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newsletter

Government Contracts Consulting

Provided by Beason & Nalley, Inc.

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DEFENSE BUSINESS BOARD REPORT RELATED TO DCAA

As a by-product of the GAO July 2008 Report on DCAA (GAO-08-087; *Allegations that Certain Audits at Three Fields Offices did not Meet Government Auditing Standards*), the Defense Business Board was awakened and otherwise engaged to make an organizational assessment and recommendations concerning DCAA. None of the recommendations issued in late October could be categorized as a surprise and in fact, a number of the recommendations are decisions/actions already in place (e.g. DCAA's discontinued participation on Integrated Product Teams which created appearances of "compromised auditor independence").

Several recommendations are related to the creation of a Strategic Plan (extending five (5) years out), which is neither an original concept nor one which will have predictable corrective

results given that DCAA has implemented and maintained a Strategic Plan since the mid 1990's.

However, there is an interesting recommendation that the DOD Comptroller, in coordination with USD AT&L, establish an adjudication process to elevate and resolve disagreements between contracting officers and DCAA prior to approving contract actions. Although this recommendation is not exactly an original concept (there have been similar processes or at least designs for similar processes such as those interrelated with the Contract Audit Follow-up or CAFU policies), the concept will have increased significance assuming DCAA's re-emphasis on auditor independence widens the schism which frequently exists between audit objectives and procurement objectives. In particular, audit issues frequently complicate contract award and/or contract administration and will do so with increased frequency as DCAA auditors attempt to attain the DCAA goal of issuing audit reports with

findings in at least 45% of their audit reports (FY2009 Audit Performance Goal for DCAA). As more and more audit issues "hit the streets", contracting officers will likely face increased choices/decisions which will not always result in sustainment of DCAA findings (particularly those audit findings which have no significance other than within the narrow confines of government accounting standards)).

An adjudication process to elevate and resolve disagreements will protect a contracting officer whose decision does not coincide with an audit; however, it will not provide the contracting officer with the expertise to know when to disagree with an audit. It remains to be seen if anyone or any process will focus on the "other" audit quality issue disclosed in the GAO Report on DCAA, that a number of audit reports were issued with conclusions ("findings") which were not supported by the facts. Unfortunately, we do not live in a perfect world and the "other" audit quality issue has been all but ignored.

2009 DEPARTMENT OF DEFENSE AUTHORIZATION ACT

The two presidential candidates were out on the stump making statements on how they think the government will utilize government contractors in the future. While they were talking about making all contracts fixed price contracts and federalizing more employees, Congress is taking actual steps to shape the relationship between the government contractor and the agencies that contract them. They are also mandating that DOD take more decisive action to professionalize the procurement community within the agency. Two things are certain; the need and use for contracted services is not going away anytime soon and the contracting community will continue to be scrutinized in all aspects of the procurement and contract performance process.

Included in the authorization is the mandate to DOD to create and maintain a database of information regarding the integrity and performance of certain persons awarded DOD contracts in excess of \$500,000, for use by DOD officials having authority over contracts. The data should outline criminal or civil proceedings and convictions or judgments against contract awardees. From a common sense point a view this makes sense. The government should know if the contracts they are awarding are to companies that have judgments against them. The worry amongst contractors was that the information collected can be inaccurate or paint contractors in a negative light even if they took actions to rectify past wrongs or removed employees that committed criminal acts while employees of the company, but without company authorization. There was also concern that this database would be open to the public and would contain information

that private corporations would not normally be required to disclose. Upon passing, the legislation was written to only permit the government access to the database.

Also included were provisions to require a contract clause in all contracts in excess of \$500,000 that calls for the performance of acquisition functions closely associated with inherently governmental functions for or on behalf of the Department of Defense. This is to address financial conflicts of interests that contractor employees, responsible for the performance of such functions, may encounter. This clause will require contractors to prohibit employees from performing acquisition functions under contracts, tasks, or delivery orders where the employee has a financial interest because the award is to their company or to a company of a member of their immediate family, without written approval of the contracting officer. This will also require contractors to: (1) obtain, review, update and maintain a financial disclosure statement from each employee assigned to perform these functions; (2) prohibit such employees from accepting gifts from affected companies or individuals; (3) prohibit employees with access to non-public government information obtained while performing on such contracts to use this information for personal gain; and (4) take appropriate disciplinary actions against employees who violate this contract clause. The contract clause should also include appropriate definitions of "financial interest" and "gift" similar to definition for federal employees and establish penalties for the contractor for failures to comply with the requirements noted.

Within the government, we see a push to "professionalize" the acquisition workforce within DOD and expedite hiring of qualified acquisition staff. In addition, we see Congress insist that the Department write policies and guidelines

that ensure: (1) the acquisition workforce has a career path that can attract the highest quality of officers and enlisted personnel; (2) there are sufficient amount of command positions and senior noncommissioned officer positions to provide opportunities for advancement and promotion to the acquisition field; and (3) a sufficient amount of service members are qualified and trained to perform contingency contracting functions in war zone operations.

This should bring more efficiency to the whole procurement process assuming the entire acquisition team for the government is better trained and certified. The hope is that a well trained acquisition workforce will reduce disagreements and claims that come about because of poorly written and/or poorly administered contracts.

DOD has also been tasked to create a Contingency Contracting Corp to ensure that the Department has the capability, when needed, to support emergency contracting actions.

Some other items of note:

Congress has limited the duration of non-competitive contracts awarded to meet urgent circumstances and increasing competition requirements for purchases made under multiple award contracts.

Congress is also pushing agencies to reduce "abuse-prone" contracts by requiring revision to the FAR to require written agreements setting out responsibilities under interagency contracts and to minimize the "abuse of commercial services authority." They are also calling for a reduction in the number of awards of cost-reimbursement contracts. The strategy to significantly reduce cost reimbursement contracts is not new, having been front and center in the mid-

1990's when it was believed that even developmental programs for major weapons systems could be contracted as fixed price or fixed price incentive. The theory, still applicable today, is to break down the contract to manageable and financially predictable tasks or subtasks; however, what's good in theory has not always worked in practice. No doubt more to come in terms of pressures to move away from cost-type contracts.

Congress has required the Cost Accounting Standards (CAS) Board to review the inapplicability of cost accounting standards when a contract is executed and performed outside the United States when the contract would be subject to CAS, but for the current exemption. Of note, the CAS Board revisited this exemption in 2008 and based upon three public comments in favor of the existing exemption, left that exemption intact; but now it is back to the drawing board and the CAS Board has 270 days to return with the results. If the CAS Board concludes that the exemption should remain, they now have the additional task of explaining that conclusion to Congress.

Congress has tasked the Comptroller General (GAO) with reviewing and reporting on the use of off-shore subsidiaries by defense contractors. Of note (before it was amended), one version of this section would have implemented a DOD contract clause prohibiting a contractor from using a subsidiary or a subcontractor that is a foreign shell company and performing work using US Citizens or permanent residents of the US. In any case, the specific target of this Congressional interest is the avoidance of US payroll taxes by using offshore companies.

Congress has asked DOD to conduct a study on the implementation of Earned Value Management (EVM). The study will include:

- A review of the methodology, accuracy of data, training and information technology systems used to develop EVM data.
- An audit of the accuracy of EVM data provided by vendors to the government concerning acquisition category I and II programs.
- Ways to measure the success of using EVM to deliver program objectives.

COST PRINCIPLE ON LEGAL COSTS: ALLOWABILITY OF COSTS ADDRESSING OR DEFENSE OF GOVERNMENT PROCEEDING

The text of FAR 31.205-47 contains a provision regarding allowability of legal costs when a "proceeding" is brought by a government entity and like many other FAR cost regulations precipitates multiple opinions as to its applicability and circumstances under which legal fees for such events are allowable.

Specifically, FAR 31.205-47(b) states that legal costs incurred in connection with any proceeding brought by a Federal, State, local or foreign government for violation of, or failure to comply with, laws or regulations by a contractor are allowable, or unallowable, depending on the outcome of that proceeding. The outcomes are outlined in subparagraphs (1) through (5) and state that costs are unallowable depending on the type of action, and the specific type of outcome (such as finding of contractor liability, conviction in criminal proceeding, etc.) (Refer to the cost principle for the complete text of these results).

For legal costs to be unallowable under this scenario, several events must have occurred or concluded:

- First, a proceeding has to have been brought by one of the government entities. There is no clear definition as to exactly a proceeding is, or at what point in time, one begins. Our understanding is that a "proceeding", as used in this cost principle, is any formal investigative action that is commenced by one of the governments stated in the cost principle.

Exactly when such a proceeding begins is subject to interpretation, but some experts assert that a subpoena for contractor data, with the purpose being to determine if a contractor has violated a law or regulation, initiates a proceeding, even though formal charges against the contractor have not been filed by the government. One may argue that a formal proceeding has not occurred until the government has stipulated, in a formal complaint, the nature of the wrongdoing.

- The proceeding must be brought against the government contractor, a contractor employee, or agent of the company for this cost principle to be relevant. If the purpose of a government subpoena for records, or other investigative techniques such as inquiry with contractor personnel, pertains to an issue not related to a contractor wrongdoing and does not target (name) the contractor, employee or agent, then a proceeding does not exist in the context of potentially restricting the allowability of legal fees.
- The government sometimes initiates investigations of government agencies (or agency employees), and those investigations sometimes require the collection of data from a contractor with whom those agencies have contracted. However, in this case, the target (government agency or contractor) of the investigation is not necessarily named at that time,

and hence contractor legal fees to facilitate the investigation are allowable. It should be further noted that legal fees incurred to facilitate an investigation which neither names nor targets the contractor, cannot be construed as unallowable at a later point in time if and when the investigation names the contractor. It should be obvious that the legal fees at a point in time apply to the relevant facts at that point in time.

- A final determination as to the allowability of legal fees pertaining to the government "proceeding" cannot be made until the outcome/result is determined, as noted in FAR 31.205-47(b)(1) through (5). Auditors who question legal costs incurred by a contractor to defend itself during the proceeding, prior to the final outcome, have no basis to do so at that point in time. Government auditors must actually wait for the result/outcome before having any basis to deem legal fees allowable or unallowable. There are provisions in FAR 31.205-47(g) for the contracting officer to withhold payment of costs which maybe unallowable depending upon the outcome; however, withholding payment during the pendency any proceeding is by no means disallowing the costs.

TRAINING OPPORTUNITIES

Federal Publications Sponsored Seminars Schedule

November 13-14, 2008

A Manager's Guide to EVMS
Marvin Conference Center
Washington DC

November 18, 2008

Cost Accounting Standards: Understanding When and How They Affect Your Government Contracts
SPARTA, Inc.
Huntsville, AL

December 9-10, 2008

A Manager's Guide to EVMS
Flamingo
Las Vegas, NV

December 11-12, 2008

Government Contract Accounting Systems Compliance
Flamingo
Las Vegas, NV

March 24-25, 2009

A Practical Guide to Incurred Cost Submission
Marvin Conference Center
Washington DC

March 31- April 1, 2009

A Manager's Guide to EVMS
Marvin Conference Center
Washington DC

Instructors

- Mike Steen
- Darryl Walker
- Scott Butler
- Chad Braley
- Courtney Edmonson
- Cyndi Dunn

Go to 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, or at 800-416-1946.

Reader Inputs for Future Newsletters

Beason & Nalley, Inc. develops its topics based upon recent regulation, 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 sbaker@beasonnalley.com.

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