



Contractor Alert: Do Not Complete All Fields in DCAA's Executive Compensation Benchmarking Template (Excel file)

By Michael Steen, CPA, Senior Advisor

DCAA, as part of its initial planning for audits of contractor indirect cost rate proposals, continues to require contractors to complete a multiplicity of forms, providing answers to somewhat voluminous inquiries which are designed to document (or more accurately over-document) the audit risk assessment. All of this pertains to DCAA's audit planning; translated, before the audit officially kicks-off on the date of the entrance conference. During this process, one of DCAA traditional forms (dating back at least 15 years) is the template requesting compensation data for the top five most highly compensated employees. In fact, FAR 52.216-7 was revised to add section (d)(iv), a listing of supplemental information not required to determine if the proposal is adequate, but which **may** be required during the audit process. As it relates to compensation, (d)(iv)(B) is supplemental information: *General Organizational information and limitation on allowability of compensation for certain contractor personnel, see FAR 31.205-6(p)*.

Not that it seems to matter to DCAA, but the template (with several data fields created by DCAA) requests compensation data primarily for DCAA's audit of the reasonableness of compensation claimed by the contractor (the "auditee"). This is a direct link to FAR 31.205-6(b), with a secondary link to the compensation cap, FAR 31.205-6(p)). Not that it ever seems to matter to DCAA, but the template is solely DCAA's, subject to DCAA's revisions and interpretations differentiated from data (in this case, supplemental data which may be required per FAR 52.216-7(d)(iv)(B)).

That said (and also considering FAR 52.215-2, Audit and Records), negotiation which states, in part that an audit cannot require a contractor to create records not otherwise created or maintained in its normal business, the contractor is under no contractual obligation to complete the DCAA compensation template (or for that matter, to respond in writing to the multiplicity of questions generated by DCAA during its audit planning and risk assessment).

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However, in the spirit of cooperating with the auditor, most contractors try to be responsive (to DCAA), even though contractor responsiveness can come back to bite the contractor.

Case in point and in reference to the title of this article: DCAA's compensation template includes a column for "sales scope" separately listed for each of the executive positions. Sales scope is used by DCAA to replace the total contractor (company) revenues for purposes of benchmarking a contractor's executives to similar-sized contractors (one of four criteria listed in FAR 31.205-6(b)). In DCAA's creative way of thinking, a company CEO should be benchmarked using total company revenues, whereas a VP for Research & Development would be benchmarked using "sales scope" reflecting only Research & Development. DCAA's creative and non-regulatory way of thinking is quite obviously intended to yield a lower amount (for reasonable compensation) because all else being equal, market surveys show higher levels of compensation for an executive of a \$1 billion company compared to a similar executive position for a \$100 million company.

In a recent case, the contractor diligently (and naively) completed DCAA's template, showing overall revenues of \$360 million, but sales scope for one or more executives of approximately \$60 million (one sixth of the overall revenues). Surprise, surprise, DCAA's benchmarking determined that the executives with much lower sales scope than total company revenues were unreasonably compensated to the tune of \$150,000 to \$200,000. Had DCAA followed FAR and benchmarked using surveys reflecting similar sized companies (i.e. comparable total revenues), there would have been little or no unreasonable compensation and DCAA's cost questioned would have disappeared.

DCAA's creative and audit strategy is (per DCAA) based upon "generally accepted compensation practices" (GACPs), a reference which is invented by DCAA and, believe it or not, neither explicitly or implicitly incorporated into the FAR. Further, and unlike GAAP (Generally Accepted Accounting Principles) of GAS (Government Auditing Standards), there is no authoritative body responsible for issuing GACPs. The closest thing to GACPs is actually "Generally Accepted Compensation Principles," which is a trademark owned by a

privately-owned business which happens to sell compensation advisory services.

In the recent compensation benchmarking case, DCAA also continues to deploy multiple surveys, in spite of the fact that this technique is clearly flawed; one cannot mix statistics from multiple compensation surveys without knowing and weighting them based upon the number of "plot points," considering differences in statistical dispersion, etc. And to no surprise, DCAA cites the non-existent Generally Accepted Compensation Practices as the basis for its statistically flawed methodology.

Lastly, DCAA's benchmarking simply ignores components of salary surveys which the auditee does not include in its executive compensation. For example, salary surveys (reflecting the compensation practices of similar sized companies in similar industries) commonly include non-cash components which may not be an element of the auditee's compensation. DCAA ignores that component, which means that DCAA is intentionally understating the "market based" total compensation with the obvious purpose of yielding a lower amount for reasonable compensation, and a higher amount of questioned costs. Ironically, DCAA does not attribute this strategy to "Generally Accepted Compensation Practices."

The moral of this story is this: If and when DCAA completes an incurred cost audit, it will deploy its statistically flawed contractor salary benchmarking, which is biased to yield unreasonably low compensation amounts. DCAA will typically:

1. Request the auditee/contractor complete DCAA's Executive Compensation Review (Excel) template.
2. Request contractor support for the contractor's compensation, and unless the contractor uses multiple surveys from the same sources as DCAA, it will summarily dismiss the contractor's market-based surveys as "unreliable" or "cannot be determined" to be consistent with Generally Accepted Compensation Practices (which don't exist, at least in the context of an authoritative source).

3. Benchmark using selective salary surveys, which in some cases differ from year to year for the same position and the same contractor. Could this be influenced by DCAA's desire to show unreasonable compensation?
4. DCAA does not show "comparables" for executive compensation, which is within DCAA's benchmarking (i.e. the claimed compensation is reasonable when compared to DCAA's analysis). The only reason for excluding this data is to hide data which shows that certain contractor executives were underpaid in comparison to DCAA's benchmarking.
5. DCAA will qualify its benchmarking for contractor executives for which the contractor did not provide DCAA with an adequate description of the responsibilities of a specific executive. In one recent case, that DCAA qualification was in reference to the contractor's CEO. DCAA's logic (or lack thereof), was that unless the contractor provides the data or information, the auditor cannot assume anything. Apparently DCAA auditors are not allowed to apply common sense to fill in the blank, so to speak.

At least for now, contractors are "on their own" in terms of dealing with DCAA's biased, unreasonable and statistically flawed benchmarking, purportedly to evaluate the contractor's compliance with FAR 31.205-6(b). In many cases, an unbiased, independent evaluation would conclude that the contractor's compensation is reasonable, but that is simply not DCAA's objective.

Miscellaneous Compliance Topics

By Michael E. Steen, CPA, Senior Advisor

Corporate Tax Reductions and "Benevolent" Employers

Our December 2017 Newsletter included a brief discussion of the Congressional Actions to revise the tax laws; one action was the reduction of the corporate tax rate (nominally from 35% to 21%, although the effective tax rate may be somewhat less in either case). In response or reaction to this "windfall," several companies/employers announced plans to enhance or increase bonuses to their employees. Although this is all well

and good for the beneficiaries, we remind government contractors that they should notify their Administrative Contracting Officer (ACO) of significant revisions or changes to compensation policies or practices (FAR 31.205-6(a)(4). FAR provides no definition of "significant revisions;" however, the safest route is to notify the ACO. No matter what, a contractor needs to reevaluate its projected indirect rates to reflect the increased costs. Lastly and perhaps most importantly, FAR 31.205-6(f) requires a contractor to have, and to consistently follow, its incentive or bonus plan(s); hence, before or concurrent with ramping up bonus payments, make sure that the action(s) are consistent with the existing plan and/or revise the existing plan (as part of the notification to the ACO).

SEC Action Related to PCAOB Employees and a Major Accounting Firm

The SEC announced that five persons were criminally charged related to an alleged scheme wherein then-employees of the PCAOB were funneling insider information to the major accounting firm. The insider information pertained to the PCAOB's planned reviews of the audits performed by the major accounting firm; armed with that information, the major accounting firm took actions to supplement the working papers for the targeted audits. Adding to this was the incidence of the major accounting firm offering employment and/or employing the PCAOB employees. Perhaps it is obvious, but there were just a few legal and/or ethical issues; we provide this message to all: you can't seek, obtain and use inside information to retroactively remediate (potentially) non-compliant services and/or inadequately documented work products. Although this situation may not appear to have any connection to government contractors, there is a common thread in the context of a prohibition on retroactively changing documents, policies, or procedures before turning them over to an auditor or other government reviewer (e.g. a DMCA Purchasing System reviewer). A contractor can/should review documents while providing them for audit, and the contractor can prepare to more fully explain what is documented; but in the end, the auditor or government reviewer should be provided with the unaltered document.

Government Inaction on a Contractor REA (Request for Equitable Adjustment)

As evidenced by a recent ASBCA decision (ASBCA No 61431-983, December 28, 2017), the Government has a tendency to become an ostrich when faced with a contractor REA (in the

context of sticking its head in the sand to avoid the threat). In the five-page ASBCA decision, the following facts are presented:

- The contract awarded in December 2011 resulted in issues which triggered the contractor's 96-page consolidated REA in June 2015 (the consolidated REAs after the Navy rejected or ignored individual REAs submitted in 2013-2014)
- The Navy summarily denied the consolidated REA in February 2016; however, the Navy then acknowledged the REA, indicating that it would require a DCAA audit followed by a decision issued on or before April 28, 2017
- The contractor supported the DCAA audit beginning in November 2016, including written responses to DCAA inquiries, only to receive redundant inquiries in September 2017 (DCAA went dark from May 2017 to September 2017)
- The contractor re-responded to DCAA's redundant inquiries and indicated it's (the contractor's) willingness to meet and discuss the responses and the REA; DCAA never responded
- In November 2017, the Navy again notified the contractor that the Navy was awaiting the DCAA audit with a Contracting Officer's Final Decision anticipated in March 2018

In its decision, the ASBCA directed the CO to issue a final decision on the contractor's claim by January 31, 2018 (we are not privy to the actions taken as of that date). Although the contractor was successful in the narrow context of forcing the CO to do his or her job, the contractor is miles away from resolving the REA. Unfortunately, DCAA is likely to hide behind assertions that the contractor REA is inadequate for audit, a strategy frequently used by any auditor who simply wants to avoid auditing a complex and difficult contractor REA. Equally unfortunate is the fact that this case isn't unique, and the government is frequently missing in action when it comes to dealing with contractor claims which will potentially increase the contract costs. It is what it is.

Training Opportunities

2018 Redstone Government Consulting Sponsored Seminar Schedule

TO BE ANNOUNCED

2018 Federal Publications Sponsored Seminar Schedule

On Demand Webinar – [DCAA Audits in 2018 - What's New and What's Not So New](#)

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

NCMA Contract Administrator's Round Table

DCAA Trends Focused on Incurred Cost Audits on Wed, Feb 28, 2018 from 7:30 am to 8:45 am – [Register Here](#)

Blog Articles to our Website

Are Work Authorizations Required by DCAA for an Adequate Accounting System?

Posted by Wayne Murdock on Tues, Feb 6, 2018 - [Read More](#)

DCAA's 2018 New Year Resolutions

Posted by Michael Steen on Fri, Dec 29, 2017 - [Read More](#)

Wishing You a Joyous Holiday Season

Posted by Scott Butler on Fri, Dec 22, 2017 - [Read More](#)

Elusive Answer: Contracting Officer Actions to Disposition DCAA Audits

Posted by Cheryl Anderson on Thu, Dec 7, 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](#).

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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