THE TOP 10 ISSUES OF THE TOP 3 BUSINESS SYSTEM AUDITS

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KEY DISCUSSION TOPICS

• Triggers and Audit Processes for the top 3 Business Systems
• Common Misunderstandings and Audit Failures Across Business Systems
• Interrelationship of the Business Systems
• Responsibilities of the Prime for Subcontractor’s Business Systems
• The 4th pillar of your Business Systems: Cybersecurity
TRIGGERS AND AUDIT PROCESSES
## APPLICABILITY OF BUSINESS SYSTEMS

### 2018 GAUGE Report

<table>
<thead>
<tr>
<th>SYSTEM</th>
<th>IMPLEMENTING DFARS CLAUSE</th>
<th>SUB</th>
<th>NOVICE PRIME</th>
<th>EXPERIENCED PRIME</th>
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</thead>
<tbody>
<tr>
<td>Accounting</td>
<td>252.242-7006</td>
<td>◆</td>
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<tr>
<td>Earned Value Management (EVM)</td>
<td>252.234-7002</td>
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<tr>
<td>Estimating</td>
<td>252.215-7002</td>
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<tr>
<td>Material Management and Accounting System (MMAS)</td>
<td>252.242-7004</td>
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<tr>
<td>Property Management</td>
<td>252.245-7003</td>
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<tr>
<td>Purchasing</td>
<td>252.244-7001</td>
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BIGGEST AUDIT CHALLENGES

2018 GAUGE Report

- **Executive Compensation**
- **CAS Compliance**
- **Unallowable**
- **Timekeeping**
- **Billing**
- **Indirect Rates**

PERCENTAGE OF RESPONDENTS
# ACCOUNTING SYSTEM AUDIT TRIGGERS

## BUSINESS SYSTEM APPLICABILITY RULES

<table>
<thead>
<tr>
<th>SYSTEM</th>
<th>FAR, DFARS, PROVISIONS, and CLAUSES</th>
<th>CRITERIA</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCOUNTING (AS)</td>
<td>FAR 16.301-3 Cost-Reimbursement Contracts - Limitations</td>
<td>1. Does your company have a Government cost-reimbursement contract? - <strong>AND</strong> - 2. Did the ACO determine a need for accounting system audit based on significant cost-reimbursement contracts, change in cost accounting practices, billing or invoicing issues, audit recommendation, or other rationale?</td>
</tr>
<tr>
<td>NON-DOD</td>
<td>DFARS 242.7502(a)</td>
<td>1. Is your Company a DoD prime contractor or subcontractor? 2. Does any prime contract or subcontract contain a similar DFARS clause or language requiring an adequate accounting system? 3. Was the Company awarded or executed any of the following contract types: (a) Cost-reimbursement contract (FAR 16) (b) Incentive contract based on cost information (c) T&amp;M (Both Commercial FAR 12 and non-commercial FAR 15) (d) Labor hour contracts (e) Contracts with progress payments made on the basis of costs incurred or on % completion</td>
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<tr>
<td>DOD</td>
<td>DFARS Clause 252.242-7006</td>
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**CRITERION APPLICABLE? INDICATE "YES" OR "NO"**
# ESTIMATING SYSTEM AUDIT TRIGGERS

## BUSINESS SYSTEM APPLICABILITY RULES

<table>
<thead>
<tr>
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<td><strong>ESTIMATING (ES)</strong></td>
<td><strong>NON-DOD</strong></td>
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<td>FAR 15.407-5 Estimating Systems</td>
<td>1. Did the Company’s CO under a prime contract determine a need for an estimating system review?</td>
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<td>DFARS 215.407-5 Estimating Systems</td>
<td>1. Is your Company (DoD contractor or subcontractor) considered other than small as defined in the Small Business Administration? - AND -</td>
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<td>DFARS Clause 252.215-7002 Estimating Business System</td>
<td>2. Did your Company receive in its <em>preceding fiscal year</em> a DoD prime contract(s) or subcontract(s) totaling $50 million or more for which <em>certified cost or pricing data were required</em>? or</td>
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<td>3. Did your Company in its preceding fiscal year receive a DoD prime contract(s) or subcontract(s) totaling $10 million or more (but less than $50 million) for which <em>certified cost or pricing data were required</em> and the contracting officer, with concurrence or at the request of the ACO, determined it to be in the best interest of the Government?</td>
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**DETERMINE OVERALL SYSTEM APPLICABILITY**
# Purchasing System Audit Triggers

## Business System Applicability Rules

<table>
<thead>
<tr>
<th>System</th>
<th>Far, Dfars, Provisions, and clauses</th>
<th>Criteria</th>
<th>DETERMINE OVERALL SYSTEM APPLICABILITY</th>
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<tbody>
<tr>
<td><strong>Purchasing (CPSR)</strong></td>
<td><strong>FAR Subpart 44.302 Requirements</strong></td>
<td>1. Did the Company’s ACO determine the need for a CPSR based on, but not limited to, your past performance, and the volume, complexity, and dollar value of subcontracts? -AND-&lt;br&gt;2. In the next 12 months, your sales to the Government are expected to exceed $25 million excluding:&lt;br&gt;(1) Competitively-awarded firm-fixed-price&lt;br&gt;(2) Competitively-awarded fixed-price with economic price adjustment&lt;br&gt;(3) Commercial items (pursuant to FAR Part 12)&lt;br&gt;As a preliminary CPSR eligibility evaluation:&lt;br&gt;3. Indicate estimated total value of sales to the Government as defined above and not including identified exclusions:&lt;br&gt;4. Indicate number of following contract/subcontract types received in past 12 months:&lt;br&gt;(a) Cost-reimbursement&lt;br&gt;(b) Time and Materials/Labor Hour&lt;br&gt;(c) Fixed-price competitively-awarded&lt;br&gt;(d) Fixed-price with economic price adjustment competitively awarded&lt;br&gt;(e) Contracts/subcontracts for sales of commercial items pursuant to FAR Part 12&lt;br&gt;(f) Fixed-price other than those in (c) and (d) above</td>
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BUSINESS SYSTEM AUDIT PROCESSES

• Before the Onsite Visit:
  – Request and review org chart and policy/procedures documents
  – Request and review personnel training for business system
  – Request data on business system transactions

• At the Onsite Visit:
  – Conduct entrance briefing
  – Sample business systems transactions which are typically not identified before the onsite audit begins
  – Conduct daily discussions of findings with contractor personnel
  – Conduct exit briefing

• After the Onsite Visit:
  – Create draft report with findings and allow contractor to develop corrective actions
  – Create report for ACO in final format
COMMON MISUNDERSTANDINGS ACROSS BUSINESS SYSTEMS
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I’m CMMI Level X and ISO 900X certified compliant. Isn’t that good enough?

I have the latest “LMNO” software package that the Government wants a Contractor to have. Isn’t that good enough?
COMMON MISUNDERSTANDINGS ACROSS BUSINESS SYSTEMS

- Business Systems have four elements, as shown
- Business Systems are to be constantly being reviewed and updated
- Business Systems require controls
COMMON MISUNDERSTANDINGS ACROSS BUSINESS SYSTEMS

• Each Business System has many REQUIREMENTS:
  – Accounting System
    • 18 Requirements from DFARS 252.242-7006
    • DCAA Audit Program
  – Estimating System
    • 17 Requirements from DFARS 252.215-7002
    • DCAA Audit Program
  – Purchasing
    • 24 Requirements from DFARS 252.244-7001
    • 30+ DCMA Checklist items
    • 11 Requirements from FAR Part 44.303
COMMON MISUNDERSTANDINGS ACROSS BUSINESS SYSTEMS

• Policy and Procedures
  – Must have written policy and procedures that address all applicable requirements
  – Actual practices have to mirror policy and procedures, no “paper tiger”
  – Policies and procedures must provide an adequate description of how your system operates and roles/responsibilities

• Training
  – Personnel participating in the business system must be trained annually at a minimum
  – Documentation of provided training must be retained (i.e. training materials)
  – Employees must have proof of having received training (i.e. sign-in sheets, rosters)
COMMON MISUNDERSTANDINGS ACROSS BUSINESS SYSTEMS

• Files, Data, Documentation
  – Establish and maintain adequate documentation to provide a complete and accurate history of business system transactions and controls

• Internal Reviews
  – At least one review of your business system annually by either your:
    • Compliance Officer
    • Internal Quality Control Group
    • Internal or External Audit Team
COMMON BUSINESS SYSTEMS AUDIT FAILURES
1. Policy and Procedures:
   Inadequate, not written, not used

2. Processes:
   Do not follow Policy and Procedures, have inadequate controls

3. Training:
   Staff inadequately trained, or training is not provided on a continuous basis

4. Internal Reviews:
   No comprehensive review of entire business system, policies, training, all artifacts

5. Artifacts/Files/Reports:
   Lack of consistency across reports/files/artifacts
   No evidence of following policy and procedures, especially timely reviews
SPECIFIC BUSINESS SYSTEMS AUDIT FAILURES
ACCOUNTING SYSTEM IMPORTANCE

PURPOSE (from DFARS Part 242.242-7006 -- Accounting System Administration) [Selecting contract type: FAR 16.104(i) & 42.302(a)(12)]

“Accounting system” means the Contractor’s system or systems for accounting methods, procedures, and controls established to gather, record, classify, analyze, summarize, interpret, and present accurate and timely financial data for reporting in compliance with applicable laws, regulations, and management decisions, and may include subsystems for specific areas such as indirect and other direct costs, compensation, billing, labor, and general information technology.

DFARS lists 18 criteria for an acceptable accounting system
ACCOUNTING SYSTEM AUDIT FAILURES

1. Contract set up
   • Lack of internal control

2. Data Entry
   • Lack of descriptions when adjusting something on audit trail

3. Overriding controls not in accordance with policy and procedures

4. Timesheets: controls being overridden

5. Treating like costs dis-alike.
PURPOSE (from FAR Part 15.407-5 -- Estimating Systems)

An acceptable estimating system benefits both the Government and the contractor by increasing the accuracy and reliability of individual proposals. It also reduces the scope of reviews to be performed on individual proposals, expedites the negotiation process, and increases the reliability of proposals. Significant deficiencies not corrected by the contractor shall be a consideration in subsequent proposal analyses and negotiations.

DFARS lists 17 criteria for an acceptable estimating system
ESTIMATING SYSTEM AUDIT FAILURES

1. Ranges are too large to be statically correct or believable.

2. Explanation of judgement usage.
   - Estimating of hours does not include estimation of impact on indirects with directs.
   - No SME discussion of how they came up with estimate.

3. Backing into rate to win number without justification or use of historical data

4. Deviating from requirements of RFP
   - Noncompliance with FAR table 15-2

5. Not going back and updating original estimate to actuals
PURCHASING SYSTEM IMPORTANCE

Objective from FAR Part 44.301

The objective of a contractor purchasing system review (CPSR) is to evaluate the efficiency and effectiveness with which the contractor spends Government funds and complies with Government policy when subcontracting. The review provides the administrative contracting officer (ACO) a basis for granting, withholding, or withdrawing approval of the contractor’s purchasing system.
PURCHASING SYSTEM AUDIT FAILURES

1. Noncompliance with public laws, regulations, and prime contract requirements
2. Lack of competition, too many sole/single source and lack of adequate justifications
3. Failure to adequately perform and/or document price analysis and source selection
4. Failure to adequately conduct and document commercial item determinations;
5. Failure to obtain required certifications at time of award (*i.e.* TINA, CAS, suspension/debarment, limitation on use of appropriated funds)
INTERRELATIONSHIP OF THE BUSINESS SYSTEMS
INTERRELATIONSHIPS OF THE BUSINESS SYSTEMS

• Starts with Estimating and the proposal
  – Price Analysis of subs and vendors should roll into purchasing and should be using data from accounting system to compare
  – Estimate should be using your Accounting System information for direct and indirect rates

• Accounting
  – Award information go in accounting system correctly, controls for subs too.
  – Bid, book, bill: Setting up in accounting system as it was structured in proposal. Allows for easier revenue recognition process.

• Purchasing
  – Awarding subcontracts/POs and using price analysis (updating) from proposal stage
  – Setting up subs and vendors in accounting system
  – Some purchases could require different accounting (related parties)
RESPONSIBILITIES OF THE PRIME FOR THE SUBCONTRACTOR’S BUSINESS SYSTEMS
ACCOUNTING SYSTEM RESPONSIBILITIES
(Prime-Subcontract Relationship) FAR 42.202(e)(2)

- Subcontractor’s accounting system is able to handle the type of award.
  - Cost Reimbursable (e.g. Incurred cost submission, indirect allocation, etc.)
  - T&M / Labor-Hour contracts (e.g. timesheets, Labor distribution, etc.)
  - Firm-fixed price
- Billing and invoicing (e.g. billing terms)
- Periodic performance reporting - Level of effort, project status, etc.
ESTIMATING SYSTEM RESPONSIBILITIES

• Flowdown DFARS Clause 252.215-7002, Cost Estimating System Requirements, in all solicitations and subcontracts to be awarded on the basis of certified cost or pricing data (no FAR clause)

• Include in subcontract, that subcontractor will allow Prime (or independent 3rd party) to audit/review the subcontractor’s Cost Estimating System elements upon request
  • Estimating Policy and Procedures
  • Basis of Estimate
  • Management reviews of estimates
  • Cost and pricing support documentation
PURCHASING SYSTEM RESPONSIBILITIES

• Prime Contractor “stands in the shoes” of the Government when allowing 1st Tier subcontractor to make direct purchases on Federal contract
• Flowdown DFARS 252.244-7001 Purchasing System Requirements or FAR 52.244-2 Subcontracts
• Include in subcontract, that subcontractor will allow Prime (or independent 3rd party) to audit/review the subcontractor’s Purchasing System elements upon request
  • Non-competitive selection justifications
  • Price analyses
  • Representations and certifications from 2nd tier sub
  • Debarment representations from 2nd tier sub
  • Cost and Pricing certifications, when required
THE 5TH PILLAR OF BUSINESS SYSTEMS: CYBERSECURITY
FAR 52.204-21: BASIC SAFEGUARDING - COVERED CONTRACTOR INFORMATION SYSTEMS

- Imposes 15 “basic” security controls on “systems” holding Federal Contract Information (FCI) (not the information itself like DFARs);

- “Information not intended for public release, provided by or generated for the government under product or service contract”;

- Covers all Federal contractors since (i) it covers systems which “may” hold FCI & (ii) the safeguarding is “most basic” protection.
DOD - DFARS 252.204-7012: NETWORK PENETRATION

- **Covered Defense Information (CDI):** Unclassified controlled technical information (UCTI) or Controller Unclassified Information (CUI)
  - (i) marked or identified by USG as provided to contractor, or
  - (ii) collected, developed, stored, transmitted, processed, or used by contractor in contract performance;

- Excludes commercial-off-the-shelf (COTS) contracts (+ basic research);

- Contractor information systems must satisfy NIST SP 800-171
Cyber incident reporting within 72 hours of discovery directly to DoD Cyber Crime Center (DC3) with DoD reporting code to prime contractor;
  - Acquire DoD approved medium assurance certificate to communicate with DC3 regarding the cyber incident

Post Cyber Incident audit requirements;

Flows down to Subs if CDI retains characteristics;

If external Cloud Service Provided (CSP) to be used, the CSP must meet FedRAMP “moderate” security requirements + cyber incident reporting/audit requirements.
TOP 5 KEY TAKEAWAYS

• Remember it’s a system not a software package

• Know the criteria of each business system and make sure your Policy and Procedures address them all

• Train your personnel at least annually on each business system

• Use checklists to ensure your business system artifacts are consistent

• Perform internal reviews of your business system annually at a minimum
QUESTIONS?
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