

newsletter

Government Contracts Consulting

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Internal Controls and Government Oversight

As we have reported in our 2008 and 2009 newsletters, internal controls continue to take center stage in terms of government oversight. Internal controls (aka contractors' business systems) have been a critical topic of discussion within the Commission on Wartime Contracting as well as a subtopic within the GAO's September 2009 report on DCAA.

It remains to be seen if and how the FAR may be changed to more specifically define internal control expectations (which are only generally defined in FAR 52.203-13 and DFARS 242.7501), but one clear expectation is that Congress and the GAO expect government oversight to expand in an environment of risks associated with deficient controls. A point of reference for this is a November 24, 2009 GAO report citing contract administration deficiencies in CMS (Centers for Medicare and Medicaid Services). Its report stated that overall control environment weaknesses continue to put billions of taxpayer dollars at risk, which is typical wording in a GAO report, without reporting an amount that could be definitively categorized as actual fraud, waste or abuse.

At issue is CMS vulnerability expressed in terms of questionable payments because of CMS failure to obtain adequate support for government payments to certain contractors (stated in a 2007 GAO report on CMS). However, in two back-to-back reports, the GAO reports were inconclusive and simply did not address actual overpayments or fraud, waste and abuse. Notwithstanding bipartisan Congressional request for a comprehensive, in-depth review of CMS contracting activity (after receiving the 2007 report), the GAO never identified anything but dollars at risk.

The GAO recommended nine corrective actions with a common thread, that of significantly improved documentation of CMS ranging from internal reviews of contract documentation, reports to management on those reviews and a strategic acquisition workforce plan. Translated, a significant increase in time and effort to implement and document internal controls.

This “internal government” issue is actually far more than an internal government issue given that the GAO (with its support from Congress) is now influencing contractor oversight; specifically, DCAA in the wake of GAO reports opining that DCAA does not comply with government auditing standards. Assuming the GAO influences DCAA audits of internal controls; one need only read GAO reports of government agencies to gain some insight into the direction this will take. Of note, the GAO rarely identifies actual harm, but merely reports dollars at risk and vulnerability. This will likely serve to reinforce DCAA’s definition of an internal control deficiency which is based upon a DCAA defined set of control objectives premised upon absolute risk avoidance and in the absence of any evidence of any amount of misallocated costs, unallowable costs or contract overpayments. In other words, no relief in sight for those of us who long for the days of government oversight which tolerates “managed risk” as opposed to absolute risk avoidance. More importantly, that a government auditor (GAO, DCAA or IG) will stop short of truly protecting the taxpayer by failing to determine if in fact an “internal control deficiency” resulted in quantifiable harm to the government.

It remains to be seen if government auditors (at least DCAA) will revert back to the day when esoteric or theoretical issues never made the light of day. Unfortunately, at least for now, government contractors should anticipate rigid and inflexible government auditor demands for internal controls with no consideration for the cardinal rule that an internal control should only be implemented if the benefits derived exceed the cost to devise and execute that control including the cost to determine if the controls are working (the last criteria, a GAO favorite).

Editor’s note, as this newsletter was going to press, the Federal Register (Vol. 75, No. 10) issued a proposed amendment to DFARS to improve the effectiveness of DoD oversight of contractor business systems (internal controls). The proposed rule will define contractor business systems and will implement compliance enforcement mechanisms which include withholding payments for business systems which contain deficiencies. Of note, interested parties should submit comments in writing on or before March 16, 2010. A more

detailed analysis of this proposed rule will be forthcoming in a subsequent newsletter.

Acquisition Workforce

The Senate introduced the *Acquisition Workforce Improvement Act* which would create an acquisition managers fellowship program inclusive of classroom training (master’s degree) as well as rotational duties with multiple agencies. Procurement officials and government officials in general have for years been pushing for “agency interchangeability” to gain a better understanding of government procurement; however, in another sense that has been driven by political appointees who enter an agency whose career executives are strictly from within (making the political appointee the odd-man-out so to speak). Additionally, government career executives cannot be easily assigned, directed assignments from one agency to another, leaving long-term executive vacancies in unpopular agencies.

Regardless of the stated or implied reasons for rotational assignments within a future acquisition managers’ fellowship program, rotational assignments are well accepted as the means to develop managers and executives with a well rounded knowledge of an organization’s operations. Suffice to say that if this acquisition workforce development strategy gains traction, it will be one more requirement for contractors to help train government employees.

An optimist might suggest that there is potentially a real gain in this should government oversight employees be rotated into non-oversight roles with other agencies. In other words, an opportunity for auditors or IGs to better understand operational constraints and to understand the implications of ever-expanding audit, IG or GAO demands for internal controls. We can hope.

DCAA Audit Policies

Although DCAA seems to have gone dormant with respect to posting new audit policies on its website (www.dcaa.mil), there were some posted in the last quarter of 2009. A synopsis of some of these audit policies:

- Audit Alert on Sources of Current Guidance, 09-PAS-023(R), November 6, 2009. This memorandum is a simple reminder to DCAA auditors that open audit guidance (Memorandums for Regional Directors) generally supersedes guidance in DCAA’s Contract Audit Manual (CAM). In other words, DCAA’s CAM is never the

complete version of current DCAA audit guidance. Of note and concern to anyone trying to keep abreast of current DCAA audit guidance, it simply does not exist in the public domain. As stated in this DCAA audit alert, the auditor source for open audit guidance is the DCAA intranet, whereas the public access (without going through a FOIA request) is limited to that on the DCAA internet. DCAA has never “published” all audit policies and we can assume that they never will. Nonetheless, any contractor subject to a DCAA audit should still consider DCAA’s CAM and the publicly accessible audit policies. Some preparation is far superior to any other alternative given that DCAA auditors are no longer allowed to help in any context.

- Audit Guidance on the Status of Contractor Systems and Internal Controls as Documented in the Contractor Organization and Systems and Scope of Audit Sections of the Audit Reports, 09-PAS-021(R), October 22, 2009. This memorandum appears to be a corrective action directly or indirectly stemming from GAO reports on DCAA audit failures concerning audits of contractor internal controls. In this case, should a prior system audit become more than four years old, DCAA will no longer consider that audit in defining the scope in any other audit. In other words, no reliance can be placed on the dated internal control audit and DCAA will report “that a current audit of that system has not been performed”. DCAA will use the same wording with respect to a new or significantly changed system. DCAA does not state if and when it will plan and perform an audit of the contractor’s current systems; hence, the disclaimer or “non-opinion” could apply for an indefinite period of time. Actually a favorable action for a contractor system that had been previously reported as “inadequate”, but an unfavorable action for a contractor system that had been previously reported as “adequate” and with regard to the latter, DCAA is also on record of rescinding direct billing privileges when a new and unaudited contractor accounting and/or billing system is deployed (or major changes are made to an existing system).
- Audit Guidance on Review of Dependent Health Benefit Costs, 09-PSP-016(R), August 4, 2009. This memorandum addresses contractor health benefits’ costs and the DCAA expectation that a contractor will only pay health benefits for eligible dependents or eligible spouses. The potential issues are the allowability of higher insurance premiums (for family coverage if no family members are eligible) and/or for specific health benefit claims for ineligible dependents/spouses. This issue hinges upon the contractor’s process for identifying

ineligible dependents and most importantly, the contractor’s documentation supporting this process. As stated in the DCAA audit policy it appears that DCAA expectations are for absolute assurance that no payments are made for ineligible dependents as opposed to reasonable assurance that procedures mitigate the risk of such overpayments. Although these DCAA audit issues are just now beginning to surface, it remains to be seen if DCAA auditors will expect perfection (no payments for any ineligible dependent), a level of absolute assurance which simply does not exist in health care insurance administration. More importantly, it remains to be seen how contracting officers will equitably resolve such issues in the face of continuing pressures to conform to audit recommendations in spite of the fact that DCAA has once again “raised the bar” independently of any change in contract regulations.

- Audit Guidance on Audit Report Points of Contact, 09-PAS-022(R), November 6, 2009. This memorandum eliminates a long standing internal DCAA policy that auditor trainees would not be listed in an audit report as a point of contact. This policy does not change the fact that the supervisory auditor remains the primary point of contact as expressly stated in the audit report. Given that the audit report will identify the auditor trainee and that he/she is an auditor trainee, this change appears to be form over substance (why would any user of the report, except for perhaps the secondary users such as an IG or GAO looking for DCAA operational problems, contact the auditor trainee?).

Training Opportunities

2010 Beason & Nalley Sponsored Seminar Schedule:

February 18, 2010 – Cost and Price Analysis in Government Contracting

Location: Huntsville, AL
Time: 8:15 AM – 4:45 PM
Cost: \$325 per person

February 25, 2010 – Fundamental Requirements of Cost Accounting Standards

Location: Reston, VA
Time: 8:15 AM – 4:45 PM
Cost: \$450 per person

April 29, 2010 – A Practical Guide to the Incurred Cost Submission (ICS)

Location: Reston, VA
Time: 8:15 AM – 4:45 PM
Cost: \$450 per person

May 13, 2010 – A Practical Guide to the Incurred Cost Submission (ICS)

Location: Huntsville, AL
Time: 8:15 AM – 4:45 PM
Cost: \$325 per person

June 17, 2010 – FAR Part 31 Cost Principles

Location: Reston, VA
Time: 8:15 AM – 4:45 PM
Cost: \$450 per person

June 24, 2010 – Fundamental Requirements of Cost Accounting Standards

Location: Huntsville, AL
Time: 8:15 AM – 4:45 PM
Cost: \$325 per person

September 16, 2010 – FAR Part 31 Cost Principles

Location: Huntsville, AL
Time: 8:15 AM – 4:45 PM
Cost: \$325 per person

October 21, 2010 – FAR Part 31 Cost Principles

Location: Reston, VA
Time: 8:15 AM – 4:45 PM
Cost: \$450 per person

November 9, 2010 – Understanding Government Audits and How to Resolve Audit Issues

Location: Huntsville, AL
Time: 8:15 AM – 4:45 PM
Cost: \$325 per person

November 17, 2010 – Cost and Price Analysis in Government Contracting

Location: Reston, VA
Time: 8:15 AM – 4:45 PM
Cost: \$450 per person

2010 Federal Publications Sponsored Seminar Schedule

March 18-19, 2010 – A Practical Guide to the Incurred Cost Submission (ICS)

Arlington, VA

March 22-23, 2010 – A Manager's Guide to EVMS

Arlington, VA

May 3-4, 2010 – A Practical Guide to the Incurred Cost Submission (ICS)

San Diego, CA

May 4-6, 2010 – The Masters Institute in Government Contract Costs

San Diego, CA

June 8-9, 2010 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risks

Las Vegas, NV

June 9-10, 2010 – A Manager's Guide to EVMS

Las Vegas, NV

June 22-23, 2010 – Government Contract Accounting Systems Compliance

Las Vegas, NV

July 13-15, 2010 – The Masters Institute in Government Contract Costs

Hilton Head, SC

August 2-3, 2010 – A Practical Guide to the Incurred Cost Submission (ICS)

Arlington, VA

August 2-3, 2010 – Government Contract Accounting Systems Compliance

Arlington, VA

August 4-5, 2010 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risks

Arlington, VA

August 4-6, 2010 – The Masters Institute in Government Contract Costs

Washington DC

September 21-22, 2010 – Government Contract Accounting Systems Compliance

Seattle, WA

October 13-14, 2010 – A Practical 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

November 30-December 1, 2010 – A Manager's Guide to EVMS

Las Vegas, NV

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

Las Vegas, NV

Instructors

- Mike Steen
- 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.

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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