

In this issue...

- White House Issues Memo to Executive Departments and Agencies: Reforming Government Acquisition Process
- DCMA Guidance on Timely Final Overhead Rate Settlement – ACO's (Administrative Contracting Officers) Actions Must Be Justified to DCAA
- Cost Allocability of Indirect Costs Across Multiple Business Segments
- Training Opportunities



newsletter

Government Contracts Consulting

Provided by Beason & Nalley, Inc.

MARCH 2009

White House Issues Memo to Executive Departments and Agencies: Reforming Government Acquisition Process

The White House, Office of Press Secretary, issued a March 4, 2009 memorandum to all heads of executive departments and agencies which defines objectives and deadlines for strengthening the Government contracting process, the end goal to save taxpayers "billions of dollars each year". This memo comes on the heels of a February 18 OMB Directive which mandates government agencies to ensure adequate "accountability and transparency" of those Government contractors who receive funds or contracts that are attached to the Stimulus Act (see our March 2009 Special Edition newsletter).

The objectives set forth in the March 4 memorandum are to evaluate existing acquisition processes, and execute acquisition reform that will minimize risk of wasteful spending and contract overruns.

The genesis of these White House objectives are the huge increases in Government contract spending since 2000 (increased from \$200 billion in 2000 to \$500 billion in 2008) with the presumption that the government has not performed its functions "efficiently and effectively while ensuring that its actions result in the best value for the taxpayers". The memo implicitly ties the unusually large growth in government spending to two undesired culprits, the overuse of the cost reimbursable contract and underuse of competitive awards.

The memo explicitly states that reversing the trends "away from full and open competition and toward cost-reimbursement contracts" could achieve significant savings equal to billions of

dollars annually. If the message of that statement isn't clear enough, the memo goes on to state "excessive use" of non-competitively awarded contracts (or limited sources solicited), and use of cost-reimbursement contracts "creates a risk that taxpayer funds will be spent on contracts that are wasteful, inefficient, subject to misuse".

And finally, even more explicit verbiage of the memo, regarding use of cost reimbursement and non-competitive awards, states "executive agencies shall not engage in noncompetitive contracts except in those circumstances where their use can be fully justified...", "there shall be a preference for fixed price type contracts", and "Cost-reimbursement contracts shall be used only when circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price type contract".

One item that is missing from the Executive memo regarding future use of cost reimbursable contracts – some empirical evidence that actually



compares the technical and cost effectiveness of differing contract types (actual experience) rather than assuming that cost-type contracts are the worst possible contracting vehicle.

The March 4 memorandum establishes two deadlines, with general contracting reform mandates for all Government executive departments and agencies to accomplish within those time frames.

Prior to July 1, 2009 (first deadline), OMB, with the participation of GSA, NASA, DOD and other agencies (selected by OMB Director) will develop and distribute guidance to assist agencies in (1) evaluating existing procurement practices and making revisions that will enable agencies to identify **existing** contracts that are “wasteful, inefficient or not otherwise likely to meet the agency needs”, and (2) creating corrective action regarding these wasteful contracts, which may include terminating or modifying those contracts.

Prior to September 30, 2009 (second deadline), the Director of the OMB (collaborating with other agency officials) is required to provide Government-wide guidance related to:

1. More effectively “govern” the use of non-competitive and/or sole-source awards and “maximize” the use of full and open competition and other competitive procurement processes;
2. Ensure the appropriate use of all contract types and achieve maximum value for award of any type of contract;
3. Develop a more effective Government workforce that is better enabled to “develop, manage, and oversee acquisitions appropriately”, and;
4. Establish better parameters for government outsourcing of services (OMB Circular A-76 awards) that are “inherently” government agency and employee job duties.

The precise flow-down effect of the Executive memo on the acquisition process is hard to define at this time, but several likely outcomes from this memo and subsequent OMB guidance are certain:

1. Contracting agencies will avoid cost reimbursable and noncompetitive contract awards; if such awards are considered necessary, a series of complicated and redundant documentation and approval

processes will likely be stipulated; hence, fewer such contracts will be awarded;

2. Government contracting administrative agencies will be less likely to provide any contractors additional monies over those amounts originally established for fully-funded cost reimbursable contracts; if such funds are granted, agencies will create more layers of administrative hoops those contractors must follow to justify added funding;
3. Fewer OMB A-76 awards will be made to government contractors, since procurement agencies will likely view any potential service requirement, where there is any possibility that such services are “inherently governmental activities”, to be off limits for award; hence, more government employees will be hired to fill those services;
4. Existing contracts are more likely to be modified (reduced scope) or terminated if any hint of wasteful spending or inefficiencies are noted;
5. Internal audit oversight of Government contracting agencies will occur, with special emphasis on those agencies that most frequently award cost reimbursable or sole-source, noncompetitive contracts, and;
6. Additional FAR and supplemental agency guidelines, with additional contract provisions, will be created

An unintended, but implied, message embedded in this memo is that historical government contracting waste and excessive spending represents a failure of government procurement agencies to maintain effective procurement processes.

After more specific guidelines are provided no later than the July 1 or September 30, 2009 deadlines, we can

better understand the temporary and permanent ramifications of those guidelines on government contractors. Be aware that the reform measures that will emerge from this Obama administration acquisition directive will apply to all government contracts, and not just those that are awarded under the Stimulus Act.

Because the White House memo is focused on acquisition reform, obviously no mention is made regarding other reform measures that could alleviate, at a foundation level, the inefficient waste in government spending. Such foundation level measures going beyond the Government acquisition process to ensure better management of taxpayers' monies might include providing our Congressional representatives training on efficient spending guidelines, and encouraging a more frequent use of the Executive veto of legislation that would otherwise keep unnecessary expenditures for supplies or services from entering the gateway to the Government acquisition process.

DCMA Guidance on Timely Final Overhead Rate Settlement - ACO's Actions Must be Justified to DCAA

DCMA recently issued the subject guidance which was triggered by a DCAA policy related to prioritizing audits of contractor final indirect cost rate proposals (DCAA MRD 08-PPD-040).

In a strange turn of events, the DCMA guidance states that if an ACO (Administrative Contracting Officers) grants an extension (with respect to the requirement for an indirect cost rate proposal within six months after the end of a contractor fiscal year); the ACO should provide DCAA a written

explanation of the exceptional circumstances that warranted the extension. A strange turn of events to the extent the DCMA guidance suggests that an ACO must now justify an extension to DCAA. Since when do ACOs justify their actions in writing to DCAA unless such an action is meant to minimize the chance that a disgruntled auditor, unhappy with an ACO's lack of support, will invite the Government Accountability Office (GAO) or Department of Defense – Inspector General (DOD-IG) in by virtue of a hotline referral?

Beyond the threat of arbitration involving the “unbiased” GAO or IG, what happens if the ACO grants the extension without the written justification (to DCAA) and/or the written justification fails to identify the “exceptional circumstances” that warrant the extension? Of greater concern, the DCMA guidance suggests that DCMA has endorsed DCAA's internal policies defining “timely, final indirect rate proposals” (DCAA MRD 07-PPD-033). Lost in translation is the fact that DCAA's specific interpretation of an adequate Incurred Cost Proposal (ICP) is neither a regulatory requirement, nor does DCAA process its ever expanding definition (of an adequate incurred cost proposal) through the regulatory notification or rulemaking process.

In more than one instance, the FAR Council has made comments in the Federal Register which clearly indicate that what is required or recommended as an adequate incurred cost proposal needs to be determined; specifically, should a schedule of cumulative allowable costs be a requirement or a recommendation. Nonetheless, DCAA continues to bypass the regulatory process through changes in its DCAA Pamphlet (DCAA 7641.90, Information for Contractors) as well as field auditor demands which frequently negate long-standing agreements. One such example – a recent DCAA supervisory demand for



a cumulative allowable cost schedule (Schedule I in DCAA's “ICE” model) as a component of the ICP when DCAA and the contractor had a long standing agreement that the schedule would be prepared by the contractor once rates were final.

Another example—a client received an ICP “rejection letter” (deeming ICP inadequate) inclusive of the following:

- Schedule H nor I failed to indicate if the listed contracts were physically complete
- A demand that the contractor explain its use of a value-added G&A base
- A list of the termination claims or requests for equitable adjustment
- Identify the work sites and the number of employees, direct and indirect, assigned to each site
- For those contracts subject to rate ceilings, provide the calculations for how the amount was calculated
- Provide the list of internal audits planned for the upcoming Fiscal Year

- A request for the SEC 10K, while also asking if the contractor was publicly traded

Absolutely none of the listed deficiencies can be tied to any regulation except for DCAA's internal policies and its ever increasing demands that contractors perform more and more of the audit for DCAA. A case in point, the auditors demand for the 10K; if applicable, this SEC filing is readily accessible on any given contractor's website. In fact, the DCAA position of "defer everything possible to the contractor" is not appropriate, and the auditor should be going to the contractor's website as a source of potentially relevant information not otherwise on DCAA's ever growing list. Or perhaps, that is the next step, simply an overarching demand for any and all data and information which is of potential relevance to the incurred cost proposal and the related audit.

Cost Allocability of Indirect Costs Across Multiple Business Segments

In its summary judgment in favor of the government, the Court of Federal Claims (*Teknowledge v United States*, US COFC No. 06-310C, dated January 7, 2009) found that software amortization costs, developed by a commercial business unit within a commercial segment were not allocable, thus not allowable as a cost to government contracts.

Although we only have visibility to the public record on the matter, we do agree with the decision and believe it represents a good example of what not to do in matters of allocating commercial product development costs to government contracts. In the absolute, costs incurred by a commercial segment

or business unit and subsequently "shared" with a government segment are the "reddest" of red flags. If subject to audit, the cost allocation will be challenged.

In asserting that there is a common benefit, thus a shared allocation, it also helps to have a specific basis for the amount of the allocation. According to the factual background in the case, the contractor's counsel stated that "he believed that the percentages were based on either the historical division revenue by the Commercial and Government segment or by headcount hours worked by employees in the two segments, although he did not know which". Arguably, not the ideal strategy (to be asserting allocability) without actually knowing the basis for allocating costs across multiple business segments.

Additionally, the contractor identified a benefit to the government based upon the commercial segments absorbing expenses that it would otherwise have charged (allocated) to the Government. Unfortunately, the success of this concept has actually required that the existing regulations be effectively waived by "Act of Congress". Specifically, the Shipbuilding Preservation Act (1990s) required that certain indirect costs otherwise allocable to commercial contracts, be reimbursed by Government contracts under the theory "but for" the commercial contracts, the Government would have absorbed the entire amount of fixed overhead and G&A. In fact, this Act never changed the underlying cost allocation principles (i.e. FAR or CAS) in which case actual cost allocations never changed; however, the Navy reimbursed certain costs allocable to commercial contracts as a separate and distinct Navy contract line item based upon memorandum accounting entries.

Finally, although the regulations (FAR 31.205-18) which permit very broad interpretations of allocability for IR&D (independent research and development) to the total contract activity of a business unit, that definition is very heavily influenced by the contractor's business unit structure which ultimately defines the G&A allocation base.

In terms of lessons learned, this case does suggest that the contractor may have been better served had it pursued an Advance Agreement (FAR 31.109). Although the outcome may have been the same (no advance agreement because the development costs were not allocable to government contracts), it should have reduced if not eliminated the legal costs which are not allocable and not allowable as a cost to Government contracts.

Training Opportunities

2009 Beason & Nalley Sponsored Seminar Schedule

Fundamentals of Cost Accounting Standards

Date: June 4, 2009

Location: Beason & Nalley, Inc.
Huntsville, AL

Time: 8:15 am – 4:45 pm

Understanding Government Audits and How to Resolve Audit Issues

Date: August 4, 2009

Location: Beason & Nalley, Inc.
Huntsville, AL

Time: 8:15 am – 4:45 pm

Cost and Price Analysis in Government Contracting

Date: September 10, 2009

Location: Beason & Nalley, Inc.
Huntsville, AL

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 Seminars Schedule

A Practical Guide to Incurred Cost Submission

March 24-25 – Washington DC

May 5-6 – La Jolla, CA

September 15-16 – Washington DC

October 20-21 – Las Vegas, NV

A Manager's Guide to EVMS

March 31 - April 1 – Washington DC

June 2-3 – Las Vegas, NV

November 5-6 – Washington DC

December 2-3 – Las Vegas, NV

Government Contract Accounting Systems Compliance

May 19-20 – Washington DC

June 16-17 – Las Vegas, NV

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

June 10-11 – Las Vegas, NV

September 15-16 – Washington DC

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:

Beason & Nalley, Inc.

Huntsville, AL
101 Monroe Street
Huntsville, AL 35801
T: 256.533.1720

Washington DC
11400 Commerce Park Drive, Suite 220
Reston, VA 20191
T: 703.860-8062

Toll Free: 1.800.416.1946
info@beasonnalley.com
www.beasonnalley.com