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# newsletter

## Government Contracts Consulting

Provided by Beason &amp; Nalley, Inc.

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### DCAA's Latest Quest for Independence-Proposal Audits

In an Audit Alert on Performing Audits of Parts of Proposals (09-PSP\_005(R), dated April 9, 2009), DCAA has expanded its proclamation of independence (from Contracting Officers and Contractors) to include "parts of proposals". The recent audit alert addressed some confusion in terms of "Can DCAA still audit only parts of proposals and remain compliant with Government Auditing Standards (GAGAS)?" In answering the question, "Yes", the audit alert identified three guidelines which must be met:

1. The contracting officer requests the audit services.
2. The audit covers a "management approved" proposal and not a draft proposal; and
3. The audit report is issued reflecting an independent opinion that is not influenced by the contractor or Government officials.

Although it is unstated, guidelines two and three are descendents of the now infamous July 2008 GAO Report (reference to GAO-08-857). In fact, virtually every audit policy or audit alert in 2008-2009 are descendents from this GAO report. Clearly DCAA will not be a participant in planning or providing input into a contractor pricing proposal (having disconnected from any IPT or Integrated Product Team participation), nor will DCAA's audit opinion be influenced by those (contractors and government officials such as contracting officers) who purportedly persuaded DCAA to remove unfavorable audit findings/opinions identified in fieldwork and/or draft audit reports but inexplicably missing from the final audit report.

In fact, the audit alert goes well beyond the confusion concerning an audit of parts of a proposal and a significant portion of the audit alert addresses "Disagreement on Audit Coverage". Contrary to long-standing audit policy, the audit alert introduces the concept of elevating any disagreements wherein the auditor

believes that the audit scope should be more expansive than as requested by the contracting officer. In other words, although the analysis of a price proposal and the negotiation of a price is clearly the responsibility of a contracting officer (FAR 15.303), DCAA has proclaimed that its field auditors should second guess that contracting officer. Historically, DCAA auditors have always been encouraged to advise the contracting officer (CO) of perceived risks (identified when auditing those parts of a proposal as requested by the CO); however, it was in the context of "advice" (which rings true with DCAA's advisory role as clearly stated in DCAA's own Contract Audit Manual, (CAM 1-100). However, auditors will now elevate the issue; first between DCAA's Regional Office and the Director of Contracts for the individual command and if unsuccessful the DCAA regional director shall elevate the issue to the DCAA Assistant Director, Policy and Plans.

As with every other DCAA audit policy or audit alert issued after the July 2008 GAO Report, it is what it is and contractor,

contracting agency (or consultant) reaction is of no particular interest to DCAA. However, in the instant case, in its unfettered zeal to demonstrate auditor independence, DCAA has completely lost sight of its role in the pricing process. First and foremost, FAR Part 15 and not GAGAS define responsibilities in Contracting by Negotiation. FAR 15.303 clearly establishes the CO authority including that the CO will “establish an evaluation team, tailored for the particular acquisition, that includes appropriate contracting, legal, logistics, technical and other expertise to ensure a comprehensive evaluation of offers. Further FAR 15.404-1, Proposal analysis techniques states that “The contracting officer is responsible for evaluating the reasonableness of the offered prices” and “The contracting officer may request the advice and assistance of other experts to ensure that an appropriate analysis is performed”. Hence, DCAA is a participant as a team member and within that, not necessarily privy to all advice sought and obtained by the CO from other expertise tailored for the particular acquisition. In simple, straightforward language, it isn't DCAA's responsibility to tell the ACO how to conduct the price analysis.

Finally, DCAA's third “guideline” is absurd and unworkable in the context of stating that an independent audit opinion should not be influenced by Government officials. Government officials issue the solicitation, which often include very specific cost volume requirements ranging from format to projections for out-year escalation. Government officials also prepare technical evaluations which DCAA expects to receive for incorporation into the audit report (notwithstanding that DCAA has to satisfy itself that the technical evaluation is realistic). It is impossible for an audit of a proposal to be free from “influence by Government Officials”.

In the final analysis, it remains to be seen how DCAA's latest declaration of (auditor) independence impacts the procurement process (pricing and price analysis). Assuming that a CO's choices are to perform the proposal evaluation without the auditor or to invite the auditor to participate on parts of the proposal only to be second-guessed on the sufficiency of the audit coverage on those or other parts of the proposal; the choice maybe to exclude the auditor. Not exactly the “team” concept as envisioned by FAR Part 15.

### Federal Circuit Reverses Tecom ASBCA Decision on Settlement Costs

The Federal Circuit issued its decision (May 19, 2009) reversing an ASBCA decision on the allowability of settlement costs (and by some implications legal costs). At issue were costs associated with the defense of a Title VII third-party lawsuit involving allegations of sexual harassment and retaliation. As frequently occurs, the case was settled without Tecom admitting any wrongdoing (“out of court settlement”). The government disallowed the settlement costs (contract direct charges) and legal expenses (indirect charges). The ASBCA ruled for Tecom, citing the inapplicability of the 2002 Boeing North America Inc v Roche decision.

The Federal Circuit disagreed with the ASBCA noting that Boeing did apply. However, the applicability of the Boeing case was simply to open the door to reconsider the case given that the Federal Circuit Judge concluded that in the final decision, the violation of Title VII by sex discrimination or retaliation is a textbook breach of this contract; hence, reasoning that the contract required that Tecom not discriminate.

Tecom argued that the decision would have broad implications under FAR 52.236-7 (Permits and Responsibilities Clause); however, the court stated that this clause does not broadly make failure to comply with the law a violation of the contract.” Rather it simply requires a contractor to obtain necessary licenses and permits, as well as comply with applicable laws, regulations and codes so that failure to perform is not excused if performance is impeded by failure to comply with legal obligations (comment: It sounds to us that the decision will or at the very least could have broad implications).



In further explaining its decision the Federal Circuit indicated that “It cannot be the policy of the FAR to permit a contractor who is certain to lose on the merits to defeat disallowance by the simple expedient of settling before the litigation is concluded.” Of note (and confusion), this statement is in the context of prohibiting a contractor from claiming settlement costs on an issue where defense and judgment costs would be disallowed. In terms of our more common experience, whenever a government auditor questions the legal costs for a third party lawsuit, they likewise question any judgment and settlement costs. In any case, it is now more than ever incumbent upon any government contractor, involved in any litigation involving Title VII or any other responsibility incorporated into the contract to be able to demonstrate that



the plaintiff was highly unlikely to succeed on the merits of the allegation.

In terms of the practical implications for the Tecom reversal, one can assume that government (DCAA) audits will continue to focus on all lawsuits and for third party lawsuits involving Title VII (or similar contractor responsibilities), the auditor will question all legal, judgment, and settlement costs (which they've been doing for the most part before the reversal). As with so many audit challenges, the burden of proof is on the contractor to establish and document that the plaintiff was unlikely to prevail. An almost impossible task if the terms of the third-party settlement also contain a confidentiality/nondisclosure provision.

And one final editorial commentary, the judge also stated that it is not just and reasonable for a company to pass the costs of Title VII violations to consumers, similarly it is unreasonable to pass such costs on to the government in a contractual context. Conversely and ironically, it is apparently just and reasonable for governments (federal, state and local) to pass such costs to taxpayers given that collectively, "governments" have been one of the biggest offenders of Title VII compliance. No one says life is fair.

## Preparing for Audits of Accounting Internal Controls

All government contractors, large or small, should be on the lookout for more government audits of financial and cost accounting systems, to include internal controls of peripheral supporting job cost sub-systems (e.g., labor charging, billing, materials management, budgeting, etc.). And be prepared to withstand a higher level of scrutiny of those systems, with a higher likelihood of reportable significant deficiencies.

We are speaking of audits performed by the Defense Contract Audit Agency (DCAA) which is chartered with the responsibility for monitoring most government contractors in terms of the evaluation of accounting internal controls as required under many government contracts.

Over the past several months, DCAA has taken a more rigid approach in considering "materiality" of observations noted during these accounting internal controls audits. Due to guidance handed down to the field level auditors, many audit issues (which are clearly insignificant in substance and impact and were once deemed not reportable as heart-stopping) are being reported as major deficiencies. And, given current DCAA audit instructions to its auditors, all it takes is one "significant" deficiency to fail the entire control system.

Being aware of DCAA's responsibilities and approach in performing these audits, and understanding the control objectives that are most frequently observed to include documentation supporting the adequacy of cost accounting systems is crucial in averting potential "significant" deficiencies.

Best practices that we recommend for getting prepared:

- Gain a complete understanding from the auditor as to the specific internal controls being reviewed, and the particular area of focus;
- Review the DCAA audit programs and guidance that auditors are required to follow (that information can be found in various materials on the DCAA website);
- Prepare, and/or update, detailed policies and procedures that speak to the accounting functions and internal controls for all accounting processes (not just the cost accounting arena);
- If you have time, perform some testing of those controls and document the outcome of that testing

Biggest targets of these types of audits are the larger companies, where DCAA employs "ICAPS" internal controls evaluations (see Chapter 5 of DCAA Contract Audit Manual). However, even the smallest of companies are subject to accounting system controls audits given that a government contractor must have an adequate accounting system (FAR Part 9.104-1). Many of these smaller companies are often treated by auditors with the same degree of detailed scrutiny as big companies, even though the extent of risk of overcharging the government is much lower.

In particular, every contractor regardless of size is subject to the same risk that an internal control deficiency maybe noted in another type of audit (such as a bid proposal or an audit of public vouchers) in which case DCAA has created the "limited scope" audit to report even isolated internal control deficiencies. One such deficiency, with or without any other impact (such as costs questioned), can result in a DCAA audit report opining that a contractor's accounting system as inadequate. One more challenge to competing for that next government contract.



## Training Opportunities

### 2009 Beason & Nalley Sponsored Seminar Schedule

#### **FAR Part 31 Cost Principles**

**Date:** June 23, 2009

**Location:** Beason & Nalley, Inc.  
Reston, VA

**Time:** 8:15 am – 4:45 pm

#### **Understanding Government Audits and How to Resolve Audit Issues**

**Date:** August 11, 2009

**Location:** Beason & Nalley, Inc.  
Huntsville, AL

**Time:** 8:15 am – 4:45 pm

#### **Cost and Price Analysis in Government Contracting**

**Date:** September 10, 2009

**Location:** Beason & Nalley, Inc.  
Huntsville, AL

**Time:** 8:15 am – 4:45 pm

#### **FAR Part 31 Cost Principles Basics Class and Advanced Workshop**

**Date:** November 17-18, 2009

**Location:** Beason & Nalley, Inc.  
Huntsville, AL

**Time:** 8:15 am – 4:45 pm (each day)

### 2009 Federal Publications Sponsored Seminar Schedule

#### **A Practical Guide to Incurred Cost Submission**

**September 15-16** – Washington DC

**October 20-21** – Las Vegas, NV

#### **A Manager's Guide to EVMS**

**November 5-6** – Washington DC

**December 2-3** – Las Vegas, NV

#### **Government Contract Accounting Systems Compliance**

**June 16-17** – Las Vegas, NV

**September 22-23** – Huntsville, AL

**October 6-7** – Washington DC

**December 8-9** – Las Vegas, NV

#### **Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk**

**June 10-11** – Las Vegas, NV

**September 15-16** – Washington DC

#### **Instructors**

- Mike Steen
- Mary Beth Jackson
- Darryl Walker
- Scott Butler
- Chad Braley
- Courtney Edmonson
- Cyndi Dunn
- David Miller

Go to [www.fedpubseminars.com](http://www.fedpubseminars.com) and click on the Government Contracts tab or call Beason & Nalley, Inc. at 800-416-1946.

#### **Specialized Training**

Beason & Nalley, 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. Sandra Baker at [sbaker@beasonnalley.com](mailto:sbaker@beasonnalley.com), or at 800-416-1946.

### Reader Inputs for Future Newsletters

Beason & Nalley, Inc. develops its topics based upon recent regulations, information, publicly accessible Government policies and our experience in assisting clients with regulatory compliance. However, we are also interested in the ongoing compliance experiences of our readers; hence, we invite your input in terms of suggestions for topics based upon your compliance experiences. Suggested topics along with any background information (i.e., your experience) should be sent to [lmiller@beasonnalley.com](mailto:lmiller@beasonnalley.com).

Beason & Nalley, Inc. provides accounting, business, financial and consulting services with a focus on serving government contractors. Beason & Nalley, Inc. goes well beyond the bounds of what one would normally consider to be "typical" services. We provide services such as government contracts services, outsourced accounting, audit, tax and Deltek Costpoint® consulting and more. Our goal is to provide the business owner with options for their financially related administrative needs. Our service list is comprehensive. Contact us:

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