

THE NEWSLETTER FROM THE BDO GOVERNMENT CONTRACTING PRACTICE

# BDO KNOWS: GOVERNMENT CONTRACTING



## ACCOUNTING SYSTEM: BUSINESS SYSTEM AND INTERNAL CONTROL REQUIREMENTS FOR FEDERAL CONTRACTORS

By John Van Meter and Giacomo Apadula

Contractors often find it challenging to identify business systems and associated internal controls requirements embedded in their federal contracts. This "identification" challenge directly impacts a contractor's ability to meet system design/implementation requirements and to effectively monitor its federal contracts' compliance requirements. Simply consider the established timeline of accounting system requirements and the various regulatory and advisory direction issued across government authorities over the last few years (as interpreted in the cycle of federal contracts):

Using this timeline of events, let's consider three contractors with varying business models to understand the complexity of requirements for one business system, the accounting system and/or related system of internal controls:

- **Contractor A:** A company that sells commercial services to various federal agencies under GSA multiple award schedule (MAS) contracts. Contracts exceed \$5 million and a 120-day period of performance.
- **Contractor B:** A small business receiving Department of Defense (DoD) and other

### DID YOU KNOW...

According to **Bloomberg Government**, the total federal IT budget proposed by President Obama would grow to \$86 billion, a 2.7 percent increase above the current year's levels.

Nonprofit research center **Good Jobs First** reports that 49 of the federal government's top 100 contractors also won grants, loans or tax credits over the past 15 years.

Government agencies spent more than \$500 billion on outside products and services in 2012, according to recent data from the **Congressional Budget Office**.

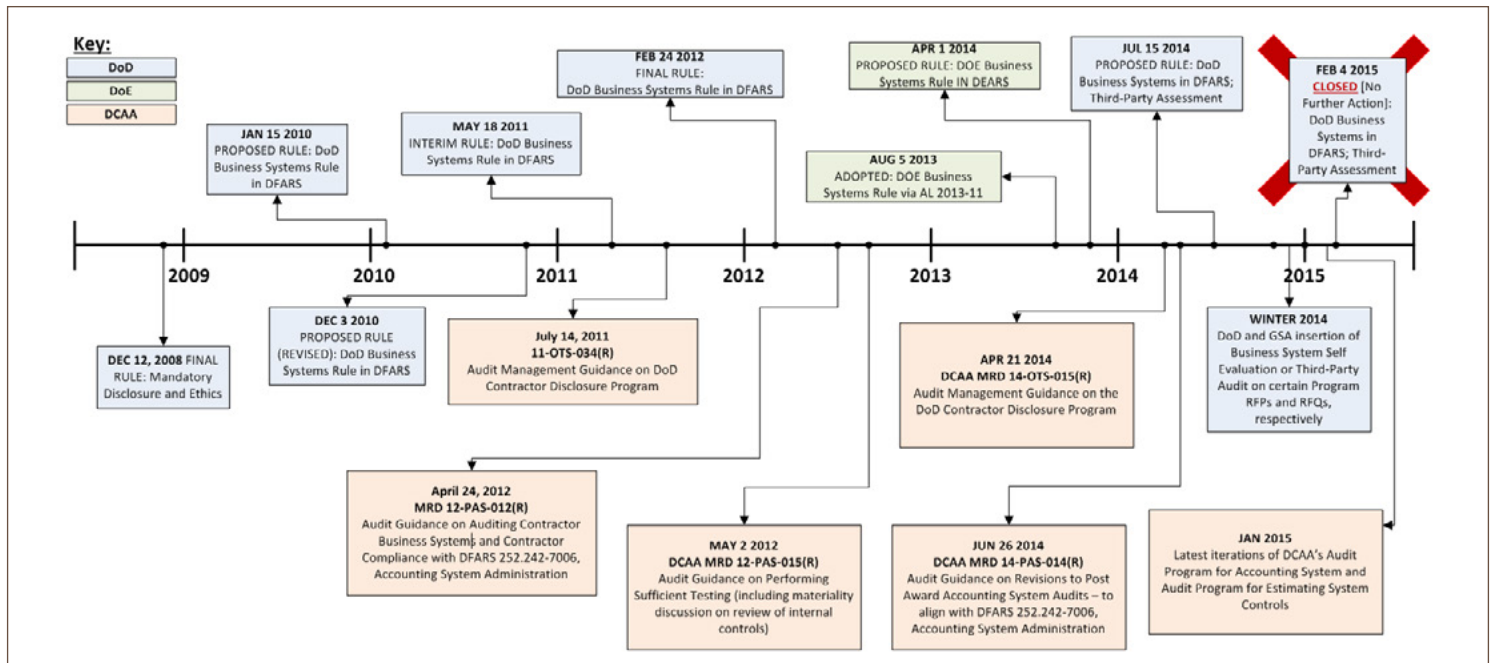
According to **Defense One**, the Navy plans to increase the number of its deployed ships to the Middle East and Asia by more than 20 percent over the next five years.

In 2014, nearly 35 percent of contracts with the Department of Homeland Security were held by small businesses, reports the **Federal Times**.

According to **Fierce Government**, federal agencies paid out \$125 billion in improper payments in 2014, compared to \$106 billion in 2013.

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Source: BDO Knows: Government Contracting newsletter

agency cost-reimbursable contracts containing the allowable cost and payment clause (FAR 52.216-7).

- **Contractor C:** A major DoD contractor with contracts containing the allowable cost and payment clause; business system requirements include 252.242-7005, Contractor Business Systems and 252.242-7006, Accounting System Administration.

Given these three different types of contractors, let's take a look at hypothetical scenarios to help us compare Contractor A and B's accounting system requirements to those of Contractor C. Try to select the answer that best supports each Company's compliance requirements.

**Scenario 1:** Does Contractor A have an accounting system and associated internal controls requirement similar to Contractor B and/or C in any aspect?

- Of course not! By definition, Company A is selling commercial services under MAS contracts and has no accounting system requirements.
- With that said, however, federal supply schedule contracts require sales tracking,

Trade Agreement Act Compliance, Basis of Award customer discount monitoring, environmental compliance and assurance deliverables are provided within the contractually negotiated terms. Therefore, MAS contract requirements could technically fall under an accounting system. But, that is entirely different from the accounting system requirements established by DoD contracts containing the allowable cost and payment clause.

- From a compliance standpoint, there are conditions that would position Contractor A for success if it were to adopt certain aspects of Contractor B and Contractor C's accounting system and related internal controls.

Now let's add a layer of complexity: During a GSA audit, the auditor discovers Contractor A has been selling an Engineer I (less experienced) as Engineer V (more experienced). The program manager explains to the auditor that she and the CFO are aware of this practice, but the customer "knew who they were getting and program ratings are through the roof!"

Does this condition change the best outcome for Scenario 1? Contractor A has contract

clause 52.203-13, Contractor Code of Business Ethics and Conduct, requiring an ethics program and mandatory disclosure. As a commercial item contractor, though, Contractor A is not required to have a formal system of internal controls as required by 52.203-13(c). Contractor A also has the requirement to deliver conforming goods and services under its contracts. Given what appears to be a reportable condition under mandatory disclosure, Contractor A should have considered adopting certain elements of Contractor B and C's control environment and timekeeping internal controls to mitigate the risk of contract noncompliance. Answer (c) above appears to be the answer in light of Contractor A's compliance risks.

**Scenario 2:** Should Contractor B implement internal controls as required by the DoD Accounting System DFARS 252.242-7006, Accounting System Administration?

- No! A company needs a CAS-covered contract to incorporate DFARS business system requirements. The accounting system clause is "inert," and Contractor B should ignore it.
- However, Contractor B may still have an accounting system requirement

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through the accounting system clause included in its contract. There may be no mandatory withhold, though, as CAS-covered contracts are absent based on Contractor B's small business status. By definition, no government agency would audit the accounting system against the rigorous internal control/documentation requirements of a full-blown accounting system. Instead, Contractor B should expect a simple Standard Form (SF) 1408 review to be conducted—incurring nowhere near the amount of scrutiny (or stress) a company being audited for an “adequate” accounting system might experience. Therefore, Contractor B should only prepare for an SF 1408 to save time and resources.

- c. Contractor B did accept a contract with the DFARS 252.242-7006, Accounting System Administration, clause appropriately included. As a best practice, Contractor B should map its current practices, policies and procedures against DFARS requirements and remediate gaps based on a reasonable definition of compliance for a small business.

However, what happens when Contractor B finally receives unfavorable incurred cost audit results from DCAA? During the audit, DCAA determines that unallowable costs have been included in federal billings, the indirect rate structure is illogical, Contractor B is unable to separate direct costs from indirect costs and billings can't be reconciled to cost records—all DFARS 252.242-7006 criteria.

It's true that Contractor B is not subject to mandatory withholds under DFARS 252.242-7005, Contractor Business Systems, based on its small business CAS exemption. However, Contractor B is at risk of having its accounting system deemed inadequate under DFARS 252.242-7006, Accounting System Administration, criteria. Contractor B may then be ineligible to receive additional cost-reimbursable contracts under FAR 16.301-3, Limitations Guidance. Therefore, it is in Contractor B's best interest to map internal controls to DFARS 252.242-7006, Accounting System Administration, requirements. Answer (c) above appears to be the answer in light of Contractor B's compliance risks.

## YOU'RE INVITED

### Learn More About Business System Challenges at BDO's Second Annual Executive Seminar for Government Contractors



On April 28, BDO will be co-hosting with the Public Contracting Institute and BakerHostetler its second annual day long executive seminar for government contractors to discuss key issues and regulatory considerations for the industry.

Attendees will have the opportunity to hear from Congresswoman Barbara Comstock (R-Va.), as well as other leading industry executives, about a range of issues facing contractors, including the current DCAA/DCMA environment, compliance matters, the impact of business system requirements in today's marketplace and the latest legal updates influencing the sector. The seminar will also explore recent DCAA audit guidance and best practices for compliance management.

Additional speakers include:

**Steve Trautwein**, Acting Director, DCMA Cost & Pricing Center

**Michele Bolos**, CEO, NT Concepts, Inc.

**Chad Braley**, Capital Edge Consulting

**Hilary Cairnie**, Partner, BakerHostetler

**Chris Gilley**, VP, Government Finance & Compliance, DynCorp International

**John Panetta**, Sr. Director of Government Accounting, Raytheon Company

**Matthew Popham**, VP, Government Compliance Director, Leidos

**Nick Sanders**, President, Apogee Consulting, Inc.

**John Van Meter**, Managing Director, BDO USA

**Russ Wright**, CEO, Sentel

The event will take place at The Ritz-Carlton, Tysons Corner in McLean, Va., from 8:30 a.m. to 4:30 p.m. To learn more and register for the event, [click here](#).

Its internal controls would address the same criteria as those used by Contractor C, but practices should be scaled to address the small business environment.

## SUMMARY

Business system requirements and business system compliance are part of a dynamic and ever-changing landscape. **Every** company doing business with the federal government should establish a practice of performing regular risk assessments, paying particular attention to internal control requirements

imposed by FAR 52.203-13, Contractor Code of Business Ethics and Conduct and agency-specific requirements for accounting/business system compliance. Stay tuned as we continue to explore other business systems in future newsletters.

For more information on contractor business system requirements please contact John Van Meter, Managing Director of BDO's Government Contractor Advisory Services (GCAS) group at 408-981-4155/ [jvanmeter@bdo.com](mailto:jvanmeter@bdo.com), or Giacomo Apadula, Senior Manager at 609-617-4191/ [gapadula@bdo.com](mailto:gapadula@bdo.com).

# WHY GOVERNMENT CONTRACTING FIRMS ARE CHOOSING TO BE ESOP OWNED

By Andrew Gibson and Jeff Schragg

## EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs) HAVE PROVEN THEMSELVES TO BE A SUCCESSFUL COMPANY OWNERSHIP STRUCTURE FOR A WIDE VARIETY OF GOVERNMENT CONTRACTORS.

While every company's dynamics and ownership base are different, and ESOPs may not always be appropriate, ESOPs offer a number of benefits that make them an option your organization may want to consider. Below, we outline nine key advantages offered by ESOPs.

### 1. Corporation's Income Tax Benefits

ESOPs are the most efficient ownership structure from an income tax perspective. The ESOP trust, as a shareholder in an S corporation, is not subject to federal as well as most state income tax liability on its share of the S corporation taxable income. In addition, employer contributions to the ESOP to fund debt payments are tax-deductible. This creates an income tax advantage of approximately 40 to 50 percent of the corporation's taxable income.

### 2. Key Associate's Income Tax Benefits

Income tax benefits can also be realized by key associates of the company through deferred compensation arrangements. The corporation does not realize the income tax deduction in a non-qualified deferred compensation arrangement until the employee reports the compensation on his/her Form 1040. A 100 percent ESOP-owned S corporation does not pay income tax, so it does not impact its cash flow to delay the income tax deduction related to deferred compensation. Therefore, it is common for ESOP companies to establish deferred compensation arrangements for key associates, allowing employees to defer their income tax on compensation until retirement, college tuition or other personal financial events warrant it.

### 3. Equity Incentive Plan for Key Associates

Government contracting companies commonly provide key associates with the opportunity to buy stock in the corporation, effectively forcing these associates to have some "skin in the game." ESOP companies commonly have equity compensation plans that allow for "reloading" of the equity (the equity is held for a limited period and then reissued), providing the board of directors a means to efficiently compensate equity to the associates who are generating value in the current year and are the future of the company. The equity is granted annually as part of the key associate's compensation package, which may require that it be exercised after a limited period of years (such as five years) so that the equity does not get "stale" with the key associate.

### 4. Refresh Ownership

ESOPs can help government contracting companies address the issue of how to effectively transfer equity from older associates or founders to newer key associates. More specifically, these plans allow the company to provide equity to associates who represent the future of the company while providing current owners with a tax-efficient means to sell their stock. An ESOP allows shareholders to realize their equity value by selling to the ESOP (ESOP also refers to the trust [ESOT] in this article) with equity compensation arrangements to efficiently allocate equity into the future. If the company is a C corporation, the shareholders may be able to sell their stock to the ESOP and elect to defer the gain on the sale under Internal Revenue Code Section 1042.

### 5. Cost Reimbursement Contracts

The ESOP is a defined contribution plan. Contributions to defined contribution plans can be a reimbursable expense in cost reimbursement contracts. Therefore, properly structuring the ESOP loan and share release can help cash flow for repaying the

ESOP transaction-related debt. This can be a significant cash flow advantage. 48 CFR Part 9904 [which amended CAS 412 (pension costs) and 415 (deferred compensation costs)] provides that the contractor's "allowable cost" in the fringe benefit rate that can be charged to the government "shall be the contractor's contribution, including interest and dividends if applicable, to the ESOP."

### 6. Prevailing Wage

Prevailing wage rates can include contributions to a qualified retirement plan. Therefore, the ESOP contribution can also be included in the prevailing wage rate since it is a qualified retirement plan. The company needs to evaluate the benefits or detriments of including ESOP contributions as part of the prevailing wage. In order to qualify for prevailing wage, the ESOP may be required to:

- Accelerate immediate vesting to 100 percent
- Provide immediate payout on termination
- Accelerate the company's cash flow to satisfy the requirement that the employer contribution be transferred to the retirement plan as the associate performs the services
- Establish immediate eligibility for allocations for new hires (rather than requiring 12 months of service and 1,000 hours)

### 7. Leadership is Uncoupled from Ownership

In government contracting companies, leadership is often directly tied to the ownership. This has both positive and negative outcomes. The negative outcome is that if a leader in the organization needs to be terminated, there is both the impact to leadership and also the impact to cash flow to buy back stock. Most ESOP companies' leadership teams consist of key associates who possess strategic vision, rather than being a collection of shareholders. ESOP company equity compensation plans allow the board of directors to incentivize leaders more effectively because ownership is settled in a 100 percent ESOP-owned company. This can lead to more efficient corporate governance



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## ESOP

decisions for ESOP companies. Note: the ESOP is the shareholder, so participants do not have shareholder rights, such as voting for board of directors, access to financial statements or attending board of directors meetings.

### 8. Employee Culture

An ESOP provides a scoreboard to reinforce a culture where associates are encouraged to work as a team with entrepreneurial spirit. The ESOP provides a long-term compensation benefit that is paid at retirement or other termination of employment. However, the motivating aspect of equity ownership is to provide associates with at least an annual reflection of how their efforts impact the company's value.

### 9. Competitive Advantage

Many government contracting ESOP companies are realizing the income tax savings, ownership motivation, compensation structure, corporate governance and other benefits of ESOP ownership. This helps generate a number of competitive advantages. For example, mature ESOP companies are able to accumulate substantial amounts of money on their balance sheets, giving them an advantage with their surety company and lender. Companies may also be better positioned to pursue acquisitions and expansions, and are able to attract and retain high-quality key talent.

### Does ESOP Align With Your Ownership Goals and Objectives?

Many government contracting companies have found ESOPs to be an effective and profitable form of ownership.

*For more information about ESOPs and to discuss whether they may be an option for your organization, please contact Andrew Gibson, tax partner, leader of BDO's Global Compensation and Benefits Practice and the Regional Managing Partner for the Southeast Tax Practice at [agibson@bdo.com](mailto:agibson@bdo.com) or Jeff Schragg, tax partner in BDO's Government Contracting practice at [jschragg@bdo.com](mailto:jschragg@bdo.com).*

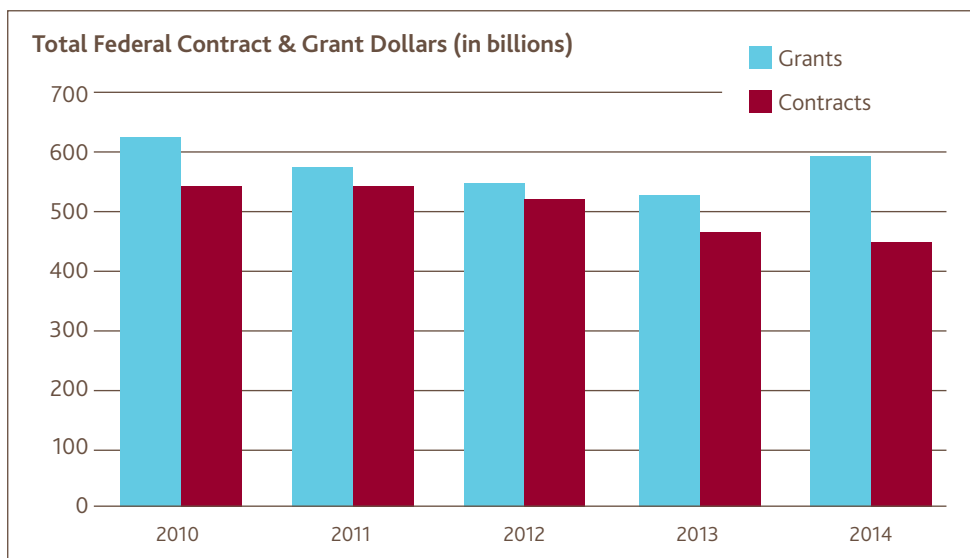
## FEDERAL GRANTS: DIVERSIFYING OPPORTUNITIES FOR FEDERAL CONTRACTORS

By Andrea Wilson

Over the last four years federal contract dollars have steadily declined from \$540.4 billion in 2010 to \$445.3 billion in 2014 causing federal contractors to explore new sources of revenue to remain viable in a highly competitive environment. While some contractors have sought to diversify their business by developing new products or services, others have looked to expand their customer base to offset potential declines in revenue. Surprisingly, federal spending under assistance instruments, i.e., grants and cooperative agreements (collectively grants), appears to have bucked the declining federal spending trend. Since 2011, the federal government has annually

awarded an average of \$5.4 billion in grants to for-profit companies. Interestingly, one area of diversification we have found to be underexplored by many in the contracting industry is the pursuit of funding through federal grants and cooperative agreements.

While federal grants do not permit profit, they do provide other benefits attractive to for-profit companies. By expanding a company's base, grants can assist in driving down indirect rates making companies more competitive and more profitable overall. Further, grants can provide new entry points into new markets, products, locations and services making firms more competitive under RFPs.



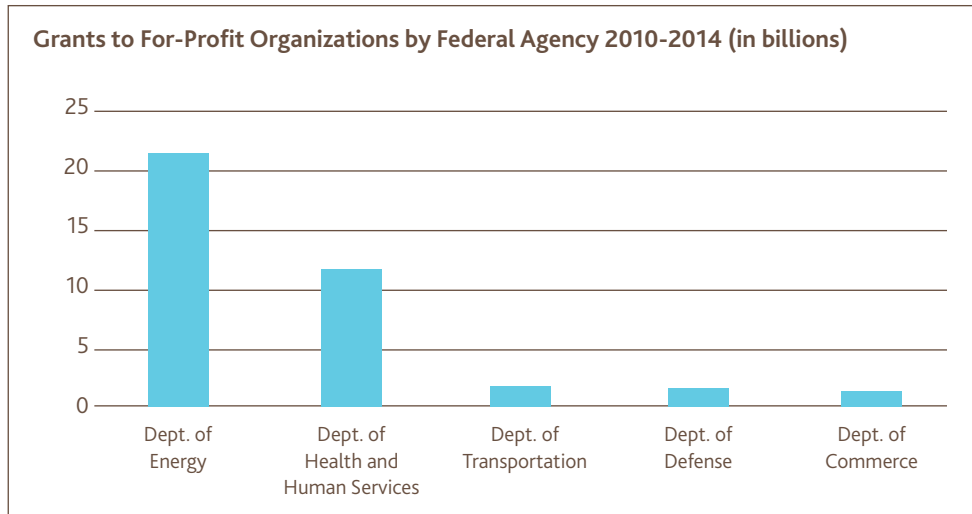
Source: USASpending.gov

	Total Award Dollars \$billions		
	Grants	Grants to for-profit organizations	Contracts
2010	622.5	20.8	540.4
2011	571.7	7.2	539.6
2012	544.8	4.4	518.3
2013	524.4	5.1	462.5
2014	590.8	4.9	445.3

Source: USASpending.gov

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## FEDERAL GRANTS



Source: USASpending.gov

Many federal agencies that provide contract funding to companies also award grants to for-profit organizations, such as the Departments of Commerce, Defense, Education, Energy and Health & Human Services, along with sub-agencies like the U.S. Agency for International Development (USAID), the National Institutes of Health (NIH), and the National Science Foundation (NSF). Similar to the contracting process, a grant recipient must respond to a published funding opportunity in order to be considered for the award. These opportunities, however, allow for more funding flexibility by focusing on a specific public objective in contrast to contracts where the government dictates precisely what it will procure. Consistent with the nuances embedded in the proposal process, the awards themselves are governed by a different set of regulations. While contracts adhere to the familiar "FAR" requirements, federal grants follow a newly revised set of regulations issued by the Office of Management and Budget (OMB) titled *Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards*, which is also known as the Super Circular and codified under 2 CFR 200, herein referred to as the Uniform Guidance.

While the tenor of the Uniform Guidance brings the grants world closer to the FAR—which contractors are very familiar with—significant differences remain. Contractors receiving federal grants should familiarize themselves with these requirements before embarking on grant activities and review the

new requirements in BDO's Uniform Guidance article that highlights significant changes from prior grant regulations. Subrecipient monitoring, audit requirements and cost principles illustrate three significant and nuanced differences between the grant and contract worlds.

The Uniform Guidance at 2 CFR 200.330 establishes onerous requirements for subrecipient monitoring. As non-procurement transactions, the FAR does not address subrecipients. Accordingly, subrecipient monitoring may be a new area for for-profit companies implanting grants. A subrecipient is a non-federal entity to which you provide a subaward to carry out the federal program. In summary, the new regulation requires pass-through entities to make a case-by-case contractor versus subrecipient determination, conduct a pre-award risk assessment of the subrecipient, monitor the subawardee throughout the implementation of the program and impose proper remedies in case of non-compliance. The costs associated with subrecipient monitoring should be strategically considered when developing both your indirect costing policies and proposals to ensure consistencies throughout your company.

Additionally, federal grants generally contain a robust audit provision as required under the Single Audit Act included in Subpart F of the Uniform Guidance (formerly referred to as an A-133 audit). Recipients receiving

\$750,000 or more in federal grants and/or cooperative agreements during the entity's fiscal year may be required to undergo a comprehensive financial and compliance audit. This audit is meant to provide assurance to the government of the proper use of its award dollars by the receiving entity. The audit should be performed by an independent accounting firm at the cost of the grant recipient.

Prior to the issuance of the Uniform Guidance, the cost principles found in FAR Part 31 applied to for-profit entities in both their contract and grant endeavors. However, the new grant regulations under 2 CFR 200 Subpart E apply uniformly to both nonprofit and for-profit entities implementing federally funded grants and cooperative agreements. While FAR Part 31 generally remains the more stringent, there are nuanced differences that for-profit entities should take note when implementing grant programs. Travel costs – one of our favorites – and airfare in particular, illustrate the slight nuance between the FAR and Uniform Guidance. Under FAR 31.205-46(b) and in accordance with the referenced Federal Travel Regulations (FTR) Chapter 301-10.123, other than coach-class airfare may be allowable under certain conditions if approved by the awarding agency.<sup>1</sup> These conditions include, but are not limited to: a lack of "reasonably available" coach class airfare<sup>2</sup>; when it is necessary to accommodate a medical disability or other special need; when exceptional security circumstances apply; or when the origin and/or destination are outside the contiguous United States (OCONUS) and the scheduled flight time, including stopovers and change of planes, is in excess of 14 hours – i.e., the "14-hour rule."

Under the Uniform Guidance travel rules (2 CFR 200.474(d)), airfare in excess of the "basic least expensive unrestricted accommodations class offered by commercial airlines are unallowable except" under five conditions when such accommodations would: (1) require circuitous routing; (2) require travel during unreasonable hours; (3) excessively prolong travel; (4) result in additional costs that would offset the transportation savings; or (5) offer accommodations not reasonably adequate for the traveler's medical needs.

# Perspective in Government Contracting



Although the federal budget outcome for fiscal year 2016 remains to be seen, the government contracting

industry continues to find opportunities in the healthcare, technology and defense industries. Specifically, the healthcare and technology sectors are providing some glimmers of hope for private equity firms looking to grow or exit their investments.

Defense retains the largest overall spend—\$200 billion in fiscal year 2014—although that figure is down by more than a third from 2008. Despite this, private equity firms have never been more invested in the defense contracting space. Between 2004 and 2013, private equity invested more than \$30 billion in 358 U.S. defense and aerospace companies, according to Pitchbook data. However, sequestration fears and budget caps mean that many have held onto their investments longer than usual, delaying exits while waiting for the market to improve, the *Washington Post* reports.

Meanwhile, the Affordable Care Act, as well as legislation passed under former President George W. Bush to modernize the government's aging IT infrastructure, have provided plentiful opportunities for providers of healthcare and more general technology. Agencies across the board are looking to update their systems

and improve their systems' defense capabilities. President Obama's proposed fiscal 2016 budget includes \$86 billion for IT spending—a year-on-year increase of 2.7 percent—including \$14 billion for cybersecurity.

These trends have spurred robust M&A activity. Big-name contractors—especially from the defense sector—have acquired smaller healthcare IT companies in order to bolster growth. Last October, defense contractor Lockheed Martin bought healthcare IT company Systems Made Simple, and defense and intelligence firm Booz Allen Hamilton made two healthcare IT acquisitions—the health division of Genova Technologies, which has received \$90 million in HHS business since the passing of the health law, and health analytics startup Epidemico. This comes as part of a larger push by Booz—part-owned by the Carlyle Group—to sell technology and consulting services to the Department of Health and Human Services, the *Washington Post* reports.

“Private equity firms are both buyers and sellers in today's market,” says **Joe Burke, Transaction Advisory Services Partner in BDO's Government Contracting practice.** “Valuations continue to vary greatly based on the level of the government contractor's capabilities and the size and visibility of their customer contracts.”

Other contractors have also been snapping up smaller technology companies for their lucrative federal contracts. In March, for example, state Medicare claims processor Maximus acquired technology contractor Acentia for \$300 million from private equity firm Snow Phipps Group in order to grow its federal healthcare IT contracting footprint. Over the last two years, Accenture and ManTech International acquired ASM Research and Delta respectively—both of which had a task order in the Department of Veterans Affairs' \$12 billion contract to modernize its electronic health records, the *Washington Post* reports.

Cybersecurity is another area of growth, attracting significant investment from private equity companies. Bain Capital recently acquired Blue Coat Systems for \$2.4 billion with the goal of returning it to the public markets. Private equity firms spent \$191.9 billion globally on data security firms last year, up from \$170 billion in 2013, according to the *San Francisco Chronicle*.

The number of defense company exits we see in the next year will hinge a lot on whether Congress increases military spending. But whichever version of the budget passes, private equity companies will likely see continued opportunity in the healthcare and technology spaces.

*PEerspective in government contracting is a feature examining the role of private equity in the government contracting space.*

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## FEDERAL GRANTS

For airfare, the Uniform Guidance does not refer to the FTR for further guidance, thus eliminating a small degree of flexibility provided by the “14-hour rule” for booking better than economy-class airfare.

Similar examples of seemingly minor nuances, which drastically alter the application of these governing principles, are repeated between the grants and contracts world. Yet we find that contractors are uniquely positioned to leverage the key business systems and

associated internal controls designed to meet the more rigorous demands of federal contract compliance to successfully manage federal grant awards. To be clear, the transition into the federal grant space is not without its challenges and brings with it a learning curve unique to the environment. However, when established correctly, contractors can successfully execute federal grants and enhance their opportunities to secure additional federal awards.

<sup>1</sup> For a complete list of conditions, see: FTR Chapter 301-10.123 <http://www.gsa.gov/portal/ext/public/site/FTR/file/Chapter301p010.html/category/21868/>

<sup>2</sup> “Reasonably available” means available on an airline that is scheduled to leave within 24 hours of your proposed departure time, or scheduled to arrive within 24 hours of your proposed arrival time.

*For more information about pursuing federal grants and the differences between federal contracts and federal grants, please contact Andrea Wilson, Managing Director of BDO's Government Contracts and Grants Advisory Services at 703-752-2784 / [aewilson@bdo.com](mailto:aewilson@bdo.com).*

# SERVICE CONTRACT ACT CONSIDERATIONS FOR GOVERNMENT CONTRACTORS

By Maureen Miller and Krysta Gamble

## IN THE GOVERNMENT CONTRACTING INDUSTRY, CONTRACTS THAT MUST COMPLY WITH THE MCNAMARA-O'HARA SERVICE CONTRACT ACT (SCA) ARE BECOMING MORE PREVALENT THAN EVER BEFORE.

The SCA's intent is to ensure that businesses with contracts whose principal purpose is to provide services in excess of \$2,500 offer established wages and benefits to covered employees. If a contract is deemed to be subject to the SCA, all non-exempt employees working on that contract—in any capacity—must be compensated based on their respective Wage Determination (WD), which establishes the minimum wage and benefits for various positions.

Companies that previously had only a few employees covered under these provisions are now finding themselves managing tens or hundreds of SCA employees. Other companies are also realizing that if they want to continue growing, SCA contracts—which are managed by the Department of Labor's Wage and Hour Division—cannot be avoided.

The reality is that SCA contracts can be overwhelming and intimidating to many employers for a variety of reasons, such as: 1) the SCA regulations are complex and make compliance challenging; 2) the DOL is active in monitoring compliance; 3) every county in the U.S. has a different WD; and 4) many unions are SCA and have a separate WD, among others. However, if the government is granting more contracts for services, are contractors really prepared to pass on a sizable market of possible work? Most likely, they are not. The bigger question is: how do they position themselves to compete in this marketplace?

The best way to get to the root of how the SCA will impact a company begins with a trusted Human Resources (HR) advisor. Some might be surprised by this suggestion as

contractual obligations are typically handled outside of HR. However, deciding which positions are SCA begins and ends with the contract position's Fair Labor Standards Act (FLSA) status. The specific duties and responsibilities of the position dictate whether it is exempt or non-exempt and, if non-exempt, if it is bound by the SCA and the WD. Often, a company executive or program manager will want all positions to be exempt to avoid having to pay overtime and risk misclassifying positions. A misclassification can be very detrimental when dealing with SCA contracts. It is in a company's best interest to ensure that a comprehensive FLSA audit is done on all SCA-eligible positions when bidding on the contract, as well as intermittently throughout the contract.

Once a company has correct FLSA classifications, an HR advisor can make sure the company complies with other aspects of the SCA/WD, including, compensating employees at the correct prevailing wage, providing the correct amount of vacation time and compensating employees for the correct holidays—which are dictated by the WD.

After tackling the standard HR items listed above, it is important to understand how to manage the Health & Welfare (H&W) dollars that each SCA employee will receive per hour worked, up to 40 hours per week. The intent of H&W dollars is to pay for eligible benefits. This can range from the full medical, dental and vision premium cost for all covered participants, additional vacation or sick leave, tuition reimbursement, 401(k) employer match, life insurance and disability coverage. The key is for a company to understand what it is able to take credit for out of this bucket of money. One of the trickiest parts of H&W dollars is completing mandatory quarterly reconciliations. A best practice is to perform a reconciliation every pay period or each month, though the DOL only requires this to be done on a quarterly basis.

What are the potential risks of not complying? Over the last few years, the DOL has taken on more SCA audits. If the DOL identifies

noncompliance, it will require the contractor to make all impacted employees "whole," which will include payments for any historical and current differences in wages and benefits. The DOL also has the authority to withhold payments on any active contracts that are federally funded, terminate the contract, find company officers personally liable and—potentially the most damaging—debarment from participating in federal contracts for up to three years. In this case, the decision to debar a contractor is solely up to DOL, and they have been known to initiate this process on findings and violations that some would consider rather small.

Although contractors are wary of the fact they must comply with many regulations, including employment-related laws, it's important that they understand the potential risks. With the government contracting industry anticipating a growing number of service contracts in 2015, opportunities abound for contractors. However, they must also be aware of the risks associated with complying with applicable regulations and conduct the necessary risk assessments before they forge ahead. The good news for contractors, though, is that following SCA regulations needn't be overwhelming or complex: Solid counsel from experienced HR advisors can help maintain compliance, and success, from start to finish.

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## REGULATORY UPDATES

### Proposed DFARs Rules

**Case 2014-D015:** *Past Performance Information Retrieval System-Statistical Reporting (PPIRS-SR)*; The Department of Defense (DoD) is proposing to amend the DFARS to require contracting officers to evaluate past performance using the information in the Statistical Reporting module of the Past Performance Information Retrieval System when involved in a competitive solicitation for supplies using simplified acquisition procedures.

The PPIRS-SR module was originally created to fill the need for past performance data on lower dollar value contracts. The goal is to use objective data on past performance to assist contracting officers in making better-informed best value award decisions on small dollar value acquisitions for supplies. This process helps to eliminate the burden of collecting subjective past performance information on contractors for smaller dollar value contracts.

### Final DFARs Rules

**Case 2012-D035:** *Forward Pricing Rate Proposal (FPRP) Adequacy Checklist*; The DoD has issued a final rule effective Dec. 11, 2014, amending the DFARS to provide guidance to contractors, which ensures the submission of thorough, accurate and complete FPRPs. It

also provides consistency and communicates expectations to prevent rework and improve the efficiency of the negotiation process.

This proposed rule promotes the increased use of forward pricing rate agreements (FPRAs) to reduce administrative costs and to promote greater efficiency and productivity in the preparation and review of FPRAs proposals.

The amendment to DFARS 215.403-5 requests contractors to submit the Contractor Forward Pricing Rate Proposal Adequacy Checklist at table 215.403-1 with FPRPs. DoD does not expect this rule to have a significant economic impact on a substantial number of small businesses.

### DCAA Office of Inspector General Created

The Defense Contract Audit Agency (DCAA) officially established the Office of Inspector General (OIG) on Jan. 5, 2015. The OIG will provide DCAA employees an avenue for disclosing incidents of fraud, waste, abuse or gross mismanagement without fear of retaliation.

The DCAA Hotline is also included in the DCAA OIG function. The hotline allows DCAA civilian employees, DCAA contractor

employees, as well as private citizens, a way to report suspicious activities. The hotline is available 24 hours a day, seven days a week and can be reached at 855-414-5892 or [hotline@dfas.mil](mailto:hotline@dfas.mil).

### Commercial Items and the Determination of Reasonableness of Price for Commercial Items

On Feb. 4, 2015, a memorandum was issued by the DoD on guidance related to commercial item determinations (FAR Part 12) and price reasonableness analyses. The topic of concern is in regards to the amount of money being spent on commercial items (\$60B in the last fiscal year) versus the amount of oversight being issued to determine if prices are reasonable.

In the past, determining commerciality of an item has been difficult for Contracting Officers. However, the DoD is working to revise the DFARS Procedures, Guidance and Information (PGI) along with an update to the DoD Commercial Item Handbook on Commercial Items.

The intent of the memo is to provide guidance for Contracting Officers as to how they should approach the pricing of items claimed to be commercial. Recommendations include:

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## REGULATORY UPDATES

- Ask the question: "Am I paying a fair and reasonable price?"
- Establish goal of determination within 10 business days
- Use market-based pricing to assist in determination
- If needed, use cost-based analysis in lieu of market-based pricing

Contract files to maintain:

- Justification of additional cost information
- Copy of any request from the DoD to the Contractor for additional cost information
- Any response received by the Contracting Officer

The Defense Contract Management Agency (DCMA) Cost & Pricing Center has been designated to provide expert advice to the acquisition workforce.

### DCAA Audit Alert on Identifying Expressly Unallowable Cost

**Jan. 7, 2015:** *Audit Alert on Identifying Expressly Unallowable Cost.* The DCAA recently released a memorandum to address expressly unallowable costs. The newest alert enhances the guidance provided in the memorandum issued Dec. 18, 2014, which distributed a list of cost principles that meet the definition of expressly unallowable costs. Based on the cost principles, expressly unallowable costs are identified if:

- It states in direct terms that the costs are unallowable, or leaves little room for differences of opinion as to whether the particular cost meets the allowability criteria; and
- It identifies the specific cost or type of costs in a way that leaves little room for interpretation.

However, some costs are not clearly stated in direct terms as unallowable. The bottom line is that these types of costs can be expressly

unallowable even though the cost principle does not explicitly state that the cost is unallowable or allowable.

### DCAA Memorandum for Updated Audit Guidance on the Treatment of Overdue Indirect Rate Proposals

On Feb. 12, 2015, DCAA issued a Memorandum for Regional Directors (MRD) providing guidance regarding the settlement of overdue indirect rate proposals. DCAA will furnish a memo to DCMA with a list of contractor fiscal years (CFYs) for which DCAA has not received a final indirect rate proposal, and the Contracting Officer has not granted a valid extension. The assignments on the list sent to DCMA will be closed on June 30, 2015, if DCMA contracting officers do not notify DCAA of any extensions or ongoing coordination that would result in leaving the assignments open.

DCAA will close the overdue proposals based on some form of a unilateral determination in conjunction with the Contracting Officer. The guidance suggests to DCMA a total contract cost decrement of 16.2 percent that the Contracting Officer may consider using when no relevant history exists. DCAA plans to reassess the decrement rate every three years.

### General Services Administration (GSA)

GSAR Case 2013-G504: *Transactional Data Reporting*; The General Services Administration is proposing to amend the General Services Administration Acquisition Regulation (GSAR) to require vendors to publish and report GSA prices paid by ordering activities under the schedule at a transactional level. The changes to federal purchasing would allow for procurements to be managed by categories of purchases rather than individually. By managing purchases by categories (i.e., IT software/ IT hardware), the government will be able to make smarter buying decisions.

GSA plans on creating a Common Acquisition Platform (CAP), which will be an online marketplace to help streamline information among agencies. CAP would make available the prices paid by other government buyers for similar products or services. Contractors would be required to electronically report contract sales monthly through this user-friendly online reporting system. The report would include transactional data elements such as unit measures, quantity of item sold, universal product code, if applicable, price paid per unit and total price.

A public meeting was held by GSA on April 17, 2015. Attendance was in person or virtually through GSA's Internet meeting platform.

### Small Business Administration (SBA)

On Feb. 5, 2015, the SBA proposed to amend its regulations to implement provisions of the Small Business Jobs Act of 2010 and the National Defense Authorization Act for Fiscal Year 2013. The proposed rule would establish a government-wide mentor-protégé program for all small business concerns, consistent with SBA's mentor-protégé program for participants in SBA's 8(a) Business Development (BD) program. As is the case with the current mentor-protégé program, the various forms of assistance that a mentor will be expected to provide to a protégé include technical and/or management assistance, financial assistance in the form of equity investment and/or loans, subcontracts and/or assistance in performing prime contracts with the government in the form of joint venture arrangements.

See 80 Fed. Reg. 6618 (Feb. 5, 2015) and comments must have been received on or before April 6, 2015, to be incorporated into the final rule.

# MARK YOUR CALENDAR...

## APRIL

April 28

**BDO Executive Seminar – Industry Insight: Compliance Issues and Business**

Systems Challenges for Government Contractors\*

The Ritz-Carlton, Tysons Corner  
McLean, Va.

## MAY 2015

May 4-5

**La Jolla Government Contracting Week: Contractors' Purchasing Systems Review\***

Hyatt Regency La Holla at Aventine  
La Jolla, Calif.

May 7

**BDO's Measuring and Monitoring Program Impact and Outcomes\***

[Webinar](#)

May 11-13

**BioTrinity 2015 – European Biopartnering and Investment Conference**

Novotel London West  
London, U.K.

May 18-20

**ALTA 2015 Federal Conference & Lobby Day**

Mandarin Oriental  
Washington, D.C.

May 20-21

**Government Contracting Training Institute: Accounting System Compliance for Federal Contractors\***

The W Hotel  
San Diego, Calif.

## JUNE 2015

June 18

**BDO's Annual Audit, Tax and Accounting Update for Nonprofit, Higher Education and Government\***

Don Taft University Center  
Fort Lauderdale, Fla.

June 19

**BDO's Annual Audit, Tax and Accounting Update for Nonprofit, Higher Education and Government\***

Florida International University  
Miami, Fla.

\* Indicates that BDO is hosting or attending this event.

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