

Audits, Investigations and Sequestration! Oh My!

- A presentation about challenges government contractors are facing with DCMA, DCAA, internal investigations and preparing for sequestration. -

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March 13, 2012 Tysons Corner



Biographies



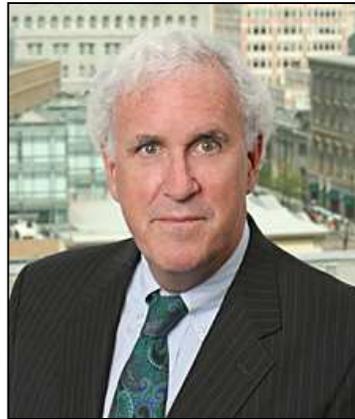
Scott Hommer, Partner at Venable LLP, concentrates his practice in business counseling and litigation with an emphasis on technology companies and government contractors. He represents clients locally, nationally, and internationally on issues including negotiating contracts, acquisitions, protecting intellectual property rights, and successful litigation. Mr. Hommer also has significant experience in counseling clients who do business with the federal, state, and local governments and has represented clients on contract administration matters, contract claims and disputes, bid protests, contract terminations, teaming agreements, conflict of interest issues, intellectual property rights issues, government socio-economic programs, and small business matters.

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John F. Cooney, Partner at Venable LLP, focuses on economic regulatory, administrative, and constitutional litigation involving federal agencies at the trial and appellate levels. His areas of experience include financial services, white collar defense, environment, and separation of powers. Mr. Cooney has 35 years of experience in regulatory policy making and regulatory litigation. He served as Assistant to the Solicitor General, Department of Justice, and as Deputy General Counsel for Litigation and Regulatory Affairs, Office of Management and Budget. Mr. Cooney served as counsel for OMB's Office of Information and Regulatory Affairs, which reviews agency regulations on behalf of the President, and was involved in policy disputes involving legal interpretation of most major federal regulatory statutes.

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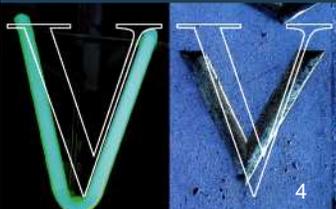
Biographies



Paul Debolt, Partner at Venable LLP, assists companies and individuals on all issues that arise from doing business with the federal government, including civil fraud. He is experienced in the competitive source selection process, defending or prosecuting bid protests, issuing advice concerning compliance with government regulations and laws during the performance of a contract, and helping to resolve disputes and claims during contract performance or as a result of contract termination. Mr. Debolt also has significant experience with due diligence in connection with the merger and acquisition of government contractors, as well as post-transaction matters such as novations. He counsels clients on the Service Contract Act, the Civil False Claims Act, joint ventures and teaming agreements, prime-subcontractor disputes and internal investigations.

Mr. Debolt has extensive government contracts law experience and applies a team approach which ensures that clients receive the benefit of firm-wide strength in all related areas.

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Biographies

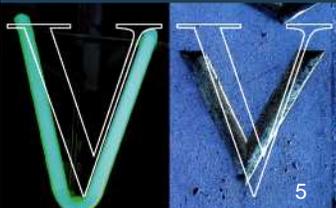


John Farenish, Partner at Venable LLP, focuses on federal, state and local procurement law. He counsels and represents clients on the applicability and interpretation of government contract-related case law, federal procurement statutes, the Federal Acquisition Regulation (FAR), and the Cost Accounting Standards.

Mr. Farenish has more than 30 years of experience in various regulatory, compliance and prosecutorial capacities with the federal government, beginning with the Army's Judge Advocate General Corps and including seven years with the Department of the Navy. Prior to joining Venable, he spent 13 years serving with the Defense Contract Audit Agency (DCAA), starting as deputy general counsel before becoming general counsel in 2003. He also spent several years with the DoD's Inspector General's office handling criminal matters related to federal acquisition policy.

Mr. Farenish has written and lectured extensively on aspects of government contracting work, including ethics, compliance, criminal investigations, and the conditions for contractor suspension and debarment.

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Biographies

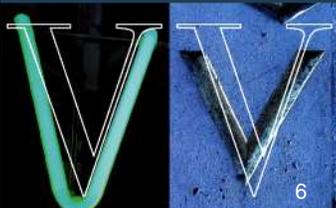


Donald J. Shoff is the Chief Financial Officer and Senior Vice President of Finance for INDUS Corporation, an information technology services company operating mainly in the Federal Government marketplace. For the last ten years at INDUS Mr. Shoff has lead the overall responsibility for directing the finance and administration activities, including bidding strategies, mergers and acquisitions, and working capital financing; those M&A activities included leading the Company team in two significant acquisitions in 2005. His responsibilities at INDUS also include significant involvement in all areas of Government contract compliance and interface with Government audit/review functions.

Prior to INDUS he was the CFO and Vice President Finance of a public company, **zeroplus.com**, Inc., formerly e-Net, Inc., since 1997 that he helped co-found in 1995. During his tenure with the company, he has assisted in capital raising rounds including pre-IPO venture and angel funding, the Initial Public Offering and post-IPO private placement rounds with both financial and strategic partners. In addition to the capital fund raising, he was heavily involved with the compliance and filing requirements, as well as interfacing with investment bankers, independent auditors and outside counsel.

From 1993 to 1996 he was a self-employed consultant as a part-time controller/CFO for small and medium sized professional and technical services firms. From 1992 to 1993, Mr. Shoff was Vice President of Finance and Administration for Comsis Corporation, a Washington, DC-based private company doing business with the Federal and various state governments. From 1987 to 1992 Mr. Shoff consulted independently and as a Senior Manager at Grant Thornton, a major accounting firm, with public and privately held companies doing business with the Federal government on issues such as indirect rates, cost recovery and profitability, and bid strategies. From 1982 to 1986, Mr. Shoff was the Corporate Cost Accounting Manager and a Group Controller for Science Applications International Corporation, a large high technology products and professional services public corporation, where he was responsible for the corporate cost accounting functions and controller of a high technology services operation group. From 1977 to 1981, Mr. Shoff was a staff accountant and senior accountant on the staff of local Washington, D.C. public accounting firms, where he conducted compilation, review, and tax engagements for privately and publicly held corporations.

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Biographies



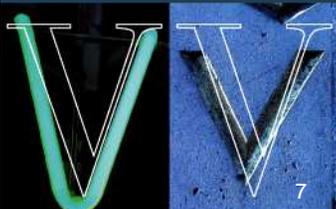
Jim Winner is Vice President & General Counsel and Vice President, Contracts & Procurement for the Information Systems Division of ITT Exelis, headquartered in Herndon, Virginia. Jim's previous ITT positions included Associate General Counsel and Senior Counsel for ITT Mission Systems, headquartered in Colorado Springs, Colorado.

Prior to joining ITT, Jim served as Corporate Counsel for Cummins Inc., in Indianapolis, Indiana. Jim joined Cummins after practicing law with the firm Barnes & Thornburg LLP, specializing in contracts, procurement, and labor and employment law. Jim's work for Barnes & Thornburg included an in-house assignment with Rolls-Royce Corporation, also in Indianapolis, Indiana, supporting Rolls-Royce's commercial and military aircraft engine programs.

Prior to joining the private sector, Jim served as an active duty officer and judge advocate attorney in the United States Air Force. His military assignments included: Deputy Staff Judge Advocate, Holloman Air Force Base, New Mexico; Appellate Defense Counsel, Bolling Air Force Base, Washington, D.C.; Area Defense Counsel, Keesler Air Force Base, Mississippi; Assistant Staff Judge Advocate, Keesler Air Force Base, Mississippi; and Systems Acquisition Officer, Military Satellite Communications (MILSATCOM) Joint Program Office, Space and Missile Systems Center (SMC), Los Angeles Air Force Base, California.

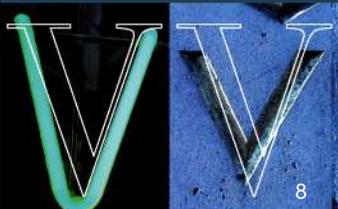
Jim received his Bachelor of Science degree as a distinguished graduate of the United States Air Force Academy in Colorado Springs, Colorado. He received his Juris Doctorate degree, *magna cum laude*, from Loyola Law School in Los Angeles, California. Jim is licensed to practice law in California, Colorado, Virginia (Corporate Counsel) and Washington, D.C.

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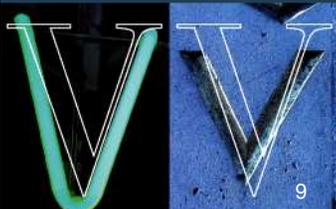
Agenda

- Current Business Environment
- DCAA & DCMA Mission
- DCAA Initiatives and Business System Rules
 - Personal Conflicts of Interest Regulations
 - Contractor Response
- Audits
 - Managing an Audit
 - DCAA Access to Internal Audit Reports
- Common DCMA Criticisms
- DCAA Subpoena Power
- Sequestration



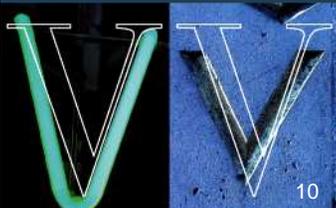
Changing Business Environment

- Contractors need to take preemptive risk management steps to ensure compliance with Business System Rules
- Factors to Consider:
 - Heightened scrutiny and audit oversight by DCAA
 - Strict compliance and disclosure requirements
 - Expansion of audit inquiries
 - False Claims Act
 - Lack of communication between contractor and CO prior to payment withholds



DCAA Mission

The DCAA, while serving the public interest as its primary customer, shall perform all necessary contract audits for the Department of Defense and provide accounting and financial advisory services regarding contracts and subcontracts to all DoD components responsible for procurement and contract administration. These services shall be provided in connection with negotiation, administration, and settlement of contracts and subcontracts to ensure taxpayer dollars are spent on fair and reasonable contract prices. DCAA shall provide contract audit services to other Federal agencies, as appropriate.



DCMA Mission

The mission of DCMA is to “perform Contract Administration Services (CAS) for the Department of Defense, other authorized Federal Agencies, foreign governments, international organizations, and others as authorized.”

DCMA primarily works during two acquisition stages:

- **Pre Contract Award**

“DCMA provides advice and services to help construct effective solicitations, identify potential risks, select the most capable contractors, and write contracts that meet the needs of our customers in DoD, Federal and allied government agencies.”

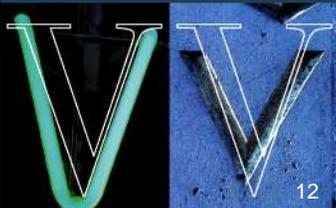
- **Post Contract Award**

“DCMA monitors contractors' performance and management systems to ensure that cost, product performance, and delivery schedules are in compliance with the terms and conditions of the contracts.”



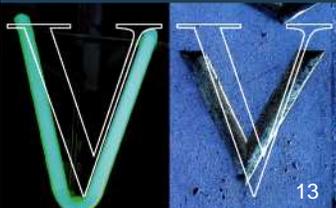
Interrelationship Between DCAA and DCMA

- DCAA plays an *advisory* role.
- DCMA, through its contracting officers and administrative contracting officers, *officially acts on behalf* of the DoD.
 - DCMA often uses DCAA Audits when issuing pricing and cost allowance decisions.
 - However, DCAA and DCMA often conflict with each other when providing guidance to contractors.
 - DCAA has also claimed that its findings have been undermined by DCMA.



DCAA Initiatives

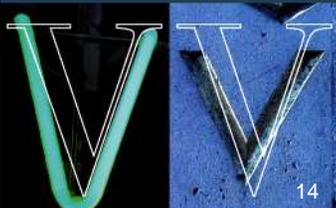
- DPAP Memorandum (1/4/2011), “Better Buying Power: Guidance for Obtaining Greater Efficiency and Productivity in Defense Spending; ‘Align DCMA and DCAA Processes to Ensure Work is Complementary’”
 - Increased Thresholds for Price Proposal Audits
 - Forward Pricing Rate Agreements/Forward Pricing Rate Recommendations
 - Financial Capability Reviews
 - Purchasing System Reviews
 - Contractor Business Systems Rule
 - Ethics Compliance Reviews



DCAA Initiatives

Rules of Engagement

- Issued guidance on establishing open and effective communications with all stakeholders
- Rules cover communications during each phase of the audit
 - Establishing the engagement
 - Entrance conference
 - During the audit
 - Exit conference
 - Post report issuance
 - Negotiations



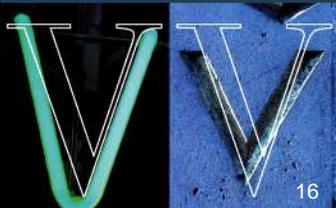
DCAA Initiatives Expectations from Contractor

- Effective contractor proposal walk-throughs
- Adequate contractor submissions and assertions
- Adequate supporting data in a timely manner and timely access to **key** contractor personnel responsible for contractor support
- Real-time DCAA access to contractor systems



DCAA Initiatives Forward Pricing Proposals

- Adequate Contractor Proposals – Facilitate Effective Audit
 - Proposed amounts supported by detailed basis of estimate and supporting documentation
 - Supporting justification/explanation provided for significant variances between prior buy actual cost data and proposed amounts
 - Consolidated Bill of Material
 - Detailed support for additive factors applied to various cost elements
- Indirect Rates supported by contractor budgetary or trend data
- Adequate Support for Subcontractor Proposals
 - Adequate prime contractor cost or price analysis
 - Adequate subcontract proposal
- Proposal reflects anticipated accounting changes



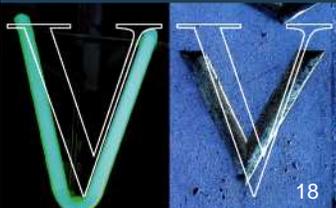
DCAA Initiatives Commercial Items

- Prime **contractor** is required to make a commercial item determination (CID) based on adequate supporting documentation and perform the appropriate cost or price analysis to establish a fair and reasonable price in accordance with DFARS 244.402 and FAR 15.404-3.
- Prime **auditor** is responsible for reviewing the adequacy of the prime/higher-tier contractor's CID and associated cost/price analysis as a basis for opining on the adequacy of the CID and the reasonableness of the proposed subcontract costs included in the prime contractor's proposal.



DCAA Initiatives Commercial Items

- An adequate CID clearly identifies and supports how the item meets the commercial item definition in FAR 2.101. Generally, support for a CID would include market analysis and subcontract sales history.
- Based on materiality and risk, the audit will include verifying subcontractor supporting data (sales and/or cost based) to the subcontractor's books and records.



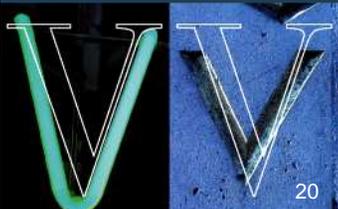
DCAA Initiatives Long Term Agreements (LTAs)

- LTAs are an acceptable pricing method since FAR allows prime contractors to reach price agreement with a subcontractor in advance of agreement with Government
- Auditors will evaluate the prime's analysis of cost/pricing data at the time the LTA was established and consider the procedures performed by the prime contractor to demonstrate that the LTA price continues to be fair and reasonable
- Existence of an LTA prior to a prime contract award does not relieve the prime contractor from obtaining certified cost or/ pricing data prior to subcontract award when required by FAR 15.404-3(c)



DCAA Initiatives Business Systems

- The interim Business System Rule was issued on May 18, 2011
- Defines contractor business systems as the contractor's
 - Accounting System (252.242-7006)
 - Estimating System (252.215-7002)
 - Material Management and Accounting System (MMAS) (252.242-7004)
 - Purchasing System (252.244-7001)
 - Property Management (252.245-7003)
 - Earned Value Management System (EVMS) (252.234-7002)
- Includes a contract clause that requires the contracting officer to apply a percentage of withhold (5%) when a contractor's business system contains a significant deficiency



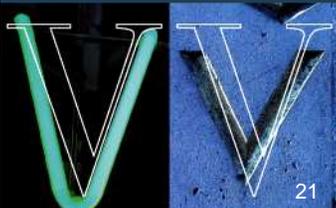
DFARS Rules: Business Systems – Definition & Administration

Interim rule published on May 18, 2011 (76 FR 28856)

Final rule published on February 24, 2012 (77 Fed. Reg. 37)

Key Points:

- Significant Deficiency: “a shortcoming in the system that **materially** affects the ability of officials of the DoD to rely upon information produced by the system that is needed for management purposes.”
 - What does “materially” entail?
- Payment Withholding Decisions: CO finds one or more significant deficiencies in a contractor’s business systems.
 - CO may withhold up to 5 % for single business systems deficiencies, and up to 10% for multiple business systems deficiencies.
 - Applies to progress payments, performance-based payments, and interim payments per each covered contract.



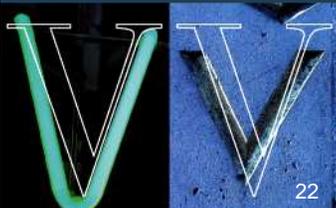
DFARS Rules: Business Systems – Definition & Administration

Corrective Action Plans: allows a contractor to implement a plan to address business system deficiencies. If corrective, CO will reduce or release payment withholds.

- If contractor submits an “acceptable” plan within 45 days of the withholding notice, and CO finds the plan is effectively implemented to address significant deficiencies, the CO shall reduce withholding to 2 percent. If contractor thereafter fails to act in accordance with plan, CO shall increase withholding amount.

Correction of Business System Deficiencies

- If CO determines contractor successfully corrected deficiencies, CO will discontinue withholding and notify contractor as such in writing.
- If CO does not act upon contractor’s successful plan within 90 days, CO shall reduce withholding by at least 50 percent.
- If contractor thereafter fails to address deficiencies, CO may increase or reinstate withholding.



The Roles of DCAA & DCMA

Section 893 of the Ike Skelton NDAA for FY 2011 provides that the program created to improve contractor business systems will “identify officials of the Department of Defense who are responsible for the approval or disapproval of contractor business systems.”

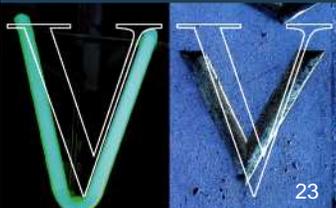
Responsibilities Identified in the Interim Rule

DCAA

- Accounting; Estimating; Material Management & Accounting System (MMAS)

DCMA

- Purchasing; Property Management; Earned Value Management System (EVMS)
- DCAA & DCMA launched Cost Recovery Initiative to address the buildup of audits awaiting resolution.
- Focus of resources on high risk proposals:
 - Cost-Type Proposals > \$100 million; Fixed-Price Proposals > \$10 million



DCAA Initiatives Business Systems

- DCAA will report on compliance with the criteria in DFARS 252.242-7005
- DCAA Reports will identify significant deficiencies – defined by the interim Business System Rule as
 - Shortcomings in the system that materially affects the ability of officials of the DoD to rely upon information produced by the system that is needed for management purposes



DCAA Initiatives Ethics Compliance

FAR Subpart 3.10 – Contractor Code of Business Ethics and Conduct

FAR Case 2006-007, effective December 24, 2007

- Added FAR requirements regarding contractor code of business ethics and display of hotline posters (similar to existing DFARS requirements)

DFARS Case 2008-D004, effective August 12, 2008

- Deleted redundant coverage from DFARS

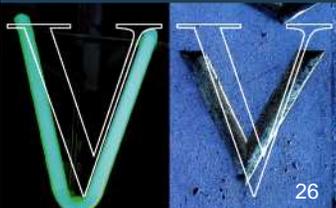
FAR Case 2007-006, effective December 12, 2008

- Added requirement for disclosure of violations of criminal law or the civil False Claims Act and consequences for failure to disclose.



DCAA Initiatives Contractor Ethics

- FAR 52.203-13
 - Written Code of Ethics and Conduct
 - Training
 - Periodic Reviews
 - Internal Reporting Mechanism
 - Disciplinary Actions
 - Full Cooperation for audits, investigations, or corrective actions
 - Disclosure of Improper Conduct to OIG
 - Provides for possible suspension and/or debarment for knowing failure to timely disclose violations (FAR 9.406-2)

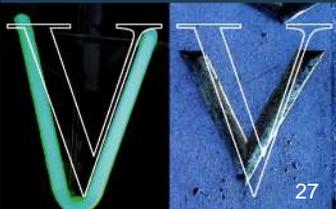


Overview Personal Conflict of Interest

FAR 52.203-16 requires Contractors to:

- Screen for and prevent PCIs for covered employees
- Obtain and maintain “a disclosure of interests that might be affected by the task”
- Require each employee to update the disclosure statement with changes
- Prohibit use of “non-public information accessed through performance of a Government contract for personal gain”; Obtain signed non-disclosure agreement
- Report violations to contracting officer
- Train employees to identify and avoid PCIs or the “appearance” of PCIs
- Maintain effective oversight to verify compliance

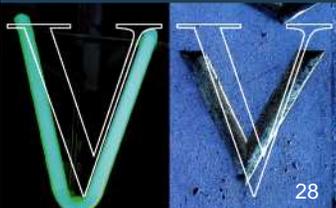
FAR 52.203-16(d): Subcontract Flowdown



Personal Conflicts of Interest

FAR 3.1103(6); 52.203-16

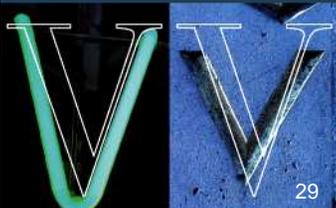
- Report to Contracting Officer any PCI violation (written description of violation)
- Contracting Officer **shall**:
 - Review Actions taken
 - If KO is not satisfied, consult with “agency level counsel”
 - DCAA review of files?
- Then what happens; refer to suspension/debarring official?



DCAA Initiatives

What This Means to you

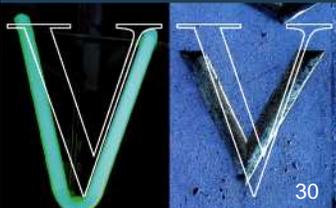
- Increased Requests for Data
- Increased Access to Electronic Data
- Request for Documents Not in the Ordinary Course of Business
 - Board of Director Meeting Minutes
 - Internal Audit Reports
- Access to Records Issues
- Development of New Record Systems
- Development of Internal Monitoring Systems
- Alternative to Internal Audit Mechanism



Response to New Audit Environment

Contractors need to take preemptive steps in response to DCAA's increased oversight and compliance requirements:

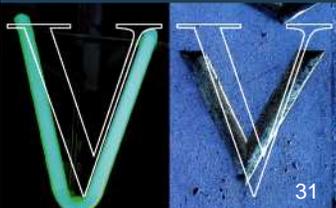
- Increase effectiveness of internal compliance procedures, allocated resources, and communications regarding potential or ongoing audits
- Increase communications with DCAA officials
- Keep abreast of current regulatory regime to ensure effective compliance



Audits

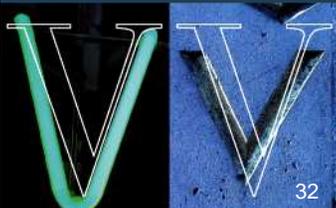
How to Prepare for a DCAA/DCMA Audit

- Review prior DCAA Audit Reports and Identify Issues
- Review DCMA Reviews and Identify Issues
- Review Policies and Procedures
- Test Internal Control Structure Relating to Area to be Audited
- Ensure Documentation (Data) is Current and Available
- Ensure Employees are Trained
- Perform Sampling of Area to be Audited
- Select a Liaison(s) to Work with the Auditors



Audits

- Develop a Professional Rapport with the Auditors
- Take Notes on Auditor's Request for Documents/Request that the Auditor put their Request in Writing
- Listen to the Auditor's Questions/Request that Questions Be Put in Writing
- Provide Documents that Are Requested in a Timely Manner and in the Form Requested
- Do Not Establish too Many Levels of Review for Release of Documents
- Ensure that the Company Liaison to the Auditors Has the Knowledge and Authority to Release Documents
- Avoid Deemed Denial of Access to Records
- Do Not be Afraid to Ask Questions and Be Prepared to Answer Questions
- Document Disputes
- Take a Deep Breath – You Will Survive



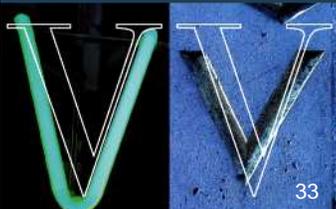
Effective Management of an Audit

In the beginning stages of an audit, contractors must internally communicate:

- Types of audits and risk assessment levels
- How and why an audit occurs; the length and scope of an audit; resources needed for an audit

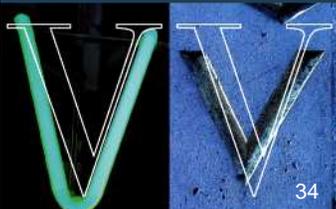
In the interim, it is important to understand contractor data and relevant facts, and identify omissions and mistakes.

At the completion of an audit, contractors should analyze and respond to the results within an auditor's draft report to account for any discrepancies.



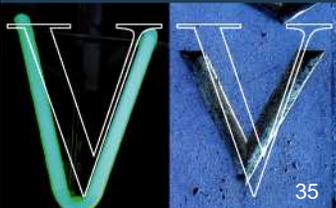
DCAA'S Access to Internal Audit Reports

- Government Accountability Office Report No. GAO-12-88
- Report calls for greater access and use for DCAA to Internal Audit Reports
- DCAA will make more frequent requests
- SecDef to direct DCAA Director to designate POC for each Company to coordinate request
- Set up a tracking system for number of requests and disposition



DCAA'S Access to Internal Audit Reports

- Number of requests for access to internal audit reports will increase
- Company should have their policies and procedures reviewed for granting access to DCAA to Internal Audit Reports
- DCAA may use Director's Subpoena Authority to enforce access denials



DCMA Review of Terms and Conditions

- FAR 44.305-1 states:

“The cognizant Administrative Contracting Officer is responsible for granting, withholding, or withdrawing approval of a contractor’s purchasing system. The ACO shall—

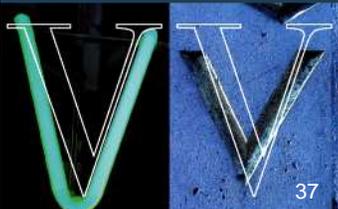
 - (a) Approve a purchasing system only after determining that the contractor’s purchasing policies and practices are efficient and provide adequate protection of the Government’s interests; and
 - (b) Promptly notify the contractor in writing of the granting, withholding, or withdrawal of approval.”
- In accordance with FAR 44.305-1, DCMA will review a contractor’s terms and conditions and will provide recommendations and comments by memorandum to ensure protection of the Government’s legal interests.



Common DCMA Criticisms

In reviewing a contractor's terms and conditions, DCMA has commented on:

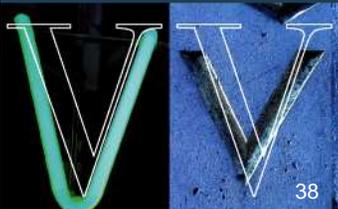
1. Missing Definitions of Critical Terms
2. Non-Appearance of Mandatory **and** Non-Mandatory Provisions and Flowdown Provisions
3. Rights of Contractors Versus Subcontractors
4. Express Inclusion of Statements in a Contractor's Terms and Conditions to Protect the Government's Legal Interests
5. Require Prime Contractor to Communicate Directly with Subcontractor



Practice Tips

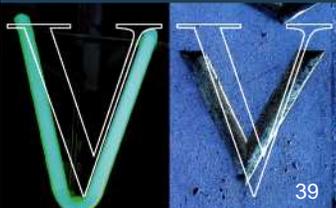
In responding to a DCMA memorandum reviewing a contractor's terms and conditions, contractors should note:

- DCMA will comment on requirements **and** recommendations. In many cases DCMA does not cite to any regulations or acquisition law to support its recommendations.
- Nonetheless, some recommendations, non-mandatory flowdown provisions for example, may be necessary for a contractor to comply with its prime contractor obligations.



DCAA Subpoena Power Overview

- 10 U.S.C. 2313(b)
 - What does it really say?
 - Broad authority, but not as broad as you think...
- Newport News Cases
 - NN I
 - NN II
 - What was the difference?



DCAA Subpoena Power Overview

10 U.S.C. § 2313 – Examination of records of contractor

(a) Agency authority.

(1) The head of an agency, acting through an authorized representative, is authorized to inspect the plant and audit the records of--

(A) a contractor performing a cost-reimbursement, incentive, time-and-materials, labor-hour, or price-redeterminable contract, or any combination of such contracts, made by that agency under this chapter [*10 USCS § § 2301 et seq.*]; and

(B) a subcontractor performing any cost-reimbursement, incentive, time-and-materials, labor-hour, or price-redeterminable subcontract or any combination of such subcontracts under a contract referred to in subparagraph (A).

(2) The head of an agency, acting through an authorized representative, is authorized, for the purpose of evaluating the accuracy, completeness, and currency of certified cost or pricing data required to be submitted pursuant to section 2306a of this title with respect to a contract or subcontract, to examine all records of the contractor or subcontractor related to--

(A) the proposal for the contract or subcontract;

(B) the discussions conducted on the proposal;

(C) pricing of the contract or subcontract; or

(D) performance of the contract or subcontract.



DCAA Subpoena Authority Overview

SecDef, acting through an authorized representative, can, for the purpose of evaluating the accuracy, completeness, and currency of certified cost or pricing data required to be submitted under 10 U.S.C. § 2306a, with respect to a contract or subcontract, examine all records of the contractor or subcontractor related to

- The proposal for the contract or subcontract;
- The discussions conducted on the proposal;
- Pricing of the contract or subcontract; or
- Performance of the contract or subcontract



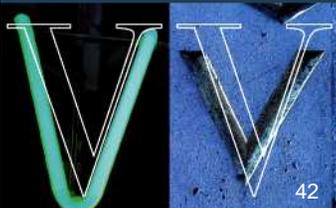
DCAA Subpoena Authority

(b) DCAA subpoena authority.

(1) The Director of the Defense Contract Audit Agency (or any successor agency) may require by subpoena the production of any records of a contractor that the Secretary of Defense is authorized to audit or examine under subsection (a).

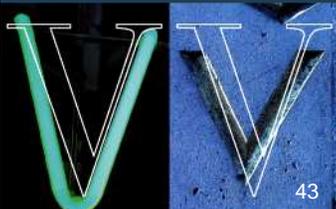
(2) Any such subpoena, in the case of contumacy or refusal to obey, shall be enforceable by order of an appropriate United States district court.

(3) The authority provided by paragraph (1) may not be redelegated.



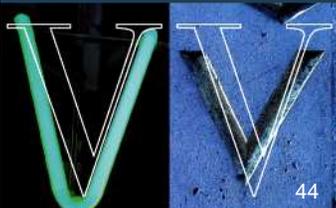
DCAA Subpoena Power Overview

- Look at 2313(b) first – that’s the direct statement of the Director’s authority
 - May require by subpoena
 - Records of a **contractor**
 - That the Secretary of Defense is **authorized** to audit or examine under **subsection (a)**
 - Refusal to obey a proper subpoena can be brought before a US District Court for enforcement
 - This authority belongs only to the Director, and cannot be redelegated



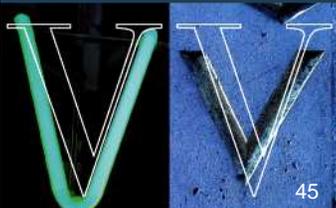
DCAA Subpoena Power Overview

- What does subsection (a) say again?
 - SecDef, acting through an authorized representative, can inspect the plant and audit the records of
 - A contractor performing a cost-reimbursement, incentive, time-and-materials, labor-hour, or price redeterminable contract (or any combination thereof); and
 - A subcontractor performing the same type(s) of contracts



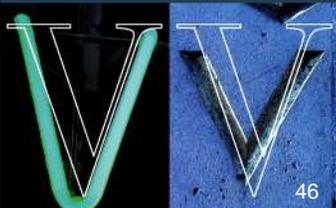
DCAA Subpoena Authority Overview

- Bottom Line, the Director, and only the Director, can issue a subpoena –
 - To a contractor or subcontractor ***only***;
 - If the contractor or subcontractor is performing a cost-reimbursement, incentive, time-and-materials, labor-hour, or price redeterminable contract (or any combination thereof); OR
 - To evaluate the accuracy, completeness, or currency of certified cost or pricing data of a contract or subcontract related to
 - Proposal
 - Discussions
 - Pricing
 - Performance



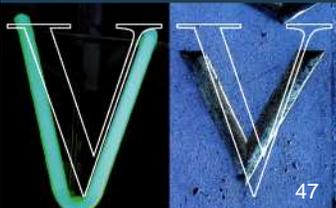
DCAA Subpoena Power Newport News Cases

- Newport News I
- DCAA subpoena for internal audits of NNS
 - Government argued:
 - NNS did 98% of its business w/ the Gov't, therefore we're entitled to the audits
 - How can we check to see if the internal audit dep't is doing their job if we can't see their audit?
 - Holding: DCAA statutory subpoena power extends to cost information related to government contracts, but DCAA does not have unlimited power to demand access to all internal corporate materials of companies performing cost-type contracts for the Government



DCAA Subpoena Power Newport News Cases

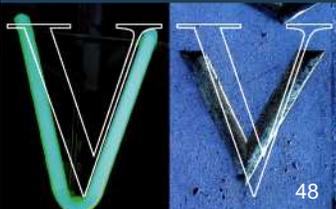
- Newport News II
 - DCAA subpoena for financial info from NNS, to include tax returns, financial statements, and supporting schedules
 - Government convinced the Court that access would allow DCAA to verify the accuracy of cost information and corroborate NNS' computation and allocation of direct and indirect costs to particular Gov't contracts.
 - Holding: DCAA statutory subpoena power extends to objective factual materials useful in verifying the actual costs, including G&A costs, charged by companies performing cost-type work contracts for the Government
 - The key? "Objective" factual information vs. "Subjective" opinions of internal auditors in their reports



THE SEQUESTRATION PROCESS

Audits, Investigations and Sequestration! Oh My!
March 13, 2012 Tysons Corner, VA
Venable LLP

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THE SEQUESTRATION PROCESS

EXECUTIVE SUMMARY

1. Defense contractors are hostages in a showdown between the President and Congress over fundamental decisions on taxing and spending
2. The President has two leverage points in the struggle:
 - The Bush tax cuts expire in early January 2013
 - Many defense programs and contractors are subject to major cuts under the sequestration process

The President's January 5, 2012 defense spending reduction policy is an integral part of this process – his opening position in the negotiations

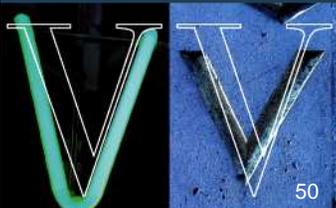


DEFINITIONS OF SEQUESTRATION

- Webster's Definition: To set apart, segregate, surrender for safekeeping
- Legal Definition – An Impoundment authorized by law

Functional Definitions

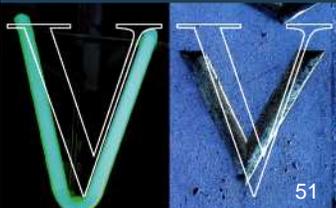
- Sequestration = automatic, indiscriminate, across-the-board budget cuts to force reductions in spending to defined levels established by statute
- Sequestration = a gun Congress holds to its own head to force program advocates to propose and to agree to compensating cuts elsewhere, for fear of having their favorite programs cut



BASIC PRINCIPLES

1. If sequestration occurs, the automatic, indiscriminate spending cuts will be divided roughly equally between:
 - eligible defense programs
 - eligible non-defense programs
2. Many domestic entitlement programs are exempt from cuts:
 - Social Security
 - federal retirement programs
 - Medicaid
 - cuts in Medicare limited to 2%
3. The major difference between this process and the 1985-86 Sequestration is that many more defense programs are subject to cuts.

This gives proponents of defense spending incentives to support tax increases and cuts in domestic discretionary spending. It also gives proponents of domestic spending incentives to raise taxes and cut defense spending.



PROCESS FOR ADMINISTERING SEQUESTRATION

- Step 1: OMB starts with the deficit reduction amount established by the statute \$1.2 trillion
- Step 2: OMB subtracts 18% of that amount for interest on the debt
- Step 3: OMB divides the remainder (an estimated \$492 billion) by 9, to allocate the spending cuts to each of the 9 covered years
- Step 4: OMB divides that amount by 2, to establish the amount to be cut separately from defense and non-defense programs
- Step 5: OMB calculates the uniform amount each eligible program in the defense and non-defense categories must be cut



CBO's ESTIMATE OF EFFECTS OF SEQUESTRATION

1. Eligible defense programs will be cut by 10% in Fiscal Year 2013
2. Eligible non-defense or “discretionary” programs will be cut by 8.5% in Fiscal Year 2013
3. Medicare will be cut by 2%



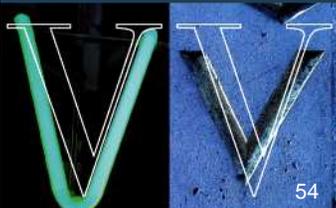
THE CRITICAL CONSIDERATION - TIMING

The sequestration will not occur until January 2, 2013 – the same time as the expiration of the Bush tax cuts.

This linkage, and the adverse effects of the indiscriminate sequestration, ensure that intense policy arguments will occur throughout 2012:

- During the election campaign
- Lame duck session
- After the new Congress convenes

FASTEN YOUR SEATBELTS



ADMINISTERING THE SEQUESTRATION -- WHAT WILL OMB AND THE AGENCIES DO?

OMB ACTIONS

1. Determine the percentage cut for defense and civilian programs.
2. Determine how to apply that cut to each separate line item in appropriations bills, using scorekeeping principles first developed in 1985-86. Discuss with agencies.
3. Closer to the date of sequestration, OMB will implement the spending reductions by formally impounding the funds that are sequestered. OMB will issue an “apportionment” to each agency.

An apportionment is a legally binding order, enforceable by criminal penalties, that forbids an agency from spending more appropriated funds than OMB allows. Its normal function is to smooth out spending through four quarters.

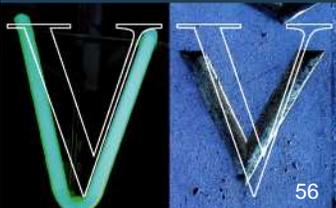


ADMINISTERING THE SEQUESTRATION -- WHAT WILL OMB AND THE AGENCIES DO?

OMB ACTIONS (continued)

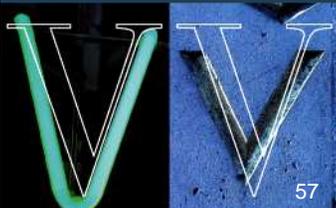
4. The President has substantial discretion in this process:
 - Timing. Date on which apportionments are issued. Logical time -- September 2012, prior to start of FY 2013. Smooth out spending to avoid first quarter rush?
 - Publicity. Pressure Congress prior to elections.
 - Policy apportionments. The President may instruct OMB to use its authority to promote his priorities. The apportionment may direct an agency to spend no more than \$x or x% of appropriated funds on Project 1, and to spend the remainder on Project 2.

Policy apportionments may support White House defense policy priorities announced January 6.
5. Reprogramming. To reduce the adverse effects of indiscriminate cuts and respond to emergencies, OMB and agencies will aggressively utilize existing reprogramming authority to shift funds around.



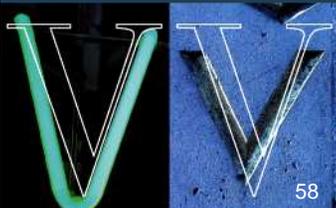
WHAT AGENCIES DO

1. Determine how to implement uniform percentage reduction by imposing uniform percentage spending cuts within each line item in its appropriation bill.
2. Discuss preliminary policy choices with OMB and White House for consistency with Presidential policy. This may include January 6 Defense spending priorities.
3. Consider reprogramming funds to reduce adverse effects of sequester, if legal authority exists.
4. Agencies will have great discretion in administering sequestration. Examples include:
 - Allocation among programs in a line item.
 - Allocation between personnel reductions and contract expenditures within a program.
 - Allocation among contracts within a program.
5. This process will take several months to implement. Contracting Officers will be told the impact on their contracts relatively late in the process.



POSSIBLE EFFECTS OF SEQUESTRATION ON CONTRACTS

1. The agencies will try to minimize recourse to termination for convenience. They will manage their contracts to reduce the amount that is deemed obligated.
2. Cost reimbursement contracts. The agency can control the “best efforts” that a contractor can exert -- i.e., we will pay only \$y, use your best efforts within that cap.
3. Indefinite delivery/indefinite quantity contracts. Inform contractor that the agency will obligate only \$y in the fiscal year, to a level below original expectation. Agencies will be reluctant to exercise their rights to extend for option years.



POSSIBLE EFFECTS OF SEQUESTRATION ON CONTRACTS

4. Service contracts. Agencies will be reluctant to exercise their rights to extend for option years and may use the prospect of non-renewal to renegotiate down costs.
5. Do not enter into new contracts. This will be a common agency practice in year one of a sequester. Procurements that can be put off will be put off.
6. Contracts funded with money obligated in prior Fiscal Years are protected.



STEPS YOU SHOULD TAKE

Be proactive.

Reach out to agency policy officials directly or through trade associations. Advocate the importance of the programs your contracts support.

Stay in close touch with your Customers within the agency. Emphasize the importance of your contracts to the program. Obtain information about the agency's plans for your contracts.

Your Customers may not know the fate of your contract until late in the process. Contracting officers will be further behind the curve.



Questions? Comments?

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