

## *In this issue...*

- Airline Travel and FAR 47.4
- Revisions to the “Yellow Book” (Generally Accepted Government Auditing Standards)
- Auditable Dollar Volume or “ADV”
- DCAA Policy Memo on Reporting Internal Control Deficiencies
- Training Opportunities

### TIP...

If using airlines with co-partners or alliances make sure that a ticket is issued by the U.S.-flag carrier as opposed to the foreign partner. Although not discussed in this newsletter, there are somewhat similar requirements for the use of U.S.-flag vessels for ocean transportation (subpart 47.5).

## Government Contracts Consulting

Provided by Beason & Nalley, Inc.

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### AIRLINE TRAVEL AND FAR 47.4

Most of us consider FAR 31.205-46 when determining allowability of travel and more specifically air fare; however, there is at least one other FAR provision which actually “trumps” FAR 31.205-46. In this case, FAR 47.4 “Air Transportation by U.S. Flag Carriers” wherein air fare otherwise allowable under 31.205-46 may not be allowable under 47.4.

As with any provision of FAR, the first step is to determine if one or more of your contracts has this subpart (52.247-63); if “yes” the second step is to comply with it. The Policy, stated in 47.402, requires that contractors, consultants, grantees and others must use U.S.-flag air carriers for U.S. Government financed air travel and transportation of their personal effects or property, if available. Availability, stated in 47.403-1 provides for some exceptions, but it is critical that exceptions be documented at the time of the travel/transport. For example, one exception involving a gateway airport

abroad (as the destination or origin point) allows the use of a “foreign” carrier if the use of a U.S.-flag carrier would extend the time in travel status (duration of the trip) by 24 hours.

Other exceptions involve a gateway airport abroad as an interchange point, in which case the exception is 6 hours or more delay (if using a U.S.-flag carrier). The preference for U.S.-flag carriers only applies if the contract includes contract clause 52.247-63; however, to the extent it does apply the potential penalty for inadvertently using a foreign-flag carrier could be the disallowance of entire

#### EXAMPLE ...

For example, one exception involving a gateway airport abroad (as the destination or origin point) allows the use of a “foreign” carrier if the use of a U.S.-flag carrier would extend the time in travel status (duration of the trip) by 24 hours.

amount of the air fare for movement of persons as well as movement of property. One tip, if using airlines with co-partners or alliances, make sure that a ticket is issued by the U.S.-flag carrier as opposed to the foreign partner.

Although not discussed in this newsletter, there are somewhat similar requirements for the use of U.S.-flag vessels for ocean transportation (subpart 47.5). The “bottom-line” when operating outside the US, make sure you pay particular attention to the atypical contractual terms and conditions.

### REVISIONS TO THE “YELLOW BOOK” (GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS)

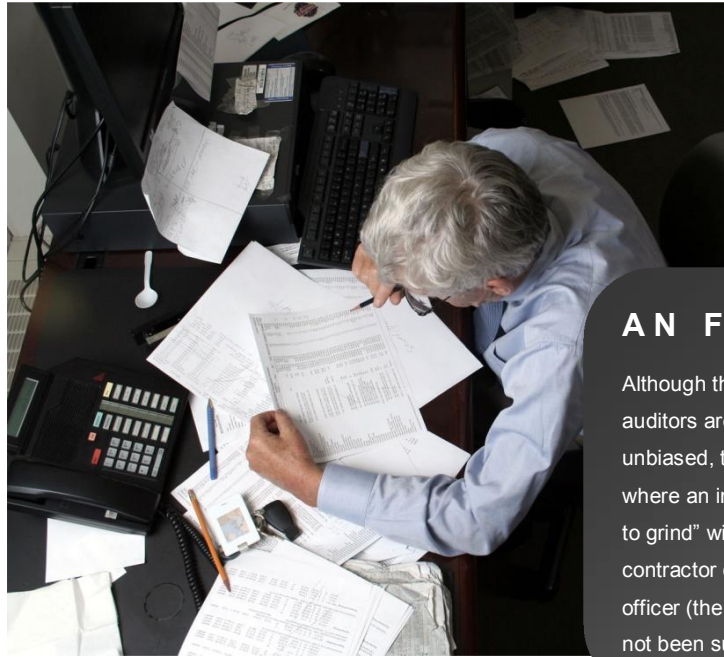
As noted by DCAA in its February 5, 2008 MRD (08-PAS-003(R)), the Government Accountability Office (GAO) revised the yellow book in July 2007. For the most part, the changes listed by DCAA are

internal and/or refinements to existing policies and procedures. Impairment to independence continues to garner some attention including procedures should auditor independence be identified after the report is issued. For the most part, auditor independence has not been changed and it remains that the primary objective is to assure that the auditor is independent; thus the audit results are unbiased either favorable or unfavorable to the contractor.

Although the primary concern is to avoid a situation where the auditor fails to identify, develop and report findings unfavorable to the contractor, there is the secondary concern that unfavorable findings not be influenced by personal bias against the contractor. Although the vast majority of DCAA auditors are professional and unbiased, there have been situations where an individual auditor had an “axe to grind” with respect to a specific contractor or a specific contracting officer (the latter because he/she had not been supportive of audit findings).

The risk in these situations is that all relevant facts may not be considered because all relevant facts would render an opinion different from an opinion based upon selective facts. One indicator maybe the auditors’ unwillingness to share anything about his/her audit results.

Another indicator maybe his/her downplaying any potentially unfavorable findings during the audit, but then characterizing them as significant issues in the audit report. It should be noted that not all audit findings can be shared with the contractor (e.g. those applicable to forward pricing bid proposals); however, incurred costs, systems, defective pricing, CAS should be shared with the contractor in a draft audit report. It should also be noted that an “aggressive” auditor is not necessarily a biased auditor, but even the most aggressive auditor must be willing to



**AN FYI...**

Although the vast majority of DCAA auditors are professional and unbiased, there have been situations where an individual auditor had an “axe to grind” with respect to a specific contractor or a specific contracting officer (the latter because he/she had not been supportive of audit findings).

report the facts even if such facts eliminate a finding.

On a related note, DCAA, on February 7, 2008, DCAA also issued MRD 08-PAS-004(R), “Assessing Independence of External Technical Specialists”.

For several years, DCAA policy has interpreted GAGAS as requiring other government employees to provide a statement of independence (e.g. technical specialists, typically DCMA engineers providing assistance on labor hour estimates); otherwise, DCAA could not incorporate the “external” technical specialist input into the DCAA audit report. As of February 7, this no longer applies although the auditor still must assess the specialist’s ability to perform the work and report the results impartially. Exactly how this will be accomplished is unstated within the MRD; however, the MRD goes on to state that the ethics policies and procedures of the specialists’ organizations provide reasonable assurance of the impartiality of specialists employed by other Executive Branch agencies, e.g., DCMA.

Although it is unstated, the MRD has been issued to address one very specific and recurring situation, that of the DCMA technical specialist who are essentially team members, along with DCAA, on the government evaluation team.

- *Does this also apply to other “external technical specialist”?* “Yes”, but only if the organization is within the Executive Branch.
- *Can the logic and thus the reliance be placed upon other external technical specialists?* The answer is “yes” as long as the auditor satisfies GAGAS on a case by case basis.

**AUDITABLE DOLLAR VOLUME OR “ADV”**

Government contracting invokes a number of acronyms including “ADV” as used internally and externally by DCAA as defining a very basic component of audit risk. There are numerous references to ADV on DCAA’s public website ([www.dcaa.mil](http://www.dcaa.mil)) including audit programs or other audit guidance whose applicability maybe defined based upon

ADV such as a risk assessment checklist for activity code 10100 incurred cost audits under \$15 million ADV (RiskAssessmentChecklistADVU15).

Basically ADV represents the total dollars incurred for a contractor fiscal year for its flexibly priced contracts. In some cases, this measure will also be translated into a percentage, such as 10% for a contractor with total costs of \$100 million, but only \$10 million of that applicable to flexibly-priced government contracts. As a percentage, simply another measure of risk (for every \$100 questioned, the government's participation or recovery is \$10 in this rather simple illustration). This measure defines the audit planning "break-points"; notably that below \$90 million is a "non-major" and above is a "major".

As a major contractor, more audits are specifically identified and planned as opposed to non-major where audit coverage is planned with fewer, but more comprehensive audits. When all is said and done, the auditor must have a GAGAS compliant basis for expressing an opinion on \$89.9 million as well as for \$90.1 million.

What's the point? ADV is more than just a planning measure; it also impacts the significance of an audit exception measured in dollars. As an example, a recent audit took exception to executive compensation (below the FAR 31.205-6(p) statutory ceiling, but considered unreasonable under FAR.205-6(b)). The auditor followed some of DCAA's internal policy in coordinating with DCAA's compensation team which identified significant amounts it believed were unreasonable based upon DCAA's use of compensation surveys. The amount deemed unreasonable was a moving target (moved down after numerous emails with additional facts and rebuttal comments, counter-rebuttals and other fun, but time-consuming activities).



After countless hours spent in attempts to resolve the issue, it was ultimately settled for almost nothing when the DCAA compensation team realized that the "ADV" was minimal. In this case, the total ADV was less than \$100K (less than 1% of total incurred costs) and the unreasonable executive compensation otherwise included as a proration to the ADV was less than \$5K. DCAA's field auditor failed to make this determination in planning the specific audit.

The moral to the story, do not assume that the auditor has done his or her homework in defining audit risk in the most basic context of "ADV". If your

#### NOTE ...

**Expect that internal control deficiencies will be identified, reported as such (in the draft report provided at the completion of fieldwork) and it will be up to the "auditee" (contractor) to provide documentation that a condition "clearly would not materially impact government contract costs".**

contracts are almost exclusively cost-type, total costs will be almost entirely ADV; but if you have a mixed-bag, make sure you and your auditor compare notes early in the audit.

## DCAA POLICY MEMO ON REPORTING INTERNAL CONTROL DEFICIENCIES

DCAA issued Audit Guidance on Reporting Internal Control Deficiencies, on March 3, 2008 (08-PAS-011(R)). The explanation for the memo is to incorporate changes in Government Auditing Standards based upon the revisions to the "Yellow Book" in July 2007. As stated in the first paragraph of DCAA's memo, "All internal control deficiencies that result in or could result in costs being charged to Government contracts that are not in accordance with applicable laws, regulations, or contract terms should be reported as significant deficiencies and be considered material weaknesses, unless the potential unallowable cost is clearly immaterial". Of particular note, the underlining ("could") is actually from DCAA's Policy Memo.

Additionally, DCAA's second paragraph states in part, conditions that clearly would not materially impact Government contract costs....should continue to be reported as "Suggestions to Improve the System".

What's the likely impact from this recent DCAA Policy Memo? That more "ICAPS" audits (Internal Control Audit Planning Summary) will involve an audit report including one or more "Statements of Condition and Recommendation" for the same condition that was previously reported as a "suggestion to improve the system". Why, because almost any internal control deficiency "could" result in unallowable costs being charged to the government and most importantly, very

few auditors are going to invest the time to obtain sufficient evidential matter to support a conclusion that the "potential unallowable cost is clearly immaterial".

Expect that internal control deficiencies will be identified, reported as such (in the draft report provided at the completion of fieldwork) and it will be up to the "auditee" (contractor) to provide documentation that a condition "clearly would not materially impact government contract costs".

## FOR EXAMPLE...

An example, a contractor who fails to properly quantify and exclude (from its incurred cost submission) compensation costs in excess of the statutory ceiling because it does not have the internal controls needed to identify and "voluntarily delete" these costs.

Where does one begin for such routinely (DCAA) identified deficiencies as poorly documented training or lack of independent reviews of a process that may otherwise be functioning without a hitch. Additionally, smaller contractors not typically subject to ICAPS audits may be identified as having reportable internal control deficiencies based upon observations from other audits. An example, a contractor who fails to properly quantify and exclude (from its incurred cost submission) compensation costs in excess of the statutory ceiling because it does not have the internal controls needed to identify and "voluntarily delete" these costs. Thus, if an auditor follows DCAA policy, he or she will flood the contracting officer with multiple reports originating with a single "condition"; in this example the incurred cost report, a separate report on the CAS 405 noncompliance (CAS 405 is incorporated into the FAR), and an additional separate report on the internal control deficiency.

The administrative costs of government contracting just keep increasing and unfortunately in the quest for perfect internal controls, someone has lost sight of the fundamental theorem that the cost of an internal control should not exceed the benefits.

## Training Opportunities

### Government Cost Accounting Systems Compliance

#### Brief Synopsis:

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