REDSTONE Government Consulting

Government Contract INSIGHTS

A MONTHLY PUBLICATION FOR GOVERNMENT CONTRACTORS

Volume 68 SEPTEMBER 2016

DCAA's New "Selected Areas of Cost Guidebook" Cost Principles

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

DCAA recently made available its cost allowability guidebook (http://www.dcaa.mil/SelectAreasCost.html) which is currently a list of 75 chapters (cost categories) which are primarily patterned after the 52 subsections within section 31.205 "Selected Costs" (Cost Principles). Obviously, DCAA's list has 23 additional selected areas of costs which implicitly reconfirms that i) FAR cost principles don't address every possible cost allowability issue (FAR 31.204(d)) and ii) DCAA has a history of interpreting cost allowability through an internal process which bypasses any regulatory process (i.e. not published in the Federal Register for public comment). Regardless, any contractor audited by DCAA is well-served to consider DCAA's interpretations which are for the most part consistent with FAR 31.205-XX. For the interpretations which are embellishments of the FAR, recognize that merely embellishing FAR does not invalidate an interpretation if the end result is consistent with the expressly stated regulation or the treatment of a similar or related cost (FAR 31.201-4(d)).

In terms of one example of the 75 chapters, number 72 applies to travel costs. DCAA provides two authoritative sources (regulatory references) including FAR 31.205-46, Travel Costs, and FAR Subpart 47.4 Transportation by US Flag Carrier (also see FAR 52.247-63). In addition, DCAA reminds its auditors (and indirectly contractors) that audits should examine contractor policies with expectations of i) consolidating trips to the same geographical area, ii) maximum use of lowest customary standard, coach or equivalent airfare accommodations available during normal business hours and iii) coordination between organizational elements to minimize the number of trips to the same location. Although one or more of these "audit expectations" may be in a contractor travel policy, none of them are in FAR. FAR 31.205-46(b) does require a contractor to use the lowest available airfare available to the contractor during normal business hours, but nothing in FAR refers to customary standard coach or equivalent. In fact, whomever authored this is inexplicably mixing and matching current and prior FAR provisions. The fact is that for any given trip at any given point in time, the "lowest available" might be business or first class (i.e. last minute travel with

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no other "available" seats). One other observation, only DCAA refers to "accommodations" in reference to airfare when the rest of us refer to accommodations in reference to lodging.

Continuing through Chapter 72, the next section is documentation required. DCAA correctly states the three-fold requirements in 31.205-46(a)(7); however, DCAA inexplicably asserts that the required information "must be maintained in a book, diary, account book, or similar records". Again, nothing in FAR explicitly states this even though DCAA asserts that it is a "must". However, there is one hidden gem within DCAA's discussion of allowability and that pertains to documentation not required if/when a contractor policy is to reimburse employees for "subsistence" based upon the regulatory per diem ("flat" amount). In these situations, DCAA states that no receipts are required; unfortunately, DCAA has interjected the word "subsistence" which is inconsistent with the wording in FAR (lodging, meals and incidental expenses). If an employee requires lodging and meals to subsist, then contractors who use "flat amounts" for lodging, meals and incidentals should not require any receipt from employees. Equally unfortunate, DCAA is only referring to a flat amount for meals and incidentals (limiting "subsistence" to exclude lodging) because their auditors will expect receipts for lodging (even if the reimbursed amount is the daily maximum per diem).

As it did with an MRD (Memorandum for Regional Directors) in 2013, DCAA gets it right with respect to the definition of a daily maximum based upon published per diems. Contractors are held to the daily (total) maximum for lodging, meals and incidentals unlike government employees who are held to a split per diem, lodging separate from meals and incidentals (subsistence is in there somewhere). Hence, depending upon the contractor policy or policies, an employee could stay at an expensive hotel and avoid meals and potentially stay within the daily total per diem.

There are a number of other interpretations within DCAA's Chapter 72 including more on airfare costs (including decrementing proposed airfare used in pricing because a contractor has a history of obtaining "ultra savers" and "ultimate super savers" airfare). For contractors who encounter international travel, DCAA's description of the Fly America Act does provide a historical perspective of a contractual requirement which is counter-intuitive; specifically requiring contractors to use US Flag Carriers even if a foreign flag-carrier is less expensive (evidence that lobbying does reward the lobbying entity or industry). The requirement to use US Flag Carriers has been muted to some extent be virtue of the numbers of countries with reciprocal agreements which allow travel on a foreign carrier. The down side of noncompliance with the Fly America Act is that the airfare is totally unallowable (as if it never happened and regardless of any cost savings by using a less expensive foreign flag carrier). However, it is the one situation where "lowest available carrier" does not apply. DCAA's guidance does not address one question, does the Fly America Act apply only to travel charged direct to a government contract or does it also include all indirect travel charged to government contracts through the application of an indirect or G&A rate? The long-standing interpretation (while the author was with DCAA including time in the European Branch Office) was that it only applied to direct (contract specific) travel because the Act applies to US Government financed international air travel. The US Government does not finance indirect travel in much the same manner as it does not finance independent research and development costs. Both types of cost are recovered through an allowable indirect cost rate, but not through any direct reimbursement of any particular transaction.

In spite of any criticisms of DCAA's "Selected Areas of Cost Guidebook", to DCAA's credit it is available to the public on DCAA's website. There has been some concern that as DCAA migrates away from its DCAM (DCAA Contract Audit Manual), that the audit policies would shift into non-releasable to the public. Perhaps the next step in terms of transparency, DCAA will publish its policies for public comment (before making them final in the same manner as proposed regulations are published in the Federal Register). Miracles do happen, but this won't be one of them.

Good News on the Regulatory Burden for FAR 52.215-2

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

The reference to "good news" is based upon a recent Federal Register (Vol 81, No 175/Friday September 9, 2016), "information Collection: Examination of Records by

Comptroller General and Contract Audit". In that posting, the regulatory burden associated with FAR 52.215-2 is 10 hours per year per contractor (respondent). The bad news, it is an estimate created in a fantasy world wholly disconnected from reality.

For anyone with a government contract, which includes the Allowable Cost and Payment Clause (FAR 52.216-7) or the Price Reduction for Defective Certified Cost or Pricing Data (FAR 52.215-10), you are somewhat familiar with FAR 52.215-2, Audit and Records—Negotiation. In the case of certain contracts (cost-reimbursement, incentive, time and material, labor-hour or price redetermination) a contractor is required to maintain records and the Contracting Officer and/or his/her representative has the authority to exam all records sufficient to reflect properly all costs claimed to have been incurred directly or indirectly in performance of this contract. In the case of contracts which required certified cost or pricing data (which would include firm fixed price contracts in excess of $750K and without any exemptions), the Government has the right to examine and audit all of the contractor's records including computations and projections related to: i) the proposal, ii) discussions including negotiations, and iii) performance of the contract.

Often referred to as the "access to records clause" FAR 52.215-2 opens the door for government audits, notably those performed by DCAA, with access to a broad range of records including policies, books, documents, practices and other data (not defined) regardless of the type of data (written, electronic/computer, or any other form—not defined). In carrying out an audit, the audit scope, thus the demand for access to records, resides with the auditor. Translated, an audit of incurred costs can involve requests for thousands of records, including many records in the form of explanations or access to employees (for the purpose of discussing records, notably timesheets and travel expense reports). In the context of an audit for compliance with FAR 52.215-10 (Defective Pricing), DCAA's FY2016 Program Plan included directions for field offices to budget 1,200 for each post-award/defective pricing audit.

With any audit performed by DCAA, one of its requirements is related to a DCAA risk or internal control questionnaire, an extensive list of questions to be completed by the contractor. Although most contractors comply, there is the fundamental question, "Is a contractor required to complete a DCAA (non-contractual) questionnaire in addition to providing DCAA with access to existing contractor records?" The answer is clearly "no" as coincidentally reinforced within the recent Federal Register (Vol 81, No 175/Friday September 9, 2016), "information Collection: Examination of Records by Comptroller General and Contract Audit". Specifically stated by the FAR Councils, "this information collection does not require contractors to create or maintain any records that the contractor does not normally maintain in its usual course of business". Given that "limitation", the FAR Council boldly states that the annual reporting burden associated with FAR 52.215-2 is 10 hours per respondent (contractors subject to the clause, estimated to be 14,380 contractors). Per the Federal Register, in the aggregate, the reporting burden is 148,300 hours (which might cover the total audit compliance hours incurred by any one of the very large government contractors).

The annual reporting burden of 10 hours per contractor is obviously suspect, if not wholly disingenuous; however, it is one of many grossly underestimated reporting burdens meant to: i) satisfy a regulatory requirement and ii) downplay the cost "delta" associated with being a government contractor subject to exhaustive and intrusive contract audits. One DCAA floor-check of contractor employees can take several days involving hundreds of contractor employees; in and of itself "blowing the budget" of 10 hours annually. Of course, that raises another question concerning DCAA's contractual right to access contractor employees. Although most contractors allow DCAA to perform floor-checks and/or employee interviews, that process has evolved in-spite of the fact that employees do not meet the FAR 52.215-2 definition of a record (unless one applies uses the undefined terminology of "any other form".

One final observation concerning the September 9 Federal Register, it states that the record retention clause requires contractors and subcontractors to retain records for three years after final payment on the contract. Although that is the default or general requirement, the Federal Register conveniently fails to mention that FAR 4.705 includes a long list of specific records' types with retention periods which are potentially far shorter (than three years after final payment). For example, timesheets must be retained for two years after the end of the year applicable to incurring and recording the labor charge/cost. That said, it should be noted that the Federal Register seeks public comments, particularly with respect to the reporting burden of 10 hours per annually per

respondent (contractor). Hopefully all 14,380 contractors will respond with more realistic estimates of the regulatory burden and in any case the public comments are due by November 8, 2016 (coincidentally election day).

Changes in Cost Accounting Practices Cost Impacts and Materiality

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

A recent ASBCA case is being heralded as a victory for contractors who are subject to FAR Part 30.600 (through contractual clause FAR 52.230-2 or -3 and -6). The contractor prevailed in ASBCA Case No. 58068 because the contracting officer (ACO) abused her discretion in failing to consider the materiality criteria in CAS 9903.305. Specifically, the ACO determined materiality solely based upon the fact that there was a cost impact associated with a unilateral change in a cost accounting practice (CAP) and that FAR Part 30.600 prohibits a change which increases cost on CAS covered contracts (prohibits the change in the context of requiring the government to recoup the cost impact).

Before CAS-covered contractors declare August 9, 2016 to be an annual holiday (with parades with a "we won CAS theme"), one needs to recognize that this was the first decision which was based upon the requirements and interpretations of CAS 9903.305. Notably, the ACO only addressed the unfavorable cost impact while summarily discounting all other measures of materiality, which might be applicable and per the regulation, "shall" be considered in the process of determining materiality ("shall" equals non-discretionary). The ACO's rationale was based upon her interpretation of FAR 52.230-2(a)(ii) that "no agreement may be made under this provision that will increase costs paid by the United States". As discussed in the published decision, CAS 9903.306 is even more restrictive stating with respect to a unilateral change, the ACO may enter into an agreement covering a change in practice proposed by the Government or the contractor "provided that the agreement does not permit **any** increase in cost paid by the Government".

Although the ACO seemingly had valid reasons for seeking a cost adjustment for increased costs attributed to a unilateral change proposed by the contractor, the ACO's failure to consider all of the regulatory requirements resulted in the ASBCA decision that the ACO abused her discretion (i.e. there might be discretion in terms of exactly which factors one considers; however, an ACO cannot summarily dismiss factors which "shall" be considered).

Perhaps the biggest potential victory for all CAS-covered contracts/contractors is the wording in CAS 9903.305: "In determining whether amounts of costs are material or immaterial, the following criteria shall be considered where appropriate; no one criterion is necessarily determinative.… (e) The cumulative impact of individually immaterial items. It is appropriate to consider whether such impacts: (1) Tend to offset one another, or (2) Tend to be in the same direction and hence to accumulate into a material amount. The significance of this particular CAS reference is that it conflicts with FAR 30.604(h), processing unilateral changes in cost accounting practices which requires separate cost impacts for each change unless all changes result in increased costs on CAS covered contracts. In other words, CAS 9903.305 appears to allow for offsets (increased costs offset against decreased costs for multiple changes) whereas FAR 30.604 prohibits such offsets. However, CAS 9903.305(e)(1) only applies to individually immaterial items which brings the focus back to the materiality determination by the ACO.

Prospectively, contractors should assume that ACOs will learn from this particular ASBCA decision and document his/her consideration of materiality criteria which maybe relevant. Lastly, in terms of extrapolating this ASBCA decision to any other application, it should be recognized that the cost impact at issue was apparently $36,000, which was applicable to as many as 1,000 CAS covered contracts. Without any further analysis the impact per contract could be as little as $36 each. As long as an ACO documents his or her consideration of CAS 9903.305 criteria and as long as the cost impact is more than $36 per contract, it is unlikely or at least unpredictable as to the applicability of ASBCA 58068 to any other unilateral change subject to FAR 30.604.

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Changes (impending) Related to Compensation

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

The Department of Labor recently published the new minimum wage for contractors (Executive Order 13658), effective January 1, 2017 the minimum wage will increase from $10.15/hour to $10.20/hour. Of note this is an annual requirement which will also result in a revision to the DOL Poster concerning minimum wages. Of passing interest, FAR 31.205-6(p) establishes a compensation cap (the other end of the compensation spectrum) which became $487,000 effective for contracts after June 24, 2014. That action also stated that this cap would be adjusted annually, but unlike the minimum wage, the current administration obviously has no interest in increasing the statutory cap applicable to contractor executives. In other words, if you are a contractor looking for the corresponding increase to the statutory cap (now more than two years after it was initially established/lowered to $487,000); you can stop looking. The current administration will unlikely publish anything given its continuing declaration that government contractor executive compensation is categorically unfair to the US Taxpayer.

One other Executive Order should be showing up in the Federal Register on September 30, 2016 (having been published by DOL on September 29) as final rule implementing EO 13706, "Paid sick leave for Federal Contractors". The version published by DOL is 466 pages, the majority of which are public comments and DOL responses to those comments. In summary, effective on contracts after January 1, 2017, a requirement for up to seven days (56 hours) paid sick leave, numerous limitations on contractor/employer policies for documentation, and a requirement to allow employees to "bank" unused sick leave (with limited forfeitures). Per the DOL, the new requirement will extend paid sick leave to approximately 1,000,000 employees not currently receiving paid sick leave. One more cost of doing business as a government contractor and one more reason why commercial companies may be reluctant to join the fun of being a government contractor. Ultimately, it's not the specific requirement for paid sick leave (many commercial companies already offer paid sick leave or paid time off sufficient to cover the new requirement), it's the fundamental issue of the US Government "managing" company HR policies (not unique to the US Government; certain states including California and New York are far more intrusive in terms of dictating HR policies).

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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 November 16, 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

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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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Redstone Government Consulting, Inc.

NEW ADDRESS
Huntsville, AL
4240 Balmoral Drive SW, Suite 400
Huntsville, AL 35802
T: 256.704.9800

Email: info@redstonegci.com
On the web: www.redstonegci.com

