

Contract Closeouts – Not As Easy as Open and Shut

COHN  REZNICK

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ACCOUNTING • TAX • ADVISORY

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OBJECTIVES

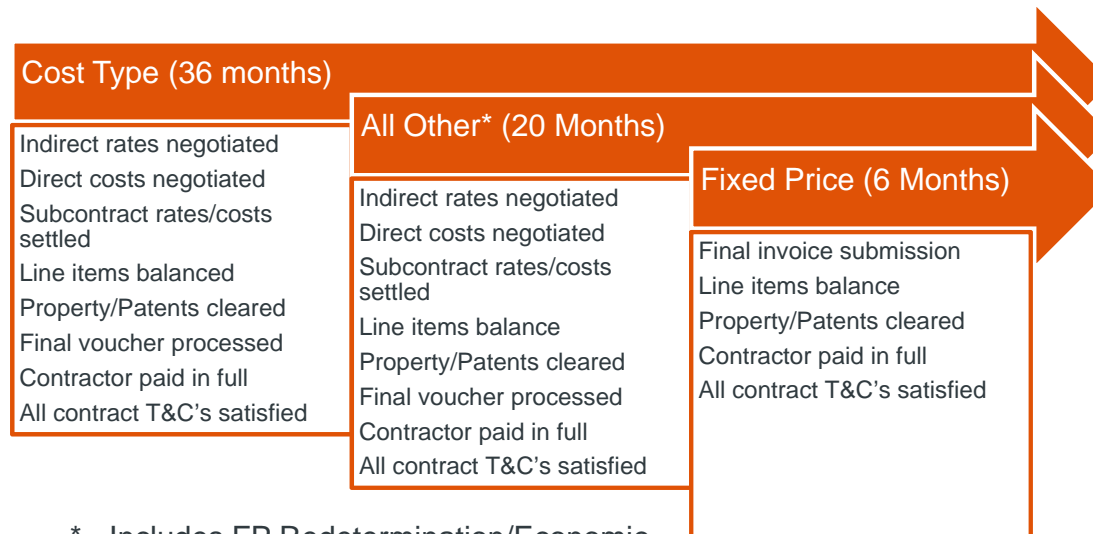
- Contract Closeout from Government Perspective
- Prime Contractor Contract Closeout Responsibilities
- Subcontract Closeout Responsibilities
- Overview of Subcontract Audits
- Best Practices



**GOVERNMENT PERSPECTIVE
ON CONTRACT CLOSEOUTS**

FAR TIMELINE GUIDANCE

- FAR 4.804-1: Time Standards for Closing Contracts



* - Includes FP Redetermination/Economic Price Adjustment and BOAs/BPAs

CONTRACT CLOSEOUT CHECKLIST

CONTRACT CLOSEOUT CHECK-LIST <i>(Use a separate page to attach any comments.)</i>				1. CONTRACT NUMBER	
3. NAME OF CONTRACTOR				2. CONTRACT MODIFICATION NUMBERS <i>(If applicable)</i>	
5. ACTION ITEMS	6. MILESTONES/CALENDAR MONTHS AFTER PHYSICAL COMPLETION <i>(FAR 4.804-1)</i>			7. FORECAST COMPLETION DATE <i>(YYYYMMDD)</i>	8. DATE ACTION COMPLETED <i>(YYYYMMDD)</i> <i>(NA if not applicable)</i>
	Category 2	Category 3	Category 4		
a. DISPOSITION OF CLASSIFIED MATERIAL COMPLETED					
b. FINAL PATENT REPORT SUBMITTED <i>(Inventions Disclosures)</i> DD 882					
c. FINAL ROYALTY REPORT SUBMITTED					
d. FINAL PATENT REPORT CLEARED <i>(Inventions Disclosures)</i>					
e. FINAL ROYALTY REPORT CLEARED					
f. ISSUANCE OF REPORT OF CONTRACT COMPLETION					
g. NO OUTSTANDING VALUE ENGINEERING CHANGE PROPOSAL <i>(VECP)</i>					
h. PLANT CLEARANCE REPORT RECEIVED DD 1593					
i. PROPERTY CLEARANCE RECEIVED DD 1593					
j. SETTLEMENT OF ALL INTERIM OR DISALLOWED COSTS <i>(DCAA Form 9)</i>					
k. PRICE REVISION COMPLETED					
l. SETTLEMENT OF SUBCONTRACTS BY THE PRIME CONTRACTOR					
m. PRIOR YEAR OVERHEAD RATES COMPLETED					
n. CONTRACTOR'S CLOSING STATEMENT RECEIVED					
o. FINAL SUBCONTRACTING PLAN REPORT SUBMITTED					
p. TERMINATION DOCKET COMPLETED DD 1593					
q. CONTRACT AUDIT COMPLETED					
r. CONTRACTOR'S CLOSING STATEMENT COMPLETED					
s. FINAL VOUCHER SUBMITTED SF 1034					
t. FINAL PAID VOUCHER RECEIVED SF 1034					
u. FINAL REMOVAL OF EXCESS FUNDS RECOMMENDED					
v. ISSUANCE OF CONTRACT COMPLETION STATEMENT <i>(Or MILSCAP Format Identifier PK9)</i>	6	36	20		
w. OTHER REQUIREMENTS COMPLETED <i>(Specify)</i>					
9. RESPONSIBLE OFFICIAL					
a. TYPED NAME <i>(Last, First, Middle Initial)</i>			b. TITLE		
c. SIGNATURE <i>(Sign only upon completion of all actions)</i>				d. DATE SIGNED <i>(YYYYMMDD)</i>	

DD FORM 1597, APR 2000

PREVIOUS EDITION MAY BE USED.

IMPORTANT NOTE!

- Contracts **cannot** be closed out if they are:
 - In litigation
 - Under appeal
 - Being terminated
 - Awaiting the completion of all termination actions



FAR 4.804-5 PROCEDURES FOR CLOSING OUT CONTRACT FILES

- Disposition of classified material completed
 - In DoD – Use DD Form 254, DoD Contract Security Classification Specification (also for subs)
- Final patent report submitted and cleared
 - If contracts has patents right clause FAR 52.227-11 or 13, a final patent report must be submitted within 3 months after physical completion (must address subs as well!)
 - In DoD – Use DD Form 882, Report of Inventions and Subcontracts
- Final royalty report submitted
 - FAR 52.227-9 requirement



FAR 4.804-5 PROCEDURES FOR CLOSING OUT CONTRACT FILES

- No outstanding value engineering change proposals (VECP)
 - FAR 52.248-1 requirement
- Plant clearance report received
 - SF 1428 (inventory disposal schedule)
- Property clearance received
 - GFP/GFE must be properly dispositioned at the end of the contract
- Settlement of all interim or disallowed costs
- Price revision completed (economic price adjustments)



FAR 4.804-5 PROCEDURES FOR CLOSING OUT CONTRACT FILES

- Subcontracts are settled
 - Subcontracts must be paid and closed
- Prior year indirect cost rates are settled
- Termination docket completed
 - All open actions and liabilities must be resolved
- Contract audit is completed
 - More on this later



FAR 4.804-5 PROCEDURES FOR CLOSING OUT CONTRACT FILES

- Contactor's closing statement is completed (letter of release of claims)
 - Release of claims required for non-commercial cost reimbursable, fixed price construction and architect-engineer, T&M and Labor Hour contracts
- Contractor's final invoice has been submitted
 - Final voucher reflects the settled amounts and rates
- Contract funds review is completed and excess funds deobligated



See the Tools and Reference Materials section on GovCon360.com for an Excel spreadsheet tool to track closing activities.

DETERMINATIONS OF FINAL INDIRECT COST RATES

- FAR 42.705
 - Contracting Officer Determination Procedure
 - Led by a cognizant contracting officer (C/O)
 - Often utilizes cognizant auditors
 - Contracting officers cannot resolve any questioned costs until adequate documentation is obtained and the contract auditor's opinion is obtained
 - C/O conducts negotiations, prepares rate agreements and negotiation memorandum which documents dispositions of significant matters, reconciles costs questions, explains why any audit recommendations were not followed, identifies certified cost or pricing data submitted and used
 - Auditor Determination Procedure

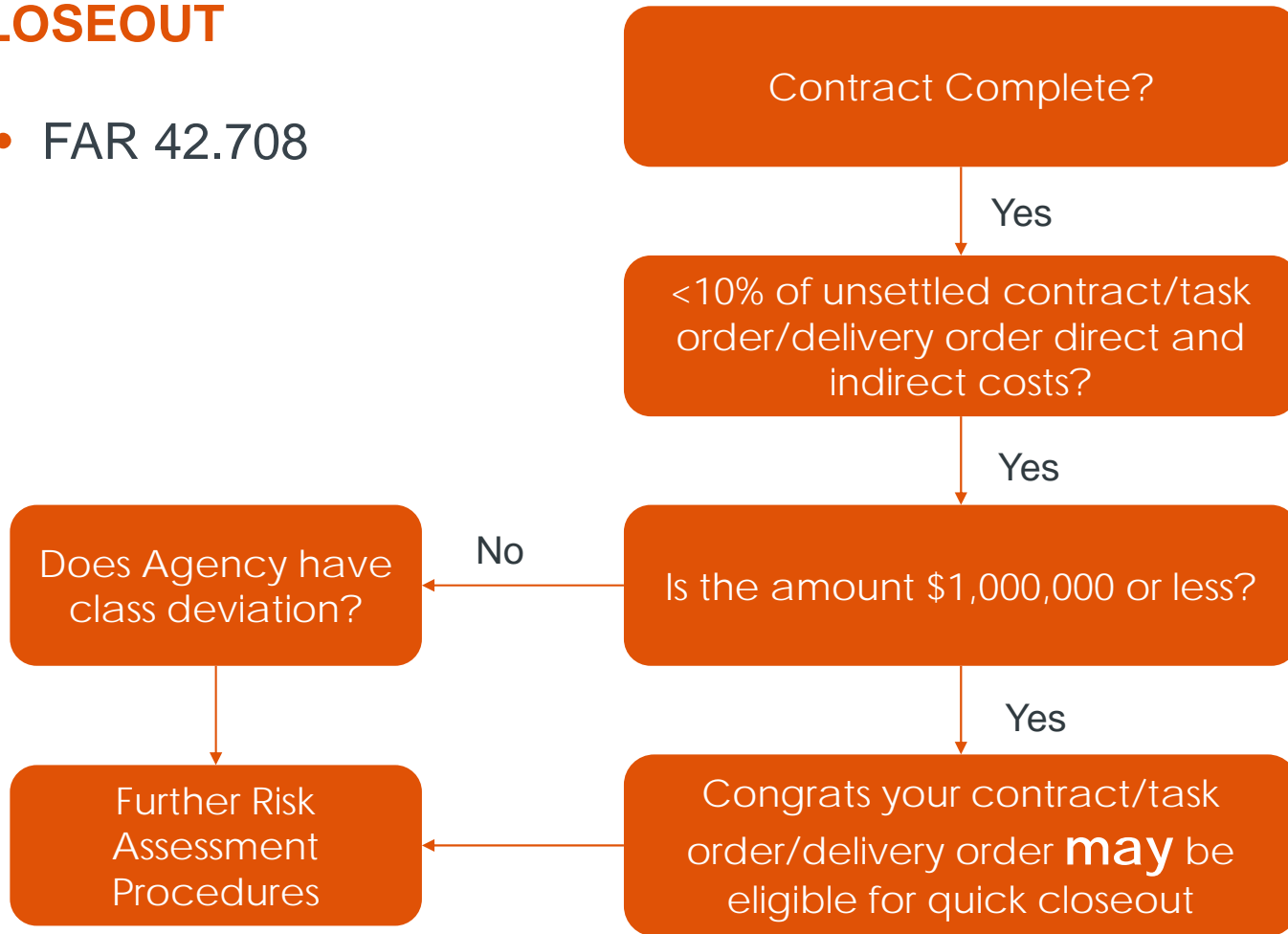


CUMULATIVE ALLOWABLE COST WORKSHEET (CACWS)

- Schedule I of Incurred Cost Submission
 - Summarizes cumulative allowable costs for each flexibly priced final cost objective (contract/task order/delivery order)
 - Often used to assist ACO's in closing without necessitating individual contract audit closing statements
 - May simplify SF1035 final voucher presentation
 - **Bottom line:** Reduced resources necessary for contractor and government

QUICK CLOSEOUT

- FAR 42.708



QUICK CLOSEOUT CONTINUED

- Risk Assessment Should Include:
 - Business System Status?
 - Concerns of cognizant contract auditors
 - Other pertinent information to include:
 - History of indirect cost rate agreements
 - Rate structure changes
 - Mergers/Acquisitions



QUICK CLOSEOUT CONTINUED

- What indirect rates will be used?
 - Provisional?
 - Submitted?
 - C – None of the above?
- **NO** impact on other final indirect cost rates



FEDERAL GOVERNMENT CHALLENGES

- GAO Report 17-738: Additional Management Attention and Action Needed to Close Contracts and Reduce Audit Backlog
 - Defense
 - Health and Human Services
 - Homeland Security
 - Justice
 - State



GAO REPORT 17-738

“None of the agencies had critical elements agency-wide that would help track and oversee contract closeout processes”

- Number and type of contracts to be closed
- Where the contracts were in the process
- Goals and performance measures

- DCAA backlog isn't helping either



GAO REPORT 17-738

Table 1: Extent to Which Selected Agencies and Components GAO Reviewed Had Available Data on Contract Closeout and Established Goals and Performance Measures

Department/component	Does Agency or Component Have			
	Centralized data on number of contracts eligible or overdue for closeout	Information on where contracts are in the closeout process	Goals associated with reducing the number of contracts needing to be closed out	Performance measures to assess progress in achieving goal
Defense	No	No	No	No
Air Force	Yes	No	Yes	Yes
Army	Yes	No	Yes	Yes
Navy	Yes	No	Yes	Yes
Defense Contract Management Agency	Yes	Yes	Yes	Yes
Defense Logistics Agency	Yes	No	Yes	Yes
Health and Human Services	No	No	No	No
Centers for Medicare and Medicaid Services	Yes	No	Yes	Yes
Homeland Security	Yes	No	No	No
Justice	No	No	No	No
Bureau of Alcohol, Tobacco, Firearms, and Explosives	Yes	No	No	No
Bureau of Prisons	No	No	No	No
Federal Bureau of Investigation	No	No	No	No
State	No	No	No	No

Source: GAO analysis of agency data. | GAO-17-738

GAO REPORT 17-738

Conclusion

“We found that closing out contracts is not the highest priority for contracting officers that are charged with awarding and administering contracts for products and services to meet missions needs”



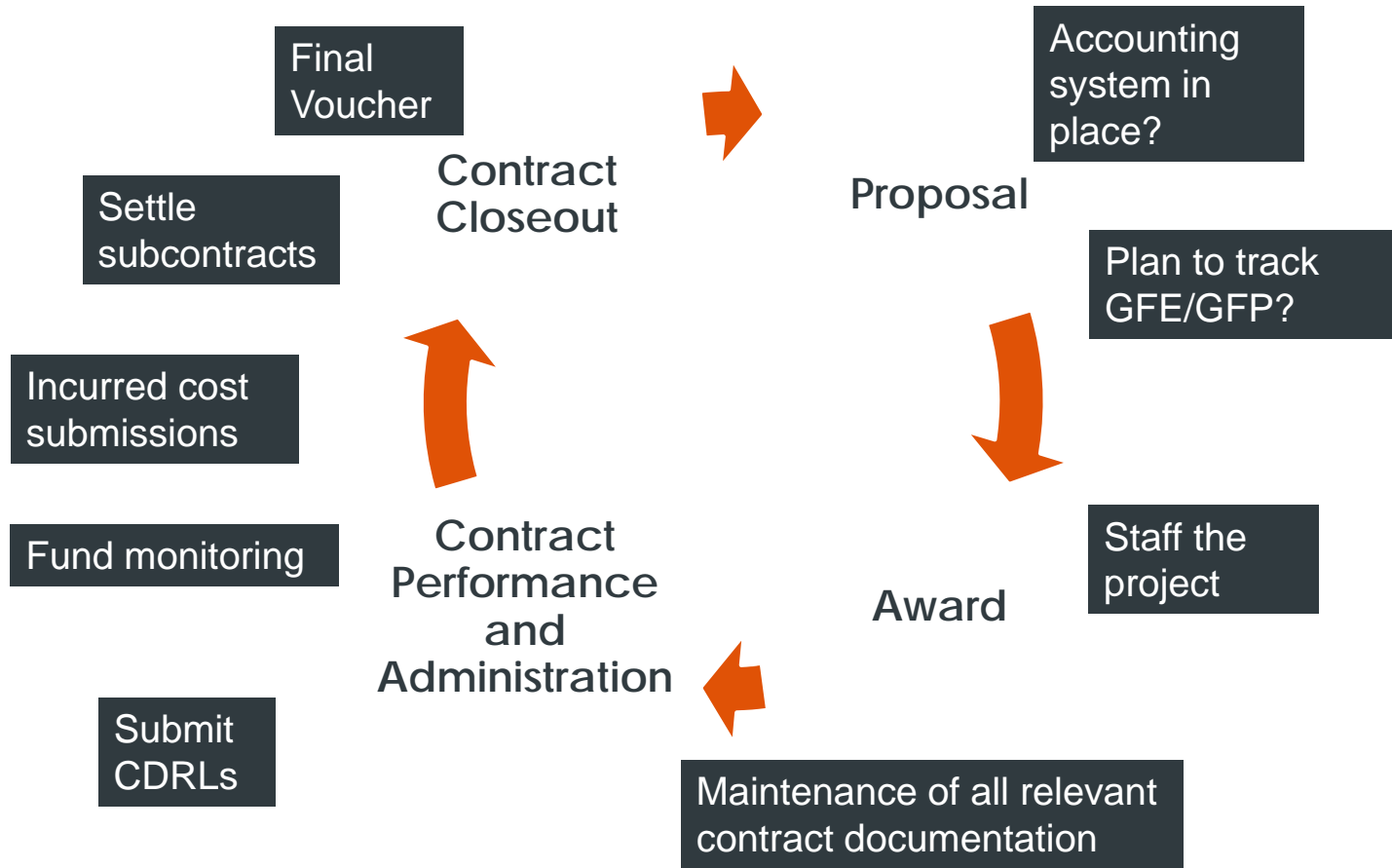
Recommendations

For each agency – “a means for department-wide oversight into components’ progress in meeting their goals on closing contracts and the status of contracts eligible for closeout”



**CONTRACTOR PERSPECTIVE
ON CONTRACT CLOSEOUTS**

CONTRACT LIFE CYCLE – BEGIN WITH THE END IN MIND



CONTRACTOR CLOSEOUT REQUIREMENTS

- Per the Allowable Cost and Payment clause (FAR 52.216-7(d)) and FAR 42.705 requirements include:
 - Prepare and submit Incurred Cost Proposal (ICP) within **six months** following end of each contractor fiscal year
 - True up all interim vouchers within **60 days** after rates are settled
 - Close subcontracts before closing the prime contract
 - Prepare final voucher within **120 days** after rates are settled, including subcontractor rates



WHY DOES THE GOVERNMENT WANT TIMELY EFFICIENT CLOSEOUTS?

- Identify and recover improper payments
- Receive money from under run contracts
- Deobligate funds and utilize elsewhere
- Assist with getting clean audit opinions
- Limit future liability
- Be compliant with FAR time requirements
- Maintain personnel who understood contract requirements



WHY DO CONTRACTORS WANT TIMELY EFFICIENT CLOSEOUTS?

- Collect debt (retainages, rate overruns)
- Expensive to maintain records
- Reduce uncertainty and risks (release of claims!)
- Minimize time searching for documents
- Maintain personnel who understood contract requirements



BEST PRACTICES TO ALLOW FOR EFFICIENT CLOSEOUTS

- Timely, Adequate Incurred Cost Submissions
- Use standardized procurement and accounting file organization
- For hard copy documents in storage, know what's in each box
- Regular IT Backups for electronic files
- Pay close attention to your subcontracts
- Don't depend on the Government to keep good records
- Timely, complete audit responses





**SUBCONTRACT CLOSEOUT
INTRODUCTION**

SUBCONTRACT CLOSEOUT RESPONSIBILITIES

FAR 4.804-5; DD 1597 as applicable:

- (1) Disposition of classified material is completed;
- (2) Final patent report is cleared.
- (3) Final royalty report is cleared;
- (4) There is no outstanding value engineering change proposal;
- (5) Plant clearance report is received;
- (6) Property clearance is received;
- (7) All interim or disallowed costs are settled;
- (8) Price revision is completed;
- (9) **Subcontracts are settled by the prime contractor;**
- (10) Prior year indirect cost rates are settled;
- (11) Termination docket is completed;
- (12) Contract audit is completed;
- (13) Contractor's closing statement is completed;
- (14) Contractor's final invoice has been submitted; and
- (15) Contract funds review is completed and excess funds deobligated.



SUBCONTRACT CLOSEOUT RESPONSIBILITIES

WHAT ARE THE PRIME CONTRACTOR'S RESPONSIBILITIES RELATED TO SUBCONTRACT CLOSEOUT?

- Prime contractor is responsible for essentially all of the requirements the Government has to close out prime contracts (see previous slide)
Cost-type subcontract FAR Clause 52.216-7, Allowable Cost and Payment, requires:
 - Determination of final indirect rates and allowable direct costs
 - Requires audit of subcontracts
 - Generally, the Government will not perform the subcontract audit unless the subcontractor is large and it already has an audit presence at the subcontractor
 - Therefore, generally this task falls to the prime contractor



SUBCONTRACT CLOSEOUT RESPONSIBILITIES

Best Practices

- Try to close out subcontracts and POs in real time whenever possible
- Try to avoid audit of subcontractor costs when possible (negotiate fixed price subcontracts when possible)
- Document closeout process and any negotiations held at closeout





SUBCONTRACT AUDIT

SUBCONTRACT CLOSEOUT AUDIT REQUIREMENTS

AUDIT REQUIREMENTS

Cost Plus Type Subcontracts

- Requires audit of direct and indirect costs

Time and Material (T&M) Subcontracts

- Requires audit of material/ODC markup
- Requires audit of indirect rates if based on costs
- Audit of labor hours may rely, to a great extent on monthly review of time charges

SUBCONTRACT CLOSEOUT AUDIT REQUIREMENTS

T&M subcontracts have to be audited?

FAR 52.216-7 (Allowable Cost and Payment Clause) is applicable to cost type and T&M contracts for other than commercial items.

The clause requires contractors to submit a “schedule of direct costs by contract and subcontract and indirect expense applied at claimed rates.”

SUBCONTRACT CLOSEOUT AUDIT REQUIREMENTS

According to DCMA they do!

DCMA Instruction 135, Section 3.2.3.2.



“The prime contractor is responsible for auditing subcontractors and generally closes subcontracts using procedures similar to the Government. The functional specialist shall ensure that the prime has settled subcontractor costs before closing a contract/order. DCAA may issue a qualified indirect cost audit report indicating that audit of certain subcontract costs has not been completed. When the subcontract costs (direct or indirect) are considered to be immaterial, the functional specialist may proceed with contract closeout.”

SUBCONTRACT CLOSEOUT AUDIT REQUIREMENTS

But, we have over a 100 T&M subcontracts!

This is where we believe the prime must exercise judgment.

Potential Risk Assessment Procedures:

- 1. Grouping by dollar value*
- 2. Grouping by known risks*
- 3. Application of known findings to low to medium risk subcontracts*
- 4. Reliance on monthly billing controls for hours and direct costs*
- 5. Performance of audits of subcontracts classified as high risk*

Note: This is one potential solution. Each CO may have a different perception as to whether this is sufficient.

SUBCONTRACT AUDIT: DCAA'S RECENT APPROACH

OVER THE LAST SEVERAL YEARS, DCAA HAS BEEN VERY AGGRESSIVE IN QUESTIONING SUBCONTRACT COSTS WHEN IT DETERMINES:

- An audit has not been performed of T&M, LH or cost type contracts
- DCAA has applied a 20% decrement to calculate questioned costs for unaudited subcontracts
- DoDIG cited DCAA for noncompliance with GAGAS and attestation standards due to the use of the 20% decrement (Hotline Complaint Regarding the DCAA Examination of a Contractor's Subcontract Costs dated 12/23/2014).
- Therefore, DCAA appears to have discontinued use of the decrement factor. However, now may question the whole amount of the unaudited subcontracts.

Implications: DCAA has not backed off from its aggressive approaches to questioning unaudited subcontract costs.



SUBCONTRACT AUDIT: OTHER AGENCY APPROACH (NON-DOD)

AS RECENTLY AS MARCH 2016, DOE OIG REPORT INDICATED:

Alliance for Renewable Energy (Alliance) is required by its contract to conduct or arrange for audits of its subcontractors when costs are a factor in determining the amount payable to the subcontractor.

In the past the subcontract audit function for Alliance did not consistently follow Generally Accepted Government Audit Standards (GAGAS) and was found deficient in this area in a 2013 report.



SUBCONTRACT AUDIT - THE CURRENT SITUATION: HOW TO PROCEED?

Given the somewhat contradictory information (i.e., DCAA approach vs. ASBCA cases vs. FAR requirements vs. agency-specific approaches), it can be unclear to prime contractors how to respond to mitigate risk while also controlling the costs of the subcontract audit

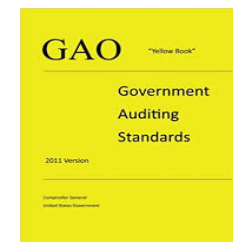
BEST PRACTICE RECOMMENDATIONS

- Conduct or cause to be conducted audits of cost type subcontract indirect rates
- Follow GAGAS in the conducting of the subcontract audits
- Consider controls in place relative to ongoing evaluation of subcontractor direct costs, hours, and application of agreed-upon (fixed) rates to hours.
- If a non-DoD contractor, determine your agency's position with regard to subcontract audit and proceed accordingly

SUBCONTRACT AUDIT: GAGAS REQUIREMENTS

GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS (GAGAS)

As mentioned in a previous slide, Government customers are now frequently expecting subcontract audits to be performed in accordance with GAGAS. Therefore, we will cover the implications of performing subcontract audits in accordance with GAGAS.



Issues to be discussed include:

- Options for conducting GAGAS audits (types of audits)
- Who can perform GAGAS audits?
- Does it make sense to outsource GAGAS audits?

SUBCONTRACT AUDIT: GAGAS REQUIREMENTS (AUDIT OPTIONS)

**UNDER GAGAS, AN AUDIT CAN BE PERFORMED
AS:**

- Financial Audit (Yellow Book Chapter 4)
- Attestation Engagement (Yellow Book Chapter 5)
- Performance Audit (Yellow Book Chapter 6)



SUBCONTRACT AUDIT: GAGAS REQUIREMENTS (AUDIT OPTIONS)

ATTESTATION ENGAGEMENTS

- Examinations: DCAA typically performs incurred cost audits as examination engagements.
- Reviews: Lesser in scope and may not be considered sufficient
- Agreed Upon Procedures (AUP): Because exercise of auditor judgment is a key element to successfully performing incurred cost audits, it is almost impossible to do these as AUP engagements.

Incurring cost audits can be performed as examination engagements, although we believe the best option is to conduct as a performance audit.



SUBCONTRACT AUDIT: GAGAS REQUIREMENTS (AUDIT OPTIONS)

PERFORMANCE AUDITS

- Audits that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria
- Enables the exercise of judgment and coordination with the client in developing the specific objective, scope and criteria to be applied
- Greater flexibility in how reports are presented and what content is reported
- Performance audit standards do not (as of yet) incorporate AICPA standards as do financial audits and attestation engagements

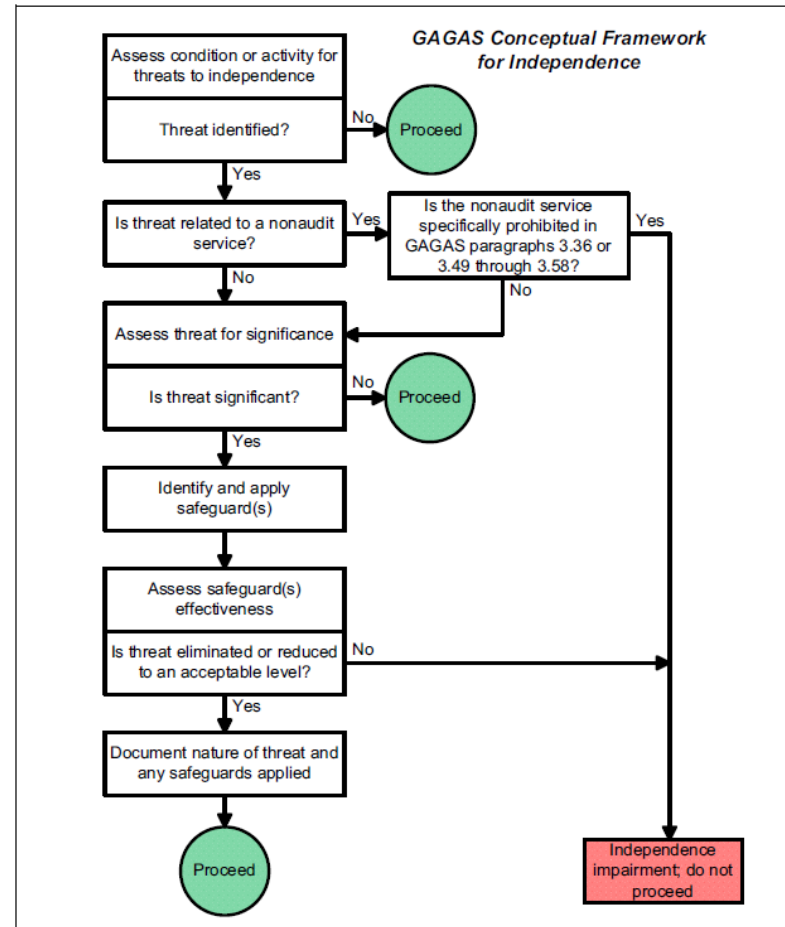


SUBCONTRACT AUDIT: INDEPENDENCE REQUIREMENTS

For all types of GAGAS audits, compliance with the Conceptual Framework is required. Independence includes:

- Independence of Mind
- Independence of Appearance

An important consideration when deciding whether to perform audits in house or to outsource is the independence consideration. If the Government believes there are unresolved threats to independence, it may not accept the audit results.



Source: GAO.

SUBCONTRACT AUDIT: OTHER GAGAS REQUIREMENTS

WHO CAN PERFORM GAGAS AUDITS?

OTHER REQUIREMENTS

- Requires audit leadership and team members with adequate professional competence and the appropriate background in performing GAGAS compliant audits (3.69)
- CPE: All auditors working on GAGAS engagements must meet GAGAS specific CPE requirements (3.76). This must be documented and retained.
- An acceptable audit Quality Control system (3.93)
- External peer review (3.96)
- Policies and safeguards related to custody and retention of audit documentation (3.92)

SUBCONTRACT AUDIT: WORKPAPER REQUIREMENTS

WHO CAN PERFORM GAGAS AUDITS?

WORKPAPER REQUIREMENTS

Workpaper files must be of high quality and have specific content to meet GAGAS requirements, including:

- Audit planning documentation
- Materiality determination
- Risk Assessment
- Sampling and Projection of Exceptions
- Testing of controls
- Summarization of results





**SUBCONTRACT CLOSEOUT
STEPS**

SUBCONTRACT CLOSEOUT

RELEASE OF CLAIMS

Add language to subcontract agreements of “deemed” release of claims if subcontractor work complete and final invoice paid and no release provided within XX time (typically 30 to 60 days)

Start release of claims process early (3 to 4 months prior to completion) to allow time to resolve issues if any

Use standard release of claim acceptable to Client

- GSA SF 1142
- www.acq.osd.mil/dpap/ccap/cc/jcchb/Files/Topical/.../release_of_claims_letter.docx

SUBCONTRACT CLOSEOUT

SUBCONTRACTOR GOVERNMENT PROPERTY

Obtain final inventory and finalize any discrepancies

- Lost, damaged property

Determine final disposition of all subcontractor held government property

- Obtain Client approval prior to finalization

Document final disposition of subcontractor government property

SUBCONTRACT CLOSEOUT

SECOND TIER SUBCONTRACTING

Prime should ask for:

- First tier subcontractors release of claims from second tier subcontractors
- Evidence of final payment to second tier subcontractors
- Documentation of any unresolved issues at second tier subcontracting level



TODAY'S TAKEAWAYS

KEY TAKEAWAYS

- Take proactive steps to close out your contracts and subcontracts
- Maintain all applicable documentation throughout contract life cycle and know where it is!
- Let your ACO know when contracts are ready for closeout/potential for quick closeout
- Submit timely, adequate incurred cost submissions
- Understand your CO's expectations with regards to subcontract audits
- Have a subcontract audit plan in place and execute on the plan in a timely manner



QUESTIONS/COMMENTS



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