Written by Nick Sanders Wednesday, 30 March 2011 00:00

Attention interested defense acquisition policymakers and DOD leadership. This article is for you. We want to show you what's wrong with your system. Here's an object lesson on how your oversight agencies take a molehill and create a mountain—a mountain that takes hundreds if not thousands of person hours, millions of dollars, and years to undo.

We're talking—once again—about the costs of ineligible dependents who participate in employee healthcare plans in violation of contractor policy.

By way of background, we first reported this issue here, way back in August, 2009. We told you about new "troubling" DCAA audit guidance that "targeted" the unallowable costs associated with ineligible dependents—i.e., employee family members who were covered by contractor healthcare plans even though they were ineligible under plan rules and contractor policy.

We also reported—

DCAA auditors 'should verify that contractors have adequate procedures to ensure payment of insurance premiums or claims are only being made related to employees and their eligible dependents.' A contractor's failure to have adequate procedures in this area will treated as 'an internal control deficiency in the contractor's accounting system and a CAS 405 noncompliance, if applicable.' Further, inclusion of costs related to ineligible dependents/spouses in cost estimates may be treated as inadequacies in the contractor's estimating system. Previous DCAA audit guidance (MRD 08-PAS-403(R), dated 12/19/2008) directs that a single control objective failure should lead to a recommendation o system inadequacy. An inadequate estimating system is a nuisance, but an inadequate accounting system can prevent a contractor from receiving any cost-reimbursement contract. (Ref. FAR 16.301-3(a)(1).) Accordingly, a threat to the adequacy of a contractor's accounting system internal controls must be taken very seriously.

We followed up with this article, in which we noted that DCMA Headquarters, in another example of a continuing ceding of business judgment and authority to DCAA, issued guidance to its contracting officers that healthcare costs associated with ineligible dependents were to be treated as "expressly unallowable" costs. We opined that the 2002 Armed Services Board of Contract Appeals (ASBCA) decision in

(ASBCA No. 49372, reversed on other grounds) established a clear—and difficult to meet—test for determining whether a cost was "expressly unallowable." The DCMA direction to its contracting officers not only ignored the ASBCA's test, it also contradicted other aspects of its own guidance regarding how final indirect cost rates were to be established.

Now comes additional DCAA audit guidance, in the form of $\frac{MRD\ 11-PAC-002(R)}{R}$, dated February 4, 2011.

Here's what you need to know about DCAA's more recent audit guidance:

Written by Nick Sanders Wednesday, 30 March 2011 00:00

- 1. A contractor's inclusion of healthcare costs associated with ineligible dependents in its indirect costs will not only be treated as inclusion of "expressly unallowable" costs, it will also be treated as a noncompliance with Cost Accounting Standard 405.
- 2. As part of resolving the CAS noncompliance, contractors must submit a "cost impact proposal" calculating the impact to affected to their CAS-covered contracts.
- 3. The cost impact proposal must calculate the impact(s) to all affected contracts for all years $\frac{1}{2} \int_{\mathbb{R}^{n}} \left(\frac{1}{2} \int_{\mathbb{R}^{n}} \left(\frac{$

in which the contractor included the "expressly unallowable" costs.

- 4. By "all years" the DCAA means "all affected years, including years that have had the indirect rates settled (closed years)."
- 5. If the contractor's cost impact proposal "does not include both open and closed years," then the DCAA auditors should report it as "inadequate for audit."
- 6. If the contractor "refuses to submit an adequate cost impact," then the auditors will "develop a reasonable estimate of the cost impact (a ROM) and recommend that the Contracting Officer pursue remedies as outlined in FAR 30.605(i) and 30.604(i)."

There are so many problems with the guidance that it's difficult to muster the patience to even organize the issues in a logical fashion. To keep us from tearing our hair out or howling at the moon, we're going to pose our concerns in the form of questions—in a quasi-Socratic dialog kind of thing.

Question: The contractor's costs associated with ineligible dependents are unallowable because such costs violate its policies and the plan coverage rules. Why are such costs thought to be expressly unallowable?

Question: If the costs are unallowable because they violate policy and plan rules, can the contractor make such costs allowable by (a) changing its policy and (b) renegotiating plan rules?

Question: Under CAS 416, insurance costs are measured on the basis of (a) premium paid or (b) projected average loss. Use of actual claims experience or actual claims paid is not an acceptable measurement method, unless the actual experience approximates one of the accepted methods. Given this—

- 1. Premium costs are shared between company and employee. For many companies, the family rate is the highest rate and the number of dependents is irrelevant. So, what is the company's share of premium costs associated with ineligible dependents when there are sufficient eligible dependents to qualify for family coverage in any case?
- 2. By and large, ineligible dependents are adult children who have reached age 21 without attending college the requisite amount. What is the incremental premium cost associated with young adults? Is it higher, or lower, than the premium cost associated with mature adults in their 40's, 50's, and/or 60's?

Question: Given the forgoing, are the costs associated with ineligible dependents likely to be

Written by Nick Sanders Wednesday, 30 March 2011 00:00

material in amount, or immaterial, when compared to a company's costs of providing healthcare coverage to its employees?

Question: If the company can show that the costs of providing healthcare coverage to ineligible dependents is immaterial in amount, when compared to the entirely cost company healthcare costs, can the company then be found to be in noncompliance with CAS 405? Can any contractor ever be found to be in noncompliance with any Cost Accounting Standard when the amount of cost at question is immaterial in amount?

Question: What is the purpose of negotiating a final indirect cost rate, and "closing" a year to further adjustment, or "closing" a contract to further adjustment, when DCAA and the FAR Councils think that contracts in closed years should be part of a cost impact analysis?

Question: Given that FAR 4.703 states that records must only be retained by a contractor for three years after receipt of final payment associated with its government contracts, why would anybody expect that a contractor would be able to prepare an adequate cost impact proposal for its closed years?

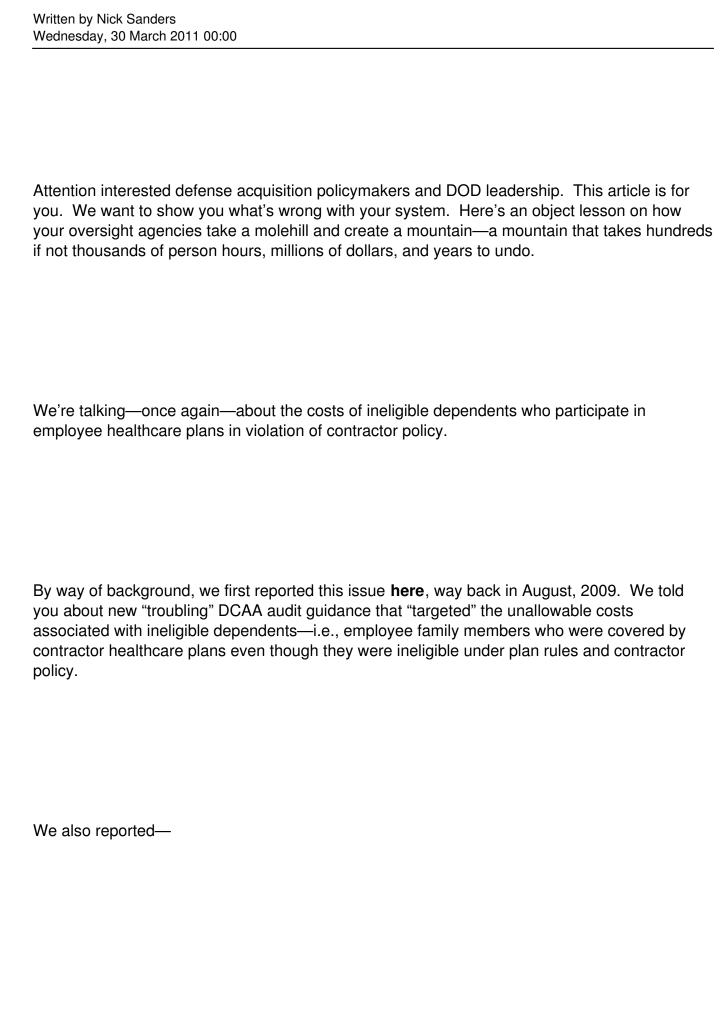
Question: Given that the enabling CAS Board statute reserves the right to interpret CAS regulations exclusively to the CAS Board, what was the statutory basis for the FAR Councils' 2005 interpretation of the cost impact regulations that required contracts in closed fiscal years to be included in the cost impact proposal?

Question: Where in FAR or CAS is the DCAA given authority to review a contractor's cost impact analysis for "adequacy"? Where in the CAS regulations are the criteria for an "adequate" cost impact analysis spelled out?

Question: If the contractor cannot or will not provide sufficient information to calculate a cost impact, how will DCAA calculate its ROM impact? What level of accuracy do you think DCAA will be able to achieve on its own?

Question: If you are a contractor caught in this swamp bog of bureaucratic bungling, this morass of regulatory misadventure, this mountain from a molehill, this tempest in a teapot, then how to you resolve it—other than by litigation? If you litigate, how much time and effort will that take? Who is going to pay for all that?

Answer: This insanity can be stopped, but only if adults step in to supervise the children. DCMA and DCAA are clearly caught up in "much ado about nothing" and DOD leadership needs to realize the price that is being paid by its contractors, who will have to resolve these issues through the courts—since they see no other avenue available to them.



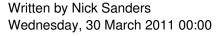
Written by Nick Sanders Wednesday, 30 March 2011 00:00

DCAA auditors 'should verify that contractors have adequate procedures to ensure payment of insurance premiums or claims are only being made related to employees and their eligible dependents.' A contractor's failure to have adequate procedures in this area will treated as 'an internal control deficiency in the contractor's accounting system and a CAS 405 noncompliance, if applicable.' Further, inclusion of costs related to ineligible dependents/spouses in cost estimates may be treated as inadequacies in the contractor's estimating system. Previous DCAA audit guidance (MRD 08-PAS-403(R), dated 12/19/2008) directs that a single control objective failure should lead to a recommendation o system inadequacy. An inadequate estimating system is a nuisance, but an inadequate accounting system can prevent a contractor from receiving any cost-reimbursement contract. (Ref. FAR 16.301-3(a)(1).) Accordingly, a threat to the adequacy of a contractor's accounting system internal controls must be taken very seriously.

We followed up with **this article**, in which we noted that DCMA Headquarters, in another example of a continuing ceding of business judgment and authority to DCAA, issued guidance to its contracting officers that healthcare costs associated with ineligible dependents were to be treated as "expressly unallowable" costs. We opined that the 2002 Armed Services Board of Contract Appeals (ASBCA) decision in General Dynamics (ASBCA No. 49372, reversed on other grounds) established a clear—and difficult to meet—test for determining whether a cost was "expressly unallowable." The DCMA direction to its contracting officers not only ignored the ASBCA's test, it also contradicted other aspects of its own guidance regarding how final indirect cost rates were to be established.

Now comes additional DCAA audit guidance, in the form of **MRD 11-PAC-002(R)**, dated February 4, 2011.

Here's what you need to know about DCAA's more recent audit guidance:



1.

A contractor's inclusion of healthcare costs associated with ineligible dependents in its indirect costs will not only be treated as inclusion of "expressly unallowable" costs, it will also be treated as a noncompliance with Cost Accounting Standard 405.

2.

As part of resolving the CAS noncompliance, contractors must submit a "cost impact proposal" calculating the impact to affected to their CAS-covered contracts.

3.

The cost impact proposal must calculate the impact(s) to *all* affected contracts for *all years* in which the contractor included the "expressly unallowable" costs.

4.

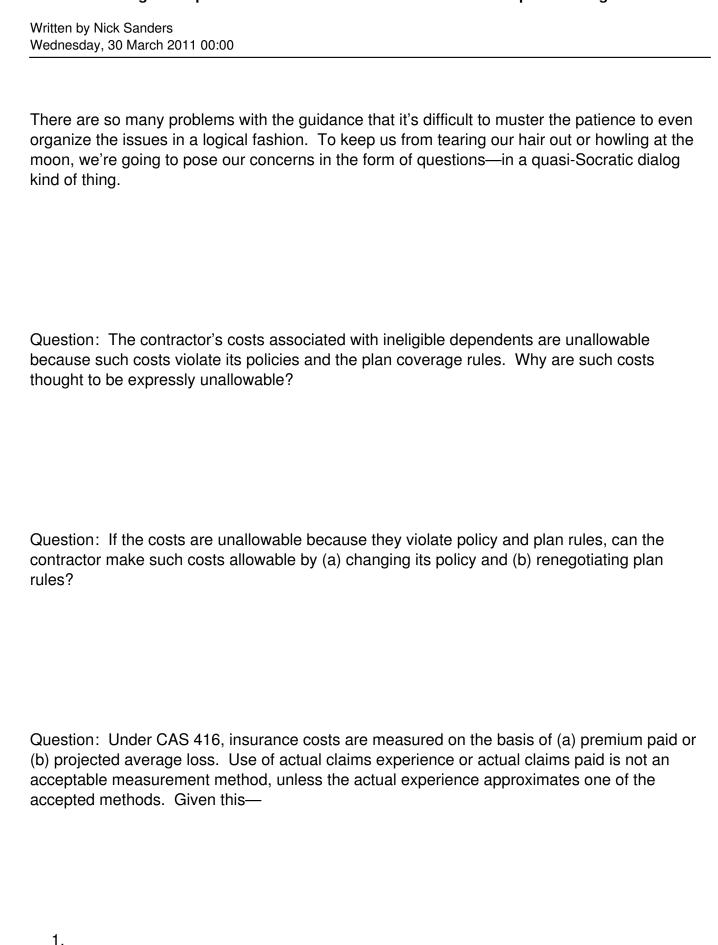
By "all years" the DCAA means "all affected years, including years that have had the indirect rates settled (closed years)."

5.

If the contractor's cost impact proposal "does not include both open and closed years," then the DCAA auditors should report it as "inadequate for audit."

6.

If the contractor "refuses to submit an adequate cost impact," then the auditors will "develop a reasonable estimate of the cost impact (a ROM) and recommend that the Contracting Officer pursue remedies as outlined in FAR 30.605(i) and 30.604(i)."



Premium costs are shared between company and employee. For many companies, the family

7 / 14

Written by Nick Sanders Wednesday, 30 March 2011 00:00

rate is the highest rate and the number of dependents is irrelevant. So, what is the company's share of premium costs associated with ineligible dependents when there are sufficient eligible dependents to qualify for family coverage in any case?

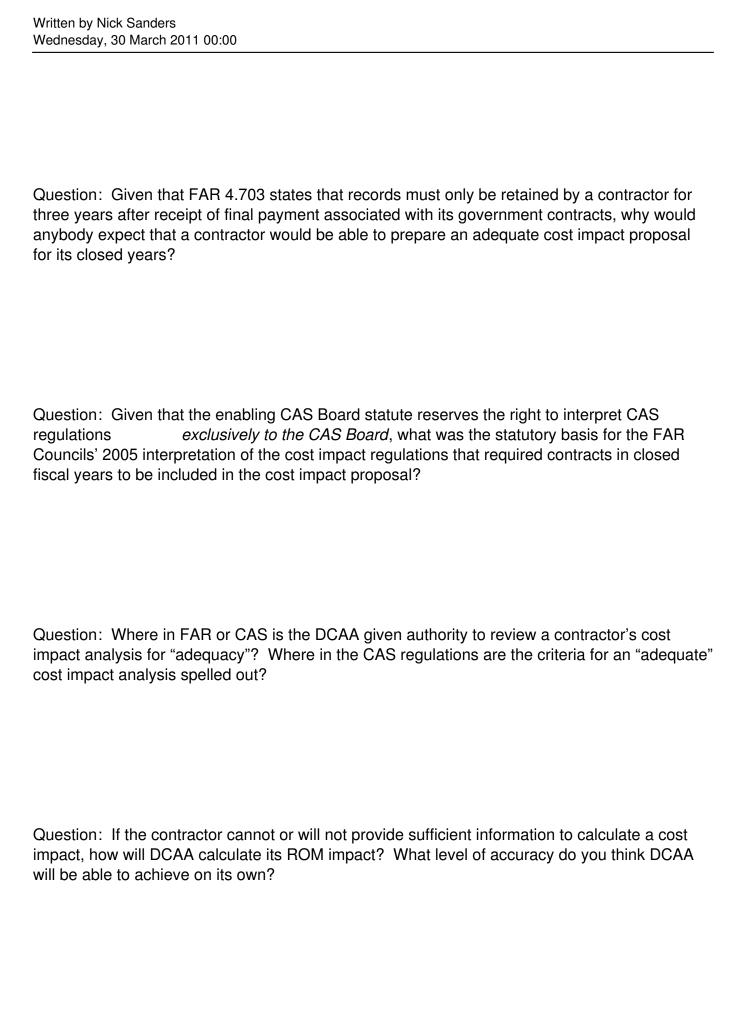
2.

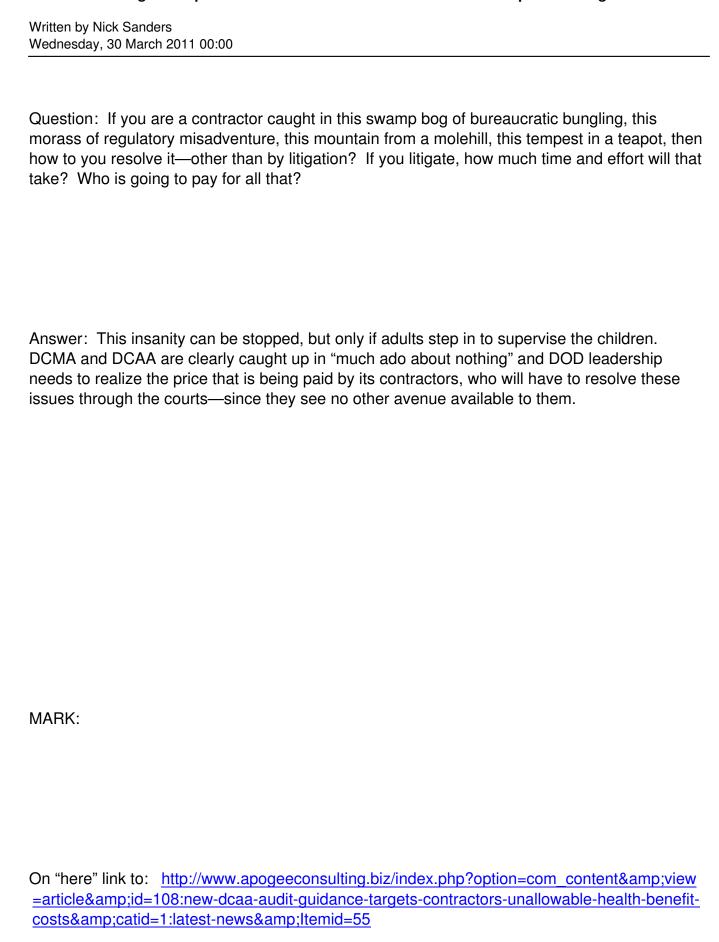
By and large, ineligible dependents are adult children who have reached age 21 without attending college the requisite amount. What is the incremental premium cost associated with young adults? Is it higher, or lower, than the premium cost associated with mature adults in their 40's, 50's, and/or 60's?

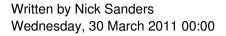
Question: Given the forgoing, are the costs associated with ineligible dependents likely to be material in amount, or immaterial, when compared to a company's costs of providing healthcare coverage to its employees?

Question: If the company can show that the costs of providing healthcare coverage to ineligible dependents is immaterial in amount, when compared to the entirely cost company healthcare costs, can the company then be found to be in noncompliance with CAS 405? Can any contractor ever be found to be in noncompliance with any Cost Accounting Standard when the amount of cost at question is immaterial in amount?

Question: What is the purpose of negotiating a final indirect cost rate, and "closing" a year to further adjustment, or "closing" a contract to further adjustment, when DCAA and the FAR Councils think that contracts in closed years should be part of a cost impact analysis?







On "this article" link to: http://www.apogeeconsulting.biz/index.php?option=com_content& http://www.apogeeconsulting.biz/index.php?option=com_content& http://www.apogeeconsulting.biz/index.php?option=com_content& https://www.apogeeconsulting.biz/index.php?option=com_content& <a href="https://www.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apogeeconsulting.biz/index.php.apog

On "MRD 11-PAC-002(R)" link to: DCAA MRD – Contractor Ineligible Healthcare Costs.pdf file attached

Contractor Ineligible Dependent Health Care Costs—The Gift That Keeps on Giving

Attention interested defense acquisition policymakers and DOD leadership. This article is for you. We want to show you what's wrong with your system. Here's an object lesson on how your oversight agencies take a molehill and create a mountain—a mountain that takes hundreds if not thousands of person hours, millions of dollars, and years to undo.

We're talking—once again—about the costs of ineligible dependents who participate in employee healthcare plans in violation of contractor policy.

By way of background, we first reported this issue here, way back in August, 2009. We told you about new "troubling" DCAA audit guidance that "targeted" the unallowable costs associated with ineligible dependents—i.e., employee family members who were covered by contractor healthcare plans even though they were ineligible under plan rules and contractor policy.

We also reported—

DCAA auditors 'should verify that contractors have adequate procedures to ensure payment of insurance premiums or claims are only being made related to employees and their eligible

Written by Nick Sanders Wednesday, 30 March 2011 00:00

dependents.' A contractor's failure to have adequate procedures in this area will treated as 'an internal control deficiency in the contractor's accounting system and a CAS 405 noncompliance, if applicable.' Further, inclusion of costs related to ineligible dependents/spouses in cost estimates may be treated as inadequacies in the contractor's estimating system. Previous DCAA audit guidance (MRD 08-PAS-403(R), dated 12/19/2008) directs that a single control objective failure should lead to a recommendation o system inadequacy. An inadequate estimating system is a nuisance, but an inadequate accounting system can prevent a contractor from receiving any cost-reimbursement contract. (Ref. FAR 16.301-3(a)(1).) Accordingly, a threat to the adequacy of a contractor's accounting system internal controls must be taken very seriously.

We followed up with this article, in which we noted that DCMA Headquarters, in another example of a continuing ceding of business judgment and authority to DCAA, issued guidance to its contracting officers that healthcare costs associated with ineligible dependents were to be treated as "expressly unallowable" costs. We opined that the 2002 Armed Services Board of Contract Appeals (ASBCA) decision in General Dynamics (ASBCA No. 49372, reversed on other grounds) established a clear—and difficult to meet—test for determining whether a cost was "expressly unallowable." The DCMA direction to its contracting officers not only ignored the ASBCA's test, it also contradicted other aspects of its own guidance regarding how final indirect cost rates were to be established.

Now comes additional DCAA audit guidance, in the form of MRD 11-PAC-002(R), dated February 4, 2011.

Here's what you need to know about DCAA's more recent audit guidance:

- 1. A contractor's inclusion of healthcare costs associated with ineligible dependents in its indirect costs will not only be treated as inclusion of "expressly unallowable" costs, it will also be treated as a noncompliance with Cost Accounting Standard 405.
- 2. As part of resolving the CAS noncompliance, contractors must submit a "cost impact proposal" calculating the impact to affected to their CAS-covered contracts.
- 3. The cost impact proposal must calculate the impact(s) to all affected contracts for all years
- in which the contractor included the "expressly unallowable" costs.
- 4. By "all years" the DCAA means "all affected years, including years that have had the indirect rates settled (closed years)."
- 5. If the contractor's cost impact proposal "does not include both open and closed years," then the DCAA auditors should report it as "inadequate for audit."
- 6. If the contractor "refuses to submit an adequate cost impact," then the auditors will "develop a reasonable estimate of the cost impact (a ROM) and recommend that the Contracting Officer pursue remedies as outlined in FAR 30.605(i) and 30.604(i)."

Written by Nick Sanders Wednesday, 30 March 2011 00:00

There are so many problems with the guidance that it's difficult to muster the patience to even organize the issues in a logical fashion. To keep us from tearing our hair out or howling at the moon, we're going to pose our concerns in the form of questions—in a quasi-Socratic dialog kind of thing.

Question: The contractor's costs associated with ineligible dependents are unallowable because such costs violate its policies and the plan coverage rules. Why are such costs thought to be expressly unallowable?

Question: If the costs are unallowable because they violate policy and plan rules, can the contractor make such costs allowable by (a) changing its policy and (b) renegotiating plan rules?

Question: Under CAS 416, insurance costs are measured on the basis of (a) premium paid or (b) projected average loss. Use of actual claims experience or actual claims paid is not an acceptable measurement method, unless the actual experience approximates one of the accepted methods. Given this—

- 1. Premium costs are shared between company and employee. For many companies, the family rate is the highest rate and the number of dependents is irrelevant. So, what is the company's share of premium costs associated with ineligible dependents when there are sufficient eligible dependents to qualify for family coverage in any case?
- 2. By and large, ineligible dependents are adult children who have reached age 21 without attending college the requisite amount. What is the incremental premium cost associated with young adults? Is it higher, or lower, than the premium cost associated with mature adults in their 40's, 50's, and/or 60's?

Question: Given the forgoing, are the costs associated with ineligible dependents likely to be material in amount, or immaterial, when compared to a company's costs of providing healthcare coverage to its employees?

Question: If the company can show that the costs of providing healthcare coverage to ineligible dependents is immaterial in amount, when compared to the entirely cost company healthcare costs, can the company then be found to be in noncompliance with CAS 405? Can any contractor ever be found to be in noncompliance with any Cost Accounting Standard when the amount of cost at question is immaterial in amount?

Question: What is the purpose of negotiating a final indirect cost rate, and "closing" a year to further adjustment, or "closing" a contract to further adjustment, when DCAA and the FAR Councils think that contracts in closed years should be part of a cost impact analysis?

Question: Given that FAR 4.703 states that records must only be retained by a contractor for three years after receipt of final payment associated with its government contracts, why would anybody expect that a contractor would be able to prepare an adequate cost impact proposal

Written by Nick Sanders Wednesday, 30 March 2011 00:00

for its closed years?

Question: Given that the enabling CAS Board statute reserves the right to interpret CAS regulations exclusively to the CAS Board, what was the statutory basis for the FAR Councils' 2005 interpretation of the cost impact regulations that required contracts in closed fiscal years to be included in the cost impact proposal?

Question: Where in FAR or CAS is the DCAA given authority to review a contractor's cost impact analysis for "adequacy"? Where in the CAS regulations are the criteria for an "adequate" cost impact analysis spelled out?

Question: If the contractor cannot or will not provide sufficient information to calculate a cost impact, how will DCAA calculate its ROM impact? What level of accuracy do you think DCAA will be able to achieve on its own?

Question: If you are a contractor caught in this swamp bog of bureaucratic bungling, this morass of regulatory misadventure, this mountain from a molehill, this tempest in a teapot, then how to you resolve it—other than by litigation? If you litigate, how much time and effort will that take? Who is going to pay for all that?

Answer: This insanity can be stopped, but only if adults step in to supervise the children. DCMA and DCAA are clearly caught up in "much ado about nothing" and DOD leadership needs to realize the price that is being paid by its contractors, who will have to resolve these issues through the courts—since they see no other avenue available to them.

MARK:

On "here" link to: <a href="http://www.apogeeconsulting.biz/index.php?option=com_content&view=article&id=108:new-dcaa-audit-guidance-targets-contractors-unallowable-health-benefit-costs&catid=1:latest-news&ltemid=55

On "this article" link to: <a href="http://www.apogeeconsulting.biz/index.php?option=com_content& view=article&id=444:update-dcma-agrees-with-dcaa-that-some-contractor-health-care-costs-are-expressly-unallowable&catid=1:latest-news&Itemid=55 & nbsp:

On "MRD 11-PAC-002(R)" link to: DCAA MRD – Contractor Ineligible Healthcare Costs.pdf file attached