Financial Reporting and Compliance

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Financial Reporting and Compliance

• Reporting & Compliance Issues for Federal Contractors
  – The Incurred Cost Submission
  – Small Business Subcontracting Plans & ESR
  – Executive Compensation Reporting
  – 1st Tier Subcontract Award Reporting
  – Cost Accounting Standards

• Emerging Legal Issues for Federal Contractors
  – The Rise of the Protest as a Competitive Tool
The Incurred Cost Submission
The Requirement

- Triggered by FAR 52.216-7, Allowable Cost and Payment
  - Contained in ALL Cost-type or T&M contracts
  - “Christian Doctrine” clause (it’s there even if it’s not)
- Requirement stated in paragraph (d), Submission of Final Indirect Cost Rate Proposal
- Required of subs as well as primes
- In 2011, of 6,182 contractors audited by DCAA, 1,402 made an ICS
Purpose of the ICS

- To establish final indirect rates by year for the adjustment of prior billings
- Required for contract closeout
Submission Requirements

- The Contractor shall submit an **adequate final indirect cost rate proposal** to the Contracting Officer (or cognizant Federal agency official) and auditor **within the 6-month period following the expiration of each of its fiscal years**.
- The Contractor shall support its proposal with adequate supporting data. (See DCAA Information for Contractors)
- Final annual indirect cost rates and the appropriate bases shall be established in accordance with Subpart 42.7 of the Federal Acquisition Regulation (FAR) in effect for the period covered by the indirect cost rate proposal.
Consequences of Non-Compliance

- Failure to submit can go undetected for years
- Once detected, audit agency will demand filing of all overdue claims within 6 months
- Once overdue 6 months, letters begin and escalate
- At about 18 months, ACO can unilaterally determine rates and close contracts on that basis
Subcontracting Plans
Subcontracting Plan Basics

- Small Businesses are exempt
  - Determined contract by contract just as Small Business size status – by NAICS code
- Plan forecasts planned expenditures by SB type
- Plan outlines procedures to achieve goals
- Required for contracts >$650K (or >$1.5M for construction) – FAR 19.702
  - Not required for SB or contracts performed entirely outside US and outlying areas
Subcontracting Plan Specifics

- Four types of plans
  - Individual plan
    - FAR 19.704 (a)
    - Covers entire contract period for specific contract
  - Master plan
    - FAR 19.704 (b)
    - Covers all contracts for 3 years
    - Specific goals negotiated by contract
Subcontracting Plan Specifics

• Four types of plans (cont’d)
  – Commercial plan
    • FAR 19.704(d)
    • Covers all production for company fiscal year
  – Comprehensive plan
    • DFARS 219.702(a)
    • Covers company wide goals for company fiscal year
Subcontracting Plan Goals

• Subcontracting Goals
  – Projected goals listed in the plan by SB type
  – Statutory percentage goals established through Public Law
  – Guidelines for the Small Business Preference Programs for Prime and Subcontract Federal Procurement Goals and Achievements
    www.sba.gov/GC/goals/ggtotal71503.pdf
Subcontracting Plan

• 11 Elements of Subcontracting Plan (FAR 19.7)
  – Goals
  – Subcontracted dollars
  – Supplies/services to be subcontracted
  – Method to develop goals
  – Method to identify sources for solicitation
  – Statement indicating whether indirect costs included
  – Name of program administrator
  – Description of efforts
  – Inclusion of flow-down clause
  – Reports
  – Records
Subcontracting Plan Reporting

- Electronic Subcontracting Reporting System (eSRS)
  - Web-based reporting system to replace SF294 and SF295
  - Government-wide
  - SBA is the system steward
  - Linked to CCR, FPDS-NG, DUNS
Reporting

- Contract with subcontracting plan
  - Entered into FPDS-NG
  - Automatically received into eSRS
  - Reports covered
    - ISR (SF294) and SSR (SF295)
    - Year-end SDB Supplementary Reports
    - SDB Participation Report (SF312)
Reporting

- System Features
  - Calculates % of contract value
  - Calculates % of subcontracted value
  - Breaks out subcontract data to buying activity level
  - Generates several standard reports
  - Generates reminders and delinquent notices
Reporting

- Troubleshooting eSRS
  - Email help@esrs.gov for technical questions regarding eSRS
  - SBA answers questions on SubK policy
  - Agency Coordinator of awarding agency addresses other problems or issues
  - CCR Assistance Center (888-227-2423)
  - Contracting Officer handles FPDS-NG issues
Liabilities and Errors

- Liquidated Damages
  - Willful or intentional failure to meet goal (19.701)
  - Liquidated Damages clause must be in contract (52.219-16)
  - Not applicable for Comprehensive plans
  - Damages equal to dollar amount by which goal was not achieved
Liabilities and Errors

- Common Errors
  - Missing goals
  - Calculated incorrectly
  - Goals for option years not included
  - Goals below required levels without justification
  - No explanation why planned purchases to LB cannot go to SB
  - Failure to list all types of supplies and services
  - No assurance that SubK plans and reports will be required from qualifying subcontractors
Executive Compensation Reporting
Prime Contractor Reporting Requirement

- Requires the Prime contractor to report the names and total compensation of the five most highly compensated executives for the preceding completed fiscal year
- This includes management personnel
Implementing Regulation

- Clause to be found at FAR 52-204-10, Reporting Executive Compensation and First-Tier Subcontract Awards
- Clause to be included in all federally funded solicitations and contracts of $25,000 or more and not exempt under one of the following:
  - Solicitation or contract is classified, or
  - Solicitation or contract is with an individual
- Small Businesses are NOT exempt
Reporting Requirement Test

• If...
  – A contractor realizes 80% or more of its annual gross revenues from Federal contracts (and subcontracts), loans, grants (and subgrants) and cooperative agreements, AND
  – The Contractor realizes $25,000,000 or more of its annual gross revenues from Federal contracts (and subcontracts), loans, grants (and subgrants) and cooperative agreements, AND
  – The public does not already have access to the information about the compensation thru periodic reports filed with the SEC or the IRS

• Then the Executive Compensation reporting is required.
Where, When and How

• Must report the names and total compensation in the preceding completed fiscal year for its five most highly compensated executives
• First report is required by the end of the month following the month of the award of the (first such) contract
• Subsequent reports are required annually thereafter
• Reporting requirement is to insert the required data in the contractor’s record at the Central Contractor Registry at www.ccr.gov
Consequences of Non-Compliance

- FAR 4.1402(d) states, in part, “...the contracting officer shall exercise appropriate contractual remedies. In addition, contracting officer shall make the failure to comply a part of the contractor’s performance information under Subpart 42.15.”
- Virtually toothless
  - As a result, compliance is spotty at best
1\textsuperscript{st} tier Subcontractor

Executive Compensation Reporting Requirement

- All subcontracts awarded under a prime contract containing the clause FAR 52.204-10, Reporting Executive Compensation and First Tier Subcontract Awards (2010), and meeting the following test must be reported
- Value of the prime contract was:
  - $20\text{ M}$ for contracts awarded before Sept 30, 2010; or
  - $550,000 for contracts awarded before Feb. 28, 2011; or
  - $25,000 thereafter, and
- The subcontractor, in its preceding fiscal year, met ALL of these criteria:
  - 80\% or more of the subcontractor’s income was from federal contracts, subcontracts, grants, and cooperative agreements, and
  - The subcontractor earned more than $25 M in annual gross revenue from federal contracts, subcontracts, grants, and cooperative agreements, and
  - The public does not have access to the subcontractor’s compensation information via the SEC or IRS filings
Reporting Requirement

- The **prime contractor** is required to report the names and total compensation in the (subcontractor’s) preceding completed fiscal year of the subcontractor’s five most highly compensated executives (includes management personnel)

- Report must be submitted electronically at [www.fsrs.gov](http://www.fsrs.gov) by the end of the first month following the month of award and annually thereafter

- Prime is also required to notify every subcontractor that this information will be made public
Subcontract Award Reporting
1st Tier Subcontractor Award Reporting

- Requires reporting of extensive data with respect to the award of certain first-tier subcontracts
  - Unique Identifier (DUNS Number) for the Sub and the sub’s parent company (if any)
  - Name of subcontractor
  - Amount of the subcontract award
  - Date of the subcontract award
  - Description of the products or services being provided under the subcontract, including the overall purpose and expected outcomes or results anticipated
  - Subcontract number
  - Subcontractor’s physical address, including address and congressional district
  - Subcontractor’s primary performance location, address and congressional district
  - Prime contract number, and order number (if any)
  - Awarding agency and code
  - Funding agency and code
  - Government contracting office code
  - Treasury account symbol s reported in the Federal Procurement Data System (FPDS)
  - Applicable North American Industry Classification System code
Criteria for applicability

- Triggered upon award of a subcontract of $25,000 or more under a prime contract containing the clause FAR 52-204.10, Reporting Executive Compensation and First Tier Awards (2010), when
  - Value of the prime contract was:
    - $20 M for contracts awarded before Sept 30, 2010; or
    - $550,000 for contracts awarded before Feb 28, 2011; or
    - $25,000 thereafter, and
  - Prime contractor’s gross income from all sources in the previous year exceeded $300,000, and
  - Subcontractor’s gross income from all sources in the previous tax year exceeded $300,000
Criteria for Applicability

- Will apply to most federal contractors, particularly now that the phase-in period is over (completed March 1, 2011)
- Many of the exemptions that apply to other federal reporting requirements do not apply in this case
  - Contracts and subcontracts for commercial items and Commercially Available Off-the-Shelf (COTS) items are not exempt
  - Reporting obligation applies to umbrella contracting agreements, such as, IDIQ and blanket purchase agreement documents
Consequences of Non-Compliance

- FAR 4.1402(d) states, in part, “…the contracting officer shall exercise appropriate contractual remedies. In addition, contracting officer shall make the failure to comply a part of the contractor’s performance information under Subpart 42.15.”
  (Same as Exec Comp reporting)
- Virtually toothless
  - As a result, compliance is spotty at best
  - Virtually NO data visible at FFATA.org (transparency act site)
CAS and the Disclosure Statement
FAR versus CAS

• FAR
  – All about ALLOWABILITY
  – Defines when and to what extent costs can be recovered under a government contract

• CAS
  – All about ALLOCABILITY
  – Dictates the way in which a contractor must maintain its accounting system and instructs contractors how to account for certain types of costs; how costs flow to cost objectives
CAS Overview

• Cost Accounting Standards
  – CAS Board Established by Public Law in 1970
  – Re-established in 1988 within OFPP which is under OMB
    • OFPP Administrator Chairman
    • 2 Industry Members
    • 2 Government Members (DOD and GSA)

• Promote Uniformity and Consistency

• Condition for Contract Award
  – Applicable to all contracts
    • Originally just Defense Contracts

• Basic requirements
  – Disclose Accounting Practice
  – Follow Accounting Practice
  – Comply with Standards
CAS Applicability

- **Modified Coverage**
  - Awards from $7.5M up to $50 Million
  - May require Disclosure Statement
  - CAS 401, 402, 405 & 406 only

- **Negotiated Contracts and Subcontracts**
  - Exceeding $650,000
    - Includes options

- **CAS coverage at award remains for life of contract**

- **Full Coverage**
  - Awards estimated to exceed $50 Million, including option amounts
  - File Disclosure Statement
  - Comply with all standards

- **Negotiated Contracts and Subcontracts**
  - Exceeding $650,000
    - Includes options

- **CAS coverage at award remains for life of contract**
EXEMPTIONS FROM CAS

- Sealed bid contracts
- Negotiated contracts and subcontracts (including interdivisional work orders) less than $650,000
- Contracts and Subcontracts with Small Business Concerns
- Contracts and Subcontracts with foreign governments or their agents
  - Foreign Contractors apply CAS 401 & 402
- Contracts and Subcontracts where the Price is set by Law or Regulation
- Firm-Fixed-Price contracts and subcontracts for the acquisition of Commercial Items
EXEMPTIONS FROM CAS cont.

• Contracts less than $7.5 million provided that not currently performing a CAS contract of $7.5 million or greater

• Firm Fixed Price Contract awarded on the basis of adequate price competition without cost or pricing data
CAS STANDARDS
(Modified Coverage Only)

GENERAL STANDARDS

– **CAS 405** Accounting for Unallowable Costs
  • Requires proper segregation, but does not address allowability
    • FAR reference – 31.201-2, 31.201-6

– **CAS 406** Cost Accounting Period
  • Defines contractor’s cost accounting period
    • FAR reference – 31.203
The Rest of the CAS STANDARDS

- CAS 403  Allocation of Home Office Expenses
- CAS 404  Capitalization of Tangible Assets
- CAS 407  Use of Standard Costs for Direct Material and Direct Labor
- CAS 408  Accounting for the Cost of Compensated Personal Absences
- CAS 409  Depreciation of Tangible Capital Assets
- CAS 410  Allocation of Business Unit G&A Expense
- CAS 411  Accounting for Acquisition of Material
- CAS 412  Composition and Measurement of Pension Cost
- CAS 413  Adjustment and Allocation of Pension Cost
- CAS 414  Cost of Money as an Element of the Cost Facilities Capital
- CAS 415  Accounting Deferred Compensation
- CAS 416  Accounting for Insurance Costs
- CAS 417  Cost of Money as an Element of Capital Assets Under Construction
- CAS 418  Allocation of Direct and Indirect Costs
- CAS 420  Accounting for IR&D and B&P Costs
CAS Coverage and Disclosure Statement Determination

CAS Exemptions – 48 CFR 9903.201-1(b)

START

Does contract/subcontract meet one of the listed CAS exemptions?

Yes  
Contract or subcontract is exempt from CAS

No  
Is current award $7.5 Million or more, or is the business unit currently performing a CAS-covered contract or subcontract valued at $7.5 million or more?

Yes  
Award is CAS Covered

No  
Is the current award $50 million or more?

Yes  
Did the business unit receive $50 million or more in net CAS-covered awards in the preceding cost accounting period?

Yes  
Contract/subcontract subject to modified coverage (CAS 401, 402, 405, 406) or contract/subcontract with foreign concerns subject to CAS 401 and 402

No  
Has the business unit received a single CAS-covered contract/subcontract of $50 million or more during the current cost accounting period?

Yes  
Contract/subcontract is subject to full CAS coverage (all 19 Standards)

No  
Business Unit Disclosure Statement required.

Home office allocating costs to one or more disclosing segments must also submit Part VIII.

No  
Did the company together with its segments receive $50 million in net CAS-covered awards during the preceding cost accounting period?

Yes  
Are the segment CAS-covered awards during the prior cost accounting period less than $10 million and less than 30% of total segment sales?

Yes  
Disclosure Statement is not required

No  
Contract/subcontract executed and performed entirely outside the U.S., its territories and its possessions

Contract/subcontract with foreign governments, their agents, or instrumentalities. Exemption does not extend to contract/subcontract with foreign concern which is subject to CAS 401/402.

Subcontract under the NATO PHM Ship Program to be performed outside of the United States by a foreign concern

Contract/subcontract less than $7.5 million, provided the contractor is not currently performing any CAS-covered contracts/subcontracts of $7.5 million or more

START
CAS STANDARDS
(Modified Coverage Only)

CONSISTENCY STANDARDS

– **CAS 401** Consistency in Estimating, Accumulating, and Reporting Costs

  (Bid = Book = Bill)

  • FAR reference - 31.201-1, 31.203

– **CAS 402** Consistency in Allocating Costs Incurred for the Same Purpose

  • Cost must be treated the same in like circumstance
  • FAR reference – 31.202, 31.203
Disclosure Statement Requirement

• Any business unit that is selected to receive a CAS-covered contract or subcontract estimated to exceed $50 million, including option amounts, shall submit a Disclosure Statement before award.

• Any company which, together with its segments received CAS-covered awards totaling more than $50 million in its most recent cost accounting period shall submit a Disclosure Statement. When a Disclosure Statement is required under this criteria, it must be submitted before award of the first CAS-covered contract in the immediately following cost accounting period. However, if the first covered award is made within 90 days of the start of the cost accounting period, the contractor is not required to file until the end of the 90 days.
Consequences of Non-Compliance

• At 6 months overdue, DCAA will write a demand letter
• At about 12 months, the letters become more strident and there will be threats of unilateral rate determination
• At about 18 to 24 months, the ACO may make a unilateral determination of the rates for the year in question
• The result is almost ALWAYS a significant repayment to the Government of amount invoiced
Protests, Enforcement and Business Systems

Charles "Chip" Fletcher

Board Certified in State & Federal Government & Administrative Practice
## Protest Statistics*

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<td><strong>Total Filings</strong></td>
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<td>2353</td>
<td>2226</td>
<td>1989</td>
<td>1652</td>
<td>1411</td>
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<td><em>Year-over-year change</em></td>
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<td>5.7%</td>
<td>11.9%</td>
<td>20.4%</td>
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<td><strong>Withdraw or Dismissed (1)</strong></td>
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<td>1936</td>
<td>1785</td>
<td>1674</td>
<td>1361</td>
<td>1076</td>
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<td><strong>Total Considered</strong></td>
<td></td>
<td>417</td>
<td>441</td>
<td>315</td>
<td>291</td>
<td>335</td>
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<td><em>Year-over-year change</em></td>
<td></td>
<td>-5.4%</td>
<td>40.0%</td>
<td>8.2%</td>
<td>-13.1%</td>
<td>34.5%</td>
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<td><strong>Denied</strong></td>
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<td>350</td>
<td>359</td>
<td>258</td>
<td>231</td>
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<td><strong>Sustained</strong></td>
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<td>67</td>
<td>82</td>
<td>57</td>
<td>60</td>
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<td><em>Success Rate (% of Filings)</em></td>
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<td>3.7%</td>
<td>2.9%</td>
<td>3.6%</td>
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<td><em>Year-over-year change</em></td>
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<td><strong>Hearings Conducted (2)</strong></td>
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<td>46</td>
<td>61</td>
<td>65</td>
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<td>41</td>
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*From the GAO’s Annual Report to Congress – 2007 - 2011
Traditional Protest Grounds

- Improper technical or price evaluation
- Relaxation of the RFP/RFQ requirements
- Failure to follow the stated evaluation grounds
- Addition of an undisclosed evaluation ground
- Improper cost-technical trade-off decision
- Improper or incomplete discussions
- Organizational or personal conflict of interest
New Trends in Protests

- Recent protests seen based on solicitation requirement to have an adequate system
- GAO has consistently refused to disturb an agency’s judgment on adequacy given reasonable grounds
- GAO has consistently held that adequacy of systems is a responsibility determination and the exclusive purview of the contracting officer
Uses of the New Protests

- Some “disappointed bidders” seek to overturn award to competitor by challenging system status of winner
- Some “disappointed bidders” seek second chance by challenging agency determination of non-responsibility
- Some prospective offers challenging use of solicitation provisions prior to closing
Agency Must Have Reasonable Grounds for Disqualification

- Recently, FTA determined a bidder was non-responsible based on DCAA report but determination was not based on law or regulation
- GAO held that “a negative responsibility determination will not be found to be reasonable where it is based primarily on unreasonable or unsupported conclusions”

McKissack+Delcan JV II, B-401973.2, B-401973.4 (January 13, 2010) 2010 CPD ¶28
If Adequacy is Solicitation Requirement, Offeror Must Comply

- A solicitation stated “[a]n offeror’s accounting system shall be adequate for determining costs applicable to the contract”
- Based on a DCAA report, the Army concluded that firm’s accounting system was inadequate
- Firm protested
- GAO held that agency had a reasonable basis for evaluating the adequacy and denied the protest

KMS Solutions, LLC, B-405323.2; B-405323.3 (October 6, 2011).
Lessons Learned

• When a solicitation contains unreasonably restrictive requirements, the time for protest is before closing!

• “Rejection of firm's proposal due to evaluated problems in its accounting system concerns a matter of a prospective contractor's responsibility, not technical acceptability.”

Pacificon Productions, Inc., B-196371, July 22, 1980, 80-2 CPD para. 58 at 4
Enforcement of Adequate Business System Requirements

- Amendments to DFARs allow withholding of up to 10% when a contracting officer finds a “significant deficiency”
  - Allows withholding of 5% for each deficient business system, up to 10% total
  - Applies to solicitations after May 18, 2011 and contracts after August 16, 2011
  - Applies only to CAS-covered contacts
  - Funds will be released after corrective action
Value of Business Systems

• FARs Subpart 9.4—Debarment, Suspension, and Ineligibility
  – . . . the debarring official should consider factors such as the following:
    Whether the contractor had effective standards of conduct and internal control systems in place . . . or had adopted such procedures prior to any Government investigation of the activity cited as a cause for debarment.

FAR 9.406-1
Value of Business Systems

• Causes for suspension or debarment.
  – Willful failure to perform in accordance with the terms of one or more contracts; or
  – A history of failure to perform, or of unsatisfactory performance of, one or more contracts.
  – Knowing failure by a principal, until 3 years after final payment on any Government contract . . . Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments . . . in 32.001.

See FAR 9.406-2(b).
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