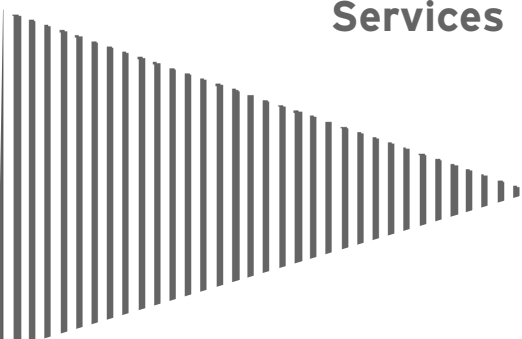


Government Contract Services



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DOE issues for-profit audit guidance

In February, the Department of Energy (DOE) released audit requirements regarding for-profit recipients and subrecipients. Initially announced in a DOE policy flash, 2011-7,¹ the guidance was distributed in a subsequent DOE policy flash, 2011-46.²

The issuance of this guidance follows a DOE Inspector General (IG) report, Solar Technology Pathway Partnerships Cooperative Agreements,³ where the IG noted that its review "...revealed that the Department's financial monitoring of the \$120 million expended for these projects was not always adequate. The IG report further stated "...the Department had neither ensured that recipients complied with audit requirements nor had it requested audits of costs incurred by recipients." The report further stated, "Problems with financial monitoring were caused by insufficient Departmental guidance concerning audits of for-profit organizations receiving financial assistance. While there is existing guidance on audit requirements for Federal assistance to states, local governments and non-profit entities, such guidance does not exist for for-profit entities. For example, the Department's Guide to Financial Assistance (the Guide) describes in detail the Department's processes for tracking, collecting, reviewing and following up on audits of states, local governments, and non-profit entities; however, the Guide is silent on audits of for-profit organizations required under 10 CFR 600.316."³

As set forth in the newly issued audit guidance, "Under Regulation 10 CFR 600.316, a for-profit recipient that expends \$500,000 or more in a year under DOE Federal awards must have an audit made for that year by an independent auditor. This requirement also applies to for-profit subrecipients. The audit generally should be made a part of the regularly scheduled, annual audit of the recipient's financial statements."⁵

The guidance further states: "For recipients, financial statement and compliance audit submissions are due to DOE within six months of the recipients' fiscal year-end dates. For subrecipients, financial statement and compliance audit submissions are due to the pass-through entity within six months of the subawardees' fiscal year-end dates. For the initial implementation of this guidance, submissions are due to DOE or the pass-through entity, as applicable, no later than June 30, 2011."⁴

Federal Acquisition Circular (FAC) 2005-50

Federal Acquisition Circular (FAC) 2005-50⁶ was published in the Federal Register on March 16, 2011 and encompassed the following Federal Acquisition Regulation (FAR) cases:

- ▶ FAR Case 2008-030, Proper Use and Management of Cost-Reimbursement Contracts (Interim)
- ▶ FAR Case 2007-012, Requirements for Acquisitions Pursuant to Multiple-Award Contracts (Interim)
- ▶ FAR Case 2009-038, Justification and Approval of Sole-Source 8(a) Contracts (Interim)
- ▶ FAR Case 2008-007, Additional Requirements for Market Research
- ▶ FAR Case 2011-004, Socioeconomic Program Parity (Interim)
- ▶ FAR Case 2008-034, Use of Commercial Services Item Authority
- ▶ FAR Case 2009-040, Trade Agreements Thresholds
- ▶ FAR Case 2009-025, Disclosure and Consistency of Cost Accounting Practices for Contracts Awarded to Foreign Concerns
- ▶ FAR Case 2009-026, Compensation for Personal Services

Much of the interim rule in this FAC appears to address the internal handling of certain procurement matters by the Government...as discussed below.

Proper Use and Management of Cost-Reimbursement Contracts (Interim).

Required by the FY 2009 DoD Authorization Act, the interim rule provisions affect the Government's award of cost-reimbursement contracts. The provisions contemplate a Government acquisition plan to justify the use of these high-risk contracts (versus firm fixed price) that is approved and signed by an official at least one level higher than the contracting officer. To better assure program oversight, the interim rule also requires the appointment of a qualified Contracting Officer's Representative (COR) (such as a Contracting Officer's Technical

Representative (COTR)) prior to contract award. One might infer these internal requirements could discourage acquisition officials from using cost-reimbursement contracts in the future.

Requirements for Acquisitions Pursuant to Multiple-Award Contracts (Interim).

Also required by the FY 2009 DoD Authorization Act, this interim rule ostensibly increases the transparency of certain contract awards in excess of the Simplified Acquisition Threshold (including those under Federal Supply Schedules (FSS)). Specifically, the provisions require that, "For each individual purchase of property or services in excess of the simplified acquisition threshold (SAT) that is made under a multiple-award contract, section 863 requires the provision of fair notice of intent to make a purchase (including a description of the work to be performed and the basis on which the selection will be made) to all contractors offering such property or services under the multiple-award contract. In addition, the statute requires that all contractors responding to the notice be afforded a fair opportunity to make an offer and have that offer fairly considered by the purchasing official. A notice may be provided to fewer than all contractors offering such property or services under a multiple-award contract if the notice is provided to as many contractors as practicable." One might question why a purchasing official would make such an award in the first place given provisions to subject the acquisition to subsequent bids.

Justification and Approval of Sole-Source 8(a) Contracts. Required under the FY 2010 Defense Authorization Act, this interim rule introduces a requirement for a Justification & Approval (J&A) for the award of sole source 8(a) contracts more than \$20 million. The provisions require, at a minimum, that the justification include the following information:

- ▶ "A description of the needs of the agency concerned for the matters covered by the contract"
- ▶ "A specification of the statutory provision providing the exception

from the requirement to use competitive procedures in entering into the contract (see 19.805-1)"

- ▶ "A determination that the use of a sole-source contract is in the best interest of the agency concerned"
- ▶ "A determination that the anticipated cost of the contract will be fair and reasonable"

The interim rule is expected to negatively affect Alaska Native Corporations (ANCs), Indian tribes and Native Hawaiian organizations. Generally, federal agencies are allowed to make sole-source contract awards to 8(a) contractors of up to \$3.5 million for services and \$5.5 million for manufacturing. There is no such dollar restriction on awards to tribal corporations.

The impact of the interim rule provisions on Alaska Native Corporations (ANCs), Indian tribes and Native Hawaiian organizations has been acknowledged by the FAR Council and a series of hearings has been scheduled in Washington; Albuquerque, N.M.; and Fairbanks, Alaska consistent with the requirements of Executive Order 13175.

Also U.S. Senator Claire McCaskill (D-Mo.) recently introduced legislation (similar to her past efforts) that will eliminate the unique government contracting preferences afforded ANCs.

Socioeconomic Program Parity (Interim).

In May 2009, the General Accounting Office (GAO) sustained a protest, Mission Critical Solutions, B-401057,⁷ that found a HUBZone firm had precedence in a small business award. The finding resulted in considerable confusion within the contracting community. The FAR Council subsequently issued this interim rule implementing Section 1347 of the Small Business Jobs Act of 2010 (Pub. L. 111-240) that states there is parity when a contracting officer selects among small businesses participating in the 8(a), HUBZone and Service Disabled Veteran Owned Small Business (SDVOSB) programs - the interim rule indicates there is no order of precedence.

The interim rule does not address the new Women-Owned Small Business (WOSB) program - WOSB is the subject of FAR Case 2010-015; additional guidance was recently introduced and will be discussed in the next issue.

Defense Federal Acquisition Regulation Supplement (DFARS) proposed rule - business systems update

Business systems means all of the following:

- ▶ Accounting system
- ▶ Earned value management system
- ▶ Estimating system
- ▶ Material management and accounting system
- ▶ Property management system
- ▶ Purchasing system

DoD had published a proposed rule for Business Systems - Definition and Administration (DFARS Case 2009-D038) in the Federal Register on January 15, 2010 (75 FR 2457) that elicited considerable comment; DoD subsequently published a revised proposed rule incorporating many of those 370 comments; responses on the revision were due on January 10, 2011 and issuance of a final rule is expected soon.

With substantive changes incorporated into the rule revision, many reflecting Government agency comments, there remain some industry concerns. The Council of Defense and Space Industry Associations (CODSIA) issued comments on the second proposed rule - some of these expressed concerns are provided below.⁸

- ▶ "Neither the original nor the current version of the proposed business systems rule contain a requirement that DCAA identify evidence of the actual or potential cost impact of the system deficiencies it has identified prior to the imposition of a payment withhold. Our comments on the business systems rule as initially proposed identified this absence as a

major flaw in the proposed regulation because, without evidence of a causal nexus between the deficiency identified and the likely magnitude of unallowable costs billed as a result, the amount withheld may be grossly disproportionate to the actual impact."

- ▶ "...CODSIA recommends that the rule must exempt from withholdings fixed-price and performance-based contracts since payments under these contracts are based on contract terms not on the basis of costs incurred."
- ▶ "Firms that 'fail' the current binary adequate/inadequate regime are increasingly unable to get DCAA to conduct the necessary follow-up audits to validate that the company's fixes have been made. While we appreciate the change made in this second proposed rule that provides authority for the contracting officer to reduce the ongoing withholds after a contractor has submitted a corrective action plan, existing withholdings are not released because DCAA is unable to conduct a timely follow-up audit."

Consistent with our earlier observations, contractors should consider reviewing the internal control attributes for the six business systems set forth in the revised proposed rule in anticipation of the issuance of a final rule.

The Defense Contract Audit Agency (DCAA) has initiated pilot audits at various contractor sites in preparation for issuance of the DFARS final rule.

Boeing recovers defense costs when no liability found

The Civilian Board of Contract Appeals (CBCA) found that The Boeing Company (Boeing), successor-in-interest to Rockwell International Corporation (Rockwell), was "entitled to recover Rockwell's defense costs incurred solely in defense of claims for which it was not found liable." (re: Boeing Co. v. Department of Energy, 09-1 BCA ¶ 34,026 (2008)).

In July 1989, a former employee brought a qui tam action against a unit of Rockwell (who later merged with Boeing), alleging violations of various environmental laws and regulations at a nuclear weapons plant. The Government initially declined to intervene, but in 1995 reversed its decision and a joint amended complaint was filed. As to False Claims Act (FCA) claims, a jury was to subsequently find Rockwell liable for three of ten claims in the count.

In the CBCA decision, Boeing, a successor-in-interest, was not able to recover defense costs for a count, wherein the jury found Rockwell liable for three of ten FCA claims. That is, although prevailing on a majority of the FCA claims, the CBCA deemed all of the defense costs unallowable.

The CBCA referred to a contract clause that stated, "Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of any false certification) brought by the Government where the Contractor, its agents or employees, is found liable or has pleaded nolo contendere to a charge of fraud or similar proceeding (including filing of a false certification)."

In so ruling, the CBCA stated, "It seems to this Board that the focus of clause (e)(32) is to disallow defense costs in a, "fraud proceeding or similar proceeding," where the contractor has been found liable. We see no further intent in the wording."

Although the CBCA decision does provide for recovery when no liability is found, it appears that the ruling must be absolute; where a majority of FCA claims are found without merit, it appears that the Contractor is nonetheless denied recovery of defense costs if liable on only one of many claims. If the decision is extended to the application of FAR 31.205-47, *Costs related to legal and other proceedings*, there is arguably a risk when defense costs for defending multiple claims are combined and even if the contractor prevails on a majority of the claims.

DFARS proposed rule - Independent Research & Development (IR&D) reporting requirement

The Department of Defense (DoD) issued a proposed rule (re: DFARS Case 2010-D011)⁹ on March 2, 2011 that requires reporting of IR&D costs for such costs to be deemed allowable in an effort "to increase the effectiveness by providing visibility into the technical content of industry IR&D activities to meet DoD needs."

Proposed at a relatively low threshold, the proposed rule will require DoD contractors whose annual IR&D costs exceed \$50,000 to report the IR&D projects to DoD using the Defense Technical Information Center (DTIC) on-line input form and instructions. The proposed rule states that, "[t]he inputs must be updated at least annually and when the project is completed. Copies of the input and updates must be made available for review by the cognizant administrative contracting officer (ACO) and the cognizant Defense Contract Audit Agency auditor to support the allowability of the costs."

Comments are due on or before May 2, 2011.

Organizational Conflicts of Interest in Major Defense Acquisition Programs

An Organizational Conflict of Interest (OCI) can occur when a firm has access to nonpublic information that could provide a competitive advantage when bidding for a Government contract. A relatively recent focus on potential OCI issues had prompted some contractors to shed portions of their business that appeared to pose potential procurement issues on future programs. Northrop Grumman sold a large Science, Engineering, Technical and Analytical (SETA) contractor (TASC) and Lockheed Martin disposed of Enterprise Integration Group (EIG).

A final rule was published in December 2010.¹⁰ Originally applicable to a wide range of Government contracts, the

final rule is reasonably limited to Major Defense Acquisition Programs (MDAPs).

DFARS proposed rule - display of DoD hotline posters

Implementing a recommendation of the DoD Inspector General (IG), a DFARS proposed rule provides for a DFARS clause to use in lieu of the FAR clause, 52.203-14, *Display of Hotline Poster(s)*. The FAR clause states that contractors who have implemented a business ethics and conduct awareness program, including a reporting mechanism, "...need not display any agency fraud hotline posters, other than any required DHS posters." The proposed rule would require the display of DoD hotline posters at business segments performing DoD contracts as well as at contract work sites.

In addition to the DoD hotline number, we understand DoD is now revising its hotline poster to include information on whistleblower protections.

Comments are due on or before May 10, 2011.

Endnotes

- 1 DOE Flash 2011-7, U.S. Department of Energy Audits of For-Profit Recipients FAQ <http://management.energy.gov/documents/AttachmentFlash2011-7.pdf>
- 2 DOE Flash 2011-46, U.S. Department of Energy Audit Guidance: For Profit Recipients and Subrecipients <http://management.energy.gov/documents/Flash2011-46.pdf>
- 3 DOE IG Audit Report, Solar Technology Pathway Partnerships Cooperative Agreements <http://www.ig.energy.gov/documents/OA-S-M-11-02.pdf>
- 4 DOE Coverage of Independent Audits http://management.energy.gov/business_doe/business_forms.htm

- 5 Title 10: Energy, PART 600-FINANCIAL ASSISTANCE RULES, Subpart D-Administrative Requirements for Grants and Cooperative Agreements With For-Profit Organizations § 600.316 Audits. <http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=40843ccb59f7ea02f39db4f61e2da5fa&rgn=div8&view=text&node=10:4.0.1.3.9.4.22.13&idno=10>
- 6 Federal Acquisition Regulation; Federal Acquisition Circular 2005-50, Federal Register Volume 76, Number 51 (Wednesday, March 16, 2011) <http://gpo.gov/fdsys/pkg/FR-2011-03-16/html/2011-5551.htm>
- 7 GAO B-401057, Mission Critical Solutions, May 4, 2009 <http://www.gao.gov/decisions/bidpro/401057.pdf>
- 8 CODSIA, Re: DFARS Case 2009-D038 CODSIA Case 01-11 [http://www.ndia.org/Divisions/Divisions/Procurement/Documents/CODSIA/DFARS_BusinessSystems_CODSIA011011\(final\).pdf](http://www.ndia.org/Divisions/Divisions/Procurement/Documents/CODSIA/DFARS_BusinessSystems_CODSIA011011(final).pdf)
- 9 Defense Federal Acquisition Regulation Supplement; Independent Research and Development Technical Descriptions (DFARS Case 2010-D011) Federal Register Volume 76, Number 41 (Wednesday, March 2, 2011) Proposed Rules <http://edocket.access.gpo.gov/2011/pdf/2011-4528.pdf>
- 10 Defense Federal Acquisition Regulation Supplement; Organizational Conflicts of Interest in Major Defense Acquisition Programs, Federal Register Volume 75, Number 249 (Wednesday, December 29, 2010) <http://origin.www.gpo.gov/fdsys/pkg/FR-2010-12-29/pdf/2010-32713.pdf>

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