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Government Property At-Odds with Direct Contract Costing

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

At a recent seminar, an expert on Government Property (years of experience as a Government Property Administrator focused upon FAR 52.245-1) made note of government contractors who "illogically" treat small dollar items as direct charges to final cost objectives (contracts or task orders). Viewed purely from the perspective of Government Property Administration, such practices result in unnecessary and inordinately costly contract administration on the part of both the Government and the contractor (most importantly, "on the part of the Government"). This somewhat academic discussion coincidentally surfaced when a contractor followed its long-established practice (identifying and direct charging material including consumables or expendables to the maximum extent possible to specific cost objectives). In this case, the Government Contracting Officer (CO) advised the contractor to change its practices if it wants contracts with this Government Agency. In the words of the Contracting Officer (CO), "it is not in the best interest of the Government or yours to devote the level of effort required for this course of action for consumables because it is too labor intensive". Rather than consider a waiver to a requirement in an application where costs clearly outweigh any benefits, the CO went as far as to offer two alternatives that the potential contractor: i) develop an indirect cost pool or ii) use history to estimate consumables for a period to develop a factor for estimating and initial costing, but adjust to year end actuals. Of passing interest, this CO referred to ASPR in terms of its stringent requirements for absolute accountability of any physical item direct charged on a cost-type contract (ASPR was replaced by the DAR in 1978 and ultimately replaced by FAR in 1984).

THIS ISSUE:

Although this CO may be 100% correct in terms of his/her literal application of ASPR…err FAR, the CO is oblivious to the easiest solution of all…accept some extremely minor degree of risk and assume that direct material items specifically listed as consumables (total estimated cost below $10,000) will in fact be consumed during the performance of the contract. Don't bother with accountability when the nature of the items and the relatively low dollar value (estimated) suggests that they will be consumed during contract performance or if not consumed, of little or no residual value. From the perspective of cost risk to the Government, if the contractor, with any degree of precision, converts these consumables to an indirect cost, the amount charged to the contract will be substantially the same as direct costing (but for the non-value added cost of tracking government property (which would also be a direct cost)). Unfortunately, the CO is ignoring the added cost of changing the cost accounting system to add an indirect cost pool (viewed by too many including this CO as merely flipping a switch).

Alternatively, merely estimating consumables using a factor (low-dollar consumables representing a dependent variable computed as a percentage of an independent variable such as labor hours) is nothing more than estimating small dollar direct costs using a cost estimating relationship. In and of itself, this does not create an indirect cost pool (hence, it would do nothing to minimize the costs to track consumables estimated using a factor, but recorded as contract specific costs). But that might a bridge too far in terms or explaining this to a CO who is still referencing ASPR.

Somewhere in FAR (actually Part 1), there are uplifting references to assumptions of regulatory flexibility which would allow the contracting parties to make logical interpretations if those interpretations were reasonable. No one responsible for administering Government contracts reads FAR Part 1 because i) it lacks specificity and ii) no one responsible for oversight (i.e. Inspector Generals) has ever read or even considered reading FAR Part 1. If anyone could consider alternatives (flexible interpretations), it should be a CO who has been around since ASPR (implies retirement eligible which oft-times enhances flexibility or discretion). But the safer route is always risk avoidance even if the risk to the government is less than $10,000 in a world of trillion dollar budgets. One last observation (for contractors) FAR 31.202 may clearly state that "direct costs of the contract **shall** be charged directly to the contract", but it doesn't really mean it if/when the contract also invokes FAR 52.245-1 (Government Property Administration).

IR&D (Independent Research and Development) Back-to-the Future for DOD Contractors

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

As a by-product of DOD's Better Buying Power III, the requirements for coordinating and reporting IR&D projects continues to expand for those fortunate DOD contractors who meet the definition of a "major contractor" (defined in DFARS 231.205-18 as those contractors whose covered segments allocated a total of more than $11,000,000 in IR&D/Bid and Proposal costs to covered contracts during the preceding year). In 2012, DFARS changed to require "major contractors" to report their IR&D projects (DTIC) and more recently DFARS changed to require these same contractors to engage in a technical interchange with DOD (unspecified point of contact) before initiating the project. Lastly, there is a DFARS Proposed Rule (DFARS Case 2016-D017) which would "ensure that substantial IR&D expenses, as a means to reduce evaluated bid prices in a competitive source selection, are evaluated in a uniform way during competitive source selections". The proposed rule would only apply to major defense acquisition programs and major automated information systems.

Although the proposed rule does not specifically state how evaluated bid prices would be adjusted, it implicates an adjustment based upon the Government's projected share of projected future IR&D costs which are indirectly or implicitly related to the contract statement of work. Hence, a contractor whose projected IR&D is 100% related to the contract and for which the Government share (of future IR&D costs) is 100%, the Government evaluation would add 100% of the projected IR&D costs to the contractor bid/cost estimate. Conversely, a contractor whose future IR&D costs are not implicitly related to the contract and/or will be absorbed on a relatively small percentage of Government contracts would only requirea slight upward adjustment to its bid proposal or possible none at all.

One observation, the future IR&D costs cannot displace costs to perform and deliver the explicit requirements of the contract statement of work because such costs would not be IR&D (certain descriptions in the proposed DFARS seem to ignore this regulatory prohibition as if contractors can freely utilize IR&D projects to ultimately meet contract requirements).

As many have already noted, for certain large DOD contractors or those who are bidding to become a DOD contractor on a major acquisition, the changes and proposed changes to DFARS 231.205-18 are less-than subtly removing the "independence" from IR&D. Equally or perhaps more frustrating, the continuation of acquisition policies which effectively treat large contractors differently than other contractors. Large defense contractors are subject to DFARS 252.242-7005 (Business Systems Rule) which can yield payment withholds for system deficiencies. Small contractors might be tested against the DFARS 252.242-7005 business systems' criteria, but not subject to payment withholds (for one or more significant deficiency). Even more pronounced, but not unique to DOD contractors, FAR 31.205-6(p) which invokes a statutory cap of $487,000 on allowable compensation. The amount not-so-coincidentally impacts disproportionately more major/large government contractors because they have significant numbers of executives earning significantly more than the "cap". The arbitrarily low cap ignores the fact that compensation exceeding $487,000 is reasonable by any other measure, notably FAR 31.205-6(b). Although some might assert that large government contractors can better afford payment withholds, unallowable compensation, and potentially unallowable IR&D costs, the fundamental issue is the diversion from the long-standing objective of FAR cost principles (31.101) which states "to the extent practicable, all organizations of similar types doing similar work will follow the same cost principles and procedures". This trend of unfavorable and inconsistent treatment of large contractors was embodied in the logic (or illogic) of a Contracting Officer attempting to resolve cost allowability issues (strongly rebutted by the contractor). This Contracting Officer stated (when negotiations were at an impasse), DCAA's cost questioned is only $2 million, your company can easily absorb that amount (hence, agree to pay it regardless of the merits of the Government assertions). Of passing interest, the contractor refrained from countering that the national debt is $17 trillion (now $20 trillion); what's another $2 million?

DCAA Audits In the News

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

Post-Award Audits of Contractor Accounting Systems. Although DCAA never mentioned it in its FY2017 Audit Planning Memorandum, DCAA has apparently decided to initiate several post-award audits of contractor accounting systems. DCAA's internal reference is its audit program for activity code 17741 and DCAA's regulatory reference is DFARS 252.242-7006. This regulation only applies to contractors with CAS-covered contracts; nonetheless DCAA has decided that the system criteria is suitable for any and all DCAA audits of contractor accounting systems. This audit is vastly different than DCAA's pre-award audit which is basically a drive-through audit (limited scope) whereas the post-award variant is analogous to an extended sleep-over by one's in-laws. For any contractor who is submitting public vouchers under cost-type contracts, there is an expanding risk that DCAA will politely notify you of its plan to perform an audit of the contractor's compliance with the system criteria prescribed in DFARS 252.242-7006 (completely ignoring the issue that the particular contractor might not have any contracts subject to that DFARS…details, details).

If/when a contractor receives notification of the 17741 post-award audit, the contractor should immediately review DCAA's fifteen-page audit program and be prepared to present a "walk-through" which describes policies and procedures which address all 18 system criteria as embellished by DCAA in its audit program. Contractors should also expect DCAA requests for data and information, regardless of its pre-existence. Stated differently, DCAA field auditors are apparently unfamiliar with FAR 52.215-2 which (paraphrased) states that a contractor is not required to create records (for a Government audit) that the contractor does not create and maintain for its own business purposes or as required by law or regulation. In addition to the system criteria (DFARS 252.242-7006(c)(1)-(18)), a contractor should expect DCAA inquiries concerning the contractor's risk assessment process (including risks identified and actions to mitigate those risks), monitoring for compliance, and communications (with appropriate employees).

Although the tendency might be to provide DCAA with everything DCAA requests, there is an alternative response

which is to press DCAA to explain its regulatory basis for adding to the stated criteria and/or to press DCAA to explain why a contractor (not subject to DFARS 252.242-7006) would have any contractual reason to demonstrate compliance with a specific regulation which does not apply. Good luck on challenging any DCAA Field Auditor because they have no choice but to follow the agency policy of auditing to regulatory criteria regardless of its applicability to a particular contractor.

DCAA Embracing Data Analytics. As DCAA continues to audit some contractor indirect cost rate proposals (FAR 52.216-7(c)), contractors should learn to expect the unexpected. In particular, DCAA requests for data and/or DCAA inquiries may be very different than the last DCAA audit. In part, this might be attributed to DCAA's use of data analytics and so-called experts using data analytics (rarely is a DCAA expert truly an expert, but that's a discussion for another time). As the name implies, data analytics implicates requests for data and in the case of DCAA, not limited to data as it exists or limited to data which the contractor would otherwise use to support its assertion (claimed direct and indirect costs). Again, DCAA is oblivious to the constraints stated in FAR 52.215-2 or more accurately, if DCAA believes that its interpretation of Government Auditing Standards implicates certain documentation, DCAA will request that documentation in a manner which facilitates the audit (ignoring any conflict with FAR 52.215-2).

In a recent entrance conference related to a multiple year audit (e.g. 2010-2012), DCAA requested a data dump listing all employees and their respective annual salary and hourly rate (not one or the other, but both for each employee which would include the CEO down to the lowest paid employee). In addition, DCAA requested the home address for each employee (not clear if the request was for the home address during the years' subject to audit or if the request is for the current home address). Although most contractors make every effort to accommodate DCAA requests, there "might" be reasons to politely push-back; in particular, to request DCAA to explain (with specificity) how the requested data will be used to audit specific contractor assertions (claimed costs) and/or to offer to provide existing data in its existing form (even thought that data might not match that which was specifically requested by DCAA). As stated many times, pick your battles, but at least consider the possibility that there will be audit requests to which a contractor might have every contractual or regulatory reason to politely decline. Additionally, contractors need to be aware of the fact that DCAA prides itself on its history of prevailing on requests for data wherein the contractor(s) initially balked at providing the data. DCAA Management has publicly stated that in absolutely all cases, the contractor ultimately provided the requested data thereby confirming that DCAA was correct (all along) in its assertion that the contractor was contractually required to provide the (initially challenged) request for data. How can one possibly argue with that logic?

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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 is scheduled for December 7, 2016 at Warren Averett 101 Monroe Stree Huntsville, AL 35801. 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

Redstone Government Consulting

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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