



DCAA Activities and Policies

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

DCAA and FAR 52.203-13 Contractor Business Ethics and Conduct. Dating back to December 2008, FAR 52.203-13 imposes a number of requirements on government contractors and subcontractors and predictably, DCAA has displayed a sporadic interest in auditing large contractors for compliance. Recent experiences have shown DCAA's attempts to use contractor gaps in documented compliance with FAR 52.203-13 as the basis for asserting that a contractor accounting system is non-compliant with the DFARS Business (Accounting) System Rule 252.242-7006. Although nothing in this particular DFARS rule specifically references FAR 52.203-13, DCAA conveniently uses system criteria (c)(1) "sound internal control environment, accounting framework, and organizational structure". This highly generalized, over-arching criteria is wide-open to subjective interpretation; hence, any government auditor can use any non-compliance as the basis for asserting a contractor's failure to comply with 252.242-7006(c)(1).

DCAA makes no attempt to determine if an alleged non-compliance with Far 52.203-13 has any discernible impact because DCAA's audit policy only requires a "reasonable probability" that the facts will result in a material non-compliance. In tandem with the wide-open DFARS criteria, leaving us with regulations and audit policies which allow an auditor to drive a Mack-truck through the door, so to speak.

Based upon recent experiences (DCAA audits for FAR 52.203-13 compliance), one of DCAA's highly debatable requests for data is with respect to employee terminations, or more specifically, involuntary terminations. DCAA requests full access to the employee file, in particular searching for employee terminations for "bad behavior"; focused on employee thefts, misappropriation of funds, etc. DCAA believes that employee thefts (of contractor funds/assets) are fraud reportable under FAR 52.203-13(b)(3)(i): "The Contractor shall timely disclose..."A violation of Federal criminal law involving fraud, conflict of interest, bribery or gratuity violations found in Title 18 of the United States Code (U.S.C.)". If DCAA uncovers employee theft, DCAA will then request a copy of the "timely (mandatory) disclosure" ignoring the fact that by regulation, DCAA is not on the list of agencies which are the intended recipients of mandatory disclosures. Less

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obvious, but further invalidating DCAA's request, FAR 52.203-13 and Title 18 pertain to Federal criminal law which is most likely not applicable when the misappropriated assets were those of the contractor.

Regardless of DCAA's misplaced assertions, contracts with FAR 52.203-13 do have a number of requirements and contractors should document and be prepared to demonstrate compliance should DCAA come knocking. The preference is to be positioned to demonstrate compliance in contrast to debating with DCAA and an ACO the significance of non-compliances.

DCAA Assist Audits In the context of incurred costs, DCAA continues to be all-over-the-map in terms of auditing subcontract costs as a component of flexibly-priced prime contracts (cost-type, fixed-price incentive or Time & Material/T&M). For years (when DCAA was relatively current in terms of its incurred cost backlog), DCAA auditors (at the prime contractor) used Schedule J to identify auditable subcontracts, and for most, coordinated/requested assist audits. DCAA auditors cognizant of the subcontractor, audited the subcontract cost while auditing the contracts and subcontracts held by that particular subcontractor (most were subcontractors as well as holding their own prime contracts). In cases where a contractor is strictly a subcontractor in terms of auditable government contracts, DCAA assist audits were still common albeit of a subcontract/subcontractor with no prime contracts.

In May 2011, FAR 52.216-7 was significantly changed to include specific requirements for an adequate indirect cost rate proposal and somewhat hidden, a statement that with respect to amounts included in contract closeouts, the prime contractor is responsible for settling subcontract costs and indirect rates (FAR 52.216-7(d)(5)). This subparagraph was added in response to a public comment that timely contract closeouts require timely government assist audits; hence, regulations should prescribe timelines/due dates. In responding to that public comment and adding subparagraph (d)(5), there are no government assist audits because it is solely the responsibility of the prime to settle both direct and indirect costs for the subcontract(s). Eliminating any expectations for government assist audits is also consistent with contract administration, in particular FAR 42.202(e)(2) which states that the prime contractor is responsible for managing its subcontracts (in

context, it is not the government ACO, rather it is the prime contractor's responsibility).

Fast-forward to 2015 and 2016 during which DCAA has been re-focused on its incurred cost backlog (in significant part, forced to do so by Section 893 of the 2016 NDAA which pertains to the incurred cost backlog). DCAA's audit policies and CAM (Contract Audit Manual) still include references to assist audits of subcontract costs; however, DCAA's audit policies also refer to reviewing the prime contractor's subcontract management including the prime contractor's audits of subcontract costs (as if any clause requires subcontract audits). In practice, DCAA auditors of prime contractors are requesting assist audits of subcontractors including subcontractors who do not have any government prime contracts. In discussions with DCAA auditors, it is apparent that they are unaware of FAR 52.216-7(d)(5) and/or firmly entrenched in their beliefs that DCAA can and will determine if/when it performs assist audits (supported by DCAA's expectation that prime contractors will include FAR 52.215-2 as a flow-down to subcontractors, thus ensuring that DCAA has access to subcontractor books and records). In application to subcontractors and subcontract direct and indirect costs, DCAA's selective use of assist audits (ignoring FAR 52.216-7(d)(5)) is once again supported by DCAA's belief that GAGAS (sufficient evidentiary matter along with no reliance on the work of government contractors) compels DCAA to audit or at least to consider auditing subcontract costs. Unfortunately, DCAA's assist audits may not have any useful purpose given that DCMA's instruction number 125 for establishing final overhead rates makes absolutely no mention of subcontract overhead rates. By implication, DCMA has read FAR 52.216-7(d)(5) and has appropriately deferred to prime contractors to settle (finalize) indirect rates at subcontractors. The end result, DCAA issuing an advisory report (subcontractor direct and indirect costs/rates) to an ACO who has no responsibility to do anything with that report. One more reason why DCAA is behind the curve in terms of completing incurred cost audits.

DCAA Audit Policy on Independent Reference Reviews (IRRs)

MRD (Memorandum for Regional Directors) 16-PPS-003(R), February 3, 2016, is an audit alert which discusses an expansion of DCAA's internal IRRs. In this case, in continuing response to the most recent Peer Review (DoD-IG Peer

Review of DCAA, August 21, 2014), DCAA will now be expanding its IRR checklist process to include audits in addition to those required under policies and procedures. Field managers will be responsible for identifying the additional assignments to be sampled (subjected to the IRR checklist to ensure that any representation within the audit conclusions is clearly supported within the working papers; unfortunately, not a qualitative review to ensure that the documented conclusion is consistent with all relevant data and the regulations). DCAA's internal process will be invisible to contractors other than increasing the possibility that a field-work completed audit might be restarted to gather additional documentation to resolve observations from an IRR. The good news for DCAA auditors, the IRR checklist has apparently been reduced to eliminate several questions useful in identifying deficiencies that should have been addressed with proper interim and supervisory reviews. Not that it matters, but it's hard to visualize an after-the-fact IRR checklist which excludes deficiencies that should have been addressed with proper supervision; conceptually, there wouldn't be anything left in the IRR checklist.

SCA (Service Contract Act) Risks

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

In our blog dated February 17, 2016, ([Click here to read](#)), we discussed the requirements of the SCA; in summary, those contracts which include the SCA must ensure that trade employees are paid at least the prevailing wages along with providing the stipulated vacation, holidays, and H&W (Health and Welfare). Two recent government actions reinforce the SCA requirements as well as the risks associated with failing to comply with the SCA.

Department of Labor Debars Contractor for Violating Wage Requirements.

In a decision dated February 23, 2016, the US District Court for the District of Columbia concluded that the DOL (Department of Labor) properly debarred a contractor for three years for underpaying employees and not maintaining employee records. As stated in the decision, the contractor's willful and deliberate actions justified the relatively harsh

punitive actions by DOL. Other available information suggests that the contractor was uncooperative with DOL and the contractor failed to promptly implement corrective actions (having received repeated warnings concerning employee records). Although it is coincidental to this particular action, a reminder to government contractors that the Fair Pay and Safe Work Place Executive Order which is a proposed rule (Federal Register May 28, 2015) will require existing and potential government contractors to disclose certain labor and safety violations as a component of the contractor response (bid proposal) to a government solicitation. Although the final rule and its effective date have not been published, suffice to say that existing and potential government contractors should be preparing for this requirement (it remains to be seen exactly what will be required to be disclosed; however, it won't be too far removed from the dictates of the Executive Order as reflected in the May 28, 2015 proposed rule).

Contractor Prevails on Government Assertion of Valueless Services (SCA Underpayments)

In a decision on February 4, 2016, a contractor prevailed on its appeal related to an earlier decision that underpaying electricians (subject to SCA) in the amount of \$9,916 tainted the entire value of the electrical work. In the initial decision, the government sought and obtained a damages award of \$763,000; treble damages associated with \$259,218 for electrical work. Notably the underpayment was by the electrical subcontractor (not the prime contractor) and the prime contractor had already paid the government \$15,000 to cover the damages. In the appeal, the Court described the government's damages claim as "fairyland rather than actual", noting that the initial award was an abuse of discretion based upon the fact that the actual damages were readily determinable (\$9,916) and that the electrical services were not valueless (the buildings were occupied with no evidence of inferior electrical work). The appeals Court concluded that the actual damages \$9,916 tripled are \$29,748 versus \$763,000.

Notwithstanding the prime contractor success with the appeal, the unfortunate fact that the prime contractor incurred unallowable legal costs to defend itself, it was found to be in violation of the civil False Claims Act (FCA) which brings with it treble damages and at some point, disclosing this violation once the Fair Pay and Safe Work Place regulations take effect. Although we are not privy to the legal expenses, it is plausible that a \$9,916 subcontractor underpayment of SCA

wages resulted in more than \$100,000 in prime contractor costs (legal and FCA damages); a reminder of the cost of noncompliance for government contractors.

IR&D: Losing its Independence for Defense Contractors

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

Large defense contractors are on the verge of obtaining “assistance” from the DOD in terms of enhancing the value of the contractor IR&D (Independent Research and Development) costs. In a rule proposed on February 16, 2016, disingenuously titled “Enhancing the Effectiveness of IR&D”, a prerequisite for the subsequent determination of allowability, major contractors must:

- Engage in a technical interchange with a technical or operational DoD Government employee before IR&D costs are generated so that contractor plans and goals for IR&D projects benefit from the awareness of and feedback by a DOD employee who is informed of related and potential interest opportunities
- Use the online input form for IR&D projects reported to DTIC to document the technical interchange which includes the specific name of the DOD employee and the date of the technical interchanges (DTIC is the same sight as currently used to report IR&D projects and expenditures to comply with the intrusive allowability reporting requirements of DFARS 231.205-18(c)).

Although the DOD publicly states its belief that it can enhance the value of “independent” research and development from “awareness and feedback”, this is but a subterfuge masking DOD’s real interest in controlling IR&D costs, at least those IR&D costs allocable to DOD contracts. It should be noted that the proposed rule does not make IR&D costs allowable (because there are additional requirements which could impact allowability), but failure to engage in the technical interchange would make the subsequent IR&D costs unallowable regardless of the value to DOD). Perhaps the most disingenuous statement within the proposed rule is that DOD’s intent is not to reduce the independence of IR&D investment selection, nor to establish a bureaucratic requirement for

Government approval prior to initiating a project. Instead the objective of this engagement is to ensure that both IR&D performers and their potential DoD customers have sufficient awareness of each other’s efforts and to provide industry with some feedback on the relevance of proposed and completed IR&D work (editor’s comment; interesting that the rule moves from a particular contractor to “industry”, further that DOD is also going to make the contractor aware of DOD’s efforts albeit without any contractual clause which actually requires or specifies if/how DOD will accomplish that promise).

For any contractor potentially impacted the February 16, proposed rule, the public comment date ends April 8, 2016. Optimistically public comments will cause DoD to revisit and to revise the rule; pessimistically DOD will move forward having forgotten why the IR&D cost allowability regulations were significantly changed in the mid-1990s to allow and encourage traditional DOD contractors to pursue other business. If successful, that other business would expand the contractor indirect and G&A cost allocation base, thus shifting fixed indirect and G&A to other than DOD contracts. How soon we or they (DOD) forget.

Training Opportunities

2015 Redstone Government Consulting Sponsored Seminar Schedule

April 6, 2016 – Incurred Cost Proposal Adequacy Requirements

NCMA Live Event, Huntsville, AL – [REGISTER HERE](#)

2015 Federal Publications Sponsored Seminar Schedule

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Orlando, FL

April 18-19, 2016 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk

Arlington, VA

April 25-26, 2016 – Accounting Compliance for Government Contractors

Alexandria, VA

May 17-18, 2016 – Cost and Price Analysis in Government Contracts

La Jolla, CA

June 15-16, 2016 – Accounting Compliance for Government Contractors

Arlington, VA

July 18-19, 2016 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk

Hilton Head Island, SC

August 22-23, 2016 – Cost and Price Analysis in Government Contracts

Arlington, VA

August 25-26, 2016 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk

Arlington, VA

September 19-20, 2016 – Cost and Price Analysis in Government Contracts

Fort Worth, TX

October 24-25, 2016 – Accounting Compliance for Government Contractors

Sterling, VA

November 3-4, 2016 – Cost and Price Analysis in Government Contracts

Sterling, VA

Instructors:

- Mike Steen
- Scott Butler
- Cyndi Dunn
- Asa Gilliland
- Sheri Buchanan
- 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

What is a Job Cost Accounting System?

Posted by Cheryl Anderson on Tue, Feb 23, 2016 – [Read More](#)

Prime Contractor Subcontract Management, National Defense Authorization Act, Section 893 Fallout

Posted by Robert Eldridge on Thu, Feb 18, 2016 – [Read More](#)

Does the Service Contract Act Apply to Your Company and Are You Compliant?

Posted by Cyndi Dunn on Wed, Feb 17, 2016 – [Read More](#)

Redstone GCI Client, Main Sail, Receives Major Contract Award

Posted by Courtney Edmonson on Tue, Feb 9, 2016 – [Read More](#)

DCAA Rewrites FAR 42.202: Primes Now Responsible for Auditing Subcontracts

Posted by Michael Steen on Tue, Feb 2, 2016 – [Read More](#)



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Why Outsourcing Accounting, HR and Contracts Administration Functions is Trending Among Small Government Contractors

Posted by Courtney Edmonson on Thu, Jan 28, 2016 – [Read More](#)

2015 Annual Update from Redstone Government Consulting

Posted by Scott Butler on Mon, Jan 18, 2016 – [Read More](#)

Congress Section 893 (2016 NDAA) and DCAA. The Saga Continues on DCAA's Incurred Cost Backlog

Posted by Michael Steen on Wed, Jan 13, 2016 – [Read More](#)

Staying Competitive in a Cost Averse Market

Posted by Asa Gilliland on Thu, Jan 7, 2016 – [Read More](#)

Department of Justice (DOJ) Fraud Recoveries

Posted by Charlie Hamm on Mon, Dec 28, 2015 – [Read More](#)

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Alleviating Bid Proposal Stress

Posted by Courtney Edmonson on Wed, Dec 16, 2015 – [Read More](#)

ICE Model Version 2.0.1e (December 2015)

Posted by Kimberly Basden on Wed, Dec 9, 2015 – [Read More](#)

2016 Defense Authorization Act Section 893

Posted by Michael Steen on Thu, Dec 3, 2015 – [Read More](#)

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Whitepapers Posted to our Website

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Commercial Item Determination

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Limitation of Funds Clause Equals No Cost Recovery

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DFARS Business Systems

A Whitepaper by Michael Steen & Robert L. Eldridge – [Read More](#)

For More Whitepapers:

<http://www.redstonegci.com/resources/white-papers>

CFO Roundtable

Redstone Government Consulting, Inc., Radiance Technologies, Inc., & Warren Averett will be sponsoring a CFO/Controller roundtable for Government Contractors.

All Government contractor CFO's or Controllers are invited to participate. The meetings will be held quarterly and will include lunch and networking from 11:30am – 1:00pm. The next meeting will be held on May, 2016 in Research Park at Radiance Technologies located at 350 Wynn Drive, Huntsville, AL 35805. Participants will be notified via email announcements for all future locations and seminar topics.

The CFO Roundtable is **free** to attend. All participants will be invited to share topics of interest and the group will be interactive. Redstone GCI, Radiance Technologies, and Warren Averett will strive to provide speakers on topics that are of interest to the group each quarter. Please provide us your email address and we will notify you 30 days in advance of each meeting. RSVP's are required.

[Sign Up for CFO Roundtable HERE](#)

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.



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