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# Contractor Estimating Systems: System Adequacy Standards and Key Compliance Issues

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# Agenda

- Third session in Public Contracting Institute's 2016 series on contractor business systems
- Focus on “hot topics” related to accounting systems
  - Business Systems Rule Overview
  - Estimating Systems Rule Overview
  - System Criteria
  - Key Audit and Compliance Issues
  - Best Practices
  - Inspector General Report
- Questions



# Overview of the Business Systems Rule

- Interim Rule published May 2011, Final Rule published Feb 2012
  - Interim rule (76 Fed. Reg. 28,856 (May 11, 2011))
  - Final rule (77 Fed. Reg. 11,355 (Feb. 24, 2012))
- Applicable through clauses in DFARS, CAS-covered contracts awarded after May 2011
  - Other agencies (e.g., DOE) adopting/applying DFARS criteria
  - Subcontractor compliance
- Disapproved system results in withholding from:
  - Progress payments
  - Performance based payments
  - Interim payments under cost, T&M, and labor-hour contracts



# Overview: Applicability

- DFARS Rule requiring acceptable estimating system applies only contracts awarded based upon cost or pricing data that meet CAS threshold
- Estimating system disclosure, compliance criteria and approval process applies to “large” contractors that:
  - Received \$50 million of DoD prime contracts or subcontracts in previous fiscal year for which cost or pricing data were required
  - May be required (if determined to be in the best interests of the government) from contractors that received between \$10 million and \$50 million of DoD prime contracts or subcontracts in previous fiscal year for which cost or pricing data were required



# Overview: The Basics

- Overarching requirement – The Contractor must establish, maintain and comply with an “acceptable estimating system.” DFARS 252.215-7002(b)
- Estimating system includes (DFARS 252.215.7002(a)):
  - Organizational structure
  - Established lines of authority, duties and responsibilities
  - Internal controls and managerial reviews
  - Flow of work, coordination and communication
  - Budgeting, planning, estimating methods, techniques, accumulation of historical costs and other analyses used to generate cost estimates



# Overview: The Basics (Cont.)

- An acceptable estimating system (DFARS 252.215-7002(a)):
  - (1) Is maintained, reliable, and consistently applied;
  - (2) Produces verifiable, supportable, documented, and timely cost estimates that are an acceptable basis for negotiation of fair and reasonable prices;
  - (3) Is consistent with and integrated with the Contractor's related management systems [e.g., accounting and procurement systems]; and
  - (4) Is subject to applicable financial control systems.
- The system accomplishes 17 relevant functions in DFARS 252.215-7002(d)(4).



# Overview: System Design and Disclosure

- The DFARS Rule requires that the Contractor (DFARS § 252.215-7002(d)(1), d(3)):
  - Disclose its system in writing to ACO
  - Comply with the system as disclosed
  - “Timely” disclose to ACO any “significant changes”
- Impact of disclosure requirement:
  - Detail requirement?
  - ACO challenge to system efficacy?
  - Failure to disclose changes?
  - What is significant?



# Overview: Contractor Processes

- Rule targets contractor processes for:
  - Budgeting/Forward Pricing Rate Development
    - Business base projections
    - Estimates of labor rates, fringes and pool expenses
    - Maintenance of up-to-date and “verifiable” forward pricing rates
  - Contract Proposal Development
    - Compliance with RFP and FAR Subpart 15.4
    - Bases of estimate/estimating methods
    - Subcontract and vendor pricing
    - Application of forward pricing rates and factors
  - System administration
    - Policies and procedures/internal audit
    - Management review of proposals
    - Training and qualifications of estimating staff
    - Integration of systems



# Functional Criteria

- The DFARS Rule's 17 relevant estimating system functions include (DFARS § 252.215-7002(d)(4)):
  - (1) Preparing and supporting an acceptable proposal
  - (2) Estimating system designed to meet requirements
  - (3) Use of sound data/integration of other systems
  - (4) Estimating methods/techniques
  - (5) Internal controls to ensure system compliance



# 1. Preparing and Supporting an Acceptable Proposal

- Proposal preparation and support (DFARS 252.215-7002(d)(4)(xiv)-(xv), (xvii))
  - Procedures to update cost estimates and notify CO in a timely manner
  - Procedures to ensure subcontract prices are fair and reasonable, based on documented review and analysis provided with prime proposal
  - Adequate system description, including policies, procedures and practices that comply with FAR/DFARS



## 2. Estimating System Designed to Meet Requirements

- Estimating system design (DFARS 252.215-7002(d)(4)(i)-(ii), (v), (xii-xiii), (xvi)):
  - Clear responsibility for prep, review, approval of cost estimates and budgets
  - Written description of organization/personnel duties for same
  - Adequate supervision through process



## 2. Estimating System Designed to Meet Requirements (Cont.)

- Estimating system design (cont.)
  - Require management review, including verification of estimating/budgeting policies, procedures and practices
  - Internal review of/accountability for acceptability of estimating system (including budgetary data supporting indirect cost estimates, comparisons of projected results to actual results)
  - Estimating/budgeting procedures that consistently generate sound proposals compliant with solicitation and adequate as basis to reach fair and reasonable price



### 3. Use of Sound Data/Integration of Other Systems

- Sound data/Integration of other systems' data (DFARS 252.215-7002(d)(4)(iv), (vii)-(ix), (xi), (xiii)):
  - Protect against cost duplication
  - Use historical experience where appropriate (“appropriate” is not defined)
  - Integrate information available from other systems
  - Internal review of/accountability for acceptability of estimating system (including budgetary data supporting indirect cost estimates, comparisons of projected results to actual results)



## 4. Estimating Methods/Techniques

- Estimating techniques (DFARS 252.215-7002(d)(4)(iv), (vi), (x)):
  - Identify and document sources of data, estimating methods and rationale used in developing cost estimates and budgets
  - Consistent application of estimating and budgeting techniques\*
  - Use of appropriate analytical methods (“appropriate” is not defined)

\* Some DCAA audits have literally interpreted this to mean that forecasts and budgets had to be at the same level of detail for all years. DCAA policy now recognizes that out-year forecasts/rates can be less detailed.



## 5. Internal Controls to Ensure System Compliance

- System administration and internal controls (DFARS 252.215-7002(d)(4)(iii), (xii)-(xiii)):
  - Sufficient training, experience and guidance of personnel to ensure performance of estimating/budgeting tasks in accordance with established procedures
  - Management review, verification of estimating/budgeting policies, procedures, practices
  - Internal review of/accountability for acceptability of estimating system (including budgetary data supporting indirect cost estimates, comparisons of projected results to actual results)



# Key Audit and Compliance Issues

## DCAA Director's Statements

### Contractor Support

- Adequate proposals and assertions
- Effective walk-throughs (early identification of inadequacies)
- Identification of internal reviews...leveraged by DCAA to reduce resource impact on contractor
- Adequate supporting data, timely access to key personnel responsible for the data or activity
- Real time DCAA access to contractor systems



# Key Audit and Compliance Issues

## DCAA Director's Statements & Planning

- DCAA focusing on identifying business systems deficiencies during ongoing audits (bid proposals or forward pricing rates)
- DCAA is performing full-up audits at select high-risk contractors—results will help improve future DCAA audits and policy
- DCAA's 2016 Program Plan did list Estimating System Audits (12 Audits at 5,000 hours each at specific contractors) and MMAS (5 audits at 4,000 hours each at specific contractors)
- All contractors (audited by DCAA) remain at risk for “deficiency reports” (business system “significant deficiency” identified during an audit of a bid proposal or forward pricing rate proposal)



# Key Audit and Compliance Issues

- Inadequate policies and procedures
- Inadequate record-keeping for proposals submitted
- Misapplication of FAR Part 15 proposal standards
  - DCAA applies non-competitive proposal requirements to competitive proposals
  - Non-compliance allegations based upon failure to comply with system and FAR Subpart 15.4 procedures
  - Compliance with DFARS proposal adequacy checklist (78 FR 18865 (March 28, 2013))
- Internal audits of estimating system
  - Too infrequent or planned but not executed
  - Insufficient scope
  - Inadequately documented and/or untimely corrective action



# Key Audit and Compliance Issues (Cont.)

- Independent management review
  - Insufficient management oversight concerning high-risk proposals
  - Unclear lines of authority for proposal approval
  - Lack of documentation of review/approval process
- Calculation of estimated labor rates
  - Appropriate grouping of labor categories
  - Reasonable basis for rate escalations
  - Reliance on historical experience
- Periodic internal reviews of estimates
  - Monitoring and tracking estimates against actual costs
  - Integration of estimate reviews into proposals



# Key Audit and Compliance Issues (Cont.)

- Integration with other systems
  - Accounting:
    - Inconsistent use of actual costs to support estimates
    - BOE states “historical costs”, but without any reference to specific accounting data
    - Inadequate monitoring/analysis of “accuracy” of estimates
  - Purchasing:
    - Subcontractor price/cost analysis
      - Insufficient objective evidence for commerciality and/or fair & reasonable price
      - Inadequate competition
      - Unsupported subcontractor cost/price analysis
    - Misapplication of competitive selection process to strategic teammates and expectations for “degree of competition” disclosed in follow-on procurements or contract rebaselining



# Key Audit and Compliance Issues (Cont.)

- Training/qualifications of estimating staff
  - Insufficiently trained and experienced estimating personnel, especially price/cost analysts
  - Lack of clear, defined training plans including comprehensive subject matter of courses or course content consistent with auditor's subjective expectations
  - One-size fits all estimating system training vs. training tailored to specific functions (e.g. rate estimators differentiated from engineers preparing labor hour basis of estimates)
  - Incomplete training records; lack of automated tracking of employee compliance with training plan



# Best Practices

- Continuous system maintenance/improvement
  - Use internal audits to identify weaknesses and implement corrective action; document improvements
  - Comprehensive training plan
  - Timely policy revisions/distribution of updates
- Focus on proposal format and content
  - Comply with FAR 15.408, Table 15-2, and DFARS Adequacy Checklists—Bid Proposal and Forward Pricing Rates' Proposal
- Integration of systems
  - Enhanced system automation
  - Purchasing and accounting system data flows into estimating to justify subcontract type and price



# Inspector General Report

- DODIG-2015-139 (June 29, 2015): Evaluation of DCMA Actions on Reported DoD Contractor Estimating System Deficiencies
  - 18 DCAA Reports (Contractor Estimating Systems 252.242-7005)
  - Contracting Officers did not:
    - Issue timely initial and final determinations
    - Obtain or adequately evaluate contractor responses, and
    - Withhold a percentage of contractor payments
- DCMA Director generally agreed with DOD-IG Recommendations

Note: DOD-IG accepts at face value that significant deficiencies (reported by DCAA) are significant deficiencies (DFARS 252.242-7005)



# Inspector General Report (Cont.)

- Implications for Contractors; Contracting Officers will:
  - Make initial determinations (one or more significant deficiencies) within 10 days of report receipt
  - Request and require contractor responses within 30 days of the initial determination
  - Make final determinations within 30 days of receipt of the contractor response (more than 30 days depending upon the complexity of the issues)
  - Implement withholds if final determination of one or more significant deficiencies



# Questions

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