



DCAA 2016 Annual Report to Congress Nothing but Good News other than DCAA Needs More Staff

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

In its 2016 Annual Report to Congress (for the year ended September 30, 2016) DCAA once again highlighted its successes and downplayed its shortcomings (but what government agency ever highlights its shortcomings in a report to Congress). As with many of its previous annual reports, DCAA provides comparative data using a particularly bad year (2012) as the base year which of course yields very favorable trends. Based upon the fact that DCAA's annual report isn't subject to any particular reporting standards and the fact that DCAA's statistics are unaudited (not independently validated by a third party), why not pick and choose comparative data which looks the best to a casual and somewhat uninformed observer. If there is any critical comment, it should be that Congress has imposed a reporting requirement with no reporting standards or specific reporting criteria which serves little or no purpose other than to give DCAA the opportunity to selectively present data in a manner which serves to reinforce the need for DCAA audit services.

Although DCAA's 2016 annual report may not serve any useful purpose (in terms of accurately measuring DCAA's performance using any form of external benchmarking), it continues to highlight the all-important concept of ROI (Return on Investment). In its unaudited performance results, DCAA reported an ROI of \$5.7 to \$1; hence, DCAA's audits not only pay for DCAA's entire budget (\$630 million budget), but DCAA also provides a premium of approximately \$2.7 billion. On paper, a highly favorable investment; however, no one seems to totally accept this ROI because Congress has yet to provide funding/staffing which meets DCAA's purported needs. Translated, we (Congress) aren't willing to accept your ROI as fact; if we did, we would provide significantly more funding/staffing.

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Other highlights (there are no low-lights):

- DCAA achieved the Congressional mandate of becoming current on its incurred cost backlog. Per section 893 of the 2016 NDAA (National Defense Authorization Act), DCAA could only perform audits for DOD unless DCAA reduced its incurred cost backlog to the equivalent of 18 months; DCAA reported and the DOD Comptroller certified that DCAA's backlog was 17.7 months as of 9/30/2016. We will never know if/how the Comptroller validated the backlog, but one peculiar statistic is that DCAA had 4,677 incurred cost submissions on hand on 9/30/2016. If that represents 17.6 equivalent months, the annual number is 3,188, less than one-half the number stated by DCAA's Deputy Director in mid-2016. Nor will we know if the results would be significantly different if the measure was based upon the weighted average value (auditable dollars) of incurred cost submissions instead of the very simplistic incurred cost submission count (each equal 1 regardless of the auditable dollars). We do know that for several years, DCAA has been "clearing the deck" of large numbers of low risk, relatively low dollar incurred cost submissions which can only mean that those remaining to be audited are disproportionately large dollar submissions. DCAA did tacitly acknowledge this in its statement that the number of incurred cost years completed in 2016 was fewer than in 2015, but the dollars examined were higher in 2016. The fact that DCAA has been deferring the larger and more complex audits is now obvious, but if Congress doesn't know or care, why not interpret the requirement to its (DCAA's) advantage.
- DCAA reported several improvements in its audit timeliness, cleverly using 2012 as the base year for comparisons. Forward pricing (bid proposals and forward pricing rate proposals) improved to 86 days from 110 days (measured from the date of receiving and adequate proposal or the audit request, whichever came later, to the date of the audit report). Other than comparing itself to itself, it remains to be seen if DCAA could compete with independent public accounting firms in terms of audit timeliness; however, as we speak, no one has restarted the public-private competitions (prohibited during the Obama administration). It is noteworthy that DCAA changed its elapsed days measure for incurred cost audits; previously measured from the date DCAA received an adequate incurred cost proposal to the audit report date. Now measured from the entrance conference date to the audit report date (with a footnote regarding the prior measure). DCAA categorizes this as a more precise indicator of "active engagement" (somewhat misleading because there can be significant "active engagement" long before the entrance conference date.
- DCAA highlights its success with pre-award accounting system audits, both in timeliness and in the relative number of systems deemed acceptable (a pre-requisite for award of a cost-type contract). There is absolutely no way that 60 days is timely; but it looks good in contrast to the 120 days to complete these audits in 2012. In fact, prime contractors who accomplish the same objective before awarding a cost-type subcontract take less than one week; but it's not an audit encumbered by weeks of preplanning and risk assessing (for an inherently low-risk audit with an extremely narrow audit scope). With respect to the increased numbers of adequate (contractor) accounting systems, DCAA attributes this to its small business outreach programs instead of the real reason, DCAA dramatically changes its audit scope and pass/fail criteria for pre-award accounting system audits. To be sure, DCAA has increased its outreach programs which is a very good initiative and far preferred over the years during which DCAA distanced itself from contractors for fear of violating its ultra-conservative interpretation of auditor independence.
- DCAA makes not of its initiatives to (finally) begin auditing contractor business systems (three of six in DFARS; MMAS (Material Management and Accounting), Accounting, and Estimating). This is evidenced within DCAA's annual program plan which detailed the planned audits (for 2017) including MMAS (3 @ 3,937 hours each), Estimating (3 @ 2,953 each) and Accounting (4 @ 7,600 hours each). For those contractors "lucky" enough to be audited, expect several auditors over an extended period and don't expect the final results anytime soon. For the 21 business systems audits conducted in FY2016 (ending 9/30/2016), DCAA issued six audit reports in 2016 with the remaining 15 planned to be issued by 3/31/2017. DCAA clearly has its own definition of timely audits.

Assuming DCAA continues to get current (or more current) on its incurred cost backlog, contractors should assume that DCAA will redirect its newly available (but still scarce) resources to audit areas which may have gone dormant such

as defective pricing, additional business systems and some of their MAARs (Mandatory Annual Audit Requirements—even though many of these have not been completed for years—perhaps they should change the name to DAARs or Discretionary Annual Audit Requirements).

As taxpayers, we appreciate DCAA's role in the acquisition process; however, we (and most contractors; aka the "auditees") know that the audit objectives could be achieved far more efficiently with little or no negative impact on protecting the taxpayer. But as long as DCAA measures its own performance and selectively compares itself to really bad years, little or nothing will change. It is what it is.

FAR Changes

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

Rescinded: Fair Pay and Safe Workplace Reporting

Although numerous blogs have highlighted the fact the so-called contractor (self) blacklisting rule has been rescinded, those "highlights" might be a tad misleading. The requirements for compliance with fair pay and safe workplace and a myriad of other federal or state employment related laws or regulations are still in play. Eliminating self-reporting merely eliminates the highly controversial "self-incrimination" concept; however, nothing changes a fundamental fact that actions with unfavorable outcomes (e.g. Department of Labor administrative findings/settlements or OSHA violations/settlements/fines) could be considered by a contracting officer in source selections. Obviously, it is now less likely that a contracting officer would have knowledge of other government agency findings; but that simply doesn't eliminate the risk and the potential negative impact on success in competitive source selections. The point, existing or potential Government contractors must know the laws and regulations and implement controls to mitigate risk of non-compliance. Additionally, solicitations routinely include various requirements for self-reporting including notifications of non-compliances (e.g. CAS or Cost Accounting Standards); thus, self-reporting will never completely disappear for existing or potential Government contractors.

Prohibition on Confidentiality Agreements—Prime and Subcontractors

The final rule published in the January 13, 2017 Federal Register is now contract clause 52.203-19. The rule prohibits the award of Government contracts to contractors who require their employees or their subcontractors to sign or to comply (with existing) internal confidentiality agreements (those prohibiting an employee or subcontractor from reporting fraud, waste or abuse to an Office of the Inspector General). Unlike most regulations, this new FAR clause with its broad prohibitions on confidentiality agreements implicitly applies to existing contracts. In fact, it doesn't even require a new contract with the new clause because FAR 52.203-18 requires a contractor certification as a component of submitting a bid for a potential contract award (without the certification, the potential contractor is ineligible for the award).

There may be some loopholes because of the exact wording, such as additional compensation (typically in application to severance at the point of employee retirement or other separation) for voluntarily signing a confidentiality agreement. At that point, the agreement would no longer apply to an employee, but an ex-employee. Hence, voluntary (not required) and an ex-employee (not an employee). Suffice to say that splitting-hairs would not be well-received by a Government auditor or contracting officer; thus, all contractors should consider the acceptable alternative of having internal hotline policies and procedures (in addition to conspicuous display of Government hotline posters) with the objective of providing employees with an internal source who will actively consider and timely investigate employee concerns.

ASBCA Reinforces that Costs are Expressly Unallowable for Incentive Compensation Based upon Changes in Corporate Stock Price Benchmarking

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

In a recent published decision ASBCA No. 58966, the Armed Services Board of Contract Appeals determined that costs are expressly unallowable for incentive compensation based upon

changes in corporate stock prices benchmarked to a peer group. FAR 31.205-6(f) Incentive Compensation, has allowability requirements including i) the existence of a policy or established practices consistently followed and ii) the basis of the award is supported. In this case, the plan clearly existed; however, the plan ran afoul of FAR 31.205-6(i) which makes unallowable “*compensation based upon changes in the prices of corporate securities or corporate security ownership, such as stock options, stock appreciation rights, phantom stock plans, and junior stock conversions*”.

The plan was a LTIP (Long Term Incentive Plan) based upon TSR (Total Shareholder Return) for which the plan funding was a function of the contractor’s stock price and dividends paid benchmarked (by a third-party) against the contractor’s peer (other publicly traded corporations in the same industry). Although benchmarking is a very basic and accepted method for establishing compensation reasonableness (FAR 31.205-6(b)), it has now been established by two ASBCA decisions that benchmarking must be something other than relative changes in stock prices. For example, compensation reasonableness and precisely how one benchmarks (at the median or higher than the median) is in fact (based upon DCAA audits) a function of company financial performance versus peer groups (similar sized companies in similar industries). Although the acceptable financial measures (e.g. revenue or net income growth, return on investment) may directly or indirectly influence the stock price; they are permissible benchmarking whereas the more straight-forward and simplistic use of stock prices is impermissible even if it only serves to set the amount of the incentive pool.

Perhaps the biggest inequity in the ASBCA decision, is its conclusion that the costs are expressly unallowable in spite of numerous DCAA audits which had audited and overtly accepted the TSR peer group benchmarking as allowable (i.e. not precisely based upon movement in stock prices). The inequity goes beyond the DCAA audits, in fact there were extensive discussions within DCAA (involving the Regional Director, if not the Agency Director) wherein highly competent auditors with hundreds of years of collective experience, concluded that the method was an acceptable and allowable technique for using predetermined formulas for computing the incentive pool fund. DCAA may only be advisory, but there was rationale for its advisory opinion wherein the DCAA concluded that the costs were allowable (as incentive compensation), but subject to the statutory limits of FAR

31.205-6(p). Apparently, in the eyes of the ASBCA, a Government contractor reliance on DCAA opinions reinforced by numerous internal discussions within DCAA, does not count as a mitigating factor in determining that the costs were or were not expressly unallowable.

Which leaves us with a final (and recurring) thought in application to Government contracting, “No one said that life is fair”.

Training Opportunities

2017 Redstone Government Consulting Sponsored Seminar Schedule

May 25, 2017 – Government Contract Closeout
WEBINAR – [Register Here](#)

2017 Federal Publications Sponsored Seminar Schedule

May 8-10, 2017 – The Masters Institute in Government
Contract Costs
LaJolla, CA

June 13-14, 2017 – Accounting Compliance for Government
Contractors
Arlington, VA

July 17-18, 2017 – Government Contract Audits: Dealing with
Auditors and Mitigating Audit Risk
Hilton Head, SC

July 18-20, 2017 – The Masters Institute in Government
Contract Costs
Hilton Head, SC

August 21-22, 2017 – Life Cycle of an Indirect Rate Cost
Proposal
Arlington, VA

August 22-24, 2017 – The Masters Institute in Government
Contract Costs
Arlington, VA

August 24-25, 2017 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk

Arlington, VA

October 23-24, 2017 – Accounting Compliance for Government Contractors

Sterling, VA

December 6-7, 2017 – Accounting Compliance for Government Contractors

DC Metro Area

Go to <http://www.fedpubseminars.com/> and click on the Government Contracts tab.

Blog Articles to our Website

Application of CAS 420 – Independent Research & Development and Bid & Proposal Costs

Posted by Kimberly Basden on Tues, Apr 25, 2017 – [Read More](#)

Unaudited Accounting Systems and Government Solicitations – Read the Fine Print

Posted by Cheryl Anderson on Thu, Apr 6, 2017 – [Read More](#)

DCAA Audit Policy Implementing Trump's 2 for 1 Regulatory Reductions

Posted by Michael Steen on Fri, Mar 31, 2017 – [Read More](#)

Labor Laws and Regulations Update

Posted by Sheri Buchanan on Wed, Mar 29, 2017 – [Read More](#)

DCAA Selection of Incurred Cost Proposals for Audit – What is my Risk?

Posted by Bob Eldridge on Wed, Mar 15, 2017 – [Read More](#)

Is My Accounting System Adequate, Acceptable or Approved...Does it Matter?

Posted by Michael Steen on Wed, Mar 8, 2017 – [Read More](#)

Documentation! Documentation! Documentation! What's a Government Contractor to Do?!

Posted by Cyndi Dunn on Tues, Feb 28, 2017 – [Read More](#)

Q1 2017 is Halfway Over!?! GovCon Reminders

Posted by Asa Gilliland on Wed, Feb 22, 2017 – [Read More](#)

DCAA ICE Model Version 2.0.1f (October 2016)

Posted by Kimberly Basden on Thu, Feb 9, 2017 – [Read More](#)

Immigration and Naturalization Homeland Security Management Alert

Posted by Michael Steen on Thu, Feb 2, 2017 – [Read More](#)

For More Blog Articles: <http://info.redstonegci.com/blog>

Whitepapers Posted to our Website

What Are The Prime Contractor's Risks Related to Subcontracts

A Whitepaper by Asa Gilliland – [Read More](#)

The Audit World's Biggest Myths

A Whitepaper by Wayne Murdock – [Read More](#)

Government Contracting and Uncompensated Overtime

A Whitepaper by Wayne Murdock - [Read More](#)

DCAA Rejection of Incurred Cost Proposals

A Whitepaper by Michael Steen – [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 is TBA. 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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