

newsletter

Government Contracts Consulting

SEPTEMBER 2010



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FAR Rule Change in Acquisition Thresholds

The FAR Councils have published a final rule, effective October 1, 2010, under FAC 2005-45, elevating certain acquisition thresholds. The upward adjustment to these thresholds is consistent with the Reagan National Defense Authorization Act which requires adjustments every five years for inflation using the Consumer Price Index. The adjustments to these thresholds are the same as stipulated in the February 4, 2010 proposed rule.

Notable adjustments follow:

- Simplified acquisition threshold is increased from \$100,000 to \$150,000
- Cost or pricing data threshold is adjusted from \$650,000 to \$700,000
- Commercial items test program ceiling is elevated from \$5.5 million to \$6.5 million
- Prime contractor subcontracting plan floor is increased from \$1.0 million to \$1.5 million

No increases were made to the micropurchase threshold (currently \$3,000).

FAR Rule Clarifies Cost or Pricing Data Definitions

The Civilian Agency Acquisition Council and Defense Acquisition Regulations Council issued a final FAR rule clarifying the distinctions among "cost and pricing data", "certified cost and pricing data", and "data other than cost or pricing data". In addition, amended verbiage clarifies contracting officers' responsibilities for requesting the appropriate level and type of data necessary to establish a fair and reasonable price and reinforces the order in which certain types of data can be requested. The rule is effective October 1, 2010.

The catalyst for this change began with overlapping and inconsistent definitions of cost and pricing data within FAR Part 15 and Truth-in-Negotiations Act (TINA), and confusion as to what “information other than cost or pricing data” represents and circumstances in which such data can be requested.

FAR Part 15 often refers to “*certified* cost and pricing data” (data that can be requested by the contracting offices for supporting certain pricing actions); yet TINA does not include “certification” as part of the “cost or pricing data” definition. The term “certified” as intended by FAR Part 15 is a written affirmation required of government contractors attesting to the currency, accuracy and completeness of a contractor’s cost or pricing data. The use of the term “certified” within FAR Part 15 had created a misperception among some contracting officers that those officials could not request “cost or pricing data” unless it was “submitted in certified form”.

The FAR Part 15 term “information other than cost or pricing data”, and the FAR 15.403 conditions in which such data could be requested, were worded in a manner making it difficult for contracting officers to understand when such data could be utilized (in lieu of cost or pricing) to make a determination of a fair and reasonable price.

The revised FAR verbiage amended or added definitions within FAR 2.101 for three key terms to separate the distinctions among types of data:

- (1) Cost or pricing data—prior definition amended to remove reference to certification
- (2) Certified cost or pricing data—expressly states data is “cost or pricing data” which is required to be certified under FAR Part 15 provisions
- (3) Data other than certified cost or pricing data—replaces former term, “information other than cost or pricing data”, and specifically states such data may include pricing or cost data which may be identical to “cost or pricing data” (but for the TINA requirement)

Sections of FAR Part 15.4 were also amended for clarity and specificity of contracting officer choices as to the types and the sequential preference of data requests to support pricing actions. A few of those more notable changes include:

- (1) FAR 15.402—states that contracting officers shall determine if certified cost or pricing data is required, and if not, request data other than certified cost or pricing data as necessary (a) by first avoiding requesting any data if prices are based on adequate price competition, (b) and if data is required, requesting pricing and/or cost data; this policy statement also affirms that the government should not request any more data than necessary to establish a reasonable price

- (2) FAR 15.403-3—succinctly states that when “certified cost or pricing data” is not required, the government may request “data other than cost or pricing data”; verbiage establishes sources of such data that can be requested to include data that can be obtained from government or the offeror’s location, and whether cost information is required if pricing data is not sufficient
- (3) FAR 15.403-4—amends paragraph (b)(1) to specifically state that contracting officers may require “data other than certified cost or pricing data” even if “certified cost or pricing data” is required
- (4) FAR 15.403-5—clarifies format requirements for submission of “certified cost or pricing data”, “data other than certified cost or pricing data”, and data supporting forward pricing rate agreements

Consulting Costs and Documentation Requirements

What Does FAR 31.205-33 Mean?

Provisions of FAR 31.205-33(f) stipulate documentation requirements that demonstrate the nature and purpose of costs incurred in connection with consulting and professional arrangements, in order for such costs to be allowable. The cost principle states that fees for services are allowable *only* when supported by evidence of the nature and scope of services furnished. Translation to the preceding sentence: if those documentation requirements are not met, the associated professional fees are expressly unallowable.

More precisely, the documented evidence required for such costs to be allowable includes:

- Consulting arrangement details such as work requirements, compensation, and nature of other expenses;
- Invoices/billings that identify “sufficient” detail as to time expended and actual services provided, and;
- Consultants’ work product and related documents (trip reports, etc.)

In reading the documentation criteria, the good and bad news for government contractors is that those parameters are vague and leave open to interpretation the specific details required identifying the “nature of expenses”, “time expended”, “work product”, and so forth. Depending on the government contracting office or audit group evaluating a given contractor’s evidential data supporting claimed professional costs, application of the FAR verbiage can be extremely rigid, whereby auditors, for example, expect a work product for every professional hour charged, to a more lenient point of view where a written outcome from the consultant for a specific consulting task would not be practical or necessary.

Audit guidance contained in the DCAA Contract Audit Manual (section 7-2105) recognizes that auditors must be reasonable in assessing adequacy of documentation that meets the FAR criteria. Verbiage in this section states, for example, “auditors may not substitute their judgment for the explicit documentation requirements”, but at the end of the day, it remains the contractor’s responsibility to demonstrate adherence to the documentation standards. Audit guidance also states “although a work product usually satisfies this requirement (work performed), other evidence may also suffice”. The guidance clearly notes that the auditors “should not insist on a work product” meaning that if a work product was not provided, auditors may rely on other information demonstrating services provided.

DCAA’s guidance is premised upon the underlying rationale with respect to FAR 31.205-33; specifically that the multiple requirements for documentation should be sufficient to establish that the nature of the professional service was for an otherwise allowable activity as opposed to an unallowable activity such as lobbying, organizational costs, advertising, as well as those listed in 31.205-33(c).

The first FAR documentation stipulation, a consulting arrangement, must at a minimum contain sufficient information regarding agreed-to services and consulting compensation terms. The cost principle however does not prescribe in-depth rhetoric outlining the arrangement terms and content; absence of such useless details in codified form is intentional, and thus the preparation of an acceptable consulting agreement is left to the contractor to use good business logic, one tailored to the specific contractor needs, and identifying responsibilities of both buyer and seller in a commercial market environment.

The government (e.g. a DCAA auditor) should therefore avoid interjecting personal preferences in what they believe the contractor/consulting agreement should entail, and stick to the requirements of FAR 31.205-33. For example, a consulting agreement for legal services may be open-ended in the services to be provided, which would allow a contractor the flexibility to seek brief guidance from counsel when needed; such an arrangement may stipulate general services that will be provided, but would not, because of its purpose, attempt to outline every possible legal service the law firm could deliver. Should a specific service be provided that falls within the general services menu listed in the arrangement (for example, a phone call regarding a patent issue), government auditors should avoid taking the erroneous and foolish position that patent counseling (as shown within an invoice) is not explicitly listed in the consulting agreement, thus precipitating a supportable challenge of consultant costs for that patent guidance.

The second documentation requirement, which states invoices must show time expended, does not necessarily translate into

invoices having to display consultant *hours* actually incurred, by consultant name, on a daily basis; nor does “actual services provided” mean that invoices must identify all details of a consultant’s daily work. Time expended may be numbers of work days, weeks, or other groupings of time, and may be identified by groups or categories of professionals; consulting labor costs however should be segregated from other expenses such as travel. The key in identification of “time expended” is allowing auditors the visibility as to actual effort performed and billed, whereby the value and the reasonableness of amounts billed for those services can be ascertained. As to “actual services performed”, invoices may refer to a more detailed outline of a consultant’s activity for the billing period within another document (time line report by task, etc.); the FAR provisions did not envision a blow by blow daily account of every activity that consultants performed in a given day, especially when daily activities may have been diverse and extensive.

Work products and related documents reflecting the outcome of the arrangement are not always necessary per se (see discussion above); however, if a defined work product is promised in the engagement agreement, contractors should ensure that those deliverables are provided and meet the specific details required. Some consulting activities will not necessarily result in a needed or required work product; for example a series of telephone calls or several meetings wherein contractors seek casual guidance of professionals (as needed services) would not necessarily generate a hard deliverable, nor would it be reasonable to expect a work product for such activities. As stated before in this article, DCAA audit guidance understands these situations, and should accept descriptions contained in consultant invoices, or contractor meeting notes, as evidence that work was performed.

One final note on retainer agreements and documentation required. DCAA audit guidance in the contract audit manual recognizes that retainer agreements may not necessarily have detailed statements of work, nor are such agreements required to provide that level of detail. Nevertheless, all FAR 31.205-33(f) documentation requirements apply to these agreements, but our experience in working with clients often disclose poorly documented invoices, and virtually no evidential data supporting services performed or time expended (other than a flat amount identified for a month and no description of services for that billing period).

Contractors beware: the cost principle expects sufficient documentation for the government to identify in some manner the consumption of a retainer value via work output and a description of time dedicated by consultants for tasks under such agreements. An invoice for \$15,000 with a statement, “per retainer agreement”, with no peripheral information from your consultants (list of meetings, daily activities, trip reports,

log of time worked, etc), will quickly land that amount into the auditor's questioned cost column during audits of any proposal or billing claim that includes this value. And remember, inadequately supported costs under FAR 31.205-33 are unique to the extent such costs will almost always include a recommendation that these are expressly unallowable costs subject to FAR 42.709 penalties (generally speaking unsupported costs are not expressly unallowable).

DFARS Final Rule on Commercial Items: T&M and Labor Hour Contracts

The Department of Defense has adopted an interim rule as final that more explicitly defines when DOD may use time and materials, and labor hour contracts, to procure commercial items.

The final rule stipulates that such contracting vehicles may be used to buy:

- Services to support commercial items
- Emergency repair items
- Any other commercial items if certain criteria are met

In addition, the DFARS also includes modified verbiage to state that major weapons systems may be identified as commercial items, provided the DOD secretary deems such systems as commercial, and the decision in categorizing such systems as commercial is in the interest of national security.

Sections of the DFARS that are modified to implement the change are 202, 212, and 234. The rule was effective as of August 13, 2011.

Secretary of Defense Announces Plans to Reduce "Support Contracts": Insourcing Goals not Achieving Savings

In an August 9 press conference, Secretary of Defense Robert Gates announced a targeted cut in "support contracts" funding by ten percent annually over the next three years. That goal is part of an initiative started in 2008 to reduce Pentagon expenditures and make the DOD more efficient.

As part of the goal in making procurement in DOD more efficient, a plan was announced in 2009 whereby approximately 33,000 private sector support contractor jobs would be "insourced" within the DOD federal employee ranks—translated, insourcing positions, first targeting those that are "inherently governmental", would create great savings. However, Gates now admits that the insourcing plan is "not achieving the desired savings", and the DOD will curtail insourcing more contracting positions that were to be cut as part of the savings initiative.

Gates stated that merely shifting the numbers of contractor personnel required to provide support effort as part of the contracted statements of work to government employee positions produced no real savings since the reduction in contract funding was apparently offset by an increase in internal employment funding. Gates said "...what we've learned over the past year is you really don't get at contractors by cutting people because you give the contractor a certain amount of money, and they go hire however many people they think they need to perform the contract. So the only way we've decided that you get at the contractor base is to cut the (contract) dollars."

This acknowledgment, in this author's opinion, is a startling admission of DOD's ineffective planning and flawed logic that moving contractor held positions to the federal roles would automatically create savings. Moreover, one might assume that the political mantra and pressure espoused over the past year that federal employees can do work currently contracted out for less, which precipitated the government's leap of faith toward insourcing and filtered into the DOD planning process, was a narrowly-focused and poorly conceived means, in and of itself, to save the taxpayer money.

Gates also highlighted other DOD reductions to include closing the Joint Forces Command, immediate cuts in funds for DOD intelligence contracts, and freezing the number of DOD required oversight reports. (Editor's note: On September 14 DOD published its guidelines in a 24 page report; we will address that report in our October newsletter).

DOD IG Stung by Grassley Report

A report issued on September 8, 2010 by the staff of Senator Charles Grassley (R-Iowa), the ranking Republican on the Senate Finance Committee, took square aim at the Department of Defense Office of Inspector General (DODIG or OIG) for failing to conduct comprehensive and adequate audits of contract programs, and thus not fulfilling its obligations in detecting and preventing fraud, waste and abuse.

The report holds the DOD's "broken accounting system" as the main culprit for impairing the OIG's mission in its comprehensive evaluation of government awarded contracts. The report states that the "quality of the financial data presented to OIG auditors by DOD...should probably be rated as poor to non-existent". In the introduction, the genesis of the OIG woes is summarized: "The continuing disconnects between DOD accounting data and OIG audit capabilities disables one of the IG's primary oversight weapons." Further the Grassley report concludes that "the situation has deteriorated to the point where OIG auditors are no longer able or willing to conduct full-scope audits."

“Having lost control of the money at the transaction level, DOD’s broken accounting system is incapable of generating accurate financial records”, the report states. DOD accounting data, related to contract award invoices and payments, are considered by the OIG as crucial in completion of its audits. The lack of credible financial data at the DOD level has impaired the OIG’s mission where the vast majority of reports reviewed were either not complete in scope, or simply inadequate, because in most cases, OIG auditors reported “no audit trail found”. The report stated that years have passed since the OIG conducted “legitimate audits of the large contracts”. Another report statement summarizing very bluntly the OIG dilemma: “The OIG Audit junkyard dog has been defanged and rendered harmless.”

The review of the OIG’s performance began in June 2009, after Grassley’s office had received a number of unsigned “hot tips” regarding the OIG Audit Office. Some of those tips included allegations that work was not getting done, OIG reports published had sharply declined, poor use of resources, mismanagement of audits, report issuance delayed for months, and poor morale. Grassley’s staff evaluated a 12-month sample of audits, focusing on OIG audit report findings during FY 2009.

The report spares no words in bluntly characterizing the issues, and what must be done to get the OIG back on track. The report cites nine critical audit issues (starting with page 11 of the report).

The most significant issue is indeed the inability, or unwillingness, of the OIG to conduct comprehensive “end to end contract performance and payment audits” with the goal of connecting contract requirements to deliveries and payments largely due to alleged “no audit trails” because of the DOD accounting mess. The report castigates the OIG for merely accepting that full-scope audits are “too difficult, too big or impossible” because of the “no audit trail”, but nevertheless conducting audits without an audit trail, with an outcome of “toothless recommendations”.

The report states “instead of taking the bull by the horns, OIG Audit has given up and relinquished contract audit responsibilities to the Defense Contract Audit Agency (DCAA)”. The report writers state that throwing the audit responsibilities over the fence to DCAA is not an acceptable option, because DCAA is not independent, and the OIG and GAO formerly cited DCAA for “weak and ineffective” oversight.

Other notable “critical audit issues” include the following:

- DOD OIG has “drifted away from its core mission” of conducting audits, and instead DOD OIG is evaluating policies and procedures
- Very few OIG audits have resulted in criminal investigations; often time, OIG auditors prematurely sent cases to the Defense Criminal Investigative Services (DCIS) with insufficient supporting backup
- Productivity is low, when compared to the current available staffing and other agency IG output
- Most OIG reports take 1.5 years to complete, rendering most of those reports ineffective and useless

The report’s principal recommendation speaks to getting the OIG back on track, and until the DOD accounting system is improved (which may be 20 years out), the OIG’s audit approach must be re-tooled to nevertheless perform its core mission. The report recommends establishing a small number of large, aggressive audit teams to perform comprehensive audits required to meet the OIG’s core mission. Numbers of personnel assigned to each team may range from 25 to 100 auditors, rather than a smaller group of 5 to 10 auditors currently used to perform those audits.

The report also calls for reducing audits of policies and procedures, curtailing audits of financial statements until DOD’s accounting system is fixed, completing and issuing audit reports within 6 to 9 months, and begin holding military and civilian authorities accountable for “financial mismanagement”.

Tip for Small Businesses Battling a DCAA Finding of “Inadequate” Accounting System

Guest Author

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FAR § 16.301-3 requires an adequate accounting system before a contractor can be awarded a cost-reimbursement contract. With increased frequency, small businesses are struggling to survive an opinion of “inadequate” accounting system from the Defense Contract Audit Agency (DCAA). This is especially threatening because rarely is the DCAA willing to perform a return audit until at least six months have expired and even if DCAA returns for a follow-up audit, there are no assurances as to the timeliness of that audit or the results.

It is true that the DCAA only renders opinions on accounting systems. Supposedly, the contracting officer can reach a different opinion; however, as a practical matter, contracting officers are reluctant to do so. First, contracting officers

usually lack both the expertise and the time to involve themselves into a vendor's accounting system. Second, contracting officers are hesitant to disagree with the DCAA because DCAA auditors are encouraged to complain to the DODIG if the auditor disagrees with a decision of a contracting officer (see Beason & Nalley August 2010 Newsletter, *DOD-IG Report Faults DCMA for Failing to Utilize DCAA Expertise in EVMS Review*).

DCAA has not always been so unsympathetic to small businesses. For decades, DCAA worked with small businesses by issuing a more benign opinion of "inadequate in part." However, on December 19, 2008, DCAA declared that it "will no longer report inadequate in part opinions." The same letter further stated that "suggestions to improve the system will no longer be reported in the internal control audit report."

Not infrequently, the DCAA auditor is mistaken in his or her opinion that an accounting system is inadequate. For example, when a vendor is not as responsive to the auditor's demands as the auditor expects, some auditors are quick to jump to the conclusion that an accounting system is inadequate. Just because a vendor may not respond to the DCAA as quickly as the auditor expects, however, should not be a basis to conclude that an accounting system is inadequate.

DCAA's audit criteria is subjective and not always valid as was the case in a rather embarrassing bid protest where the GAO found no basis for the DCAA auditor's assertions concerning the accounting system for a joint venture (McKissack & Delcan JV II, B-401973, January 13, 2010).

Similarly, in BearingPoint, Inc., ASBCA No. 55354, 09 BCA ¶ 34,289, the contracting officer relied upon DCAA and disallowed costs of a subcontractor, Custer Battles, on a cost-reimbursement contract. The Contracting Officer, Ms. Kolstrom, testified:

[T]hey did have paper records but it was a mess. That's what DCA[A] said. Was that the paper records ideally they should tie in, they should have **nice neat little files** with labels and just something showing the paper backs up what they log into the electronic system so it can all be tracked to a certain project. I mean that's basically in general how things should work.

(Emphasis added.) Simply put, the DCAA has no right to hold an accounting system hostage until a vendor provides "nice neat little files." As explained by the Armed Services Board of Contracts Appeal (ASBCA), "the contract clauses do not impose the stringent requirements of ... 'nice neat little files' that Ms. Kolstrom sought." The ASBCA sustained BearingPoint's appeal.

Whether a small business has an adequate accounting system is a question of responsibility. See FAR § 9.104-1(e). If a contracting officer adopts a DCAA opinion that the accounting system of a small business is inadequate, the contracting officer must withhold contract award and refer the matter to the cognizant Small Business Administration (SBA) Contracting Area Office. FAR § 19.602-1. If the small business can convince the SBA that the small business has an adequate accounting system, then the SBA can issue a Certificate of Competency (COC). Usually, a contracting officer will accept a COC and award the contract to the small business.

Stated differently, there is hope for any small business that is struggling to survive because a DCAA auditor has incorrectly opined that the company's accounting system is inadequate. When a DCAA auditor improvidently opines that the accounting system of a small business is inadequate, the small business should seek a COC from the SBA.

Training Opportunities

2010 Beason & Nalley Sponsored Seminar Schedule:

October 20, 2010 – DCAA Hot Topics and Trends in Government Contract Accounting and Compliance Issues
Virginia Beach, VA

October 21, 2010 – Understanding Government Audits and How to Resolve Audit Issues
Location: Reston, VA
Time: 8:15 AM – 4:45 PM

November 9, 2010 – Understanding Government Audits and How to Resolve Audit Issues
Location: Huntsville, AL
Time: 8:15 AM – 4:45 PM

November 17, 2010 – Cost and Price Analysis in Government Contracting
Location: Reston, VA
Time: 8:15 AM – 4:45 PM

If you need additional information, please contact Lori Beth Miller at lmiller@beasonnalley.com or 256-533-1720.

2010 Federal Publications Sponsored Seminar Schedule

October 13-14, 2010 – A Contractor's Guide to the Incurred Cost Submission (ICS)
Las Vegas, NV

October 19-20, 2010 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risks
Herndon, VA

October 25-26, 2010 – Government Contract Accounting Systems Compliance
Washington DC

December 6-7, 2010 – Government Contract Accounting Systems Compliance
Las Vegas, NV

Instructors

- Mike Steen
- Darryl Walker
- Scott Butler
- 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. Lori Beth Miller at lmiller@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.

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