BEASON & NALLEY, INC.

newsletter

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In this issue…

- DCAA Audits and Exit Conferences
- DCAA Memorandum Transmitting Air Force Memorandum on Timely Definitization of Contract Actions
- DCAA Announces the New Western Regional Director
- Rules and More Rules for Government Contractors
- Training Opportunities

DCAA Audits and Exit Conferences

Although very little has changed in terms of DCAA's publicly available audit policies, (i.e. DCAA Contract Audit Manual or CAM), in actual practice DCAA auditors have declared that there is no government auditing standard (GAGAS) requirement for exit conferences. Auditors have made this statement in flatly rejecting contractor requests for exit conferences and/or DCAA auditors having simply declined to meet for the purpose of discussing the results of the audit (those for which they actually complete the audit fieldwork). Equally or perhaps more frustrating, when DCAA auditors have met with a contractor for the purpose of an exit conference, the dialogue is so restrictive as to serve no meaningful purpose. In one case, the auditors continuously insisted that they would only discuss the computations and would not discuss the merits of an issue or the DCAA interpretation of a regulation (to the extent the audit bothered to cite a regulation).

Hence, the question, is there any standard which requires an exit conference or more specifically, does GAGAS require an exit conference (DCAA's Contract Audit Manual may refer to exit conferences, but that manual is by no means an authoritative citation). DCAA audits are performed under the Attestation Standards (Chapter Six of GAGAS) and in fact, there is no reference to an "exit conference" in chapter six. However, it is worth noting that GAGAS Attestation Standard 6.45 makes reference to providing a draft report to the audited entity and more importantly, that standards 6.45 through 6.48 clearly reinforce the value in obtaining the comments of the audited entity.

In those cases where DCAA does provide a draft report to the audited entity, another questionable if not indefensible DCAA audit strategy is to demand the audited entity's comments within hours (as little as four hours).

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By any measure, providing a contractor with a draft audit report and only four hours to provide contractor comments is simply (and disingenuously) “checking a box” that the audited entity was given the draft audit report. In fact, GAGAS 6.48 does address this and only if there is a reporting date critical to the user’s needs would DCAA have a GAGAS supportable basis for allowing an audited entity only a limited time to respond and only then if “auditors have worked closely with the responsible officials of the audited entity through the conduct of the fieldwork”. With rare exception, DCAA does not work closely with the responsible officials of the audited entity during fieldwork as evidenced by the fact that DCAA auditors are unwilling to share audit results until the “unveiling” of the draft audit report.

There is little question that DCAA has no intention of giving any contractor any real opportunity to review and rebut the draft audit results because such rebuttals could lead to the elimination of draft audit findings; thus exposing DCAA to GAO criticisms that contractors (inappropriately) convinced DCAA to drop audit findings (the same GAO criticism of DCAA that the GAO reported in July 2008 and September 2009). Exit conferences and at the very least providing contractors with the draft audit findings and a reasonable opportunity to review and respond to those findings could and should have a valid purpose of assuring that the auditor has given proper consideration to all relevant facts and the proper application of regulations. Unfortunately, allowing contractors a reasonable opportunity to rebut audit findings simply does not reconcile with the strategies of the “New DCAA” which is to protect the taxpayer even if such protection disregards the relevant facts and regulations.

DCAA’s behavior is to some degree understandable in the aftermath of the harsh criticisms (of DCAA) by the GAO reports and by certain members of the US Senate. However, it is inexcusable in the context of blatantly ignoring GAGAS (6.45 to 6.48) in (DCAA’s) deference to avoiding any possibility that auditor independence may be a perceived issue if audit issues are dropped (between the issuance of the draft audit report and the issuance of the final audit report). It is all too obvious that DCAA has no intentions of being the part of any solution (except by accident) and that the unpublished objectives are to issue audit reports with “findings” regardless of immateriality or testing those findings against contractor rebuttals. For those less and less frequent opportunities for contractors to provide rebuttal comments to draft reports, the most frustrating aspect of the process is the manner in which DCAA auditors discredit or discount the contractor rebuttal (i.e. as simple as “we (DCAA) disagree” as if the auditor was ever going to agree). With that in mind, we are not sure that contractors gain anything with superficial DCAA exit conferences or with opportunities to respond to draft audit reports when such opportunities are but a façade. In all too many cases, audits will be issued with audit findings even if such findings require the intentional and deliberate ignorance of relevant facts offered in contractor rebuttals. That said, it is far easier (and less of a moral dilemma for DCAA) to simply not allow the contractor any reasonable opportunity to offer a rebuttal.

DCAA Memorandum Transmitting Air Force Memorandum on Timely Definitization of Contract Actions

DCAA issued 10-PSP-016(R), dated May 25, 2010, which transmitted the Air Force memorandum while also interpreting that memorandum for DCAA auditors. While DCAA policy indicates that DCAA will participate in meetings, such participation will avoid any auditor comments which could be construed as advising the contractor on how to develop its proposal (although the Air Force initiative is to promote open communications, apparently DCAA will refrain from such open communications). DCAA’s memorandum does reconcile with the Air Force memorandum in terms of similar expectations that contractor supporting data should be readily available once the proposal is submitted.

However, DCAA goes on to state that the contractor should identify the personnel responsible for the underlying data and estimates because DCAA “will require access to those individuals” during the audit process (a less than subtle reference to a DCAA access to records audit policy wherein DCAA misinterprets FAR 52.215-2, “access to records” to include “access to employees”). Of passing note, it is impossible for DCAA to know in advance of receiving a proposal and the supporting documentation that it will “require” access to certain personnel and such a statement contradicts DCAA’s expectations that the proposal will be fully supported when submitted. All too obvious, DCAA is insistent on emphasizing its flawed policy which is DCAA’s incorrect interpretation that “access to records” include “access to employees”.

There is one glaring difference between DCAA’s memorandum and that of the Air Force with respect to due dates. The Air Force states that “it is vital that lines of communication remain open and that established due dates are well-known and met”. In contrast, DCAA states that audit report due dates for the

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particular proposal should be established after the completion of the audit risk assessment. By implication, Air Force due dates are not DCAA audit report due dates (a continuing declaration of auditor independence from contracting agencies).

And one final observation with respect to the Air Force memorandum and its expectations that documentation supporting a contractor's proposal should be readily available and should be provided upon request. For circumstances where the requested data may not be readily available, the Air Force states that extenuating circumstances could include a request for data "that did not form the basis of the contractor's proposal". More than disconcerting to hear that requests for data will include that which did not form the basis for the contractor's proposal and oh so benevolent on the part of the Air Force to allow the contractor time to provide data which does not support the contractor's proposal.

DCAA Announces the New Western Regional Director

DCAA's Director announced that Donald L. Mullinax will be the Western Regional Director effective June 28, 2010. Mr. Mullinax was an Associate Director with AAA (Army Audit Agency, which is perhaps more than a coincidence because AAA is also the agency which provided DCAA with its current Director, Patrick Fitzgerald). Mr. Mullinax has a number of certifications (but is not a CPA) and his announcement focuses upon his experience in dealing with fraud across a broad array of industries (apparently and in spite of numerous proposed regulations which apply to government procurement, fraud is not restricted to government contracting).

Of note, Mr. Mullinax is the first DCAA Regional Director who was not "home grown" within DCAA which is hardly a surprise given the Congressional interest in cleansing DCAA of its wayward culture. Hopefully Mr. Mullinax will understand and apply the distinction between audits and investigations.

Rules and More Rules for Government Contractors

June offered no relief from the plethora of rules and proposed rules which are generally unfavorable to government contractors. The following are just a few of the highlights (or "lowlights"):

- DHS proposed a rule which would place a limit of 65 percent on subcontracting to correct the multi-tiered subcontracting which accompanied the clean-up efforts in the aftermath of Hurricane Katrina. Although we were led to believe that the FAR restrictions on excess pass-through costs was meant to address this very same issue, apparently one rule is not sufficient to address this perceived issue. The rule would apply to contracts in excess of $100,000 awarded in response to three types of disasters (presidentially declared disaster, uncontrolled fire, and an event prompting the activation of Emergency Support functions). Inexplicably this petulant rule will not apply to DHS contracts in general but will apply when urgent services are required when it would be most logical and desirable to provide maximum contracting flexibility. So much for logic.

- Senate Armed Services Committee (SASC) defense authorization bill includes a provision to "promote aggressive and thorough oversight of DOD's programs "which includes a requirement to evaluate contractor business systems to ensure these are adequate to protect the government's interest at whatever cost (actually we added at "whatever cost" although the unending list of rules and proposed rules never address or even begin to consider the administrative cost of the rules). This requirement duplicates a proposed DFARS rule (see our February Newsletter); however, the obvious difference is that the DFARS proposed rule has no prescribed time for finalization whereas the SASC requirement will take effect within 180 days. Apparently the SASC has no faith in DPAP to satisfactorily implement a proposed rule using

the traditional rulemaking process. The SASC also adds $33.8B for the DOD IG to continue growth designed to promote more effective oversight and help identify waste, fraud and abuse, “especially in the areas of procurement” (but again, “waste” apparently excludes the administrative cost of complying with the unending growth in procurement and government regulations).

- Congress passed the “DISCLOSE” Act which will affect government contractors holding contracts exceeding $10 million (could have been as low as $50,000) and will restrict campaign spending for those receiving government funding. This action is obviously directed at the US Supreme Court Decision in Citizens United vs. Federal Election Commission (which had extended individual freedom of speech rights to corporations and trade associations). The inflammatory rhetoric which accompanied this Act fails to mention that current regulations (FAR Part 31) already make such costs unallowable; hence, government contractors who incurred these types of cost could not recover them on government contracts. The Act also contains a public disclosure requirement, but does contain a specifically worded exemption that the disclosure requirement would not apply to any group that has been in existence for a decade, has at least 500,000 members from all 50 states, and receives less than 15 percent of its funding from corporations (exemption from disclosure would apply to NRA, Humane Society, and AARP).

- DPAP (Defense Procurement and Acquisition Policy) issued a class deviation to include language for a contract clause which will ensure that contractor’s employees are informed of their rights under the National Labor Relations Act. The action implements an executive order and requires a contractor to post this information in conspicuous places where employees engage in activities related to the performance of the contract (presumably direct and indirect) including all places where notices to employees are customarily placed both physically and electronically in the languages employees speak (in the interest of brevity we will not discuss the endless possible interpretations of the reference to “languages employees speak”). Although contractors must make such postings of rights under the NLRA (which include the right to collectively bargain), the government contractor must walk the fine line and not otherwise advise employees of their rights to exercise or not exercise the right to organize and bargain collectively (such costs are unallowable under executive order 13494 as incorporated into FAR 31.205-21(b)). Seems to be a bit confusing if not contradictory, but such is the life of government contracting in an era of endless regulations coming from all possible sources.

Training Opportunities

2010 Beason & Nalley Sponsored Seminar Schedule:

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

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

2010 Federal Publications Sponsored Seminar Schedule

July 13-15, 2010 – **The Masters Institute in Government Contract Costs**
Hilton Head, SC

August 2-3, 2010 – **A Contractor’s 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

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

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

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

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.

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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