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DCAA's Ever-expanding Demands for Access to Contractor Records

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

Many government contracts include FAR 52.215-2, Audit and Records—Negotiation, affectionately known by DCAA as the "Access to Records" clause. In addition to broadly defining records, this clause also defines the purpose of the clause which includes subparagraphs (b) examination of costs and (c) certified cost or pricing data. The following are two recent examples of DCAA requests which were pushing the limits of the Access to Records clause, but the respective contractors opted to be cooperative assuming that cooperative behavior helps build good working relationships with government auditors. Although attempting to work "with" auditors is the typical strategy, it should be recognized that auditors must be independent and objective; hence, they should not be unduly influenced by "nice contractors". Moreover, devious auditors and those intent on finding and reporting issues will never be moved by cooperative contractors.

Request for employee personnel files for involuntarily terminated employees. As part of its overall risk assessment of a contractor, DCAA auditors are required to consider employee and management turn-over. Excessive turn-over might be a sign of unrealistic management expectations, such as goals for increasing or excessive profit margins, which might motivate employees to mischarge (and those who don't achieve the excessive profit margins are terminated). Employees and managers might be terminated for other reasons, including falsification of time charging and/or overstating travel expenses, in either case an audit lead. The particular audit leads can trigger additional audit inquiry such as i) how did the contractor correct the expenses to eliminate the false time charge or the false expense report, or ii) were the actions the result of lax internal controls (an overarching requirement for an adequate accounting system)?

THIS ISSUE:

The fact that a DCAA auditor might request employee personnel records specifically for involuntary terminations begs the question, do these records support costs claimed? If not, what's the nexus of the record to direct or indirect costs claimed by the contractor? The answer, there isn't any meaningful nexus of employee involuntary terminations to any claimed cost unless there is a severance pay policy which precludes severance payments for specified employee actions (misbehavior). Is there any risk in providing employee personnel files to a DCAA auditor, after all, the file is a record (as broadly defined in FAR 52.215-2) and the DCAA auditor insists that alone gives him/her the right to the record? Not exactly, there is always a risk in giving an auditor a record(s); moreover, a fundamental access to records contractual issue given that there are countless records which have no nexus to the objective of a particular audit and/or the specifically requested record does not support a contractor assertion (claimed direct or indirect cost). In this particular audit, the auditor ultimately misused the personnel files (showing involuntary terminations) to support the auditor's assertion that the contractor failed to timely disclose actions define in FAR 52.203-13 (mandatory disclosures). For example, that an employee theft of contractor property must be reported (even though the auditor made no attempt to determine if there was any accounting data showing that the contractor loss had been directly or indirectly charged to the Government). The moral to the story, there is always a risk in providing an auditor with data/information which has no discernible connection to the objective of the audit. The auditor may have requested a document for innocent reasons (i.e. they had no "audit objective" reason to request it, they simply didn't know what they were requesting or why) or the auditor may have requested records for devious reasons (they are trying to build their case to support a pre-determined conclusion relative to an issue which is arguably outside the scope of a particular audit).

DCAA Request for Subcontractor Confirmations. For anyone who has ever performed financial statement audits, third party confirmations are a very basic means to confirm certain balance sheet representations including accounts receivable and accounts payable. Unlike its distant audit cousins involved with financial statement audits, DCAA rarely utilizes third party confirmations, a fact which raises all types of concerns if/when DCAA seeks prime contractor authorization letters to set in motion third party confirmations (subcontractors who receive a prime contractor letter requesting a confirmation for DCAA, automatically assume that there is an investigation versus a routine audit). For the record, for purposes of performing assist audits of subcontractor costs on cost type or incentive contracts (which included FAR 52.215-2 as a flow-down), DCAA does not need a prime contractor authorization letter. In most cases, the DCAA assist auditor receives a request from the DCAA prime contract auditor; with or without any coordination with the prime contractor (which explains why Schedule J of an indirect cost rate proposal requires information concerning subcontracts and subcontractors). But what about audits for TINA compliance (Truth in Negotiations Act) where DCAA recently requested a prime contractor prepare third party confirmation letters authorizing DCAA to send inquiries to the respective subcontractor(s). To the extent a subcontract was subject to TINA, FAR 52.215-2 should have flowed-down to the subcontractor in which case DCAA does not require a prime contractor authorization. But what about subcontracts which are exempt from TINA, such as fixed price commercial items/services or competitively awarded subcontracts without certified cost or pricing data? The obvious answer, FAR 52.215-2(c) *Certified cost or pricing data* does not apply and DCAA has no contractual rights to expand its after-the-fact TINA compliance audit to a subcontractor which was exempt from TINA.

Even when the auditor is knowledgeable of TINA applicability and exemptions, in all too many cases, the DCAA auditor will interject GAGAS (Government Auditing Standards) and its requirement for sufficient evidentiary matter to support the audit conclusion as if GAGAS trumps FAR 52.215-2. The last time we checked, a contractor is held to compliance with its contractual clauses including those which permit the government to access contractor records for purposes of an audit (incurred cost or TINA compliance). Nothing in FAR 52.215-2 explicitly or implicitly modifies FAR to adapt to DCAA's broader interpretation of GAGAS (coincidentally, GAGAS is the reason why DCAA insists that it has the right to interview contractor employees). If GAGAS and revisions to GAGAS or revisions to DCAA' interpretations of GAGAS actually trumped FAR/CAS, audits would be in a state of turmoil with audit criteria independently changing outside of the Federal Rulemaking Process (In view of some of the audit turmoil unique to DCAA audits, perhaps it's not a matter of "if",

but "when" DCAA unilaterally changes its audit criteria with or without any change in the underlying regulations.)

Miscellaneous Decisions and Regulations

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

FAR 31.205-6(p) Change to Compensation Cap. OMB (Office of Management and Budget) can rest at ease having issued its last "embarrassing" increase to the compensation cap under the statute which pre-dates June 24, 2014. After years of OMB and the current Administration publicly complaining about the statutory formula for annual increases to the ("excessive") statutory cap, the June 24, 2014 Federal Register posted a new and improved (much lower) cap of $487,000 for all employees on all government contracts subject to FAR Part 31. In contrast, on March 15, 2016 OMB, bound by the previous statute, reluctantly and apologetically published the caps for 2013 and 2014, $980,796 and $1,144,888, respectively. The higher caps apply to contracts executed before June 24, 2014 and one can assume that the only future changes will be the annual changes to the $487,000 cap. The fact that there are two distinctively different caps which apply in 2014 (and potential later years) has resulted in DOD authorizing blended rates (subject to advance agreements a discussed in DCAA MRD 16-PSP-005 available at www.dcaa.mil/mrd.html.)

Not that it matters nor will the administration change its delay tactic, but the $487,000 cap (published on June 24, 2014) is subject to annual increases based upon the change in the Employment Cost Index for all workers calculated by BLS. BLS has published this data (annual increase) for 2014 and for 2015; however, OMB apparently can't locate the BLS website and/or no one is sure how to adjust 2014 because the adjustment could be for just over one-half the annual percentage increase. Noting that the BLS annual index increased by 2.2 percent (2014) and 2.0 percent (2015), there is not a lot of movement from year-to-year; actually no movement as long as OMB does nothing to update the statutory cap. Remarkably, the same delay tactics began to surface with the old statutory cap (annual increase based upon compensation data obtained from publicly traded corporations with revenues greater than $50 million). For most years, the new annual cap had been published in May; as an example the cap for 2010 was published in April 2010 using 2009 financial reports. Beginning with the 2011 cap, it was mysteriously unpublished until late April 2012 (essentially one year late) followed by the 2012 cap which was published in December 2013 (nineteen months late, with no explanation). A reminder that Government actions can be late if not delinquent, whereas contractual due dates applicable to contractors don't permit the same flexibility.

One last reminder, the statutory cap is not the only test for allowabiliy, compensation must also be reasonable as defined in 31.205-6(b). With the artificially low statutory cap, the allowable compensation ($487,000 which includes base, incentive, and deferred compensation and employer payments to defined contribution pension plans) will result in far fewer challenges to reasonableness. However, in benchmarking to salary surveys, relatively small companies will find that amounts up to $487,000 are within the statutory cap, but in excess of reasonable compensation (e.g. for specific position, a salary survey may indicate a median of $350,000 versus the $487,000 cap).

Valid Contractor Claim in-spite of Cost Under-runs.

Although it is well established that merely over-running costs (actual costs versus estimated costs) does not support a contractor REA (Request for Equitable Adjustment), the Government recently attempted to use this in reverse to summarily discount a contractor REA claim based upon the fact that the actual costs were less than those originally estimated by the contractor. In a recent CBCA (Civilian Board of Contract Appeals) decision involving a construction contractor Tucci & Sons, Inc., the FHA (Federal Highway Administration) filed and lost on a motion for summary judgement asserting that there can't be any damages when the total actual costs to perform are less than the originally estimated costs (i.e. even if there were changed site conditions which could support an REA, there aren't any increased costs, thus no possible claim). Fundamentally, the FHA assertions ignore the fact that the contractor could be entitled to a price increase if differing site conditions exist and the contractor can support its claim for quantum. By implication, the construction contractor was under-running actual costs versus original estimates and the amount of the

under-run was enough to absorb additional work caused by differing site conditions.

It is worth noting that the contractor only prevailed on FHA's motion to dismiss the claim; the CBCA cautioned that the burden of proof is on the contractor to support the claim (entitlement as well as quantum). In the end, the contractor may have "won the battle, but lost the war". A reminder that a successful claim (REA) requires timely recognition of the facts which trigger the claim (e.g. differing site conditions or government caused delays) as well as timely actions to isolate the additional costs.

Failure to Disclose Corporate "Family" Misbehavior = Contract Termination

In US CoFC (Court of Federal Claims) No. 15-1279C, issued for publication on March 14, 2016, a bid protest was successful on the basis of material misrepresentations by the initially successful offeror. As stated in the decision, "the Court permanently enjoins the Navy by requiring termination of the contract award to (the initial awardee) and the cessation of any further performance under the contract. Although the initial awardee priced its proposal 4 percent below the bid protestor's price proposal, the solicitation included an eligibility requirement "including a satisfactory record of integrity and business ethics". Awarding the contract to an offeror which materially misstated its certifications and representations is "arbitrary and capricious".

As stated in the published decision, the fundamental issue, the initial awardee is part of a family of companies which was facing government investigations and prosecution for fraud and bribery related to multiple procurements around the world. The former Chairperson pleaded guilty to a 20-year conspiracy to defraud the Government (2014), a business segment entered into a Deferred Prosecution Agreement (2010), and perhaps most damaging, the home office which had assumed responsibility for managing all international operations (including the initial awardee) was involved in a Government investigation concerning payments to foreign officials (violation of the Foreign Corrupt Practices Act). None of this had been disclosed by the initial awardee (certifications and representations) and non-disclosure was essentially the issue which resulted in the Court's decision. The Contracting Officer, once he/she became aware of the corporate history, discounted it by concluding that the initial awardee (segment within the family of companies) was not involved with the corporate misbehavior and that the home office did not exert operational or managerial control over the segment (initial awardee). The Court flatly disagreed with the Contracting Officer's interpretation noting the segment was a wholly owned subsidiary of the home office and that the Deferred Prosecution Agreement specifically stated that the home office would be responsible for monitoring the employees of the wholly owned subsidiaries. As stated in the published decision, "The Court fails to understand how (the home office) can wholly own and legally control all entities, but not exert power over them so that each is a standalone business. The Contracting Officer failed to justify or explain this patently inconsistent finding. Where, as here, a contracting officer relies on an offeror's misstatement, the award is arbitrary and capricious."

Coincidentally, there is an Executive Order (13,373) and a proposed FAR regulation (FAR Case 2014-025) which will require potential government contractors to disclose a number of violations (labor laws, environmental, OSHA). The so-called Fair Pay and Safe Workplace regulation is anticipated to be issued as early as this April and given the fact that it implements an Executive Order (EO), it will necessarily reflect the requirements stated within the EO (i.e. the final rule cannot be significantly different than the EO). One more reason to fully disclose as required by a Government solicitation. In source selections, if the Government "overlooks" an offeror's questionable past performance (actual or alleged), rest assured that unsuccessful offerors will be considering bid protests to over-turn contract awards as was the case in US CoFC No. 15-1279C.

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Instructors:

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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 18, 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

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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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