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newsletter

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Wartime Contracting Issues and Contract Oversight

The Commission on Wartime Contracting in Iraq has since 2008 been conducting its reviews of contracting in Iraq and Afghanistan, an effort which will culminate in a final report in August 2010. In June 2009, the Commission issued its interim report complete with anecdotal evidence of massive amounts of monies misspent (fraud, waste and abuse although the main theme is arguably waste). One example is the multi-million dollar construction of a dining facility coming on the heels of a major rehabilitation and upgrade of the existing facility at the same camp. Only one such dining facility was required and the government had mistakenly contracted for two essentially new dining facilities. Clearly "waste", but hardly fraud and in fact indicative of the number one problem cited by the commission thus far, the lack of sufficient numbers of competent government procurement personnel. This number one issue is somehow lost in translation in terms of more recent activity as will be discussed in the ensuing paragraphs.

In addition to the interim report, the commission has scheduled and completed its hearings for August 11-12, 2009 to further probe whether billions of dollars are at risk from inadequate contractor business systems. Given that the commission and its "probe" appears to be limited to billions at risk in Iraq and Afghanistan, one may logically question the relevance of this commission vis-à-vis contractors operating solely in the United States (or otherwise not in theatre). There are multiple answers including the simple fact that any action (and reaction) to allegations of "fraud, waste and abuse" will ultimately have an impact on procurement regulations and/or more predictably expectations for more diligent government oversight. Regardless of the accuracy of the allegations, publicizing government actions to correct such issues seems to play well to the public. At the very least, it is the theme of the day as the government (the current administration) again attempts to improve government procurement in an effort to save as much as $40 billion dollars (the administration's declared savings that will come with the newest initiative for procurement reform).

Beyond the predictable demands for better contract oversight, there is a much more specific Wartime Contracting Commission activity of critical importance to all government contractors. In "probing" the facts and within its August Hearing, the commission is fundamentally attacking the longstanding process of issue resolution in the context of redefining the roles and responsibilities within government procurement and oversight agencies. Referring to Defense oversight agencies' relationship as dysfunctional (a reference to DCMA and DCAA), the assertion ("dysfunctional") was squarely aimed at DCMA for its propensity to agree with defense

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contractors or more accurately for DCMA Contracting Officers to frequently disagree with DCAA's recommendations ("audit opinion").

Quoting a co-chairperson of the commission (Christopher Shays), in reference to DCMA Contracting Officer's who have not agreed with DCAA "opinions"; "I am struck with the fact that there's a little bit of gray area so you're going to make sure that you are totally on the contractor's side".

Not that there is any evidence that any ACO was "totally on the contractor's side", nor is there any indication that this co-chairperson is unbiased on this matter having declared before the hearings that "some contractors have had inadequate business systems in place for years without suffering serious consequences". This pre-hearing assertion/conclusion is neither unbiased nor accurate given that contractors have endured and continue to endure huge withholds on contract payments (costs clearly incurred, but unpaid by the government for various reasons extolled by DCAA audit reports). To state that contractors have not suffered any consequences from the alleged system inadequacies is plainly an inaccurate statement.

DCAA's Director is by all appearances more than willing to take advantage of ongoing circumstances (attacks directed at DCMA) to advance an agenda of expanding DCAA's role in the decision making process. This is in total disregard of the Federal Acquisition Regulations, which with rare exception, clearly assign the decision making authority to DCMA (Contracting Officers). DCAA's Director has softened her recommendation which had been that *DCAA's recommendations be mandatory* to her preference *for accountability when DCAA's findings are ignored or appear to be ignored.*

It is easy to argue for accountability, but to whom? DCAA because it has now declared (or been told by Congress) that its actions are strictly to protect its primary customer, the US Taxpayer? Regardless of DCAA softening its opinion, the original statement (that DCAA recommendations be mandatory) is more accurate. In fact, the DCAA Director's comments placed in the context of existing laws and regulations can be translated: When a Contracting Officer, duly authorized by the laws and regulations of the United States, makes a decision clearly within his/her authority, but contrary to DCAA's recommendations, it is self-evident that the Contracting Officer ignored DCAA's findings.

To even suggest that DCAA recommendations be mandatory is a complete reversal of government procurement roles and responsibilities and it is contrary to basic and universal auditing concepts. Auditors provide an opinion which should be based upon sufficient and relevant evidentiary matter and should support that opinion; however, it is nonetheless an "opinion". When the auditor expresses an opinion, there can be no absolute assurance that it is correct because an audit rarely examines all relevant facts (audits by their very nature do not consider all facts; to do so would be cost prohibitive). Moreover, government procurement regulations are not always clear; hence, an audit opinion is in fact an interpretation of regulations and an opinion of a contractor's compliance with that auditor's interpretation of applicable regulations.

In terms of irrefutable evidence that audit opinions can and do misinterpret the regulations, one need only consider the number of "audit opinions" which have led to a contracting officer decision, which in turn led to a contract dispute and in a number of cases a decision against the government's interpretation. As the judicial process has clearly shown, auditors and contracting officers' decisions premised upon audit conclusions are far from infallible.

The current role and responsibility of contracting officers recognizes that an auditor opinion may not be correct. In that regard, FAR Subpart 1.602 clearly assigns the decision making authority to contracting officers and more specifically states that "In order to execute these responsibilities, contracting officers should be allowed wide latitude to exercise business judgment". Obviously, mandatory audit recommendations or any presumption that audit recommendations are absolutely correct (hence mandatory) is ignoring the FAR. Moreover ignoring reality.

DCAA and all government auditors have a critical role in the procurement process; however, that role has limits for valid reasons. Arguably, the criticality and validity of limits placed on auditor responsibilities applies more today than at any other time. DCAA has been told that its audits failed to comply with Government Auditing Standards and in so doing, failed to adequately protect the US Taxpayer (July 2008 GAO Report and Congressional Hearings which followed). In response, DCAA has introduced a metric which targets issuing 45% of its audits with tangible results which are defined as costs questioned or contractor systems identified as deficient (this applies to many, but not all types of audits). Given these circumstances the field auditor (no longer held to due dates or audit budgets) can and will expand an audit and freely define the audit criteria to accomplish (or more than accomplish) this goal. Hence, when faced with a "gray area", the auditor will take exception to the cost or the adequacy of a business system as automatically as Christopher Shays alleges that contracting officers look for gray areas to "totally agree with the contractor". Perhaps this process *is dysfunctional* but not for the reasons

asserted by the Wartime Contracting Commission.

Irreconcilable Differences: The GAO and the Wartime Contracting Commission

As reported within two articles in this edition of our newsletter, we've noted that the GAO is expected to issue its report citing DCAA for failing to comply with Government Auditing Standards on virtually all of the Internal Control Systems audits reviewed by the GAO (audit timeframe 2004-2006). Quite simply, none or virtually none of these "business systems" audits complied with Government Auditing Standards. In stark contrast, the co-chairman of the Wartime Contracting Commission (Christopher Shays) has by all appearances placed wholesale reliance on DCAA's audit reports and audit opinions concerning the business systems of various contractors in Iraq and/or Afghanistan. Even before the August 11-12 hearings, Mr. Shays had declared these business systems to be inadequate because of significant deficiencies and his declaration was squarely based upon DCAA audit reports. During the hearings Mr. Shays summarily accused DCMA of almost uniformly ignoring recommendations from DCAA with regard to business systems.

Although DCMA (in disregarding DCAA recommendations) could not have had knowledge of a GAO report which has not yet been issued, DCMA's decision to disregard DCAA audits of contractor business systems seems to reconcile with the conclusions within the soon-to-be released GAO report. Unlike the Wartime Contracting Commission's wholesale reliance on DCAA audit reports and opinions as "matter of fact". A rather obvious case of irreconcilable differences.

GAO Issues Draft Report on DCAA Audits: Challenges Compliance with GAGAS on Internal Controls Audits

The General Accountability Office (GAO) has issued another draft report to Defense Secretary Robert Gates, identifying major problems in DCAA's conformance to government auditing standards (GAGAS) when performing audits of contractor internal controls.

Because the draft report has not been made available to the general public, the information we have is general and comes from other news reports, such as the Government Executive on-line magazine. Nevertheless, DCAA credibility is once again being challenged with respect to established standards of quality outlined in GAGAS.

The GAO reported findings were based on an examination of 37 DCAA audit reports issued between 2004 and 2006, and primary findings are reportedly focused on lack of adequate substantive testing when performing the field work. Thus, reported findings related to contractor internal control systems are insufficiently supported with adequate testing of transaction data (a GAGAS requirement). Of passing interest, DCAA was cited by the GAO in July 2008 for a similar failure with respect to GAGAS (audit conclusions and opinions were not supported by sufficient evidentiary matter).

With respect to the current GAO draft report, internal DCAA memos obtained by other sources also note that the GAO found GAGAS issues which varied with respect to each DCAA audit assignment established for reviewing contractor internal controls. Also, according to these memos, "GAO believes there were some cultural issues within DCAA that will take several years to change, that contributed to the deficiencies noted."

Without having the specific reported findings, it is difficult to ascertain the effect of this report on DCAA audit policy and the impact on government contractors subject to internal controls reviews. GovernmentExecutive.com's August 6, 2009 article notes that one auditor stated that internal control audits are "untimely and poor in quality". Our experience with government contractors certainly validates this statement, inasmuch as many internal controls audits are outdated by the time they are issued (as much as two years after field work completed), and field work has been insufficient to substantiate (or even attempt to measure) the potential impact of alleged system deficiencies; nonetheless an "inadequate" system is the reported opinion.

The outcome as to the impact of this GAO report, and the one issued in July 2008, may include more time allowed for performing audits, reorganizing DCAA's management structure,), a more myopic audit view as to the adequacy of contractor systems of internal controls and making DCAA more independent (to include DCAA's usurping the long standing FAR authority of the ACO in determining the final outcome of reported findings; see further discussion in the article on the Wartime Contracting Commission).

OMB Issues First Round Guidance on Acquisition Reform

The Office of Management and Budget (OMB) has issued the first of two planned guidance papers to heads of government departments and agencies which outline strategies for reforming the acquisition process, with a goal of saving $40 billion annually through procurement initiatives

to analyze and improve existing contracts and evaluation of acquisition practices.

In the "President's Memorandum on Government Contracting", issued on March 4, 2009, the Obama Administration promised to deliver two guidance memorandums, one by June 30, 2009, and the second to be delivered no later than September 30, 2009. In the President's Memorandum, the current administration drew a vague correlation of an increased trend in acquisition spending during the Bush Administration to poor contract oversight resulting in cost overruns; failure to adequately use the competitive process; misuse of cost reimbursable type contracts; and ineffective acquisition practices in general.

This first memorandum, issued July 29, 2009, outlines, in very general terms, objectives and agency requirements for reviewing existing contracts and acquisition processes, to include revising existing acquisition practices, better utilizing the multi-sector workforce, and increasing the quality of contractor performance information.

The July 29 memo contains two critical objectives that specifically require agencies to: (1) review existing procurement practices and develop a plan to save 7% in contract spending by FY 2011, and (2) reduce by 10% dollars awarded with "high-risk contracting authorities" (translated: non-competitive, cost type and T&M/Labor Hour contracts).

The contents of the July 29 memorandum outlines objectives with high-level requirements for agency heads to follow, rather than in-depth strategic methods and processes for meeting the two critical objectives. For example, verbiage such as, agencies should "develop a tailored plan" and "should begin taking actions" still leave the responsibility for formulating strategic implementation plans up to the agency heads.

Two attachments to the OMB memo, one each for the two objectives discussed above, do provide several very broad suggestions for achieving these objectives.

More specific directions and suggestions for achieving the two objectives noted above follow.

Reduce 7% Spending by FY 2011

The memo states that methods for achieving this savings objective may include:

- Ending programs that are "ineffective, wasteful, support programs that are being terminated or reduced in scope, or not otherwise likely to meet the agency needs".
- Strengthening skills of existing government procurement workforce—verbiage states that agencies should "develop plans to increase the size of their acquisition workforce", as well as restructure workflows and improve employee training.
- Enhancing procurement practices—such as increasing attention to evaluation of requirements, selecting best contracting vehicle, performing adequate market/cost analysis, and instituting peer reviews at critical stages of high-priority contracts.
- Ensuring that "systems are in place to review contract cost, schedule and performance…" during the contracting life cycle.
- Leveraging buying power through more "strategic acquisition approaches".
- Increasing use of technology in administering contracts.
- "Reengineering ineffective business practices".

Reduce 10% Spending on High-Risk Contracts

Executive agencies are mandated to "reduce by at least 10% the combined share of dollars obligated through new contracts in 2010" that are not awarded competitively, are cost reimbursement, or are time and materials (T&M) and Labor Hour (LH) contracts.

The administration without question wants to end the practice of, or significantly curtail awards of non-competitive contracts, cost reimbursement contracts, and T&M/LH contracts. The memo verbiage states, "Noncompetitive contracting, cost-reimbursement and T&M/LH contracts pose special risks or overspending". Moreover, the memo states, "Cost-reimbursement and T&M/LH contracts provide limited incentive to control costs". And, the memo notes that agencies should limit use of these contracts to circumstances where appropriate.

The memo provides little evidence for limiting such contracts other than to state that GAO, IG and other agency officials "point to an overuse" of these contract types.

However, the memo does provide some, but limited flexibility for contracting offices to consider these type contracts. Guidance includes:

- Ensuring adequate resources are applied in analyzing noncompetitive contracts, and/or reasons why only one qualified offer was received.
- Considering migrating an initially cost type to a fixed-price vehicle as "requirements become better defined".
- Analyzing agency organizations who have used T&M/LH contracts to determine the continued need for using such contract types, and determining if in-source (government) personnel

could be used rather than contracting to private companies.

Although not specifically discussed in this memo, a companion memorandum issued to Chief Acquisition Officers, Senior Procurement Executives by Lesley Field; Deputy Administrator ("Improving the Use of Contractor Performance Information") refers to new FAR regulations that require past performance evaluations in the procurement process when selecting future contract recipients. (FAC 2005-34, effective July 1, 2009). To comply with this requirement, contracting officers can access a single data base of contract performance information (identified as Past Performance Information Retrieval System (PPIRS), http://www.ppirs.gov)).

A second memorandum is due to be released around September 30, 2009 which will address competition, contract types, acquisition workforce, and outsourcing.

Training Opportunities

2009 Beason & Nalley Sponsored Seminar Schedule

Cost and Price Analysis in Government Contracting
Date: September 10, 2009
Location: Beason & Nalley, Inc.
Huntsville, AL
Time: 8:15 am – 4:45 pm

Understanding Government Audits and How to Resolve Audit Issues
Date: September 17, 2009
Location: Sheraton
11810 Sunrise Valley
Reston, VA
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
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
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 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 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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