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As 2020 (thankfully) draws to a close, it is time for the final quarterly newsletter for the year and coincidentally, the final newsletter for which I am the primary author. I will fully retire at the end of 2020; however, the newsletter will most assuredly continue. I am forever grateful to DCAA (my employer from July 1973 until April 2007) and Redstone Government Consulting (my employer from June 2007 until now). With respect to Redstone (and its predecessor Beason & Nalley), I am especially honored to have known and worked with Scott Butler and Darryl Walker (sadly Scott passed-away in August 2019 and Darryl retired a couple of years' ago but Darryl and I still meet over breakfast to discuss the good old days). Lastly, to thank all my co-workers, all of the clients with whom I've worked, and all of those who have endured my newsletters and blogs for the last 13 years.

The articles herein are primarily focused on DCAA including its audit policies, audit strategies or auditor communications. These include a very recent audit policy (MRD) related to COVID-19 costs and/or legislation as well as the outcomes (published decisions) involving contract disputes originating with DCAA audits.

THIS ISSUE:

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DCAA MRD on COVID-19 Costs and Legislation (e.g., CARES Act including the PPP/Paycheck Protection Program)

By Michael Steen, Senior Advisor

In MRD 20-PIC-006(R) (Memorandum for Regional Directors and Corporate Audit Directors) dated December 11, 2020, DCAA advised its auditors of the audit implications related to a number of legislative actions in response to COVID-19. This MRD follows an April 10, 2020 Memo (20_PAS-001) which solely addressed audit expectations as a by-product of the

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limitations (physical access to contractors and contractor facilities) attributed to COVID-19, now known as "social distancing" or in some cases "lock-downs".

The more recent 14-page MRD identifies and discusses the various legislative acts which had been passed, but not anything which is still moving through the enactment process as well as some related policies issued by DPC (Director of Pricing and Contracts within the Department of Defense). Although DCAA's MRD identifies and discusses the various Legislative Acts primarily from an audit perspective, it should be self-evident that a company/contractor is responsible for implementing policies and procedures which address and comply with the numerous requirements of these laws. With respect to these laws, DCAA notes the requirements for complete and accurate (contractor) record-keeping along with an expectation that contractors will provide DCAA auditors with this documentation (editor's comment: to the extent a record exists, and it is relevant to an audit objective, DCAA does have access under FAR 52.215-2; however, DCAA should not be asking for contractors to generate or create additional records or analysis solely to support a DCAA audit).

Any contractor participating in any of these legislative acts (e.g., economic relief such as a loan with loan forgiveness, expenses which yield tax credits, etc.) needs to first consider the requirements of the specific act and any sections under the act, but then consider the impact on allowable contract costs which might include the following:

Loan forgiveness under the "PPP"

In reference to FAR 31.201-5 which applies to credits (reductions of costs/expenses for which the Government contract(s) previously participated), DCAA notes that a contractor must determine if any loan forgiveness was applicable to a direct or indirect cost claimed on cost-type/flexibly-priced government contracts. For example, if a portion of the forgiven loan had been used to fund direct labor (payroll) on a cost-type contract, that contract is entitled to that amount as a reduction of previously claimed direct costs. However, amounts related solely to payroll for employees working on commercial work would not become credits on any Government contract. Of passing interest, DCAA does not address Government fixed price contracts, but with rare exceptions, credits earned subsequent to negotiating a "fixed" price are not credits payable to the Government. Although DCAA does not clearly address it, another consideration is the allowability or unallowability of a cost which is linked to the forgiven loan. If the cost is unallowable (not claimed as either a direct or indirect cost on Government contracts, such as interest expense on a mortgage), that portion of the forgiven loan does not become a credit to Government contracts. Perhaps obvious, but documentation ("audit trail") is critical to the extent loan amounts forgiven may or may not be subject to FAR 31.201-5. One closing thought on credits vis-à-vis costs on Government contracts, there is a history of FCA (False Claims Act) settlements associated with credits received and fully retained by a contractor without giving any consideration to amounts "shareable" with the Government. If a credit or portion thereof might be linked to a previously claimed direct or indirect cost impacting flexibly-priced Government contracts, a contractor must comply with FAR 31.201-5 even if the credit occurs after a contract has been administratively closed.

Timing Including Subsequent Events

At the time DCAA issued 20-PIC-006, essentially all the economic relief from Legislation addressing COVID-19 ends on or before December 31, 2020. Thus, for contractors whose fiscal year is the calendar year, there was no economic relief impacting 2021 costs. Hence, there are no audit assumptions that contractors reflect future economic relief from future (unknown) legislation. As stated by DCAA, these are contingencies which are not predictable in terms of the probability of occurring or the amount should they occur. As noted by DCAA, this concept also applies to future loan forgiveness (the loan is in 2020, but as of 12/31/2020 the loan has not been forgiven, thus it remains a contractor liability). If the contractor seeks and obtains loan forgiveness in 2021, the contractor would then be expected to link the amount forgiven to the costs for which the loan was used in 2020 (but to actually record the loan forgiveness transaction in 2021).

In the context of discussing contingent (subsequent) events, DCAA reminds auditors that contingencies are rarely an allowable incurred cost and that contingencies should not be included in cost estimates on bid proposals, but subject to separately negotiating any contingencies with a contracting officer. In fact, FAR 15.408, Table 15-2, does require a contractor to separately identify "the nature and amount of any contingencies included in the proposed price"; however, that does not mean exclusion from the cost estimate (editor's comment: unfortunately, DCAA has a track record of rewording FAR and apparently no one within DoD exercises any "supervision").

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In terms of contingencies as a consideration in pricing and negotiating firm fixed price contracts, it is incumbent on a contractor to identify and to propose costs albeit for a contingency. History (i.e., decisions in contract disputes) has shown that the Government will not offer any financial relief for additional costs incurred as a result of unforeseen events happening during contract performance (one example, significant losses of a contractor's equipment and vehicles attributed to "bandits" operating on routes from Pakistan to US bases in Afghanistan). For more on contingencies in Government contracting, one can "read all about it" in DCAA's Chapter 12, Selected Areas of Cost Guidebook (www.DCAA.mil/Customers/Guidebook), but don't forget that DCAA guidance may include interpretations that may not be consistent with the precise wording of a regulation.

DCAA's MRD also references the DPC Guidance Memo in the context of donated leave as a by-product of COVID-19 absences causing contractor employees to exhaust his/her PTO; however, DCAA links this to a 12/31/2020 end date (implications that the cost of donated leave continuing into 2021 is unallowable). For what it's worth, nothing in FAR Part 31 or any DFARS Part 231 defines donated leave as an unallowable cost. Further, the DPC Guidance Memo mentions donated leave, but there was no need to issue a FAR deviation in DFARS; in effect, confirming that nothing in FAR categorizes donated leave as unallowable. The only potential issue is for a contractor to implement a donated leave practice without embedding it in a policy.

Provisional Billing Rates and DCAA Request for a Contractor Proposal

By Michael Steen, Senior Advisor

Recently, one or more clients received a letter from a DCAA Branch Office requesting a "provisional billing rate proposal" from the contractor as a prelude to DCAA establishing the contractor's Fiscal year 2021 provisional billing rates (see FAR 42.704). Although these requests appear to be unique (i.e., crafted by a specific DCAA office and not any agency-wide template), they are a continuing display of DCAA's tendency to request that contractor's do far more than is necessary to manage risks while achieving an objective. Historically this has been captioned as "auditor arrogance" exemplified by audit demands or expectations: i) unsupported by any contractual requirement, ii) which require contractors to create records or analysis purely to satisfy the subjective expectations of the auditor, and iii) which give absolutely no consideration to the time expended and the costs incurred by the contactor personnel to satisfy DCAA's quest for documentation which will most likely "paper the file" (included in the audit working papers, but with little or no utilization by the auditor).

DCAA's letters stated that "Each contractor submitting interim public vouchers should provide DCAA with a detailed billing rate proposal". This statement is without any regulatory basis and is also at odds with a DCAA MRD (Memorandum for Regional Directors) 14-PPS-012 which included a Provisional Billing Rates audit program (code 15500) which required the auditor to notify a contractor that DCAA is initiating the process of establishing provisional billing rate and to "ask if the contractor wishes to provide any input, e.g. budget or projections for changes. The remainder of the audit program instructs the auditor to consider data in DCAA's permanent file including incurred cost submissions, comparisons of prior years' provisional billing rates to actual rates, etc., and "If" the contractor provides input (e.g., budgets or projected changes), ask for a walkthrough. Significant to the auditor and the expected "non-audit' scope, establishing provisional billing rates is not an audit (i.e., there are no expectations that the auditor will perform any preparatory risk assessments nor will the auditor perform substantive tests to ensure the validity of anything voluntarily provided by the contractor).

Ignoring DCAA's audit program and the limited expectations conveyed in FAR 42.704, these recent DCAA letters requested the following (in addition to the proposed billing rates):

- Comparison of forecasted and actual rates for the prior two completed years,
- A listing of the forecasted and the incurred pool expenses by account for the current fiscal year (which would be 10 months year-to-date data by account).
- Identify and explain unallowable costs year-to-date and identify the mix Government contracts separate from commercial contracts and by contract-type for Government contracts (but it isn't necessary to identify contract type for commercial contracts!).

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- A listing of government contracts awarded during the year including contract number, award date, period of performance, dollar value, contract type,
- A description of changes in organization, operation, business volume, allocation bases that impact the subject fiscal year (never defining what is the "subject" year),
- A listing of the forecasted pool expenses by account including identifying and explaining any unallowable costs (adjustments to gross amounts forecasted).

Apparently, DCAA without any regulatory backing for its demands, assumes that all of this data is readily available (i.e., generated by "pushing a button") or more likely, that DCAA really doesn't care what it takes. Of passing interest or perhaps indicative of a lack of any "internal controls" on the part of DCAA, one of DCAA's letters was dated December 23, 2020 and it requested all of the above no later than December 15, 2020 ("back to the future").

Notwithstanding that none of this DCAA-requested data, if submitted by the contractor, will serve any meaningful purpose (for the purpose of establishing provisional billing rates) or will be subjected to any meaningful substantive audit testing, the contractor is between a rock and a hard place in terms of if/how to respond. If unresponsive, the contractor risks DCAA retaliation, i.e., DCAA establishing provisional billing rates well below historical or projected rates causing a significant cash-flow issue in a circumstance where FAR 42.704 clearly states that the Government (DCAA) shall establish the provisional billing rate (these are not negotiated). Once established they "may be" revised by mutual agreement between the Government (DCAA) and the contractor (good luck obtaining mutual agreement with DCAA if you've ignored their previous demands).

Perhaps the only alternative in the near term is to be "sort of" responsive, that is to provide reasonably accurate data/information, but not in the same context as submitting a final indirect cost rate proposal which has data requirements defined in a contract clause along with a contractor certification. In no case should the provisional billing rate proposal data be misleading, but no one needs to expend any significant time for data gathering for an "uncertified submission" to satisfy (or placate) the subjective whims of a DCAA Office. One could consider elevating this to DCAA management, but to whom and what are the risks of retaliation by the specific office?

One final observation regarding DCAA's billing rate letter, it defies all logic that DCAA refers to "contract mix" data concerning commercial contracts but notes that it does not expect the commercial (non-government) contracts' data to be identified to "contract type". As if the bizarre world of government contract-types also applies to commercial contracts. Seriously?

And one additional point of reference on the topic of "audit arrogance", in this case, that exhibited by the Agency in MRD 20-PAS-005(R), dated September 29, 2020, Subject: Guidance on the Contractor Information Survey (CIS). Although this survey (template) is hidden behind the walls of DCAA's Intranet, presumably a number of contractors have seen it by virtue of being "asked" to complete the form which is "a tool to assist the audit team in identifying potential areas where future audit effort may be warranted". What a deal for contractors to complete a "CIS" in hopes of giving DCAA information to facilitate DCAA's identification of future audits of your company. Not only that, but expecting contractors to take the time to complete the survey when there is absolutely no contractual basis for DCAA's request (unlike other contractually required forms such as the final indirect cost rate proposal specified in FAR 52.216-7(d)). The good news (more accurately the irony of it all), DCAA gives its auditors a time charge to capture their hours spent completing the form? Hours for whom?

Business Systems' Audits and Regulatory Changes

By Michael Steen, Senior Advisor

In May 2011, the DFARS added its infamous Business Systems Clauses including the administrative clause 252.242-7005, as well as the six DFARS clauses for each of the six business systems (Estimating, MMAS, Accounting, Government Property, EVMS, Purchasing). In order to avoid unfavorable outcomes (disapproved system and withholds) a contractor must have a system which does not have any "significant deficiencies" (defined as "shortcomings in the system that materially affects the ability of official of the Department of Defense to rely upon the information produced

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by the system that is needed for management purposes”). As defined, a significant deficiency is from the perspective of the DoD (and not the contractor) and the terminology is unique to the DFARS regulation (i.e., was not stated using the interrelated auditing terminology, “material weakness”, which is applicable to audits and the internal controls of the auditee).

Although DCAA immediately linked the DFARS terminology to the auditing terminology, MRDs 12-PPS-009 and 14-PAS-009, which conjoined the criteria listing it as “significant deficiency/material weakness”, we now have Section 806 of the 2021 NDAA (National Defense Authorization Act), which will replace ‘significant deficiency” with “material weakness” (defined as: a deficiency or combination of deficiencies in the internal control over information in contractor business systems such that there is a reasonable possibility that a material misstatement of such information will not be prevented, or detected and corrected on a timely basis. Reasonable possibility is further defined as “more than remote, but less than likely”. The rationale from the House Conference Report is that the new definition will:

- Better align with generally accepted auditing standards,
- Eliminate confusion about the seriousness of deficiencies identified in the contractor business systems, and
- Provide a more nuanced approach to classifying contractor business system deficiencies according to their severity.

For anyone with an auditing background, the change might mean something; however, to everyone else it probably appears to be “form over substance”. As business systems reviews (DCMA) or audits (DCAA) have evolved, there has obviously been some attention given to achieving consistency in terms of measuring a condition against the DFARS criteria. In particular, DCMA uses a numerical rating or categorization system which links a shortcoming with a “degree of seriousness”. Although it tends to be more subjective, DCAA also has policies which are intended to help auditors identify and report significant deficiencies (aka material weakness) from those conditions which are less severe.

Although the business system rule has been out there for ten years, it is now apparent that that terminology specific to auditing will replace the existing wording notwithstanding that it will mean both DCAA and DCMA will have to revisit existing policies to ensure that they reconcile with the new definition. For any contractor hoping that the change will add objectivity and reduce subjectivity on the part of the Government review or audit team, only time will tell (but if it does happen, it will be coincidence because the new terminology isn’t any more objective than was the old terminology). Noting that DCAA has always conjoined the old terminology with the new terminology and that DCMA has evolved into a working numeric rating scheme, one would expect almost nothing to change.

On the topic of business systems and those subject to DCAA audits (Accounting, Estimating or MMAS), client experience shows that little has changed over the years other than the fact that DCAA is now doing more of these audits thanks to becoming current on incurred cost audits. Regardless of the terminology used to define a serious condition, it remains subjective in large part because each of the business system criteria is conceptual at best and it is evaluated against the expectations or interpretations of the auditor(s). In rare cases, does any auditor defer to the specific, unique needs of the contractor even though the nature of the audit (attestation) is to evaluate the contractor’s (auditee’s) assertions that its business system complies with each of the business system criteria (e.g., each of the eighteen for the accounting system). From the perspective of defending an assertion of compliance, the criticality of a contractor benchmarking its policies and procedures against the criteria with the objective of demonstrating point-by-point compliance. Unfortunately, that strategy has to be reconciled with the expectations of the auditor(s) or DCMA review team. In other words, avoiding issues whether categorized as a “significant deficiency” or as a “material weakness” will always involve an element of knowing the subjective expectations of the government compliance personnel.

One other observation concerning any DCAA audit of an accounting system (their activity code 11070 which is for the comprehensive audit of a contractor subject to DFARS 252.242-7006); be prepared for a long and protracted “slog” starting with an initial request (contractor questionnaire unlike any other) and a team of auditors who just might be onsite for a year or more (once “onsite” is an option; otherwise, yours to “virtually support” for months). In closing this topic and seemingly at odds with some of my statements, it remains that the best, if not only way to survive a business system audit or review is to perform your own self-assessment with clear

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linkage of your policies and procedures to the DFARS criteria of the particular business system.

Procurement and Compliance News - Published Decisions

By Michael Steen, Senior Advisor

In discussing published decisions (primarily those issued by the ASBCA/Armed Services Board of Contract Appeals), always a note of caution that cases are fact specific and seemingly similar issues may not yield the same results. Further, there are more issues involving the CDA (Contract Disputes Act) which are settled by the respective parties without any decision by the ASBCA (hence, without any public disclosure of the underlying issue and/or how it was settled). Nonetheless, the following decisions to provide some insight into how to interpret or apply some of the contractual clauses involving FAR or CAS.

CAS (Cost Accounting Standards) and FAR Part 30.600 (CAS Administration)

In published ASBCA or CoFC (Court of Federal Claims) decisions this year we've learned the following about CAS including some interplay between CAS and FAR.

1. Cost Impact Statements (FAR 52.230-6 and 30.600). For all contracts subject to 52.230-6 in effect after April 8, 2005, contractors are not permitted to combine the cost impact for multiple concurrent changes in cost accounting practices into one computation. Each change stands on its own unless each/all concurrent changes result in increased costs to the Government (something of a joke because the only way to prove that is to first do the cost impacts individually). In a recent case, the contractor challenged the legality of the FAR clause (e.g., the FAR Councils illegally assuming the role of the CAS Board); however, this was not only unsuccessful, but the decision stated that the contractor should have taken this action before contract award (while giving all indications that such an attempt would have been fruitless). However, we've also been reminded or learned that the cost impact is measured in the aggregate which meant that the Government cannot effectively recover the same dollars twice. The example, a voluntary/unilateral contractor change to a cost accounting practice which shifted the same dollars from fixed price CAS contracts to cost-type CAS contracts. In isolation, each represented an unfavorable cost impact (cost increase as defined in FAR 30.600), but "step two" requires measurement of the "aggregate cost impact". The Government (DCAA) asserted that the impact was the absolute value from each contract group, but the decision correctly opined that this calculation was contrary to the regulations (i.e., the Government is not entitled to recovering the same dollars twice).

2. Penalties and Interest--FAR Part 31 is linked with CAS 405 (for contractors with CAS-covered contracts). In a published decision and subsequent appeals by the contractor, it's been effectively confirmed that a contractor claiming expressly unallowable costs (subject to the penalties and interest clause FAR 52.242-3 and the CAS clause 52.230-6) is potentially facing "double jeopardy" in terms of the combined impact of the two clauses (in particular separate, but duplicate computations for interest). Fortunately, we have yet to see a similar issue where the Government also injects DFARS 252.242-7006(c)(18) related to a contractor's accounting system (which is the business system criteria which requires compliance with Cost Accounting Standards).

Contractor or Government Claims including FAR 33.206, Six-Year SOL (Statute of Limitations)

In a nutshell, this six-year SOL requires either the contractor or the Government to initiate a claim (under the Contract Disputes Act) within six-years of the accrual date of the claim, the date when the aggrieved party knew or should have known that it had a claim. Its "potential" applicability had been fueled by DCAA's untimely incurred cost audits (thousands of contractor indirect cost proposals (ICP) submitted, but unaudited for six or more years), but DCAA's reversal of fortunes (i.e., auditing within 365 days of receipt of a contractor ICP as required by the 2018 NDAA) has all but eliminated untimely incurred cost audits. Nonetheless, there are still contract disputes being currently dispositioned on issues which date back years; in other words, where a part of the dispute involves an assertion related to the six-year SOL.

One of the most novel contractor assertions was that Government/DCAA knowledge of the contractor's "inadequate" accounting system was the start date for the accrual of a Government claim (when the Government had facts sufficient

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to know that the Government had a monetary claim against the contractor). To be sure, the Government knew that the contractor's accounting was unreliable for purposes of accumulating and reporting costs on cost-type contracts (evidenced by multiple rejections of incurred cost proposals), but the ASBCA opined and reaffirmed that knowledge of an inadequate cost accounting system fell far short of that which would initiate a Government claim. Hence, the Government was not time-barred from seeking monies from the contractor based upon later audits which identified expressly unallowable costs and associated penalties.

In another slightly different case involving a contractor assertion that the date of the contractor's certified ICP (deemed acceptable for audit by DCAA) is the initiation date for the accrual of the Government claim, the Government once again prevailed on the basis that the contractor's ICP is a summation of accounting data, but it lacks the details necessary to identify unallowable costs. Of note, it did not matter that at one-point DCAA vacated its in-process incurred cost audit citing the lapse of time vis-à-vis the SOL (the fact that DCAA may have misinterpreted a regulation is of almost no value in this or any other case involving the ASBCA or CoFC). There was one positive outcome, that the ASBCA Administrative Judge concluded that DCAA and the CO had incorrectly deemed patent costs to be unallowable (FAR 31.205-30) because the costs incurred were for patents required by the cost reimbursable research and development contracts (SBIR) containing FAR 52.227-11 which obviously anticipated patentable discoveries which required patent applications, etc. (Editor's comment: It is a sad commentary that neither the audit staff or the administrative contracting officer and his or her legal support understood FAR 31.205-30 in conjunction with 52.227-11 on the SBIR program).

One last development concerning a contractor assertion that a Government claim is untimely (beyond the six-year SOL), relatively recent cases have shown that Government knowledge of an issue and the related costs in earlier years did support the contractor assertion that a Government claim was time-barred. However, a continuing saga of the same contract non-compliance issue (into more recent years with different amounts at issue) did not result in a time-barred claim. Even though the Government had reason to know that "an issue" was a continuing issue, the accrual of a Government claim only initiates when there is an amount which can be reasonably attributed to the issue in each of the more recent years.

In a Government assertion that the contractor's claim was time-barred, there is a published decision which considered facts (building a 200-meter deep well in Afghanistan) which purportedly took place in 2011 along with the Government's successful assertion that the SOL was time-barred in application to the contractor's claim in 2018 (at least seven years after the accrual date of the claim). The facts and the chronology in the case read like a fairy-tale including the absence of any contractual records in 2018 in the files of the Government (when a new Contracting Officer received the contractor's official claim). Not only was the new CO unable to locate any contract files, but the security situation at the site of the well made it impossible to verify that a well even existed. The key fact accepted by the ASBCA (assuming that there had been a contract) was that the contractor knew that it had completed the well in 2011 as evidenced by several "back and forth emails" into 2012, but the contractor never actually filed a claim until 2018. In effect, the Government received the services without any payment to the contractor which would appear to be a violation of another law, except for the fact that no Government records established that there was a contract or a well. As with many contractor failures involving an untimely claim involving the six-year SOL, a foreign company dealing with unfamiliar US Government contractual terms and/or administrative processes.

Compensation

By Michael Steen, Senior Advisor

Severance Pay and FAR 31.205-6(P), statutory cap on contractor employee compensation

This FAR subpart limits contractor compensation based upon specific amounts or "caps" linked to a calendar year. The amount peaked at $1,144,888 for 2013, dropped to $487,000 for 2014 with annual increases yielding the most recent "cap" of $555,000 for 2020 (an amount computed by and published by DCAA in its audit policy 20-PSP-004, but not actually published in the Federal Register). For purposes of ASBCA Case 61950, the relevant caps were from 2010-2014; $693,951 to $1,144,888. The subpart also provides its own definition of compensation (subject to the cap) which: "means the total amount of wages, salary, bonus, deferred

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compensation (see 31.205-6(k)) and contribution to pension plan". These categories are only a few of the types of compensation listed in subparts within 31.205-6 and notably missing is any reference to severance pay (31.205-6(g)).

In its audits of the severance payment to the contractor's CEO (Corporate), DCAA had previously deemed the CEO Severance Agreement to be reasonable (terms and conditions which was two times base pay plus target bonus) and DCAA had tacitly accepted severance costs of $1,150,000 for 2014 (but DCAA insisted that the costs had not been specifically audited even though included in the 2014 incurred cost audit). Additionally, per the ASBCA's decision, DCAA's acceptance of an incentive compensation plan is not acceptance of the costs later incurred under that plan.

In DCAA's incurred cost audits which questioned a total of $7,812,098 ($4,983,333 paid in 2015 and $3,066,667 paid in 2016) relied upon selective (Reasonableness) subparts of FAR 31.201-3(b) inextricably intertwined with the statutory cap in 31.205-6(p). Although DCAA explicitly stated that "severance payments do not meet the definition of compensation (for purposes of the "cap"), the salary and bonus components of the severance calculation do meet this definition". "Therefore, in our opinion, the FAR 31-205-6(p) limitation is an appropriate benchmark to determine reasonableness of the salary and bonus components". In regard to reasonableness, DCAA was highly selective in using only one of the five criteria in FAR 31.201-3(b), that a cost is reasonable as a function of the "contractor's responsibility" to the Government. DCAA and ultimately the published decision selectively ignored the other reasonableness criteria including the two linked to the contractor's responsibility to its employees and to its stockholders. In fact, the terms and conditions of the CEO severance agreement was an arm's length transaction, benchmarked with other similar agreements, which would indisputably support the contractor's responsibility to its stockholders and to its employees.

In furtherance of the Government claim, the Government's trial attorneys selectively quoted from Black's Legal Dictionary while also ignoring that authoritative source for its definition of severance pay. The Government insisted that because the severance pay was "computed based upon" salary and bonus, the severance pay fell within the more limited definition of the compensation subject to the cap.

Editor's comment: Although I have no direct or indirect involvement with this particular issue (other than in reading and rereading the ASBCA decision), it illustrates the lengths at which the Government (DCAA and DCMA) will rewrite the regulations to support their crusade against contractor compensation. In fact, DCAA/DCMA simply revised the limited definition of the types of compensation included in 31.205-6(p) to expand it to include a type of compensation (severance pay) stated in other parts of 31.205-6, but clearly excluded from (p). Additionally, DCAA/DCMA have inserted the words, "calculated based upon" salary and bonus to further their cause of disallowing severance pay. If FAR 31.205-6(p) had intended its definition to be a function of "calculations based upon", the FAR councils would have used terminology identical to that in 31.205-6(i) which makes unallowable "any compensation based upon changes in the price of corporate securities…such as stock" and "any compensation which is calculated or valued based upon changes in the price of corporate securities". This subpart has been applied to incentive compensation plans where the employee bonus is a function of the changes in stock price of the contractor/corporation measured against the changes in stock prices of a peer group". Compensation "calculated or based upon" salary or bonuses is much broader than "salary or bonuses". Finally, the Government "team" asserted that severance pay is for services rendered in the fiscal year, a "force-fit" to meet the definition in 31.205-6(p), when in fact severance is an employment termination payment earned over the entire period of employment.

Before leaving the topic of potential challenges to the allowability or reasonableness of contractor (employee) compensation, we've noted that DCAA continues in its benchmarking for compensation reasonableness under FAR 31.205-6(b). As contractors (and consulting firms like Redstone Government Consulting, Inc.) have developed and used benchmarking (the use of well-known and reputable salary surveys, most often subscription based) to anticipate and to deflect DCAA challenges, DCAA continues to revise its strategies. Very recently on the long-standing debate as to what percentile to use for benchmarking executives against a survey (i.e., defaulting to the 50th percentile versus the use of something higher, such as the 75th percentile). Although published decisions in 2012 and 2013 suggest that there could be a number of factors/considerations including corporate or individual performance (i.e., annual) or intangibles such as executive-specific skills and credentials, DCAA has never

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accepted “intangibles” which do not lend themselves to DCAA’s highly prescriptive benchmarking. And now, DCAA is asserting that only incentive compensation can be benchmarked at higher than the 50th percentile (i.e., if an executive and/or the company has an exceptional year, that should only affect the bonus or incentive compensation). Suffice to say, DCAA will never “throw in the towel” in terms of its creative methods of independently determining what is reasonable compensation for contractor executives/employees.

With that, it is time to wrap-up this part of the Fourth Quarter Government Insights and for this author to ride into the sunset singing “happy trails to you” (showing my age and the fact that I know where this reference originated).

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Government Consulting

Redstone Government Consulting, Inc.

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

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