



DOECAA Spring Conference Presentation

Cost Reimbursement Contracting Issues - DOE Proposed Business System Rule

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Implementing and Maintaining Adequate Contractor Business Systems in Light of DOE Proposed Business System Rule

The Impetus for the DoD Business Systems Rules

- Audits of contractor systems became outdated (i.e. DCAA audits, DCMA audits for DoD contractors).
- DCAA began to receive heavy scrutiny from the Government Accountability Office (GAO) related to its audit performance.
 - The GAO, which reports to Congress, found that the DCAA was issuing audit findings of “inadequate in part” for contractors with significant deficiencies. (July 2008 GAO Report).
- In June of 2009, the Commission on Wartime Contracting issued its first interim report recommending, among other things, increased oversight and improved effectiveness of contractor business systems.

- On February 24, 2012 the DoD Defense Acquisition Regulation Council adopted a final rule regarding improved effectiveness and oversight of contractor business systems. (DFARS Case 2009-D038)
- DoD rule defines six business systems, their applicability, and criteria for approval on DoD contracts:
 - Accounting System
 - Earned Value Management System (“EVMS”)
 - Estimating System
 - Material Management and Accounting System
 - Property Management System
 - Purchasing System
- Implements for DoD contracts a DFARS Contractor Business Systems clause that addresses the administration of the review and approval of business systems and Government remedies for disapproved systems.

- DOE recently published a proposed rule (Fed Reg. 4/1/14) that will implement a DEAR clause similar to the DFARs Business Systems requirements.
 - Business systems are similar to the DoD defined systems; however, Material Management (MMAS) is excluded as a DOE business system, leaving five business systems for DOE.
 - A Business System Administration DEAR Clause (952.242-71) will be included in solicitations and contracts that include any of the five business system clauses.

Five Business Systems

Business System	DEAR Clause
Accounting System	952.242-72
Cost Estimating System	952.215-71
Earned Value Management System	952.243-71
Purchasing System	952.244-71
Property Management System	952.245-70

Overarching Requirements of Rule

- Contractors are required to establish and maintain acceptable business systems in accordance with the terms and conditions incorporated in the contract (i.e., the relevant Business Systems DEARS clauses incorporated in the contract).
- Contractors required within 60 days of contract award to have acceptable business systems.

- DOE findings that for major projects EVMS indicators were not providing sufficient status on success/issues on projects. Contractors not timely informing DOE of significant cost or schedule increases.
- DOE seeking “tools to improve contract/project management and contractor’s business systems to ensure the systems provide timely, reliable information for the management of DOE projects/programs.”
- DOE projects adequate business systems will be key to effective contract and project management:
 - Business systems and internal controls seen as first line of defense against Government payment of unallowable or unreasonable costs, and potential fraud, waste, or abuse.

DOE Proposed Rule - Applicability

- M&O contracts are exempted from the proposed rule. Expected that future issuance of a separate rule for M&O contracts will be forthcoming.
- Clauses apply to **prime contracts awarded to large businesses**, including contractor teaming arrangements, in excess of \$50 million, including options.
- Contracts greater than \$10 million including options, but <\$50 million, where CO believes in best interest of Government.
- Fixed-priced contracts awarded on the basis of adequate price competition (except EVMS n/a for fixed-price).
- Cost reimbursement contracts subject to Cost Accounting Standards.

- Small Business
- M&O Contracts
- Energy savings performance
- Advisory and assistance services
- Utilities
- Security guard and housekeeping services
- Office of Deputy Administrator Naval Reactors
- National Environmental Policy Act of 1969 Support
- Orders against another Federal agency contract (e.g., GSA Schedule)
- Education and Training

- Proposed rule provides that solicitations (post final rule) will include the new business system DEARs clauses, specifying the systems that must be adequate.
- Proposed rule also provides that the business system requirement may be adopted on existing contracts through bilateral agreement.
- One overall Business System Clause will be incorporated in the DEARs, triggering the requirement for adequate systems and remedies for significant deficiencies.
- One or more of five system-specific clauses will be incorporated in each contract based on business systems deemed relevant to the contract.
- Rule will be applied prospectively after incorporation in affected contracts.

- **Contractors will submit documentation supporting system adequacy** within 60 days of contract award.
- CO/CO's designee/auditor will evaluate and determine whether system complies with criteria identified in clause.
- CO's designee documents findings and makes recommendation in report to CO. Report details any **significant deficiencies**.
- Initial determination made by CO and communicated to contractor whether system is acceptable and approved, or if there are significant deficiencies, where system does not meet criteria.
- Contractor has 30 days to respond if system not approved.
- CO evaluates response and makes final determination. If system disapproved, payment withholds start after contractor notified. (see next slide for more detail).

“Significant Deficiency”

- A significant deficiency is defined as:
 - “a shortcoming in the system that materially affects the ability of officials of the Department of Energy and the contractor to rely upon information produced by the system that is needed for management purposes.”
- If the CO, in his/her **final determination**, decides that the contractor’s business system contains significant deficiencies, the final determination will include a disapproval of the system and a notice to withhold payments.
 - 5% for one or more significant deficiencies in any single business system
 - Up to 10% for one or more significant deficiencies in multiple systems
- Contractors have 45 days to correct the deficiency or submit a corrective action plan to correct it.
- To be subject to a withhold, a contract must have both the Contractor Business System Clause and the applicable business system clause for the business system containing the deficiency.

- Withholds can be affected on cost reimbursement vouchers, progress billings, or performance-based billings. Withholds can occur on cost-reimbursement, time and materials, fixed-price, incentive-type, and labor-hour contracts.
- Contractor receives withheld payments once **significant deficiencies** are resolved or at contract closeout.
- Prompt Payment Act interest is not applicable to withheld funds because those funds are considered “contract financing payments.”
- ACO final decision to withhold payment is not a final decision for purposes of the Contract Disputes Act.
- If significant deficiencies are not corrected, the CO can recommend non-award of potential future contracts.

DOE Business System Rule Contrasted to DoD Rule



- DOE appears to have essentially adopted the DoD business system requirements, excluding the MMAS system.
- DOE rule could prompt action by FAR Council for similar requirement across all agencies.
- **Significant deficiency** and **withhold provisions** are defined similar to DoD rule: “a shortcoming in the system that materially affects the ability of officials [at Department of Energy] to rely upon information produced by the system that is needed for management purposes.”
- DOE recognizes contractors at each DOE site will provide documentation to support the system criteria they are using for that contract. They can leverage predecessor and/or DoD documentation and reviews for DOE purposes.
- DOE appears to put more onus on contractor to self-assess/certify adequacy status of business systems.

Example of Business System Withholds

- Lockheed Martin was the first company to have payments withheld under the Business System Rule. Issues related to legacy EVMS matters. EVMS findings identified 19 of 32 areas that were considered deficient. DCMA performed follow-up audits and identified significant deficiencies were not corrected.
- Government began applying withholds at 2% on LMC's \$4 billion F-35 production contract. Withholds estimated at \$1 million a month; totaled \$46.4 million.
- Northrop Grumman - \$1.4 million
- BAE Systems - \$19 million
- Boeing - \$5.2 million

- Business System Audits are used for multiple purposes:
 - To assess audit risk:
 - A contractor with a system found to be adequate should have less audit oversight and scrutiny in the way of substantive testing
 - System inadequacy would result in an increase in the level of testing necessary on audits
 - To assess contractor qualifications in a solicitation. Many proposals include requirements for approved systems.
 - To be eligible to receive certain types of contracts (Accounting System, for cost-type contracts).
 - To enter into subcontracts without need for consent or approval (Approved Purchasing System).

Example - Accounting System Criteria

1. Sound internal controls
2. Segregation of direct from indirect costs
3. Accumulate direct costs by contract
4. Accumulate and allocate indirect costs to intermediate and final objectives
5. Accumulate costs in general ledger
6. Reconcile subsidiary ledgers to general ledger
7. Approve/document adjusting entries
8. Periodic monitoring of system
9. Timekeeping system for employees by cost objective.
10. Labor distribution system for charging direct and indirect labor to cost objectives
11. Routine (at least monthly) posting of books of account
12. Excludes unallowable costs (FAR Part 31 and other contract provisions)
13. Identify costs by CLIN and units if required by contract
14. Segregate preproduction from production costs
15. Cost accounting info required by contract clauses
 - Limitation of Funds/Costs
 - Allowable Cost and Payment Clause
 - To readily calculate indirect cost rates from books of accounts
16. Billings can be reconciled to cost accounts for current and cumulative amounts claimed and to comply with contract
17. Adequate, reliable data for pricing follow-on acquisitions
18. Compliance with CAS and GAAP

Estimating System Criteria

1. Clear responsibility for cost estimates and budgets
2. Organization and duties of people responsible for cost estimates and budgets
3. Sufficient training, experience, and guidance
4. Data sources, estimating methods, and rationale
5. Adequate supervision
6. Consistent application
7. Error detection and correction
8. Avoid duplication and omission
9. Historical experience
10. Appropriate analytical methods
11. Integrate information available from other management systems
12. Management review
13. Internal review
14. Update cost estimates timely
15. Ensure reasonable subcontract prices
16. Sound proposals adequate to reach fair and reasonable price
17. Adequate system description

Government Property System Criteria

1. Document acquisition of Government Property
2. Document receipt of Government Property
3. Create and maintain records of Government Property accountable to the Contract
4. Periodically perform, record, and disclose physical inventory results
5. Subcontractor control
6. Reports of discrepancies; loss, theft, damage or destruction
7. Relief of stewardship responsibility
8. Utilizing Government Property
9. Maintenance of Government Property
10. Contract property close-out
11. Internal review and audits
12. Establish and maintain Government accounting source data as required by the contract (i.e., recognition of acquisition and dispositions of materials and equipment)

Earned Value Management Criteria

- Applicable to Capital asset projects on cost or incentive contracts and subcontracts based on dollar thresholds.
 - For contracts >\$20 million, Contractor must use an EVMS that complies with 32 EVMS guidelines in the American Standards Institute/Electronic Industries Alliance Standard 748 (ANSI/EIA-748).
 - Contracts >\$20 million but <\$50 million, Contractor must conduct self-certification reviews and periodic surveillance reviews.
 - Contracts >\$50 million but < \$100 million, DOE Program Office (OAPM) will conduct certification reviews and periodic surveillance reviews.
 - Contracts <\$20 million and fixed-price contracts, EVM not required unless CO determines benefit outweighs cost.
- Contractor will provide to DOE notification of any proposed substantive changes to its EVMS and the impact of the changes.
- If contract is over \$50 million, changes require advance approval, unless a waiver is granted.

Purchasing System Criteria

1. Adequate system description
2. Applicable purchase orders (POs) and subcontracts contain all flow-down clauses
3. Clear lines of responsibility and authority
4. Purchase orders based on authorized requisitions
5. Document history of purchase transactions to support vendor selection and price
6. Consistent make-or-buy policy
7. Competitive sourcing which excludes debarred or suspended contractors
8. Evaluate price, quality, delivery, technical and financial capabilities of competing vendors
9. Management level justification and cost or price analysis for sole or single source award
10. Adequate cost or price analysis, tech evaluation to ensure fair and reasonable prices
11. Document negotiations in accordance with FAR 15.406-3
12. Seek, take, and document discounts
13. Select proper contract type and prohibit cost-plus-percentage-of-cost subcontracts
14. Subcontract surveillance to ensure timely delivery of acceptable product and to notify Government of potential subcontract problems that may impact delivery, quantity, or price
15. Justify subcontract changes that affect cost or price

Purchasing System Criteria (cont.)

16. Notify the Government of all subcontracts with flow-down clauses that allow for Government audit
17. Policies on conflict of interest, gifts, and gratuities and Anti-Kickback Act
18. Perform internal audits, training, and maintain policies to ensure integrity of the purchasing system
19. Policies to ensure POs and subcontracts contain mandatory flow-down clauses required by FAR and prime contract provisions
20. Org. and admin. structure for procurement of required quality materials and parts at the best value from responsible and reliable sources
21. Selection processes ensure most responsive and responsible sources for furnishing required quality parts, materials and to promote competitive sourcing among dependable suppliers
22. Procedures for adequate price or cost analysis on purchasing actions
23. Procedures to ensure proper types of subcontracts are selected and that there are controls over subcontracting, including surveillance
24. Procedures to ensure Contracting Officer is notified in writing if Contractor changes subcontracts after award to >70% of total cost of work performed and verify Contractor added value or any subcontractor increases value of lower-tier subcontracts to >70%

Status of Proposed Rule

- Proposed Rule published in Federal Register April 1, 2014 – see Federal Register Vol. 79, No. 62
- Public comment period open through June 2, 2014
- Comments should be submitted to DEARrulemaking@hq.doe.gov
- Federal Register includes other methods of submitting comments

Proactive Business Systems Compliance Considerations

- DOE rules contemplate contractor self assessment and representation regarding adequacy of the business systems
- Contractors should designate resources, either internal or external, to project manage and complete internal assessments of adequacy of the five business systems
- Documentation should be prepared that can be shared with DOE
- Any deficiencies should be addressed by the development of corrective action/remediation plan

- A critical element of compliance with Business System requirements is integrating the ownership of the various systems with the individual control owners
- Integration need not be in the context of the individual Business Systems
- Identifying the various control owners for each system criteria
- Assign responsibility of controls to each control owner
- Ensure that the control owners know why the requirement exist s
- Ensure the owners are adequately trained on their respective control requirements

Several steps can be taken to develop the proper control environment:

- Ensure a system of controls exists for all finance and contract functions
- Develop a methodology to assess system and control risk on a periodic basis
- Develop process for periodic monitoring and assessment of compliance
- Develop a table of authorities/delegation of authorities
- Periodically assess segregation of duties
- Develop a process for management monitoring of systems
- Utilize dashboards and metrics to report to management/Audit Committee
- Develop a robust set of written policies and procedures addressing various compliance requirements addressing various compliance requirements

- Prepare for system reviews/audits – even if you do not have covered contracts
- Document systems as they relate to the regulatory criteria and controls
 - Utilize documentation processes similar to Sarbanes Oxley (SOX)
 - Develop control matrices identifying control requirements, owners and how the control objective is met
 - Track changes to systems and notify Government of changes.
- Supplement your contract briefing process to identify
 - Applicability of the various business system clauses
 - CAS applicability
- For disapproved systems:
 - Ensure that any withholds are being applied properly
 - Develop a tracking mechanism to track withholds by contract – communicate to Contracts and Billing functions
 - Bill progress payments at full amount (Government will withhold from them) and bill interim payments net of withholding

- To the extent an internal assessment of a Business System reveals a deficiency or weakness in the system, the Contractor should develop a detailed corrective action plan addressing the deficiency to include milestones and actions to eliminate any deficiencies
- All corrective action plans and the correction of deficiencies should be documented.
- By demonstrating corrective action plans in advance of an audit, contractors can mitigate future system disapproval and minimize the potential withhold percentages
- An established process for assessing systems and remediating identified deficiencies also demonstrates sound management monitoring and oversight