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DCAA 2016 Staffing and Program Plan

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

In its FY2016 annual program plan (15-OWD-025(R); August 13, 2015) which begins October 1, 2015 (assuming the Government is funded), DCAA lays out its high level plans for deploying 4,969 staff years (virtually unchanged from its FY2015 plan for 4,982 staff years). There are very few changes in terms of audit priorities which are summarized as follows (changes from FY2015 to FY2016 are highlighted):

- Demand work including audits of bid proposals and forward pricing rates remain the top priority (to the extent such audits have not been shifted to DCMA which is getting more and more involved with reviews of contractor forward pricing rates).
- Incurred cost audits or backlog of contractor indirect cost rate proposals for which DCAA's goal is to complete all for 2010 and a portion of those for 2011-2012. DCAA notes certain high priority audits for NASA and DOE; translated, each civilian agency has separately funded DCAA to complete certain incurred cost audits. For contractor years 2008 and earlier, DCAA continues to mention the need to assess the planned audit against the six year statute of limitations (FAR 33.206).
- **Business systems** for which DCAA has the responsibility to audit three of six DFARS business systems including Accounting, Estimating and MMAS (Material Management and Accounting). Unlike FY2015 when essentially nothing was planned, DCAA is now planning estimating system and MMAS audits at 5,000 and 4,000 hours each, respectively. In unprecedented fashion, DCAA lists the 12 Estimating System audits by contractor and the 5 MMAS audits by contractor. Oddly enough, DCAA is not auditing contractor accounting systems even though that is the one system for which DCAA auditors should be the most qualified to audit and the accounting system is ultimately linked to both estimating and MMAS. Although somewhat speculative, we suspect that DCAA cannot afford the resources it would take for DCAA's vision of a comprehensive accounting system audit (which were never ending in "pilot" tested audits in 2012-2013).

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Regarding MMAS, it is amazing that DCAA projects 4,000 hours per audit noting that the MMAS system criteria is built upon a contractor demonstration of compliance which would involve extensive self-testing by the contractor. DCAA seems to be unwilling to give any measure of reliance to the documented compliance efforts of a contractor, even when the underlying regulation expressly requires a contractor demonstration of compliance. In a recent mock audit of contractor MMAS compliance, we've been able to complete an assessment (of a well-documented MMAS) within 60 hours or less. Of passing note, DCAA's FY2016 plan mentions EVMS (Earned Value Management), but only in the context of disengaging from any involvement consistent with an interagency letter (DCAA and DCMA) wherein only DCMA will now have any role in reviewing EVMS compliance.

- **Post-award** (defective pricing or compliance with TINA) for which DCAA HQs has identified 27 audits at 16 different contractor business segments. As with every other DCAA audit, the planned hours per audit, 1,250, are exponentially greater than in years past (prior to 2009) when most post-award audits were completed in less than 250 hours. Now a risk assessment takes at least 250 hours which should contribute to a more focused and more efficient audit, but not the case when risk assessments and audits are performed by risk averse auditors working for a risk-averse audit agency which is apparently immune to any pressures to be cost efficient.
- Real time audit testing including floor-checks, physical observation/verification of direct materials and post-payment testing of paid vouchers are minimal except for "Major Contractors" (those with $100 million or more of annual costs on flexibly priced contracts). For Major Contractors, testing should be sufficient to support DCAA's opinion for the entire contractor fiscal year; hence, the most likely translation is quarterly audits. To our knowledge, DCAA remains the only audit agency which believes that government auditing standards require real-time physical verification of employees and direct materials; otherwise, the need to qualify the after-the-fact incurred cost audit. For what it's worth, DCAA appears to have an unwritten rule that qualifications will only be for circumstances caused by the auditee (the contractor) or the audit requestor. If the scope is limited (self-imposed by DCAA), DCAA will avoid categorizing the activity as an audit.

DCAA's FY2016 presents no obvious changes in terms of DCAA priorities or strategies which is coincidentally in consonance with DCAA audit strategies. In particular, DCAA seems to change nothing in spite of suffering massive failures in terms of cost questioned sustained. DCAA's concepts of auditor independence appear to encompass independence from court decisions as evidenced by DCAA's maintaining certain tactics which have been dismissed by a published decision as "statistically flawed" (reference to DCAA's compensation benchmarking which is exactly the same methodology as was deemed by the ASBCA to be "statistically flawed"). Similarly, DCAA's incurred cost audits question costs in later years ignoring the unfavorable (not-sustained) disposition of the very same issue in earlier years. In other words, FY2016 will be just another year of dealing with DCAA audits which are all too often designed for one thing only, to overstate sustainable audit exceptions (cost questioned) leaving it to contracting officers to appear to be unsupportive of the "expert" advice from DCAA. To be sure, there are valid audit exceptions; however, these appear to be the minority based upon recent cost questioned sustention rates (as low as 22 percent for a six month period). Let the games begin.

The Government Mantra: "Do as we say, not as we do"

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

Although it is nothing new, recent published reports (IG or Inspector General) and other sources re-emphasize that the Government is not exactly a role model. Two recent

Examples:

<u>Non-business Travel by a Government Executive.</u>

The EPA IG reported that an EPA Regional Administrator (Region 9) was traveling on the Government's "dime" for trips which appear to be personal. The individual was duty stationed in San Francisco, but maintained a personal residence in OC (Orange County) California which generated a rather high number of "business trips" from San Francisco to OC (per the EPA-IG, almost every week). While in OC on "business trips", he stayed in his personal residence, but

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charged meals to the EPA. To serendipitously facilitate this individual's desire to frequently travel home at Government expense, during his tenure as Region 9 Administrator, the EPA opened a Los Angeles Field Office. The EPA's analysis determined that this particular Regional Administrator's travel dwarfed the travel by his predecessor and by his successor, calling into question the "mission requirements". Per the EPA-IG report, the EPA is working on a voluntary repayment schedule to recover approximately $3,800 from the employee. If this situation pertained to a contractor executive or employee, the Government would probably assert that it is a violation of the FCA (False Claims Act) and assess treble damages as well as attempt to recoup unallowable costs associated with a portion of the employee compensation (for unallowable/unnecessary travel time).

Beyond the questionable behavior and travel costs incurred by the EPA Regional Administrator, the EPA-IG also determined that EPA employees used premium class airfare, but failed to report it as required by the GSA (General Services Administration). Additionally, the EPA apparently paid for lodging in excess of JTR/FTR per diems, but failed to document why (no justification). Again, if contractors followed these practices, Government audits would not only disallow the costs, but assert that the contractor's accounting system was inadequate for purposes of Government contracts.

Editor's comment: Although the EPA-IG did identify and report excessive and/or non-business travel by an EPA Regional Administrator, we are personally aware of other instances where Government executives (SES-Senior Executive Service) took advantage of Government travel to essentially subsist on the Government "dime". In the case of a Government audit agency, it was determined that a Regional Director assigned to the Dallas Regional Office, frequently planned trips (typically on a Thursday) to the Phoenix field office to allow the Regional Director to then drive home to his Los Angeles personal residence. Although the trips required review and approval, it required a hotline referral from an employee to bring this issue to light and because the Regional Director had retired, the only recovery was for non-business long-distance telephone calls (perhaps calls home before traveling to Phoenix).

In another case, a Senior Executive coordinated his/her travel to accommodate his/her participation in running marathons. Apparently no one reviewing and approving his/her travel requests was able to connect the dots.

In a more recent case, a Senior Executive was in a perpetual travel mode because his daily commute (non-travel mode) was approximately two hours (one-way) as a result of relocating from his local commuting area to a primary residence located in a recreational area. By constantly traveling, the Senior Executive not only eliminated his daily commute time, but essentially subsisted on meals furnished by the Government. Additionally, the Senior Director was able to establish additional field offices in his/her preferred travel locations; although some new offices may have been justifiable, there was an obvious conflict of interest because personal interests were a significant factor.

NASA Policy on Contractor Employee Access to NASA Facilities

As we once again teeter on the brink of a federal Government shutdown, Government contractors are left to deal with the impact which might include denied access to Government facilities. Coincidentally, NASA has a new contractual clause, 1842-7001, effective October 2015 which pertains to "Denied Access to NASA Facilities". As described in the new policy, NASA may close or deny contractor access to a NASA facility for all or part of a day for a number of reasons, including:

- Federal public holiday for federal employees,
- Fires, floods, earthquakes, severe weather (snowstorms, tornados, hurricanes),
- Occupational safety or health hazards,
- Non-appropriation of funds by Congress,
- Any other reason.

NASA's policy goes on to state that contractor employees may be impacted and it is the contractor's responsibility to monitor various sources for announcements of NASA facility closures and to notify contractor employees. If there is an event causing NASA employees to be on administrative leave, NASA's policy expressly states that "the leave status of NASA employees shall not be conveyed or impute to contractor employees. Accordingly, unless the NASA facility is closed and the contractor is denied access to the facility, the contractor shall continue performance in accordance with the contract".

By implication, just because NASA employees are on administrative leave due to a snow-day, the contractor employees are to be at the NASA facility unless the facility itself is not accessible. Beyond the apparent double-standard,

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there is the question of cost accounting and cost recovery for disruptions; either in terms of facilities access or for inclement weather for which a contractor has its own administrative leave policy. The theme within NASA's new policy is relatively clear, if contractor employees can continue to work at the NASA facility, they will and the labor will be a direct cost to the NASA contract. If contractor employees cannot continue to work, the contractor should not automatically expect NASA to allow direct labor charges for idle time. Although NASA benevolently states that the contracting officer may consider properly documented requests for equitable adjustment, claim or other remedy pursuant to the terms of the contract, NASA also states that the contractor is expected to minimize unnecessary contract costs.

In many respects, the new NASA contractual clause changes very little, there remains a fine line between disruption (labor) costs which could be charged to the contract and those which might be allowable, but only as an indirect cost. For example, the contractor might have a policy for inclement weather (e.g. delayed reporting to the job site) for which any paid administrative leave is charged to fringe benefits (typically allocated to a broadly defined labor base). Even if the NASA facility was not officially closed, NASA could not preclude the contractor from having such a policy and incurring indirect costs allocable per contractor policy. However, NASA has gone on record of stating that the labor costs could not be charged directly to the NASA contract as long as the NASA facility was officially open and regardless of the paid administrative leave extended to NASA employees.

Price Reasonableness and Commercial Items. The Saga Continues

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

As a follow-up to our article in our August Newsletter, we've become aware of some recent developments concerning price reasonableness applied to commercial items. The evolving issue appears to be rooted within a few DOD-IG reports concerning spare parts pricing involving commercially available catalog prices. In typical DOD-IG fashion, it reported a number of individual spare parts (using a biased, non-generalizable sample) which were ultimately shown to include "astounding" profit rates (thousands of a percent). Additionally, for any given spare part, the recent sales history lacked significant sales to commercial buyers; hence, the conclusion that the DOD was paying too much for spare parts from sole sources whose prices were not influenced by the commercial market (DOD seems to miss the obvious, that single sources for critical spare parts have a "slight" pricing advantage over commercial or government customers; in other words, even if there were more commercial sales, there would be little or no downward pressure on spare parts pricing).

Even though the commercial pricing issue involving spares is an extremely small piece of the overall DOD acquisition budget, it seems to have solidified DOD's resolve to force the issue as evidenced by a proposed DFARS rule (Case 2013-D034) which would result in far more disclosure of actual cost data (other than certified cost or pricing data albeit cost data and not merely sales history supporting a price). In reaction to the proposed DFARS Rule, CODSIA has issued an eighteen page letter requesting the DAR Council to withdraw the proposed rule, address CODSIA's concerns, and start over (note that the DAR Council cannot simply withdraw the proposed rule because it traces back to a requirement from a legislative action, Section 831 of the FY2013 National Defense Appropriations Act).

As the public debate continues, we have become aware of very intrusive and unprecedented requests from DCMA to commercial prime or subcontractors. In particular, one recent activity involved DCMA's directly contacting a commercial subcontractor to obtain actual cost data (by implication, "other than certified cost data") to substantiate the commercial price; however, the DCMA request is after-the-fact and it relates to a fixed price commercial item subcontract which does not include FAR 52.215-2 (Access to Records Clause). Apparently DCMA has no issue with directly requesting cost data, after-the-fact, from a commercial subcontractor for which privity of contract is between the prime and subcontractor. Moreover, DCMA is less than forthright in explaining why it is requesting cost data, particularly actual labor hours along with direct material costs. An optimist would believe that DCMA is trying to paper its files to support its contracting officer's determination that the prime contract price was fair and reasonable (by implication neither the contracting officer's nor the prime contractor's files satisfied an internal review by DCMA). A pessimist would believe that DCMA is trying to

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identify one more occurrence of “excessive profits” attributable to sole source commercial items. Regardless of the Government’s undisclosed motivations, contractors should be aware of the rapidly expanding expectations for “other than certified cost or pricing data” related to commercial items or any other circumstance wherein the contracting officer does not believe that he/she has a sufficient basis to determine a price to be fair and reasonable. And as evidenced by the recent activity involving a subcontractor, prime contractors will likely be compelled to require (other than certified) cost data from subcontractors which only provided sales data in the past. An unexpected application of “transparency” if one choses to remain a Government contractor.

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October 15, 2015 – Government Contractor Challenges, Live One-Day Seminar in Ft. Walton Beach. FL.
WEBINAR – Announcement coming soon

October 15, 2015 – Contract Cost Accounting and Pricing Compliance 2015 Webinar Series – Topic: TBD.
WEBINAR – Announcement coming soon

November 19, 2015 – Contract Cost Accounting and Pricing Compliance 2015 Webinar Series – Topic: TBD
WEBINAR – Announcement coming soon

December 17, 2015 – Contract Cost Accounting and Pricing Compliance 2015 Webinar Series – Topic: TBD
WEBINAR – Announcement coming soon

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

Instructors:

- Mike Steen
- Scott Butler
- Cyndi Dunn
- Asa Gilliland
- Sheri Buchanan
- Darryl Walker
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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.

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