

The Final Business Systems Rule

Overview

On February 24, 2012, the Final Rule pertaining to contractor business systems was adopted into law (DFARS Case 2009-D038). The final business system rule is very similar to the interim rule published on May 18, 2011.

Major system reviews have been performed by the federal government since 1985. Internal controls have been a major focus of the federal government for several years and have been paid even more attention since the adoption of FAR 52.203-13, Contractor Code of Business Ethics and Conduct (effective as of December 24, 2007). One of the stated criteria of FAR 52.203-13 was to create an internal control system that will facilitate timely discovery and disclosure of improper conduct in connection with government contracts. Over the next several years, internal control requirements slowly evolved into system-specific requirements for major business systems, as defined by the DoD.

The DFARS clause for business systems is 252.242-7005. As was the case with the interim business system rule, the Final Rule defines six contractor business systems:

- Accounting ([252.242-7006](#))
- Earned Value Management (EVM) ([252.234-7002](#))
- Estimating ([252.215-7002](#))
- Purchasing ([252.244-7001](#))
- Material Management & Accounting System (MMAS) ([252.242-7004](#))
- Property ([252.245-7003](#))

It is unclear at this time whether the business system rules clause will apply if the DFARS business system clause is included without reference to one or more of the six business systems or, conversely, if a business system specific is included without the business systems clause.

Points of Interest from the Final Rule

The business systems rule applies only to contracts subject to CAS covered awards (modified and full coverage). Contractor business systems will be considered either “Approved” or “Disapproved.” Pursuant to the 2008 Memorandum for Regional Directors (MRD), DCAA and DCMA will not issue audit opinions finding a system to be “Inadequate in part”.

There is a new definition for the phrase “Significant Deficiency” It is now defined as “A shortcoming in the system that materially affects the ability of officials of DOD and the Contractor to rely upon information produced by the system that is needed for management purposes.”

A single significant deficiency in any one of the six business systems will trigger disapproval of that system and may result in withholding on invoices.

Withholding as a result of one significant deficiency in one system is capped at five percent.

Withholding as a result of more than one significant deficiency (whether in a single system or across multiple systems) is capped at ten percent.

If a contract is completed while one or more business systems are disapproved, the government may continue withholdings on other contract(s) until the deficiency or deficiencies are corrected. However, withholdings on closed contracts are to be released.

Withholds are reduced to 2% per system if the contractor submits an acceptable corrective action plan within 45 days of final determination of a significant system deficiency.

If the corrective action plan is not evaluated within 90 days by the Contracting Officer (CO), the CO is required to reduce remaining withholdings by 50%.

COs may rely on data solely from the contractor to assess whether a significant deficiency has been corrected.

Withholds from disapproved systems are not subject to prompt payment interest upon release. Release occurs when either the deficiency is corrected or the contract is closed.

University Research Centers are excluded from the Business Systems Clause.

The DFARS clause for accounting systems was updated with the Final Rule. Accounting systems subject to the business systems clause now must be reviewed by management or be subject to internal system audits to ensure compliance with the Contractor’s established policies, procedures, and practices in order to be defined as adequate/approved under the newly enacted Final Rule.

The Final Rule clarifies language providing for the Contracting Officer to make determinations based on the evidence submitted by the Contractor, if there is a reasonable expectation that the Contractor’s corrective actions have been implemented and are expected to correct the significant deficiencies.

Business System Timeline

The following represents a timetable for significant events following the audit of a business system subject to the Final Rule resulting in a negative determination.

Timeline Begins	Contracting Officer (CO) shall communicate initial determination of system approval or disapproval within 10 days of receipt of functional specialist report.
+30 days	Contractors have 30 days to respond to the initial determination of system disapproval.
+30 days (+60 days total)	COs are to issue a final determination of system adequacy within 30 days of receipt of a contractor initial determination response. **Withholds begin within final determination of a contractor’s system adequacy. Maximum of 5% withhold for one significant deficiency in one system; maximum of 10% withhold for one or more significant deficiencies in more than one system.
+45 days (+105 days total)	Contractors have 45 days to respond to the final determination of system adequacy. During this time, contractors can (a) correct deficiencies, or (b) submit a corrective action plan (CAP). If the CO determines the CAP is acceptable, the CO can reduce withholdings to 2% per system.
+15 days (+120 days total)	COs have 15 days to review the CAP and/or the corrective actions.

Audit Guidance

DCMA and DCAA have NOT published formal audit guidance on business system audits under the newly enacted Final Rule as of the date of this article. However, DCMA has issued internal guidance within its "Guidebook". Significant guidance includes:

Contracting Officers (COs) will track the status of Contractor's Business Systems via the Contract Business Analysis Repository (CBAR); CBAR is not tied to FAPIIS and is NOT a public system.

Guidance currently states that the CO is to impose withholds on CAS covered contracts greater than or equal to \$50M in value.

IDIQ awards are to be measured at the delivery-order level.

DCMA has issued guidance to state withholds may be imposed on CAS-covered contract values less than \$50M if the withholds are in the best interest of the government.

Implications Resulting from the Final Business System Rule

There will likely be more transactional testing under the new guidelines, and as a result, audits will likely take longer to complete. Contractors may want to consider increasing compliance operations budget to take into consideration additional resource drain and cost to support longer audits, more reporting requirements, increased internal monitoring and control activities and processes.

DCAA has identified Incurred Cost Submission (ICS) audits as an area of focus for calendar year 2012. Contractors with approved Business Systems will likely receive first priority for ICS Audits. Contractors with open ICS proposals, particularly for 2006 and 2007, should plan and prepare to settle final rates via the impending audits.

Accounting and purchasing systems are the first targeted system audits resulting from the changes to the final business system rule. Contractors with significant purchasing volume, including subcontracts, should ensure that procurement files, policies, procedures, management and organizational controls are operating as planned. Contractors should plan to include the functional areas of Billing, Compensation, Labor, Indirect & ODCs, Budget & Planning and EDP (IT) as subsystems within the auspices of the accounting system audit.

When invoicing via progress payments (Fixed Price contracts), guidance dictates that the gross invoice amount should be shown and any withholding pursuant to the Business Systems Rule would become aged receivables. When invoicing on vouchers (Flexibly Priced contracts), withholdings should be excluded and the net amount should be shown, effectively making the withholding an "unbilled receivable." Contractors should consider an update to Billing policies, procedures and processes to account for these new requirements. Contractors should also track carefully the total amount of withholds they are subject to so that they can recoup the withheld amount upon remediation of the system deficiency(ies) or contract closeout, whichever occurs first.

The new rules will likely have negative cash flow implications for contractors subject to withholds. Contractors who anticipate withholds, may want to consider increasing cash reserves.

Internal controls around all systems will be more important than ever. Contractors should consider conducting internal controls monitoring on a rolling basis to ensure internal controls are operating as intended.

Since the business systems clause only applies to contracts subject to DFARs and CAS, it is critical for contractors to document CAS coverage for each contract if not already doing so. Contractors should, if not already doing so, prepare contract briefs and track in a contract database, repository or other file, the clauses applicable to the contract including CAS coverage.

If the business system clause is included in a non-CAS covered award, the clause is supposed to be self-deleting. Contractors should adjust contract administration procedures to provide guidance relative to self-deleting clauses, if they have not already done so.

Under the new definition of significant deficiency, Materiality is not further defined and therefore its definition is open to varying interpretations. Contractors may want to consider defining materiality in their policy/procedures and providing guidance for employees to follow corporate policy.

For disapproved system(s) subject to invoice withholdings, there is no statutory guidance requiring the CO to ever review a corrective action plan; therefore, there is a risk that withholds could continue even following remediation of previously identified deficiencies absent a follow up audit. Conversely, COs may rely on data solely from the contractor to assess whether a significant deficiency has been corrected. Contractors should maintain fluid communications with the CO administering any withhold. Converse and seek guidance, in writing, relative to that CO's requirements and protocol for reporting remediation of the documented deficiency, and processing removal of the withhold from future progress payments and vouchers.

Contractors cannot validate their system status within CBAR. Therefore, a contractor's status within the system will be unknown to them.

Specific guidance was absent in the February 24, 2012 Final Rule regarding unreviewed systems. As a result, it is unclear what terminology should be used for business systems that are in a "not approved" status. Not approved may refer to:

- A business system(s) that has not been audited or reviewed
- A business system(s) where the system has not been reviewed in more than 3 years
- Business systems where a contractor is under review but no audit determination has been made

In a report last year (No. 12-83, November 2011) GAO recommended that DCMA "identify ways to accurately reflect the status of contractor business systems, such as changing the status to unassessed when audits are delayed." DOD concurred with this report recommendation and it is likely that we will see many systems reported as "unassessed" in the next few years. This status may be assigned to systems not yet reviewed, systems for which the last review was more than three years ago, or even system under review for which a determination has not been made.

Contractors may want to consider establishing a policy on how to refer to unreviewed systems and the parameters for using such a term. If a particular solicitation includes a requirement for the offeror to have an "approved system" (whichever system it might be), a status of unassessed may be just as bad as a status of "deficient."