

Special Interest Articles

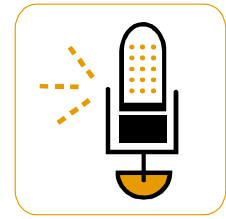
Cost Accounting Standards Update – See Page 2

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Business Ethics Compliance Program

The FAR's new Contractor Business Ethics Compliance Program and Disclosure Requirements will require significant changes for all Government contractors and subcontractors.

On December 12 last year, a new rule took effect that requires all contractors to establish and promote awareness of a code of conduct and to disclose in writing to the Inspector General and contracting officer violations of fraud-related criminal statutes or the civil False Claims Act if they have credible evidence of such violation. This mandatory disclosure rule should be of great concern to all Government contractors.

In 2007, the Department of Justice asked the Office of Federal Procurement Policy to amend FAR to require contractors to notify the Government without delay whenever they become aware of violations of criminal law or contract overpayment. At that time, a related provision was making its way through the regulatory process. This provision (about which we have discussed in prior newsletters) became effective in December 2007 and required Government contractors to have a written code of business ethics and post "hotline" posters around their facilities to encourage their employees to report possible fraudulent contract

activity.

DOJ sought mandatory reporting because few companies responded to DoD's invitation to voluntarily disclose suspected instances of Federal criminal laws relating to contracts and subcontracts.

Judging from the public comments, the proposed rule had a great deal of opposition. Nevertheless, the rule was ultimately adopted and became effective in contracts awarded beginning December 12, 2008.

There are three parts to the mandatory disclosure requirement.

First, contractors must timely disclose, in writing to the agency Inspector General (IG) and the contracting officer (CO) whenever, in connection with the award, performance, or closeout of the contract or any subcontract thereunder, the contractor has credible evidence that a principal, employee, agent, or subcontractor has committed a violation of Federal criminal laws or the civil False Claims Act. This disclosure is limited to contracts containing the new clause. The second part is more insidious.

The second part to the mandatory disclosure clause requires contractors to establish and maintain an internal control system that includes mandatory disclosure to the IG and CO. The

internal control system must include timely disclosure, in writing to the IG and CO whenever, in connection with the award of any , performance, or closeout **of any** Government contract, the contractor has credible evidence of a violation of criminal law involving fraud, conflict of interest, bribery, or gratuity violations.

This internal control reporting obligation is broader than the first requirement because it covers violations in connection with any Government contract or subcontract. This might include violations that occurred before award of the contract containing the clause.

The third part of the rule states that the knowing failure to timely disclose to the Government credible evidence of crimes, false claims and overpayments is grounds for suspension and debarment. This also applies to any Government contract but is limited to Knowing failure by a principal of the firm (a principal of the firm is defined broadly).

The clause and associated promulgation comments include definitions of "credible evidence", "timely disclosure", and "significant overpayments" as well as details on the "crimes "covered by the clause. This clause increases the risk of doing business with the Government and contractors must ensure that they have effective compliance programs that prevent misconduct.





New rules for
amortizing actu-
arial gains and
losses

Cost Accounting Standards Administration

The Administrative Contracting Officer (ACO) is the individual responsible for administering Cost Accounting Standards for individual Government contractors. While the ACO relies upon the support and expertise of auditors (usually DCAA), the ultimate decision making authority concerning CAS matters rests with the ACO. The auditors will self-initiate compliance reviews of

applicable standards but any alleged finding of non-compliance is reported to the ACO for determination.

In our last newsletter, we discussed two of the ACO's delineated functions; Reviewing Contract CAS Requirements and Evaluating the Disclosure Statement. In this second of three installments, we examine two more functions; Evaluating Alleged Findings of Non-compliance and Reviewing

Accounting Changes. The final installment in this series appearing in our next newsletter will deal with Analyzing Cost Impact Proposals and Determining Contract Price Adjustments and Negotiating Contract Price Adjustments.

At the end of the day, it's the ACO, not the auditor that you need to satisfy on matters pertaining to Cost Accounting Standards.

Evaluating Alleged Findings of Noncompliance

Allegations of CAS non-compliance will involve either a noncompliance with a disclosed accounting practice or noncompliance with a CAS standard. These allegations typically originate with an audit report.

Within 15 days of receiving a report of alleged non-compliance from the auditor, the ACO will make an initial finding of compliance or noncompliance.

If the ACO makes an initial finding of compliance, the process ends. If the ACO

makes an initial finding of non-compliance, the contractor will be given up to 60 days to agree or disagree with the allegation. If the contractor disagrees, it must submit reasons why it considers the existing accounting practice to be in compliance.

As a practical matter, the ACO will almost always issue an initial notice of non-compliance – it provides everyone more time to understand each other's positions.

After the 60 days, ACO will review whatever additional materials are provided and

make a final determination of compliance or non-compliance. If the determination is one of compliance, the issue ends. If it is one of non-compliance, the next step depends on whether the noncompliance is material or immaterial. If immaterial, the ACO will request the contractor to correct the noncompliance. If material, the ACO will require correction and request the contractor submit a general dollar magnitude proposal showing the cost impact of the noncompliance.

Reviewing Accounting Changes

There are two types of accounting changes. One results from new or revised Cost Accounting Standards ("required" changes) and the other from voluntary accounting changes (either "unilateral" or "desirable" accounting changes). Voluntary accounting changes are much more frequent than required changes. Required changes may require an equitable adjustment for contracts

awarded prior to the effective date of the new or revised standard.

Unilateral accounting changes will usually require a cost impact proposal unless it is obvious that there is no impact. Unilateral accounting changes cannot increase costs to the Government. From the contractor's perspective, a "desirable" change is better than a unilateral change but it is also the hardest to justify. The ACO will

consider whether the change improves the cost allocation process and whether funds are available to pay potentially increased costs on existing contracts.

Whatever accounting change is being considered, the ACO will rely heavily on audit input in its determination process. A cost impact proposal is typically required.

Random Musings

IRS Announces 2009 Standard Mileage Rate – Beginning January 1st, the standard mileage rate for business use of a car is 55 cents per mile. In 2008, the rate was 50.5 cents per mile for the first half of the year and 58.5 cents per mile for the second half.

Beginning April 3rd, employers will need to implement the new Form I-9, Employment Eligibility Verification. Pay attention to the listing of documents acceptable for employment eligibility as the list has become shorter.

In January, Homeland Security and Governmental Affairs Committee Chairman Joe Lieberman announced the creation of a new subcommittee to oversee federal contracting. Senator Claire McCaskill will chair the new Subcommittee on Contracting Oversight. Senator McCaskill said that she “can’t wait to get to work saving huge money for taxpayers”.

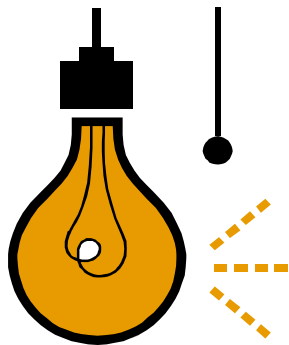
GAO unveiled its “High-Risk” list of Federal programs most

susceptible to waste, fraud, abuse, and mismanagement. DOD Contract Management made the list again – every year since 1992. DOD needs to be more pro-active, perform better risk assessments, follow its own guidance and better train its employees. They’ve been saying this since at least 1973.

The newly formed Commission on Wartime Contracting in Iraq and Afghanistan held its first hearing in February with testimony from Senators and Inspector Generals. It was formed to ensure that in the future, the government pays fair and reasonable prices for the goods and services ... and receives full value as goods are deployed and services are rendered. One of its mandates is to review the use of contractors in combat zones.

DCAA recently revised audit guidance (CAM 6-1008b) to require its auditors, when reviewing interim public vouchers, to reconcile billed costs to the contractor’s accounting records.

To find out where dead politicians are buried, visit www.politicalgraveyard.com.



Bye Bye Auditor Judgment

DCAA recently issued new guidance that will severely restrict the auditor’s authority to exercise judgment in audits of contractor internal control systems.

On December 19, 2008, DCAA issued new guidance for auditing and reporting on internal control audits. This guidance represents a significant change in the way that DCAA reports internal control deficiencies and adds the requirement to recommend withholding contract payments.

Previously, audit reports on internal control systems could have one of three opinions; adequate, inadequate in part, or inadequate. Any of these opinions could also have a section dealing with suggestions to improve the system. Under the new

guidance, inadequate in part opinions and suggestions to improve the system are no longer permitted. Now, audit reports on internal controls that report any significant deficiencies or material weaknesses will include an opinion that the system is inadequate – even if only a small part of the system is inadequate.

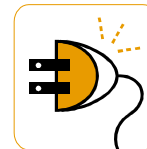
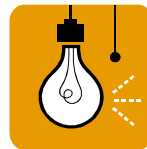
Furthermore, these opinions will be accompanied by recommendations to the contracting officer that he pursue suspension of a percentage of progress payments or reimbursement of costs. How this suspension will be calculated is anyone’s guess right now.

This new guidance severely restricts the discretion of DCAA field auditors in exercising judgment in making determinations as to the significance of internal

control weaknesses and recommendations as to the adequacy of internal control systems. This restriction on auditor judgment as converted the internal control audit process from one in which internal control deficiencies are to be viewed objectively as to their impact on contractor costs and operations to one in which contractor failure to accomplish any inter control objectives could automatically result in a determination that the system is inadequate with a recommendation that the contracting officer suspend payment.

We believe that this new guidance is contrary to GAGAS 3.23 which requires that professional judgment should be used in planning and performing audits ... and in reporting the results.

What ...! Our incurred cost proposal's been rejected!



Internal Control Objectives



On the previous page, we discussed DCAA's new guidance to the effect that a deficiency in any control objective renders the internal control system inadequate. What are "control objectives"? It depends upon the particular internal control system.

DCAA concentrates on 10 internal control systems. Each of those systems has several objectives associated with them.

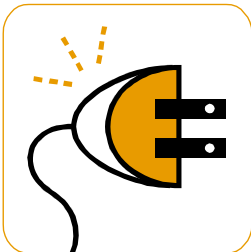
For example, the audit of labor has eight control objectives. Examples include:

- monitoring the overall integrity of the labor/timekeeping system
- reasonably assure that all employees are aware of the importance of proper time charging
- controls the accumulation and recording of labor costs allocable to

cost objectives for the purpose of determining proper cost reimbursement on Government contracts,

Prior to any internal control review, you should familiarize yourself with the objectives of the planned audit. All ten internal control audit programs and the associated internal control objectives are available on the DCAA website at www.dccc.mil under Standard Audit Programs.

Reconciling Billings to Accounting Records



DCAA recently revised its audit guidance for reviewing interim public vouchers to include a reconciliation of billed costs to the contractor's accounting records.

DCAA does not review every public voucher. It uses sampling techniques to select specific vouchers for review. These reviews consist of:

- A comparison of the voucher information

to related information in the auditor's files such as the contract briefing card

- Determination that contractor used the approved billing rates
- Determination that claimed fees are properly computed
- Determination that claimed amounts are not precluded by contract terms and

provisions

- The vouchers are mathematically accurate, and
- Tracing claimed amounts to the contractor's accounting records.

At major contractors, these reviews are performed prior to approving the voucher. At non-major contractors, these reviews are performed on the auditor's next visit.

Reporting Suspected Contractor Fraud and Other Irregularities

On February 9, 2009, DCAA issued new fraud reporting guidelines in the form of a "reminder" streamlining the process for submitting DCAA Form 2000s. "Form 2000" is DCAA's vehicle to elevate indications or suspicions of contractor fraud and other contractor irregularities to investigative agencies.

Under the old guidance, DCAA I 7640.16, Form 2000s represented a professional DCAA opinion and therefore required management review and signature.

The first line supervisor had to review the form to ensure it contained information suggesting a reasonable basis for suspicion of fraud, corruption,

or unlawful activity. If not, the form was declined. If so, the form was forwarded on to the manager. The manager reviewed it and either killed it or forwarded it on to Headquarters. HQ also reviewed it and if approved, forwarded it to an investigative agency.

Under the new guidance,

management review is severely restricted. It is "limited to that necessary to ensure clarity" – nothing more.

Now that DCAA management can no longer require a high standard of proof of fraud, we expect to see the number of Form 2000s increase.

Employment Practices

In January, President Obama signed three executive orders that have implications for the employment practices of Government contractors.

First, the Economy in Government Contracting order makes unallowable, all costs from activities undertaken to persuade employees to exercise or not to exercise their the right to organize and bargain collectively. Contractors can however recover costs incurred in maintaining satisfactory relations with employees.

The second order, Notification of Employee Rights under Federal Labor Laws requires contractors to post a notice informing employees of their rights under federal

labor laws. The order authorizes the Secretary of Labor to investigate contractors' compliance. Non-compliant contractors face sanctions such as the termination of existing contracts and a bar on future contracts until compliance is achieved. This also applies to subcontractors.

The combined impact of these two orders is to promote unionization. Contractors will find it increasingly burdensome to speak out against union organizing campaigns while at the same time, be required to post notices that favor union interests.

The third order, Nondisplacement of Qualified

Workers under Service Contracts, requires successor contractors to offer employment to qualified employees who worked under the prior contract. A successor contractor is one who is awarded a follow-n contract to provide the same services at the same location as a previous contractor.

Before offering jobs to the previous contractors' employees, the successor contractor can offer continued employment to its own workers as long as they were employed for the previous three months and would otherwise be laid off.

This order does not apply to supervisory and managerial employees.



Obama issues some Executive Orders that seem to encourage unionization

"Allocability" of Costs

Under Federal Acquisition Regulations (FAR) the only costs a contractor can charge to a Government contract are those that are **allocable** and allowable under FAR Part 31 cost principles, agency supplements, and contract terms. A cost is **allocable** to a Government contract if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. To be **allocable**, costs must meet one of three tests: i) it must be incurred specifically for the contract (i.e. a "direct" cost), ii) it must benefit contracts and other work and can be distributed to them in reasonable proportion to the benefits received, or iii) is necessary to the overall operation of the business, although a direct relationship to a particular cost objec-

tive cannot be shown (see FAR 31.201-4).

There are rarely any disputes involving the first of the three prongs – incurred specifically for a contract. However, the second and third prongs require contractors to show sufficient nexus between the cost and a Government contract. A recent opinion by the US Court of Federal Claims (Teknowledge Corp v. U.S., 2009 WL 57014) illustrates this point.

Teknowledge is an internet transaction company that provides secure transactions over the internet. In 1999, Teknowledge began developing a program for the finance services industry. In 2001, Teknowledge charged (amortized) about \$285 thousand of development costs to its Gov-

ernment overhead pool. Teknowledge argued that these costs were allocable because it benefited the Government through a potential increase in business, potential reduction of indirect costs charged to Government contracts, and continued viability of the company.

The court ruled that these benefits were remote and insubstantial and do not meet the requirement of the FAR standard. The court stated that there needs to exist a sufficient nexus between a given cost and a government contract. The word benefit as defined in the allocability test requires some showing that the cost relates to a government contract, not merely that it promotes the Government's public policy interests.

Allocability requires that contractors show a nexus between the cost and a Government contract.



A great place to begin
your search for new ac-
counting software

Smart Stops on the Web

Awesome QuickBooks Add-ons for 2009 <http://www.sleeter.com/>

Many of our clients use QuickBooks for their accounting so naturally, we keep our eyes open for QuickBooks add-ons that provide useful features at a reasonable cost. Previously, we've discussed a couple of web-based timekeeping systems in this space and last year, we alerted read-

ers to Awesome QuickBooks Add-ons for 2008. The Sleeter Group recently issued its annual update of QuickBooks add-ons. These add-ons won because of their superior design, implementation and features, and conformity to good accounting principles and operating standards.

If you would like to access your accounting system anywhere at any time,

check out a hosted solution from Right Networks. If you would like to store all of your source documents electronically off-site but still be able to link it to QuickBooks, check out SmartVault. It provides visual association between QuickBooks transactions and stored documents. If you're still evaluating web-based timekeeping systems, check out Big Time Time and Billing.

Interesting Software – Power Utility Pak (Excel)

Power Utility Pak Version 7 (PUP v7) is a useful collection of add-ins that brings significant new functionality to Excel 2007. When PUP is installed, you can do things with Excel that you never thought were possible. Regardless of your experience level, you'll find features in PUP that can make your job easier. PUP v7 augments Excel with about 70 new commands and 53 new worksheet functions. The

product is designed to work seamlessly with Excel 2007. If you use an earlier version of Excel, PUP v6 is for you.

If you spend your life in Excel like we do, this utility is well worthwhile. While we don't use most of the added functionality, the commands and functions we do use make it well worth the price. The price is \$40 but quantity discounts are available. You can download a trial version at no

cost.

One of our favorites is "Create Workbook Contents Sheet" This utility adds a new worksheet, which functions as a table of contents for quick navigation to other sheets in the workbook. Choose between hyperlinks or buttons.

Download and try it out:
<http://spreadsheetpage.com>.

Need Training?

PNWC provides specialized training in a variety of government contracting areas. Our standard training modules generally take three to four hours while our extended training modules are designed for one and two days. PNWC training qualifies for CPE in most states.

PNWC training modules are continuously updated to

reflect the most current regulations and trends in the Government including current high risk areas identified by DCAA.

Current training modules include:

- Truth in Negotiations (TINA)
- FAR Cost Principles (Allowable and Unal-

lowable costs)

- Internal Controls over Labor and Timekeeping
- Internal Controls over Estimating Systems
- Ethics for Government Contractors
- Terminations and Claims.



Increased Emphasis on Financial Capability

The Defense Contract Audit Agency recently issued an alert to its auditors to be on the lookout for adverse financial conditions that could affect contractors' ability to perform on Government contracts.

The current economic conditions and issues related to financial markets have increased risks associated with contractors' continued financial viability. Contractor cash flow or other financial difficulties may disrupt production schedules, cause inefficient use of resources, and result in contract nonperformance.

Under DoD guidance, the contracting officer has the responsibility to make a determination of financial responsibility. DCAA has the responsibility to provide all necessary financial advisory services to the con-

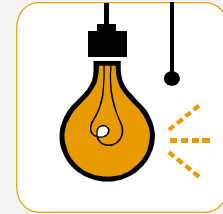
tracting officer. Sometimes, financial capability audits are initiated in response to a specific contracting officer request. However, regardless of whether a request is made, DCAA will initiate its own financial capability risk assessment at every contractor with Government sales over \$1 million in conjunction with other audits. If no audits are planned or conducted, DCAA typically will not make a special effort to conduct the risk assessment unless there is a compelling reason.

DCAA's recent alert is advising auditors to be particularly alert for situations where contractors may try to inappropriately accelerate billing costs to the Government in order to improve its cash flow. Look for increased activity when auditors are reviewing progress payments, testing for direct billing eligibility, billing system reviews, and reviews of interim

vouchers (public vouchers).

The audit alert provides specific indicators of possible unfavorable financial conditions. These include:

- Increase in the aging and amounts of accounts payable
- Defaults of loan/line of credit agreements
- Denial of usual trade credit from suppliers
- Restructuring of debt with higher interest rates
- Noncompliance with loan/line of credit covenants
- Failure to fund pension plans
- Loans from employees or issuing stock to employees in lieu of salary
- Significant unpaid debts and/or liabilities
- Unusual progress payments or other billing concerns
- Poor physical condition of the work facilities.



Don't believe that no one from the Government will ever check to see if you comply with the new ethics regulations.

Defense Business Board Report on DCAA

The Independent Review Panel under the Defense Business Board (DBB) recently issued its report on DCAA operations and made several recommendations for improving DCAA mission, strategic planning, culture, structure, and business practices.

Most of the DBB's recommendations involve matters internal to DCAA and if implemented, are not likely to have an immediate impact on contractors. There are a couple of recommendations however that have the potential of in-

creasing audit oversight at contractor facilities.

The DBB noted that while DCAA staffing has remained relatively constant since 2000, DoD contract actions have increased 328 percent. DBB recommended that DCAA obtain an independent assessment of resource needs to ensure the organization was properly staffed to provide GA-GAS compliant audit coverage. If the outcome of the independent assessment is more audit staff for DCAA, contractors might eventually see increased

audit activity.

Another recommendation with the potential for increased oversight was DBB's concern that that a significant amount of spending is not audited. Competitive contract spending increased 130 percent from 2000 to 2006 and represents 62 percent of DoD contract dollars. DBB believes that expanding DCAA's ability to self-initiate high-risk audits based on its own risk assessment could increase the potential for achieving higher rates of return to the taxpayer.

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From left, Ron Sabado, Paul Cederwall, Bill Vermie, and Terry Nuzzo.

Pacific Northwest Consultants, LLC

PNWC is dedicated to providing Government contract consulting, litigation support, and training services. We provide affordable consulting and training services to help Government contractors grow their business, increase profits, and comply with Government contracting

rules and regulations.

PNWC's consulting and training services include forward pricing, incurred cost, terminations and equitable adjustments, cost accounting standards and defective pricing allegations. We assist in developing adequate internal control systems and

company-wide ethics programs.

PNWC staff has extensive teaching experience. They have developed and presented training classes covering all aspects of Government contracting.

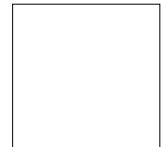
Our Staff

Pacific Northwest Consultants, LLC was formed in January 2006 by four individuals who decided to combine their various expertise and interests into a full-service Government consulting group. Com-

bined, PNWC's consultants and trainers have over 120 years of Government contracting experience with the Defense Contract Audit Agency. Two of the four are licensed CPAs and hold a variety of other ad-

vanced degrees and certifications. All have had teaching experience at the collegiate level.

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