



DCAA's Fiscal Year (FY) 2017 Planning Document

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

We recently obtained DCAA's Fiscal Year 2017 Staff Allocation and Future Plan Guidance's; aka DCAA's Program Plan. DCAA's plan anticipates resources of just under 5,000 work years (auditors and support staff) and this includes funding from DoD as well as from reimbursable audits for civilian agencies (e.g. NASA). In the context of reimbursable audits, it remains to be seen if or how DCAA recovers from the 2016 Congressional prohibition on such audits, particularly NASA given that NASA recently selected 8 IPAs (Independent Public Accounting firms) to perform contract audits (in lieu of DCAA audits).

In its planning document DCAA emphasizes providing timely audit services to customer requests (including audits of contractor bid proposals/bid rates and termination proposals) and completing timely incurred cost audits. As a point of reference, DCAA is now touting its performance statistics which demonstrate "timely", responsive audits and the elapsed days by type of audit include:

- Forward pricing (bid proposals), 85 days from date of receipt of an adequate proposal to issuance of the audit report,
- Pre-award accounting systems; 64 days, presumably from date of the request to issuing the audit report,
- Terminations; 300+ days (based upon public statements made by DCAA Management no published data specific to terminations),
- Incurred cost audits (audits of contractor indirect cost rate proposals); 883 days from receipt of an adequate ICP, but only 124 days from the actual audit start date to report issuance.

THIS ISSUE:

- ❖ DCAA's Fiscal Year (FY) 2017 Planning Document
- ❖ Labor Laws, Regulations and Risks
- ❖ Training Opportunities: See page 5 below
- ❖ Blog Articles and Whitepapers Posted: See page 6 below
- ❖ CFO Roundtable: see page 6 below

It's indeterminable if DCAA's audits are timely because DCAA only benchmarks itself to itself including significantly improving on forward pricing from FY2011 when forward pricing audits averaged 120 days. Thus, confirming a cardinal rule in benchmarking, you only need one really bad year to provide a point of reference for several good or great years). An interesting (but unlikely) test would be comparing NASA audit completion data, DCAA versus IPA incurred cost audits (the latter completed in FY2017).

Although DCAA's plan is relatively unchanged from recent prior years, there are several changes related to the geographic reorganization, consolidating regions and creating "CADs" (Corporate Audit Directors). DCAA's reorganization will result in numerous internal changes (i.e. changes to field audit offices including alignments with contractors); however, the plan also introduces a shift in audit resources to include more business systems and post-award (defective pricing) audits. Regarding business systems (reference DFARS 252.242-7005), DCAA is responsible for three of six, Accounting, Estimating and MMAS (Material Management and Accounting System); however, DCAA actually covers contractor accounting systems using four or five interrelated audits including; post-award accounting system, real-time labor and material audits, General IT Controls and a comprehensive accounting system audit. For certain audits of specified contractor business segments, DCAA directs its field offices to program the following:

Audit	DFARS	Number of Audits	Hours per Audit
Estimating	252-215-7002	3	2,953
MMAS	252-242-7004	3	3,937
Accounting	252-242-7006	4	7,155
General IT Controls	252.242-7006	4	350-450

Only DCAA can explain why it requires nearly 7,155 hours to comprehensively audit a contractor accounting system when DCAA has had a long-standing permanent resident office which gives it thousands of hours of relevant, contractor-specific audit history to use to focus on known risks (or to rely on the lack of known risks). Similarly, why it would require almost 4,000 hours to audit a contractor's MMAS when one of the explicit regulatory requirements is for the contractor to self-assess and to provide the results of the self-assessment to the

Government. Perhaps self-evident, DCAA does not trust contractor self-assessments and DCAA will place very limited (if any) reliance on the work of others. Regardless, if you happen to be one of the contractors listed in DCAA's plan, expect a team of auditors who will be involved for months followed by a draft report, which will identify one or more significant deficiency. Rarely (if ever) does DCAA perform a comprehensive system audit without uncovering one or more system deficiencies because most of the audit assertions involve a significant amount of professional judgment (translated: subjective interpretations of oft-times highly generic regulations). But there is some good news in the table above, DCAA is only planning to spend 2,953 hours for each of the three estimating system audits (down from 5,000 hours in the FY2016 plan).

Fourth on the list of DCAA's audit priorities is post-award audits for compliance with TINA (Truth in Negotiations Act); not only has this audit area moved up (from seventh to fourth priority), it has essentially tripled in terms of the number of planned audits (58) at specified contractors. Each audit is planned for 1,200 hours (down slightly from 2016's 1,250 hours). Recent experience with TINA compliance audits has shown relatively high "hit rates" (audits yielding recommended price adjustments) suggesting that contractors will be responding to loads of audit requests and inquiries and draft audit reports asserting TINA non-compliance. Contractors subject to TINA compliance audits also need to be fully aware of the other risk associated with any alleged noncompliance, in the context of potential audit referrals to an investigative agency (implicitly assuming the contractor defective pricing was not inadvertent).

Hopefully it will not repeat itself, but one unfortunate client endured a TINA compliance audit in a situation where the contracting officer had indicated (in an email at the time of finalizing contract price negotiations), that he/she did not want the contractor to update its proposal. In this somewhat unusual case, the DCAA auditor (of the contractor bid proposal) was independently updating the contractor's priced bill of material for negotiations (going to a third-party/vendor website to obtain the latest pricing information for computers and peripherals). The effect, the Government relied on its updates and did not rely on the contractor's certified cost or pricing data; unfortunately, the TINA compliance auditor had a

1,250-hour budget, nothing better to do and by all appearances, little or no supervision.

Some major contractors (very large contractors) may already be familiar with DCAA's FY2017 plan by virtue of a DCAA-initiated meeting to discuss the plan with the contractor and the contracting officer(s). In addition to the DCAA FY2017 planning document (which mentions certain planned audits and contractor business segments by name), the program plan discussion will identify other contractor specific planned audits and approximately when the audit will be initiated. There is one type of audit whose start date is "top secret", that is the infamous real-time labor audit, aka DCAA floor-checks or employee interviews (two slightly different audit programs, but similarly focused on the internal controls related to contractor time-keeping). DCAA continues to be the only agency which insists that Government Auditing Standards requires it to use unannounced floor checks to interview contractor employees; otherwise contractor labor costs are not sufficiently audited.

There is also one other audit area, contractor compensation (a component of the incurred cost "backlog" audits) which will continue to garner DCAA's attention. Compensation is covered by FAR 31.205-6, perhaps the longest and most complex subsection within the cost principles involving subparagraphs (a)-(p). Within those 16 sub-paragraphs, DCAA will likely be expanding its audit testing related to 31.205-6(b), compensation reasonableness. For years, DCAA focused almost exclusively on benchmarking the compensation of the five most highly compensated employees (typically executives) using the supplemental schedule "T", a contractor prepared schedule listing the five management level employees and for each, certain categories of compensation (e.g. base salary, incentive compensation, company contribution to 401K, health insurance premiums paid by the employer). Even if the contractor did its own benchmarking, DCAA would likely benchmark the listed employee compensation to two or more salary surveys. Based upon public comments by DCAA's Deputy Director and confirmed within the recent experience of a client, DCAA will now be benchmarking significantly more employees. A client's recent experience involved a DCAA list of 23 contractor executives and managers along with a request that the contractor input employee specific compensation data including (as specifically listed on DCAA's spreadsheet):

- Salary, sick, vacation (all in one column)

- Exec bonus
- Deferred comp
- Cash dividends
- Retention bonus
- Company 401K match
- Stock options

DCAA's request applied to four incurred cost years; hence, DCAA is expecting the contractor to retrieve data (from whatever source) and complete DCAA's spreadsheet from which the local DCAA field office will coordinate with DCAA's Compensation Team (formerly the Mid-Atlantic Compensation Team). At the point of requesting the contractor to complete the spreadsheet, DCAA had not yet asked the contractor for the contractor support for compensation reasonableness (i.e. contractor benchmarking or "market pricing" to assess and compare compensation to comparable companies).

Beyond the time and effort involved in completing DCAA's spreadsheet, there are some fundamental questions in terms of DCAA's approach:

- Does any regulation require the contractor to extract compensation data (from various data sources) and populate a DCAA spreadsheet? Although DCAA does have the right to audit contractor data (FAR 52.215-2), nothing in that regulation requires the contractor to convert contractor data into a DCAA spreadsheet. If DCAA wants the data converted/formatted to meet DCAA expectations which are beyond anything required by contract, it implicates a contract modification (a new deliverable and funding).
- Exactly how is DCAA going to use the contractor compensation data (if a contractor agrees to provide the data in DCAA's format)? Assume that DCAA will first expect the contractor to reconcile the data to the underlying accounting source; hence, certain compensation data might be reconciled with the employee W-2 whereas other data (not reported on an employee W-2) would have to be reconciled with other records. The fundamental issue, FAR requires a contractor to support the contractor's direct and/or indirect costs as claimed (i.e. in the "native" cost accounts). Within an attestation audit engagement, DCAA should be auditing the contractor's assertion which suggests that it is fundamentally inconsistent with an attestation engagement to extract data (from the native accounts) only to require that data to be



reconciled back to the underlying accounting records. Unfortunately, one more example of DCAA's tendency to insist on data conversion or reformatting rather than gaining an understanding of and auditing "as is" the contractor accounting system and data therein.

- Why is DCAA asking for compensation data which is either unallowable or most likely unallowable? Cash dividends implicate ownership versus services rendered and are expressly unallowable. Stock options are typically unallowable because most stock options only have value (to the employee) if stock prices increase over time, in which case the compensation would be linked to changes in the value of corporate securities which is expressly unallowable.

DCAA's request for compensation data by employee has expanded and in the case of the 23 employees, DCAA will benchmark (test for reasonableness per FAR 31.205-6(b)) each employee as if there can be no offsets (for two different employees, DCAA will not offset compensation in excess of benchmarking with compensation which is less than benchmarking). Although FAR does not explicitly address offsets across employees, it also appears that DCAA's internal audit policy (Contract Audit Manual or CAM 6-413.7) asserts that benchmarking should be for each component of compensation. As presented in CAM, DCAA will benchmark each element of compensation separately and limit offsets (among elements of compensation) depending upon the "itemized" benchmarking. In practice, it isn't clear how DCAA applies offsets to individual components of an employee compensation; however, it is clear that DCAA plans to significantly expand its benchmarking in hopes of identifying more employees whose compensation falls outside of DCAA's benchmarking (median plus 10% range of reasonableness).

One other noteworthy component of DCAA's audit strategy related to compensation benchmarking, DCAA HQ has prepared a 14-page dissertation (legal discussion) to be used whenever a contractor mentions certain ASBCA cases (where the Government was largely unsuccessful in sustaining DCAA's benchmarking). DCAA may have had very limited success within the ASBCA cases; but it is all too obvious that DCAA will not dis-embrace from its long-term audit strategy of benchmarking contractor compensation using averaging methods which are statistically flawed.

Labor Laws, Regulations and Risks

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

Fair Pay and Safe Workplace "On Hold" Although it's been all over the news (at least the blogs which discuss events impacting government contractors), a Federal Judge, Eastern District of Texas, issued a preliminary injunction which enjoined the Government from enforcing parts of Executive Order 13673. In particular, the FAR Rule or the DOL guidance relating to the new reporting and disclosure requirements regarding labor law violations as described in EO 13673. Further, the Government is enjoined from enforcing the restriction on arbitration agreements. The injunction did not block the requirements for paycheck transparency; hence, effective January 1, 2017, contractors will be required to provide employees with paycheck details (hours worked, overtime, itemized deductions...not a requirement which will force many contractors to do anything different than current practices).

The published preliminary injunction is a somewhat enlightening discussion of what's wrong with an Executive Order which would require disclosure of a long list of violations long before the action has been adjudicated. Beyond the obvious issue of disclosing in process, unresolved actions, the injunction made note of the fact that certain agency (preliminary) actions are frequently dismissed or settled without any finding of merit. In the case of the EEOC, it issues more than 3,000 reasonable cause notices each year, but litigates only about 150 such cases per year and a significant percentage of those are ultimately found to lack merit (as published, the EO would require contractors to disclose EEOC reasonable cause notices and a contracting officer could determine a contractor to be non-responsible based upon an action which ultimately was determined to lack merit).

Additionally, and equally enlightening, the injunction noted that each of the disclosable violations traced to a law enacted by Congress and that in most cases, Congress spelled out in precise detail the process including how findings would be determined and what the penalty or remedy would be. Per the injunction, "certainly none of these laws provides for any such action to occur based on non-final, unadjudicated, administrative merits determinations"

At this point, good news for government contractors, but not exactly the end of the debate.

Antitrust Guidance for Human Resource Professionals.

The DOJ and FTC (Federal Trade Commission) issued a joint guidance document complete with a “Q&A” section which appears to be designed to instill fear into any HR person who might know of a company policy which might be a violation of certain antitrust interpretations by the DOJ and FTC. Stated differently, the guidance is beyond a friendly reminder, it contains many overt threats and specific examples of illegal actions by wayward employers.

Antitrust and HR policies may not appear to be interlinked, but the antitrust guidance mentions at least two fundamental “illegal” policies:

- Agreement among employers not to recruit or hire (poach) certain employees
- Collaborative agreements (explicit or implied) to compare and to control salaries even when this is accomplished by membership in an association (e.g. an association of hospitals which collects, then shares the salaries of certain positions such as Registered Nurses).

The less than objective antitrust guidance references several cases with alleged violations and in almost all cases, the result was a consent judgment (an agreement to change one’s policies, in many cases the only option to avoid a protracted and costly battle with the DOJ...not that DOJ was necessarily correct in its interpretation). One threatening and chilling theme throughout the antitrust guidance is the suggestion to contact either DOJ or FTC if one is aware of an HR policy which might violate the antitrust laws. As evidenced by one of the “Q&A”:

Question: I am an HR professional and we spend a lot of money to recruit and train new employees. At a trade show, I mentioned how frustrating when a recent hire jumps ship to work at a competitor. A colleague at a competing firm suggested that we deal with this by an agreement (written or “gentleman’s”) not to recruit or hire each other’s employees. She mentioned that her company has entered these kinds of agreements in the past. What do I do?

Answer: What that colleague is suggesting is an anti-poaching agreement. That suggestion amounts to a solicitation to engage in serious criminal conduct. You should refuse her suggestion and consider contacting the Antitrust Division’s Citizen Complaint Center or the Federal Trade Commission’s Bureau of Competition to report your colleague’s company.

The message should be loud and clear, if you are an HR professional, be careful who you have lunch with and what you discuss. In the eyes of DOJ and FTC, everyone is a potential informant.

One last observation, the antitrust guidance also recommends that employers avoid sharing sensitive information with competitors. In this case, sharing salary or other terms of employment could serve as an implicit agreement (to fix compensation). Seems to border on paranoia and poses a question for teaming partners on government contracts (and in pursuit of government contracts). Apparently, the DOJ and FTC believe that knowledge of each other’s compensation and/or terms of employment could be a sign of an (implied) illegal agreement to fix or control wages. Interesting times...

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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 a location TBD. 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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