government Purchase and Travel Cards Act of 2015" (referred to as a short title). Seemingly lost on most, including the Senate, the individual travel card holder (and not the Government) is financially responsible for his/her travel card expenses. As long as the travel card holder was not attempting to claim casino/adult entertainment expenses on a travel claim, the US Government has almost no financial interest in this issue. But of course it is slightly embarrassing and one more chance for the Legislative Branch to do what it does best, taking advantage of the moment to grandstand. This is the same Legislative Branch which continues to block efforts to create laws which would address government employees and retirees with unpaid taxes; an issue which does have a measurable cost impact to the Government. The reason the Legislative Branch will not address delinquent tax payers, the delinquency rate for government employees/retirees is less than the overall average. Yet this same Legislative Branch is investing time and money into addressing an issue involving significantly fewer misbehaving government employees for an issue which has almost no cost impact to the Government. We have met the enemy and he just might be us.

Regarding the FCPA (Foreign Corrupt Practices Act) and a casino on the Northern Mariana Islands, the US Treasury Financial Crimes Enforcement Network (FinCEN) levied a $75 million penalty because the casino lacked an anti-money laundering (AML) program altogether. This conclusion seems to be supported by statements made to investigators, in particular by the casino owner's chief auditor. In reference to 2,000 CTRs (Currency Transaction Reports), prepared but unreported, the chief auditor allegedly explained the failure to report "because no one had noticed the casino's failure to report CTRs in the past". Not exactly the explanation one would expect from a chief auditor.

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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
- Sheri Buchanan
- Darryl Walker
- Courtney Edmonson
- Cheryl Anderson
- Robert Eldridge

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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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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.

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