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newsletter

Government Contracts Consulting

Provided by Beason & Nalley, Inc.

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DCAA Policy Revision- Denial of Access to Records Due to Contractor Delays

As the title implies, DCAA has recently drawn a line in the sand in terms of its latest interpretation of FAR 52.215-2, Audit and Records. Actually the policy memorandum, one of three publicly releasable, dated December 19, 2008, is narrowly focused on "contractor delays" as opposed to overt contractor denials of a record(s). Historically, DCAA has always interpreted access to records as "timely" access wherein untimely access has been considered a denial (whether stated or unstated by the contractor).

In its recent policy memo, DCAA is now telling its auditors and its customers Defense Contract Management Agency (DCMA) what is meant by contractor delays. In making this a releasable

memo (the "(R)" designation), DCAA is also telling the contractor community how DCAA interprets contractor delays. As with most DCAA policies that have no connection to any recent change in a procurement regulation, there is a history behind the "new" audit policy.

In this case, we are speaking of years of auditor frustration with respect to records which were requested, but not provided for months and/or not provided to the auditor but provided to an ACO or Procurement Contracting Officer (PCO) during negotiations (typically designed to keep the auditor from having a chance to review the documentation/support, leaving the ACO/PCO to act without audit input). In fact, a significant percentage of DCAA costs questioned are for lack of adequate support (in some cases none was provided).

More recently, the criticisms following the July 2008 Government Accountability

Office (GAO) report have included DCAA auditor allegations that DCAA Management tolerates excessive contractor delay tactics when the documents ultimately provided are seemingly within the definition of a record which should be provided within the parameters of FAR 52.215-2.

DCAA's latest definition of timely audit access is replete with DCAA interpretations which are simply not found in the Access to Records regulation. Conspicuously absent from FAR 52.215-2 is access to persons (employees or contracted labor) which DCAA asserts is part of the deal. Of more than passing interest and relevance, FAR does expressly provide for access to persons, except in the very limited context of validating qualifications for T&M contracts (FAR 52.212-4) or for purposes of compliance with mandatory disclosure and full cooperation under FAR 52.203-13.

Further, DCAA states that auditors should generally obtain documentation from the person responsible for the document/support (as opposed to documentation provided through an audit liaison person). A slight flaw in DCAA's general expectation is that a contractor audit liaison employee is actually the person most likely "responsible" for providing the documentation to DCAA. For that matter, who defines the person responsible for the document? Similarly, does the FAR, thus the government (other than DCAA) care who specifically provides the document so long as the document is provided?

Another slight flaw is DCAA's statement that anything supporting a contractor assertion should be readily available, thus provided to DCAA upon request. DCAA's example is documentation which supports a bid proposal; however, it would similarly apply to the annual incurred cost proposal. DCAA's expectation of timely response ("upon request") is heavily influenced by DCAA's individual and collective lack of any real world experience, except of course its own delay tactics when responding to the now infamous GAO review leading to the July 2008 report. In order to be responsive to DCAA's expectation of "provided upon request", we can visualize rows of persons (each responsible for one or more documents), waiting by the telephone or computer (instant messaging) analogous to a Public Television Station during a fund raising campaign.

Other elements of DCAA's recent policy memorandum raise additional questions as to the regulatory basis for DCAA's expectation. For example, the introductory paragraph addresses lost or stolen documents with the mandate that

the contractor will prepare and provide a statement concerning the missing documents. At least conceptually, the expectation that the contractor will prepare a document is incongruent with respect to the fundamental procurement regulation that Access to Records is exactly that, access to existing records as opposed to demands that a record be created (reference to FAR 52.215-2(d)).

Although DCAA does not expand its December 19 policy document to discuss records or documents in the context of original versus a copy, clients routinely experience an audit request for original documents only. Once again, such requests are not consistent with FAR 4.703(c), "original records need not be maintained or produced in an audit if the contractor provides photographic or electronic images of the original document and meets three requirements", with one requirement being the retention of the original document for one year. Thus an auditor may request a sampling of "originals" to establish that electronic or photographic copies are reliable; however, that does not extend to all documents/records.

One final observation, DCAA makes note of the fact that the December 19 policy has been coordinated with DCMA, the agency whose contracting officers are most likely deal with the resolution of DCAA issues. The fact that DCAA has coordinated with DCMA does not answer the question, "Does DCMA agree with DCAA's policy?" Moreover, individual ACO's will be addressing these and other audit issues on a case by case basis; however, DCAA has advised its auditors: **"Instances where the ACO does not agree with DCAA's request for data should be referred promptly to the regional office for resolution"**

(the bold print is directly from DCAA's document). Perhaps unintended, but it certainly appears to be an intimidation tactic directed at contracting officers.

Access to records has been a matter of interpretation, disagreement and in some cases litigation. It appears that the classic example of "agree to disagree" may have restarted, and perhaps DCAA is interested in flexing its muscles in terms of issuing a DCAA subpoena (referenced in the December 19 policy with the only widely known use of this authority having been the Newport News access to records disputes in the 1980's).



Obama Agenda in Defense Reform: Objectives Announced But Loosely Defined

The Obama Administration has posted on the Whitehouse.gov website several major initiatives designed to improve the effectiveness of the Department of Defense while also focusing on the efficiency in implementing DOD's mission.

Several of the more notable objectives shown on this website follow:

- Develop and revamp special operations forces, civil affairs, information operations, and other units and capabilities that remain in chronic short supply.
- Mandate that the DOD and State Department “develop a strategy for determining when contracting makes sense, rather than continually handing off government jobs” to well-connected private enterprise; such an initiative is characterized as “create transparency” for military contractors.
- Formulate parameters for the Dept. of Justice to determine when prosecution of “contractor abuse” is needed.
- Establish a “war funds oversight system” and do away with defense budget war “supplemental” provisions.
- Improve ability of our National Guards and Reserve units through modernization programs.

Another very important initiative of the Obama agenda would be to “curb the award on “no-bid” contracts by requiring that nearly all contract orders over \$25,000 be competitively awarded”.

The full text of the Obama Defense program agenda can be found on the website,

www.whitehouse.gov/agenda/defense.



Fixing the SBA: The New Administration's Challenge

Although many are familiar with the Small Business Administration (SBA) from its loan programs which many small businesses rely on, the agency also plays a significant role in the Government procurement world. Their influence stems from the agency's role in assuring that 23 percent of all Government procurement dollars are awarded to companies qualifying as a small business.

Recent reports, however, have shed light on a growing number of deficiencies within the SBA and many see it as one of the biggest challenges facing the new administration. Though the commercial marketplace may be interested in what happens to the SBA loan programs, those in the Government contracting world are concerned with enforcement problems relating to small business procurement dollar thresholds.

The challenge is two-fold: the SBA is struggling to track not only which businesses are small, but also if procurement dollars earmarked for small businesses are actually going to large contractors. While it is unclear how the new administration will address these issues, it is clear that the next four years will have a major impact on the future of Government contracting.

Federal Regulations require 23 percent of all Government contract awards go to businesses considered small, as defined by the SBA. While the SBA is in charge of enforcing the requirement, individual agencies are in charge of tracking and reporting the information. According to recent reports the SBA staff has been reduced 26 percent and has impacted the agency's ability to correct reporting errors. The lack of oversight has led to some glaring errors. In October it was reported that \$5 billion in procurement dollars were erroneously reported as being awarded to small businesses. The errors stemmed from contracts being awarded to companies which either, long ago graduated from the SBA's 8(a) program, or never even qualified in the first place.

Most embarrassing perhaps, it has been reported that the Government counted a very large and obviously non-small business as a small business on over 200 contracts and listed \$89 million in small business awards that actually went to a very large computer company.

These examples are only a glance into the much larger issue facing the SBA. How can an agency whose staff is already overworked keep track of millions of contracts and enforce a requirement which it is not even in

charge of reporting? The answers from experts range from promoting the agency to Cabinet status to eliminating it entirely. In any case, it is a decision that will likely be made in the next four years. If the agency retains its authority, however, it must focus on becoming more effective, particularly in defining which companies qualify as a small business.

Currently, the SBA uses over 30 pages to define what constitutes a small business. The standards include definitions by business type, total employees, and total revenue. For examples, a company may claim small business qualifications based on having less than 500 employees, revenue of less than \$7.5 million, depending on their industry (NAICS). The employee and revenue requirements may also change from industry to industry, with some companies able to have as many as 750 employees and still be considered a small business. Such an expansive list with differing criteria makes it difficult to determine when a business graduates to a large concern, and recent reports have exposed this. Another report that was issued in December stated that the GAO recently audited the 8(a) program and the results were less than stellar. In a sample of 80 SBA 8(a) companies, over 30 percent were found to be out of compliance with 8(a) requirements.

Given the SBA's extensive requirements for revoking a company's 8(a) status, it remains to be seen if the SBA will improve its performance without a major overhaul of its processes. Several other loopholes and other bureaucratic blockades may even make it impossible to do so. One way to ensure a higher compliance rate is to simplify the 8(a) requirements and reduce the exemptions

available to businesses. Doing this, however, may disqualify several companies who rely on their 8(a) status to survive, thus impeding the overall goals of the SBA's program. Again, it is unclear how the new administration will handle this challenge, but in all likelihood the future direction of the 8(a) program will be decided in the near future. Clearly, the future of Government contracting, especially with regard to small business awards, lies in the hands of the new administration.

Given the country's current credit crisis, it is understandable why much of the focus on the SBA surrounds the agency's small business loan programs. For small Government contractors, however, the implications may be even greater. Surely, the challenges facing the new administration are great, particularly in defining the requirements of a small business and enforcing federal regulations regarding small business contract awards. As the new administration forms policy and begins to implement any changes, it is critical for Government contractors, both large and small, to keep an eye on changing regulations and be aware of how their businesses may be affected. The next four years may prove to be the most significant in the history of Government procurement.

Drawing the Line on Provisional Billing Indirect Rate Responsibilities

Over the past several months, we have noted several instances where the Defense Contract Audit Agency (DCAA) has been castigating small business



government contractors for not using Administrative Contracting Officer (ACO) or DCAA approved provisional indirect billing rates during the billing process. Although the ACO and/or DCAA have the responsibility for "establishing" provisional billing indirect rates, what is the responsibility for government contractors in ensuring provisional indirect billing rates follow regulations?

Provisional indirect rates are often based using a budget forecast, which should take business base projections, historical costs, and projected costs into account. Provisional indirect rates developed for billing purposes can also be utilized for managing incurrence of actual indirect cost as well as in determining fiscal year profitability via comparison to actual indirect cost rates.

Provisional billing indirect rates must be reconciled to actual rates for flexibly-priced contracts under the contract regulations where billed costs are based on actual recorded costs. However, the contractor is afforded the option of changing provisional billing rates during the year to more accurately reflect actual

indirect rates to prevent over or under payment.

According to FAR 42.704(c), "Once established, billing rates may be prospectively or retroactively revised by mutual agreement of the contracting officer (or cognizant Federal agency official) or auditor and the contractor at either party's request, to prevent substantial overpayment or underpayment. When agreement cannot be reached, the billing rates may be unilaterally determined by the contracting officer (or cognizant Federal agency official)."

Approved provisional billing rates are sometimes established during the contract proposal process, or those billing rates may be agreed to via use of a separate forecasted budgeting process. Another option of contractor calculation, and auditor establishment, of those rates is the use of historical (most recent fiscal year rates) for billing purposes.

The government (ACO/DCAA) is responsible for "establishing" provisional indirect billing rates. According to FAR 42.704(a), "The contracting officer (or cognizant Federal agency official) or auditor responsible under FAR 42.705 for establishing the final indirect cost rates also shall be responsible for determining the billing rates." Unlike other related provisions, for example, FAR 42.705-1(b)(1) which explicitly states that "the contractor shall submit a final indirect rate proposal....", there is no similar provision in FAR 42.704 for the contractor to prepare and submit an annual billing rate proposal.

In other words, regulations do not explicitly assign responsibility to the contractor for establishing provisional indirect billing rates, but rather those responsibilities are those of the ACO or DCAA. However, under these provisions, the ACO or DCAA does have the prerogative to insist on a formal billing rate proposal, but should assert that requirement in explicit terms to the contractor.

We believe it is important for a government contractor, regardless of size, to prepare its own calculations supporting billing rates on an annual basis. With a new fiscal year beginning for many businesses, government contractors should be focusing on developing accurate indirect rate models based on historical costs and budgeted costs to project profitability and for purposes of managing costs to provisional budgets.

Government contractors may choose to interface with contracting officers to discuss preliminary billing rates in order to prevent issues from arising when DCAA begins evaluation of contractor proposed billing rates. By taking a proactive approach, the contractor can hopefully preclude negative findings by the government.

Training Opportunities

2009 Beason & Nalley Sponsored Seminar Schedule

Preparing an Incurred Cost Proposal: Avoiding Audit Trap Doors

Date: February 24, 2009
Location: Beason & Nalley, Inc.
Huntsville, AL
Time: 11:00 pm – 1:00 pm



FAR Part 31 Cost Principles

Date: March 12, 2009
Location: Beason & Nalley, Inc.
Huntsville, AL
Time: 8:15 am – 4:45 pm

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

**The Masters Institute in Government
Contract Costs**

May 4-8 – La Jolla, CA

July 20-24 – Hilton Head Island, SC

December 7-11 – 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.



We deliver objectives.

**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 miller@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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