



Defined Contributions (401K) Pensions: The Hidden Risk

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

Government contractors (and employers in general) have largely abandoned defined benefit pension plans in favor of the far less complex defined contribution pension plans. Defined benefit pension plans involve continuous measurements (e.g. actuarial gains and losses which can involve amortization periods of 15 years) whereas a defined benefit pension plan (commonly known as a 401K) involves a plan which essentially defines employee and employer contributions (with subsequent investment income or losses effectively borne by the employee). For government contractors, as long as a defined contribution plan results in reasonable costs (FAR 31.201-3) and the employer makes timely contributions to the trust or employee accounts, the costs should be allowable and allocable to government contracts (Note there are IRS regulations which more extensively apply to 401K plans; however, IRS regulations are not discussed in this article).

Although it is generally accepted that a 401K pension plan is relatively risk free for a government contractor (or any employer), recent events suggest the hidden risk associated with class-action lawsuits which allege mismanagement of the employer retirement plan. For a listing of numerous actions and events involving 401K plans: www.401Khelpcenter.com which includes the example of a recent action involving a university which has the "honor" of being the fifteenth university being sued for alleged 401K mismanagement. In many of the cases, the alleged mismanagement included:

- Failure to monitor recordkeepers and/or to use multiple recordkeepers instead of one (an issue of excessive fees)
- Failure to remove underperforming funds from the investment options
- Too many investment options (too complicated; an allegation which was dismissed by the court)
- Funds with affiliations with the service provider
- Use of actively managed fund versus passively managed funds (the latter with fees)

THIS ISSUE:

- ❖ Defined Contribution (401K) Pensions: The Hidden Risk
- ❖ Contractor Allowed to Recover Deferred Compensation Attributed to Delays in Government Payments
- ❖ Miscellaneous Contract Issues
- ❖ Training Opportunities: See page 4 below
- ❖ Blog Articles and Whitepapers Posted: See page 5 below
- ❖ CFO Roundtable: see page 5 below

Many of the allegations involve “Monday-morning Quarterbacking”; while true, this is not a basis for claims’ dismissal unless the employer (plan sponsor) can demonstrate that it continuously exercised its fiduciary responsibilities. Perhaps obvious, but simply engaging a third party to handle all aspects of the 401K over a period of years is a high-risk strategy in terms of inviting a class-action lawsuit.

Beyond the risk of class action lawsuits (and potential legal costs and settlements), what’s the risk of cost allowability for a government contractor? FAR 31.205-47 applies to legal costs and with respect to employee lawsuits (an action which does not involve a government entity or agency), the only specifically listed unallowable cost (f)(4) is defense of suits brought by employees or ex-employees of the contractor under section 2 or the Major Fraud Act of 1988 where the contractor was found liable or settled (i.e. a Qui Tam). While an alleged 401K mismanagement involving an employee/ex-employee class action lawsuit is not covered by FAR 31.205-47, FAR 31.204(d) provides for cost allowability to be determined based upon “similar-to” criteria within FAR 31.205. Noting that a class action lawsuit involving 401K management is connected to ERISA (Employee Retirement Income and Security Act of 1974), one can assume that a government auditor will challenge the allowability of any legal and/or settlement costs using 31.204(d). Alternatively, challenge allowability based upon reasonableness (31.201-3) because a reasonable employer would not fail to execute its fiduciary responsibilities as required by ERISA.

As with many similar “out-sourced” functions (e.g. purchased insurance, payroll processing, consultant services), a government contractor must monitor the services and fees which should include some form of benchmarking. If there is more than one qualified service provided, seek competitive bids on a periodic basis and document, document, document. One suggested strategy to consider, but probably avoid, is to engage another third party (investment consultant) to monitor the service provider...that may work, but it also means that someone must monitor the investment consultant who is monitoring the service provider. Ultimately the employer bears the fiduciary responsibility.

Contractor Allowed to Recover Deferred Compensation Attributed to Delays in Government Payments

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

A recent (June 26, 2017) opinion and order by the US Court of Federal Claims was “for” the plaintiff, in this case a relatively small government contractor whose owners/managers were forced to defer payments of their respective salaries because DCAA had disapproved the contractor accounting system along with disapproving payment of interim vouchers. More accurately, the contractor was effectively prohibited (by DCAA) from submitting any invoices until it received DCAA approval of the contract accounting system. The contractor began contract performance in July 2003 and DCAA did approve one invoice (for 2003 costs) in February 2004. At that point, no additional invoices were approved or paid; however, de facto accounting system approval occurred in November 2004 (DCAA approved the contractor’s provisional billing rates); however, DCAA inexplicably failed to approve any invoices until April 2005.

As all of this was evolving, DCAA advised the contractor that the contractor’s deferred compensation would be unallowable (“deferred” = unpaid salaries to the respective owners). In November 2010, the contracting officer (ACO) issued an intent to disallow \$148,684, partially relying on DCAA’s 2007 audit of the 2004 costs (the ACO used different FAR references noting that DCAA used 31.205-6(a)(6)(iii) which was not in effect when the contract was executed). The ACO used FAR 31.205-6(b)(2)(i) which provides “for closely held corporations, compensation costs shall not be recognized in amounts exceeding those costs that are deductible as compensation under the IRS code and regulations”. For deferred compensation, the ACO construed that for closely held corporations, allowability would be in the year paid (versus the year accrued even if the accrual was based upon a deferred compensation plan). On March 4, 2011, the ACO issued a final decision which the contractor disputed on March 2, 2012.

In the published decision (more than five years after the contractor filed), the Court focused on the IRS deductibility of the deferred compensation (owners’ salaries which were accrued, but unpaid due to lack of working capital due to

unpaid invoices). In that context, the government asserted that the IRS requires payment within two and one-half months of the end of the contractor fiscal year (i.e. March 15, 2005); however, the court noted that the IRS provides for exceptions when the facts demonstrate that it was impracticable, either administratively or economically, to avoid the deferral.

The decision favoring the plaintiff/contractor stated that the contractor was left with no choice...deferral was the only option as the Government forced the contractor's hand. It would be inequitable to find these deferred compensation cost unallowable nearly thirteen years after the fiscal year in question.

Although the contractor ultimately prevailed, it is undisclosed if the unallowable legal costs (to prosecute the claim against the government--reference FAR 31.205-47(f)(1), negate the amounts at issue in the case (amounts which were admittedly misstated by the government, but corrected during the proceedings). For the record, there is a different ASBCA case where accrued, but unpaid owner salaries were determined to be unallowable; however, there was no government "complicity" in the ASBCA case. One final comment or observation, there remains the unanswered question of (planned) deferred compensation for owners of a closely held corporation for which an ACO asserted that allowability is only in the year paid. The implications, deferred compensation for non-owner employees could be allowable in the year accrued, but potentially only allowable in the year paid for the owners.

Miscellaneous Contract Issues

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

1. Government Eliminates FICA Tax Elimination but Additional Costs DO NOT Equate to an Increased Contract Price. At issue, \$2,051,551 in additional costs incurred on a fixed-price contract based upon a 2008 law which eliminated the FICA exemption for offshore subsidiaries of US corporations. Approximately six-months after contract award, Congress passed a law which now required US Corporations doing business with the United States to pay FICA taxes for US citizens and residents working abroad. The contractor asserted a claim for breach

of contract and mutual mistake; however, the decision rejected both claims. The continuing message for contractors who sign-up to firm fixed price contracts, the unfavorable cost impact of future events is not predictably recoverable in terms of a contract price adjustment...even when the unfavorable impact is caused by the Government. In theory, this is an example of a contingency which is to be identified and priced when submitting a cost proposal (good luck getting the government to include the contingency in the negotiated price).

2. Government Employee Travel Reimbursements for Long-Term TDY. The GAO (Government Accountability Office) recently issued a report on the subject of flat rate per diem for long-term temporary duty (TDY). In 2014, DOD (Department of Defense) changed the JTR (Joint Travel Regulations) to reduce the locality rate payable for each full day for assignments between 31 and 180 days. The GAO was expected to report on the costs and the benefits, including DOD's estimate that the change would save \$194 million (from inception through January 2017). As with all other GAO reports, it found that DOD's cost-benefit analysis was not comprehensive and that there was some confusion over the policy change. Of note, the new policy no longer required lodging receipts, but does require proof that lodging costs were incurred and the confusion, what's proof the lodging costs were incurred if not lodging receipts?

Of passing interest to government contractors, this JTR change only applies to government employees (not to contractor employees traveling on government contracts). FAR 31.205-46 was not changed and it does not incorporate this particular section of the JTR. Nonetheless, contractors should expect auditors and contracting officers to inquire as to contractor policies for long term assignments (31 days to 180 days and for that matter, any long-term assignments between 31 and 364 days assuming that lodging costs are typically less than for short-term assignments). The government rationale? FAR 31.201-3, Cost Reasonableness, because it's presumably unreasonable to allow full "short-term" per diem for long-term assignments when the government has reduced its allowance for its employees (when nothing else applies, FAR 31.201-3 is the catch-all).

3. Government to Lower Improper Payments—Again. Included in the July House Budget is a proposal to engage a Commission to Reduce Improper Payments. For FY2016, the “estimated” improper payments totaled \$144 billion; in contrast, the estimated improper payments were below \$100 billion through Fiscal Year 2009 (\$98 billion in 2009). In 2009 the Obama administration issued an executive order to reduce improper payments by at least \$50 million (the amount actually estimated went up by almost that amount) and there have been “recovery audits” contracts to third parties to identify overpayments to be recovered by the government (recovery auditor paid on a commission basis, such as 2% of the amount actually recovered). In one case, the third party had to resort to legal action because of government agency failures to pursue recoveries of overpayments identified by the third party. In the opinion of the US Court of Claims, for a number of reasons, the government agency (NASA) breached its third-party contract for recovery auditing. Although the decision only addressed the issue of contract breach, the third party alleged that it identified \$121 million in improper payments for which NASA had pursued less than \$5 million. To date, the third-party has only collected \$197,000 in “commissions” and many of its commission-based auditors resigned noting that they could not continue working for nothing.

It is most noteworthy that improper payments are “estimates”; no one knows the amount of the actual overpayments and for that matter, the GAO routinely faults government agencies for having “inaccurate estimates”. Coupled with the fact that political “intervention” has led to higher estimates and that recovery auditors (third parties) have been short-changed by government agencies, perhaps the answer is to accept that government improper payments are a fact of life, they will be a big but inaccurate number and that monies spent to solve the problem could be better spent on a solvable problem.

Training Opportunities

2017 Redstone Government Consulting Sponsored Seminar Schedule

August 16, 2017 – Compensation for Government Contractors – Part 2

FREE WEBINAR – [Register Here](#)

2017 Federal Publications Sponsored Seminar Schedule

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

Travel Reimbursement Expenses – Did You Know?

Posted by Karen Cartwright on Wed, Jul 26, 2017 – [Read More](#)

Are you prepared for an Equal Employment Opportunity (EEO)/ Affirmative Action Evaluation?

Posted by Sheri Buchanan on Thurs, Jul 20, 2017 – [Read More](#)

Key Performance Indicators (KPIs) for Small Business Government Contractors

Posted by Beverly Murphy on Fri, Jun 30, 2017 – [Read More](#)

Contract Disputes on Cost Type Government Contracts

Posted by Charlie Hamm on Tue, Jun 27, 2017 – [Read More](#)

House Bill to Address DCAA Auditor Hiring, Qualifications, and Private Sector Experience

Posted by Bob Eldridge on Tue, Jun 20, 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., and Warren Averett are sponsoring a CFO/Controller roundtable for Government Contractors.

All Government contractor CFO's or Controllers are invited to participate. The meetings are held quarterly and will include lunch and networking from 11:30am – 1:00pm. The next meeting is 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 updates [here](#).

Redstone Edge Conference 2017

We have an exciting slate of speakers, panels and networking sessions planned where you will earn 8-hours of NASBA CPE. We are also happy to help with accommodations for other CPE types.

Limited seating is available for this event, so we hope you will [register soon!](#) We are continually adding highlights of the day's sessions, topics and speakers. Since the focus of the Redstone Edge is on emerging industry concerns the sessions will largely be driven by the changing regulatory landscape and challenges as they arise during 2017.



[Click here](#) to view the schedule or register today!



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.



Redstone
Government Consulting

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