Back in the “old days” before Congress and DoD significantly revised the standards for contractor internal controls, there were ten (10) internal control “systems” that contractors were supposed to establish and maintain. To be clear, not all ten systems applied to every contractor; as contractors grew they became subject to new system requirements. The larger the contractor, the more robust and sophisticated its internal controls were supposed to be.

Back in the “old days” DCAA maintained audit programs for each system, along with “matrices” that established expected control objectives, control activities, and the audit procedures that would be used to test them. To be clear (again), these systems were (by and large) not regulatory requirements; except for the more fundamental systems (*e.g.*, estimating, purchasing, government property control), they were not to be found in contract clauses. The ten systems, the control objectives, and the control activities largely were based on DCAA’s own notions regarding what control systems DoD contractors should have.

Yet there was nothing else upon which to base an internal control environment. For better or worse, DCAA’s notions became the *de rigueur* standard for contractors. And it wasn’t just defense contractors that adopted them; the DCAA notions of internal control adequacy became the *sine qua non* for every single government contractor. Perhaps the original impetus for the widespread adoption of DCAA's standards came from the fact that DCAA auditors performed audits for agencies other than DoD on a reimbursable basis—including DOE and NASA, to name two major agencies—and thus by default those non-DoD agencies adopted DCAA’s standards. But we think the more salient fact is that *there was simply nothing else available*. DCAA’s standards were the only game in town.

But that all changed in early 2012 with the promulgation of the “contractor business systems” management and oversight regime. By public law and DFARS rule-making, six contractor business systems were defined, along with associated system adequacy criteria. DCAA audit programs related to areas outside those six systems were retired, and audit programs for those six systems were substantially revised. Internal control matrices related to the old “ICAPs” were retired, and internal control matrices for the six systems were changed to tie to the new official adequacy criteria. It was a sea-change, a revolution in how defense contractors were going to manage their operations. It was the new thing.

Non-DoD agencies were in a quandary, because the six business systems were exclusively

the province of DFARS and defense contractors. For example, there were no DOE contract clauses similar to the DFARS contract clause 252.242.7005 (“Contractor Business Systems”). Thus, the actions of the DAR Council created two distinct and separate approaches to contractor internal control: one for defense contractors and another for contractors doing work for civilian agencies.

That wasn’t a terrible thing if you knew which agency you were supporting. But for the many contractors that held contracts with both DoD and non-DoD agencies, it was confusing, to say the least.

To a large extent, DOE solved the problem by **adopting** an approach that was very similar to the DoD regime. That certainly made things easier for the DCAA auditors performing reimbursable work for DOE! (Not to mention clarifying things for DOE contractors.) However, that approach also resulted in an unforeseen challenge when DCAA **cut back** on the amount of audits it performed for DOE. It didn’t matter which internal control regime was in place, when nobody was checking to see if contractors were following it.

And that audit challenge was exacerbated when the 2016 National Defense Authorization Act (NDAA) included an express prohibition on DCAA performing audit services for non-DoD agencies. Not only was the DCAA audit coverage of DOE contractors being significantly eroded over time (because of changes to DCAA’s “risk-based” audit procedures); but now Congress had effectively reduced it to zero.

It doesn’t matter whether or not DOE adopts the DFARS business system management regime if there are no auditors available to enforce it.

One of the actions that DOE has taken to address its sudden shortfall of audit coverage is to reduce the requirement for audits. For instance, it is officially reducing the need to approve DOE contractors’ compensation systems on an individual contract (or contractor) basis. The fewer contractors that have to have their compensation systems reviewed and approved, the fewer reviews that will need to be performed.

Or in the words of the DOE **Acquisition Letter** (AL-2016-01)—

DOE Order 350.1 establishes the responsibilities, requirements, and cost allowability criteria for the management and oversight of contractor human resource programs. The Order establishes oversight responsibilities to ensure DOE contractors manage their human resource programs to support the DOE mission, promote work force excellence, champion work force diversity, achieve effective cost management performance, and comply with applicable laws and regulations. Chapter IV, Compensation; Chapter V, Benefits; and Chapter VI, DOE Contractor Pension Plans, establish oversight responsibilities to promote reasonable contractor compensation and benefits in accordance with the Federal Acquisition Regulation's (FAR) cost principles (FAR Part 31). DOE has determined that a risk-based approach, rather than a transactional approach, is appropriate to promote cost reasonableness in accordance with the referenced FAR cost principles.

Thus—

The purpose of Acquisition Letter (AL) 2016-01 is to provide guidance regarding required actions to move from DOE traditional transactional approach for approving certain costs relating to compensation and benefits, to a risk based approach that removes a requirement for DOE approval where risk reducing conditions are met.

To implement the new approach, DOE has issued a new **Section H** clause to be "bilaterally" incorporated into the following contract actions:

M&O and non-M&O cost reimbursement solicitations and contracts where work had been previously performed under a DOE M&O contract and the successor Contractor is (a) required to employ all or part of the former Contractor's workforce and sponsors the employee pension and benefit plans; or (b) retains sponsorship of benefit plans that survive performance of the contract work scope. Contracts in this latter category include, but are not limited to, environmental remediation, infrastructure services and other site-specific project completion contracts.

The new Section H provision/clause defines the type of information that an affected DOE contractor must submit for review. The information includes:

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Philosophy and strategy for all pay delivery programs.

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System for establishing a job worth hierarchy.

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Method for relating internal job worth hierarchy to external market.

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System that links individual and/or group performance to compensation decisions.

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Method for planning and monitoring the expenditure of funds.

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Method for ensuring compliance with applicable laws and regulations.

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System for communicating the programs to employees.

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System for internal controls and self-assessment.

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System to ensure that reimbursement of compensation, including stipends, for employees who are on joint appointments with a parent or other organization shall be on a pro-rated basis

In addition to the foregoing, DOE contractors subject to the new provision/clause must—

… develop, implement and maintain formal policies, practices and procedures to be used in the administration of its compensation system consistent with FAR 31.205-6 and DEAR 970.3102-05-6; “Compensation for Personal Services”. DOE-approved standards (e.g., set forth in an advance understanding or appendix), if any, shall be applied to the Total Compensation System. The Contractor’s Total Compensation System shall be fully documented, consistently applied, and acceptable to the Contracting Officer. Costs incurred in implementing the Total Compensation System shall be consistent with the Contractor's documented Contractor Employee Compensation Plan as approved by the Contracting Officer

But that’s not all. Contractors that have the new Section H clause in their contracts (or agree to have their contracts modified to include the new clause) must also submit to their cognizant Contracting Officer the following information—

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An Annual Contractor Salary-Wage Increase Expenditure Report to include, at a minimum, breakouts for merit, promotion, variable pay, special adjustments, and structure movements for each pay structure showing actual against approved amounts; and planned distribution of funds for the following year.

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A list of the top five most highly compensated executives as defined in FAR 31.205-6(p)(4)(ii) and their total cash compensation at the time of Contract award, and at the time of any subsequent change to their total cash compensation. This should be the same information provided to the System for Award Management (SAM) per FAR 52.204-10.

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An Annual Compensation and Benefits Report no later than March 1st of each year.

There's more to it than that, of course. (Pages and pages of detail, actually.) But the foregoing provides the basic compliance requirements. In return for agreeing to the clause requirements, DOE contractors (presumably) won't need to have their compensation systems reviewed by auditors and approved by Contracting Officers.

Not addressed in the DOE Acquisition Letter is what the DOE Contracting Officers will actually do with all the detailed information they receive from their contractors. They are going to be inundated with compensation and HR and pension data; who is going to review it? Who will evaluate it for acceptability? What if it is not acceptable—what happens then? We did not see the answers to those questions in the DOE policy guidance.

If there is no ability to actually evaluate the information received, to determine whether or not the contractor's compensation system is low-risk, then the result of the new clause is to create the illusion of management oversight and control where none actually exists. In our view, that's really not a good thing for taxpayers.

Also not addressed is what kind of compensation system a contractor needs if it neither sells to DOE or to DoD. For example, what kind of compensation system is required of a contractor that provides services solely to the Environmental Protection Agency? We don't know.

For those contractors that fall outside of current regulatory or contractual coverage, or for those contractors that are small businesses and hope to grow into a large business one day, there is precious little guidance available to assist them in this area. The only guidance we would recommend is the DCAA control matrix related to the compensation internal control system, the "ICAPs" internal control matrix that existed before the DFARS contractor business system changes were promulgated.

But where do you find that retired document?

We don't think you can find that information on the current DCAA website, but it might be

available via Google archive or similar data-mining efforts. Or you can ask your local DCAA auditors to see if they can find it. Or maybe your compliance folks retained a copy.

We did.