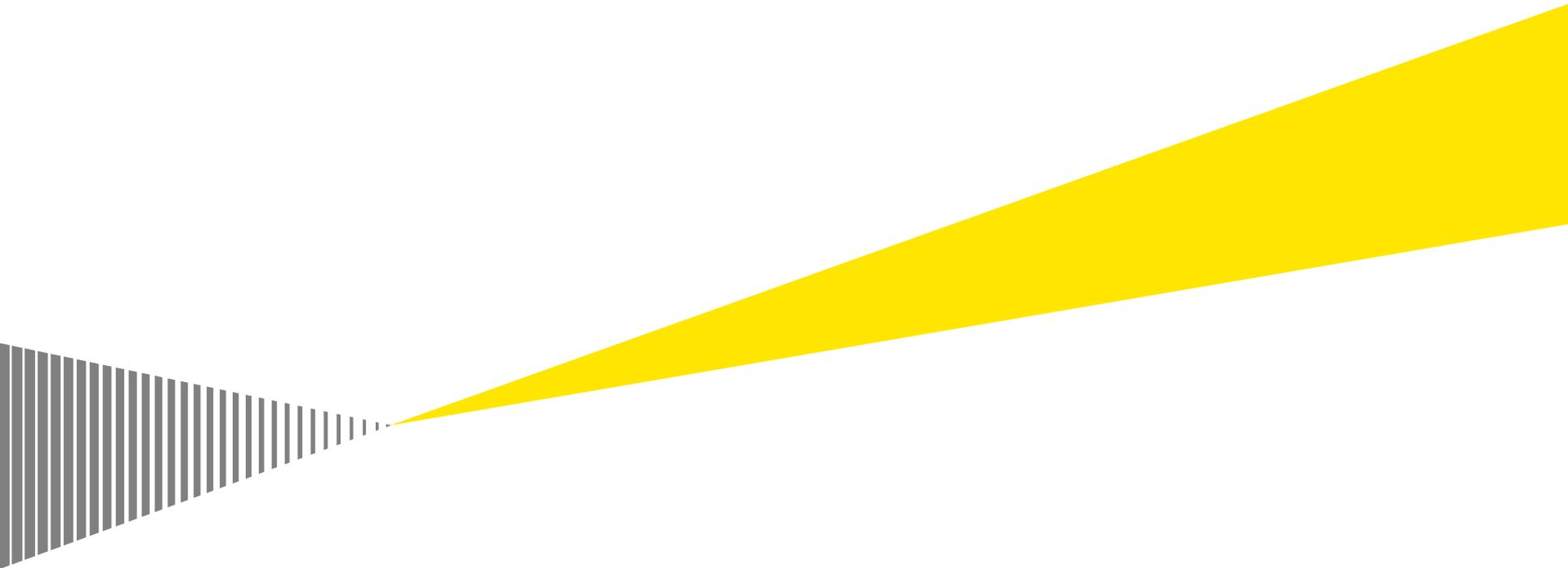


DFARS Business Systems Compliance

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Building a better
working world

DFARS Business Systems Compliance Speakers



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Agenda

- ▶ Course description
- ▶ DFARS business system background
 - ▶ DFARS case 2012-D042
 - ▶ Current DFAR business system requirements
 - ▶ Key clauses
 - ▶ Applicability
 - ▶ Criteria
- ▶ DCAA/DCMA business systems audit process
 - ▶ DFAR Business system agency responsibility
 - ▶ Initial determination
 - ▶ Withholds
 - ▶ Corrective action and monitoring
 - ▶ Timeline
- ▶ Contractor best practices
 - ▶ Framework
 - ▶ Actions
 - ▶ Business strategy

DFARS Business Systems Compliance –Course Description

Business systems (Accounting, Estimating, Property, Purchasing, EVMS, & MMAS) are an integral part of the day-to-day compliance for companies contracting with the Government. The provisions of the Defense Federal Acquisition Regulation Supplement (DFARS) authorize Contracting Officers (COs) to withhold a percentage of payments, under certain conditions, when a contractor's business system contains a "significant deficiency" and the CO makes a final determination to disapprove the contractor's system. In addition to the cash flow impact, a disapproved business system may result in competitive disadvantages and loss of confidence in the company's financial and operational credibility. Our presentation will share best practices with regards to contractor risk assessments, gap assessments, compliance testing, correction action plans and remediation, and monitoring.

DFARS Business Systems Compliance –Recent News DFAR Case 2012-D042

- ▶ On February 4, 2015 the proposed rule changes to the Defense Federal Acquisition Regulation Supplement (DFARS) Business Systems Rules (DFARS Case 2012-D042) was closed with no further action (http://www.acq.osd.mil/dpap/dars/case_status.html).

- ▶ Why?????
 - ▶ Defense Procurement and Acquisition Policy (DPAP) received legitimate industry concerns which were provided in August 2014 public meeting as well as in public comments submitted in response to the proposed rule. The proposed rule would have added requirements for contractor annual certifications and for independent CPA audits (initially and then triennially)
 - ▶ Business systems that were in Play - Accounting, Estimating and MMAS

- ▶ Although the controversial proposed rule was closed, the fact remains that contractors with the DFARS Business Systems Clause (252.242-7005 and other clauses specific to one of six systems) are required to comply with the business systems criteria and are expected to demonstrate compliance should DCMA or DCAA initiate a review or an audit.
 - DCMA is already actively engaged in reviewing contractor systems (Purchasing, EVMS, and Government Property);
 - DCAA will now need to re-evaluate their approach and to determine if/how it will audit contractor business systems.

- ▶ Bottom Line - Contractors subject to the DFARS business systems regulations should already be compliant and should be positioned to demonstrate compliance if/when DCAA or DCMA plans an audit.

DFARS Business Systems Compliance

- ▶ In response to a U.S. Government Accountability Office (GAO) report on DCMA's challenge to meet objectives, the Department of Defense (DoD) agreed to consider alternative approaches to auditing contractor business systems
 - ▶ On July 15, 2014, the DoD published its proposed changes to the Defense Federal Acquisition Regulation Supplement (DFARS) Business Systems Rules (DFARS Case 2012-D042)
 - ▶ Objective to improve the efficiency and effectiveness of auditing business systems
 - ▶ Proposed updates apply primarily to large CAS-covered contractors (small business exemption) and are applicable to Accounting, Estimating, and Material Management and Accounting Systems (MMAS)
- ▶ Public comments were due on or before September 15, 2014

DFARS Business Systems Rule Background

DoD issued an interim rule effective May 18, 2011 which mandated withholding a percentage of payments when a contractor's business system has one or more significant deficiencies.

Rule final released with minimal changes effective February 24, 2012.

A "significant deficiency" is defined as "a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes."^{*}

* DFARS 252.242-7005 Contractor Business Systems

DFARS Business Systems Rule Applicability

The requirements of the final rule apply to solicitations issued on or after May 18, 2011 (effective date of interim rule) that are subject to the Cost Accounting Standards

- ▶ In order to be subject to a withhold, a contract must have both the Contractor Business System Clause (252.242-7005 and the applicable system clause for the system containing the deficiency).
- ▶ Contracting Officers (COs) encouraged to amend existing solicitations, as applicable, so contracts (including delivery orders and task orders) to be awarded after May 18, 2011 may contain the business systems clause.
- ▶ COs directed to amend existing solicitations so contracts awarded after August 16, 2011 would include the business systems clause.

DFARS Business Systems Clauses

- ▶ DFARS 252.242-7005, Contractor Business Systems
- ▶ DFARS 252.215-7002, Cost Estimating System Requirements
- ▶ DFARS 252.234-7002, Earned Value Management System
- ▶ DFARS 252.242-7004, Material Management and Accounting System
- ▶ DFARS 252.242-7006, Accounting System Administration
- ▶ DFARS 252.244-7001, Purchasing System Administration
- ▶ DFARS 252.245-7003, Property Management System

Estimating System Applicability

FAR/DFARS contract clause guidance

- DFARS 252.215-7002

Exemptions

- Sales of commercial items; competitively awarded fixed-price contracts; small businesses, educational institutions, or other nonprofit organizations

Cognizant audit / review authority

- DCAA/DCMA/Contracting Office

Audit frequency

- Every three years

Threshold level and attributes

- Large businesses who in preceding fiscal year received DOD prime contracts and subcontracts > \$50M for which cost and pricing data were required, or
- Contractors having awards > \$10 million where procuring contracting officer and administrative contracting officer determine audit to be in government's best interest (e.g., significant estimating problems believed to exist).

Estimating System Requirements Summary*

- ▶ Disclose estimating system to the ACO in writing
- ▶ Estimating system documentation to:
 - ▶ Accurately describe policies, procedures, and practices currently in use to prepare cost proposals; and
 - ▶ Provide sufficient detail for the Government to reasonably make an informed judgment of the acceptability of estimating practices.
- ▶ The Contractor shall—
 - ▶ Comply with its disclosed estimating system; and
 - ▶ Disclose significant changes to the estimating system to the ACO timely
- ▶ Provide for the use of appropriate source data, utilize sound estimating techniques and good judgment, maintain a consistent approach, and adhere to established policies and procedures. An acceptable estimating system shall accomplish 17 functions, which are defined on the next slide.

*See full text for criteria DFARS 252.215-7002, Cost Estimating System Requirements

Estimating System Criteria

1. Clear responsibility for cost estimates and budgets
2. Organization and duties of personnel responsible for cost estimates and budgets
3. Sufficient training, experience, and guidance
4. Data sources and estimating methods and rationale
5. Adequate supervision
6. Consistent application
7. Error detection and correction
8. Avoid duplication and omission
9. Historical experience
10. Appropriate analytical methods
11. Integrate information
12. Management review
13. Internal review
14. Update cost estimates timely
15. Ensure reasonable subcontract prices
16. Sound proposals adequate to reach fair and reasonable price
17. Adequate system description

Earned Value Management System Applicability

FAR/DFARS contract clause guidance

- DFARS 252.234-7002; FAR 52.234-4

Exemptions

- DOD contracts valued at less than \$20 million; DOD firm-fixed-price contracts (per DOD memo); Federal contracts (inclusive of firm-fixed-price awards) valued at less than established agency threshold.

Cognizant audit / review authority

- DCAA / DCMA – INST
- Reference the Memorandum of Understanding between the DCAA and DCMA for EVM Oversight Services, June 2011

Audit frequency

- Every three years

Threshold level and attributes

- DOD; 1) Cost and incentive contracts and subcontracts valued at \$20 million or greater must comply with ANSI 748; 2) cost or incentive contracts and subcontracts valued at \$50 million or greater shall have an earned value management system that has been determined by the cognizant federal agency to be in compliance with ANSI 748; 3) for cost or incentive contracts or subcontracts under \$20 million, application of earned value management is a risk-based decision.
- U.S. Federal Government: Various agency specific earned value management thresholds.

Earned Value Management System Requirements Summary*

- ▶ An Earned Value Management System (EVMS) that complies with the EVMS guidelines in the American National Standards Institute/Electronic Industries Alliance Standard 748, Earned Value Management Systems (ANSI/EIA-748) (as described on the next slide); and
- ▶ Management procedures that provide for generation of timely, reliable, and verifiable information for the Contract Performance Report (CPR) and the Integrated Master Schedule (IMS)

*See full text for criteria DFARS 252.234-7002 Earned Value Management System

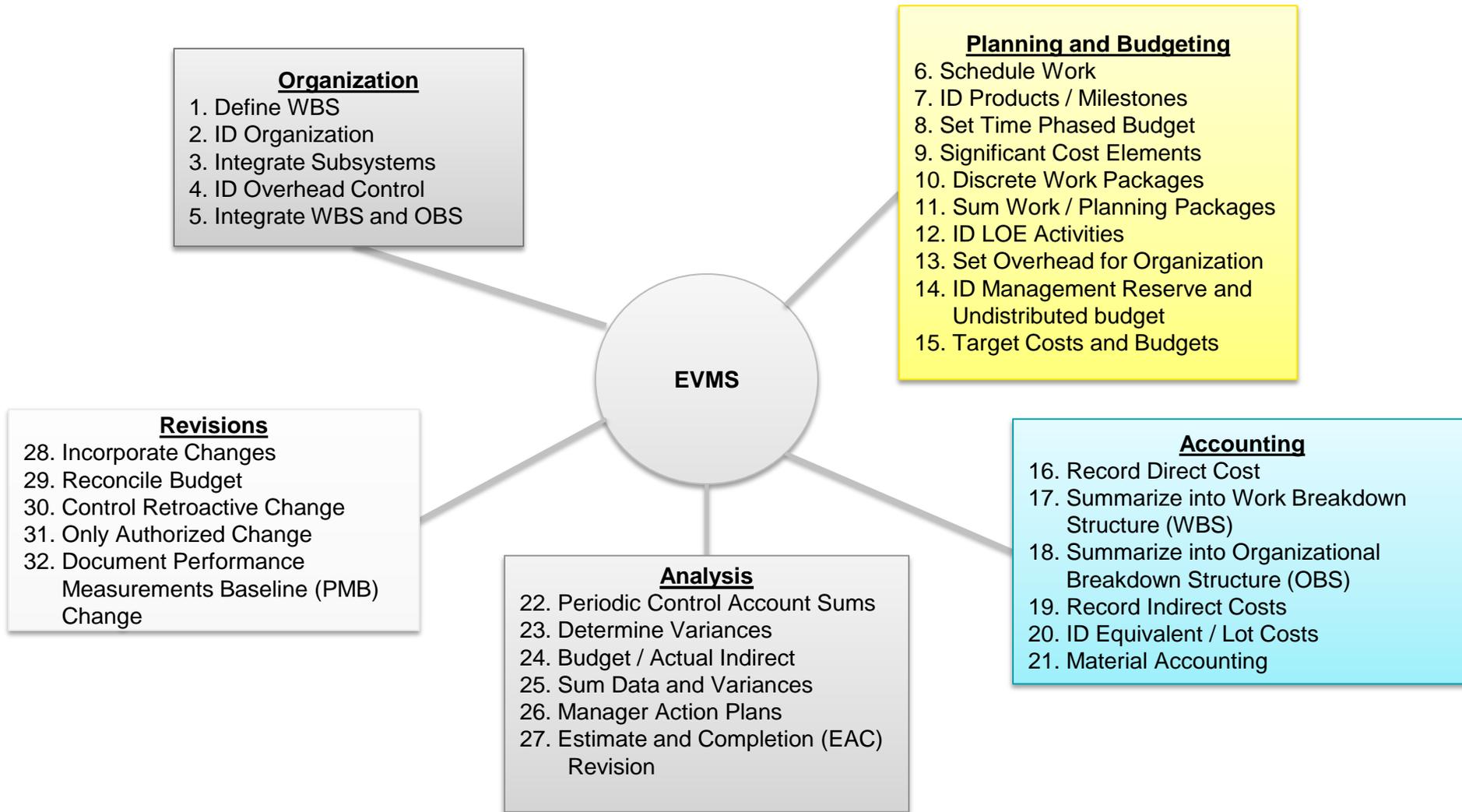
Earned Value Management System Criteria (Slide 1 of 2)

1. Define WBS
2. ID Organization
3. Integrate Subsystems
4. ID Overhead Control
5. Integrate WBS and OBS
6. Schedule Work
7. ID Products / Milestones
8. Set Time Phased Budget
9. Significant Cost Elements
10. Discrete Work Packages
11. Sum Work / Planning Packages
12. ID LOE Activities
13. Set Overhead for Organization
14. ID Management Reserve and Undistributed budget
15. Target Costs and Budgets
16. Record Direct Cost

Earned Value Management System Criteria (Slide 2 of 2)

17. Summarize into Work Breakdown Structure (WBS)
18. Summarize into Organizational Breakdown Structure (OBS)
19. Record Indirect Costs
20. ID Equivalent / Lot Costs
21. Material Accounting
22. Periodic Control Account Sums
23. Determine Variances
24. Budget / Actual Indirect
25. Sum Data and Variances
26. Manager Action Plans
27. Estimate and Completion (EAC) Revision
28. Incorporate Changes
29. Reconcile Budget
30. Control Retroactive Change
31. Only Authorized Change
32. Document Performance - Measurements Baseline (PMB) Change

Earned Value Management System Criteria



Material Management and Accounting System Applicability

FAR/DFARS contract clause guidance

- DFARS 252.242-7004

Exemptions

- Sales under the simplified acquisition threshold. Sales of commercial items. Small business; education institutions; non-profit organizations also exempt.

Cognizant audit / review authority

- DCAA

Audit frequency

- Every three years

Threshold level and attributes

- Awards of \$40 million or more in qualifying (DOD prime or DOD subcontract) business during contractor's preceding fiscal year (i.e., contracts over simplified acquisition threshold: cost reimbursement contracts or fixed-price contracts that provided for progress payments) and where administrative contracting officer and auditor determine that material management and accounting system review is needed.

Material Management and Accounting System Requirements Summary*

- ▶ Contractor shall maintain an MMAS that:
 - ▶ Reasonably forecasts material requirements;
 - ▶ Ensures that costs of purchased and fabricated material charged or allocated to a contract are based on valid time-phased requirements; and
 - ▶ Maintains a consistent, equitable, and unbiased logic for costing of material transactions; and
- ▶ Contractor shall assess its MMAS and take reasonable action to comply with the MMAS standards

*See full text for criteria DFARS 252.242-7004, Material Management and Accounting System

Material Management and Accounting System Standards

1. Adequate system description
2. Material allocated on valid time-phased requirements
3. Mechanism to identify, report and resolve control weakness and manual override
4. Audit trails and records to evaluate system logic and transaction testing
5. Adequate record accuracy and reconcile to physical inventory
6. Circumstances that will result in manual or system-generated parts transfers
7. Logic for costing of material transactions
8. Controls for allocations from common inventory accounts
9. Controls for physically commingled inventories
10. Periodic internal reviews to ensure compliance with policies and procedures

Accounting System Applicability

FAR/DFARS contract clause guidance

- DFARS 252.242-7006; FAR (PGI) 9.106-1; FAR 52.216-7; FAR 53.209-1(f)

Exemptions

- Sales under the CAS threshold. This includes sales of commercial items and sales by small businesses, education institutions and non-profit organizations.

Cognizant audit / review authority

- DCAA

Audit frequency

- Every three years

Threshold level and attributes

- Cost-reimbursement, incentive type, time-and-materials, or labor-hour contracts, or
- Fixed-price contracts with progress payments made on the basis of costs incurred by the contractor or on a percentage or stage of completion

Accounting System Requirements Summary*

- ▶ The Contractor shall establish and maintain an acceptable accounting system.
- ▶ The Contractor's accounting system should provide for compliance with the 18 criteria on the next slide.

***See full text for criteria DFARS 252.242-7006, Accounting System Administration**

Accounting System Criteria

1. Sound internal control environment, accounting framework and org structure
2. Segregation of direct and indirect costs
3. ID and accumulate direct costs by contract
4. Accumulate & allocate indirect costs to intermediate & final cost objectives
5. Accumulate costs in general ledger
6. Reconcile subsidiary to general ledger
7. Approve/document adjusting entries
8. Periodic monitoring of system
9. Timekeeping system for employees
10. Labor distribution system for charging direct and indirect labor
11. Monthly posting of books of account for costs charged to contracts
12. Exclude unallowable costs in compliance with FAR Part 31
13. Identify costs by CLIN and units if required by contract
14. Segregate preproduction from production costs
15. Cost accounting info, as required by contract clauses e.g. limitation of cost / limitation of funds, or allowable cost & payment
16. Billings can be reconciled to cost accounts for current and cum amounts claimed and to comply with contract
17. Adequate, reliable data for pricing follow-on acquisitions
18. Compliance with CAS, if applicable, otherwise GAAP

Purchasing System Applicability

FAR/DFARS contract clause guidance

- DFARS 252.244-7001, FAR 52.244-2

Exemptions

- Firm-fixed-price contracts awarded on a competitive basis; competitively awarded fixed-price contracts with economic price adjustment; and FAR Part 12 qualifying sales or commercial items.

Cognizant audit / review authority

- DCMA INST-109/DCAA/Contracting Office

Audit frequency

- Every three years

Threshold level and attributes

- Awards expected to exceed \$25 million over the next 12-month period include those represented by prime contracts, subcontracts under government prime contracts, and modifications.
- NOTE: 1) contractor purchasing system review is not performed for a specific contract; 2) the head of the agency responsible for contract administration may raise or lower the \$25 million review level if it is considered to be in the government's best interest.

Purchasing System - Requirements Summary*

- ▶ The Contractor shall establish and maintain an acceptable purchasing system.
- ▶ The Contractor's purchasing system should provide for compliance with the 24 criteria on the next slides.

***See full text for criteria DFARS 252.244-7001, Contractor Purchasing System Administration**

Purchasing System - Criteria (Slide 1 of 2)

1. Adequate system description
2. Applicable subcontracts contain all flow-down clauses
3. Clear lines of responsibility and authority
4. Purchased orders (POs) based on authorized requisitions
5. Document history of purchase transactions
6. Consistent make-or-buy policy
7. Competitive sourcing which excludes debarred or suspended contractors
8. Evaluate price, quality, delivery, technical and financial capabilities of competing vendors
9. Justification and cost or price analysis for sole or single source award
10. Adequate cost or price analysis and tech evaluation to ensure fair and reasonable prices
11. Document negotiations in accordance with FAR 15.406-3
12. Seek, take and document discounts
13. Select proper contract type and prohibit cost-plus-percentage-of-cost subcontracts
14. Subcontract surveillance to ensure timely delivery of acceptable product and to notify Government of potential subcontract problems that may impact delivery, quantity, or price
15. Justify subcontract changes that affect cost or price

Purchasing System - Criteria (Slide 2 of 2)

16. Notify the Government of all subcontracts with flow-down clauses that allow for Government audit
17. Policies on conflict of interest, gifts, and gratuities
18. Perform internal audits, training, and maintain policies to ensure integrity of the purchasing system
19. Policies to ensure POs and subcontracts contain mandatory flow-down clauses required by FAR, DFARS, and prime contract provisions*
20. Org. and admin. structure for procurement of required quality materials and parts at the best value from responsible and reliable sources*
21. Selection processes ensure most responsive & responsible sources for furnishing required quality parts and materials & to promote competitive sourcing among dependable suppliers*
22. Adequate price or cost analysis on purchasing actions
23. Ensure proper types of subcontracts are selected & that there are controls over subcontracting, including surveillance
24. Ensure Contracting Officer is notified in writing if Contractor changes subcontracts after award to >70% of total cost of work performed and verify Contractor added value or any subcontractor increases value of lower-tier subcontracts to >70%

*Updated May 6, 2014 to reference flow down of DFARS 252.246-7007, *Contractor Counterfeit Electronic Part Detection and Avoidance System*, if applicable

Property Management System Applicability

FAR/DFARS contract clause guidance

- DFARS 252.245-7003, FAR Part 52.245-1

Exemptions

- Contracts without government-furnished or contractor acquired property

Cognizant audit / review authority

- DCMA

Audit frequency*

- High Risk contractor – At least annually
- Moderate Risk contractor - At least once every 2 years
- Low Risk contractor - At least once every 3 years

Threshold level and attributes

- All contracts with government-furnished property or contractor-acquired property

*Contractor risk based on criteria in DCMA-INST 124

Property Management System Requirements Summary*

- ▶ The Contractor shall establish and maintain an acceptable property management system.
- ▶ The Contractor's property management system shall be in accordance with paragraph (f) of the contract clause at FAR 52.245-1
 - ▶ Contractual requirements regarding the acquisition or acceptance, control, accounting for, and final disposition of government-owned property in the hands of the contractor.
 - ▶ Control Government Property in accordance with FAR, Part 45 and contractual requirements where appropriate.
 - ▶ Maintain current written policies and procedures, as appropriate, pertaining to administration of Government/Customer Owned Property.

***See full text at DFARS 252.245-7003 – Property Management System**

Property Management System Criteria

Contractors shall establish and implement property management plans, systems, and procedures at the contract, program, site or entity level to enable the following outcomes:

1. Acquisition of property
2. Receipt of government property
3. Records of government property
4. Physical inventory
5. Subcontractor control
6. Reports
7. Relief of stewardship responsibility
8. Utilizing government property
9. Maintenance
10. Property closeout

DFARS Business Systems Agency responsibility

- ▶ DCAA lead
 - ▶ Accounting
 - ▶ Estimating, DCMA to support
 - ▶ MMAS
- ▶ DCMA, lead or co-lead
 - ▶ EVMS, DCAA to support
 - ▶ Contractor Purchasing System Review, DCAA to support
 - ▶ Property
- ▶ Contracting Officer makes the final decision on adequacy of ALL business systems

DFARS Business Systems Deficiency reports

- ▶ DCAA will perform attestation examinations for contractors' compliance with the DFARS system criteria. DCAA is required to follow GAGAS while DCMA is not.
- ▶ Based on that examination, DCAA will opine on the contractor's compliance with the system criteria prescribed in DFARS. DCMA will not opine on compliance, however will identify significant deficiencies.
- ▶ If significant deficiencies/material weaknesses are identified, a deficiency report will be issued to report the noncompliance with the DFARS system criteria when sufficient evidence supporting the deficiency is obtained.

Source: DCAA MRD, Audit Guidance on the DFARS Final Rule Regarding Contractors' Business Systems, dated April 24, 2012

DFARS Business Systems Initial determination

- ▶ Cognizant Administrative Contracting Officer (ACO), in consultation with the functional specialist or auditor, determines the acceptability of the Contractor's business systems and **approves** or **disapproves** the system.
- ▶ If the CO rejects advice from specialists (e.g., technical specialists, legal, CPSR, Property) on Business Systems, the determination is subject to Board of Review requirements at the Headquarters level.
- ▶ ACO Group Director to approve the initial determination notice before issuance.
- ▶ System adequacy reports issued by DCMA are not subject to GAGAS 3-year audit requirements.

DFARS Business Systems Withholds and impact to billing

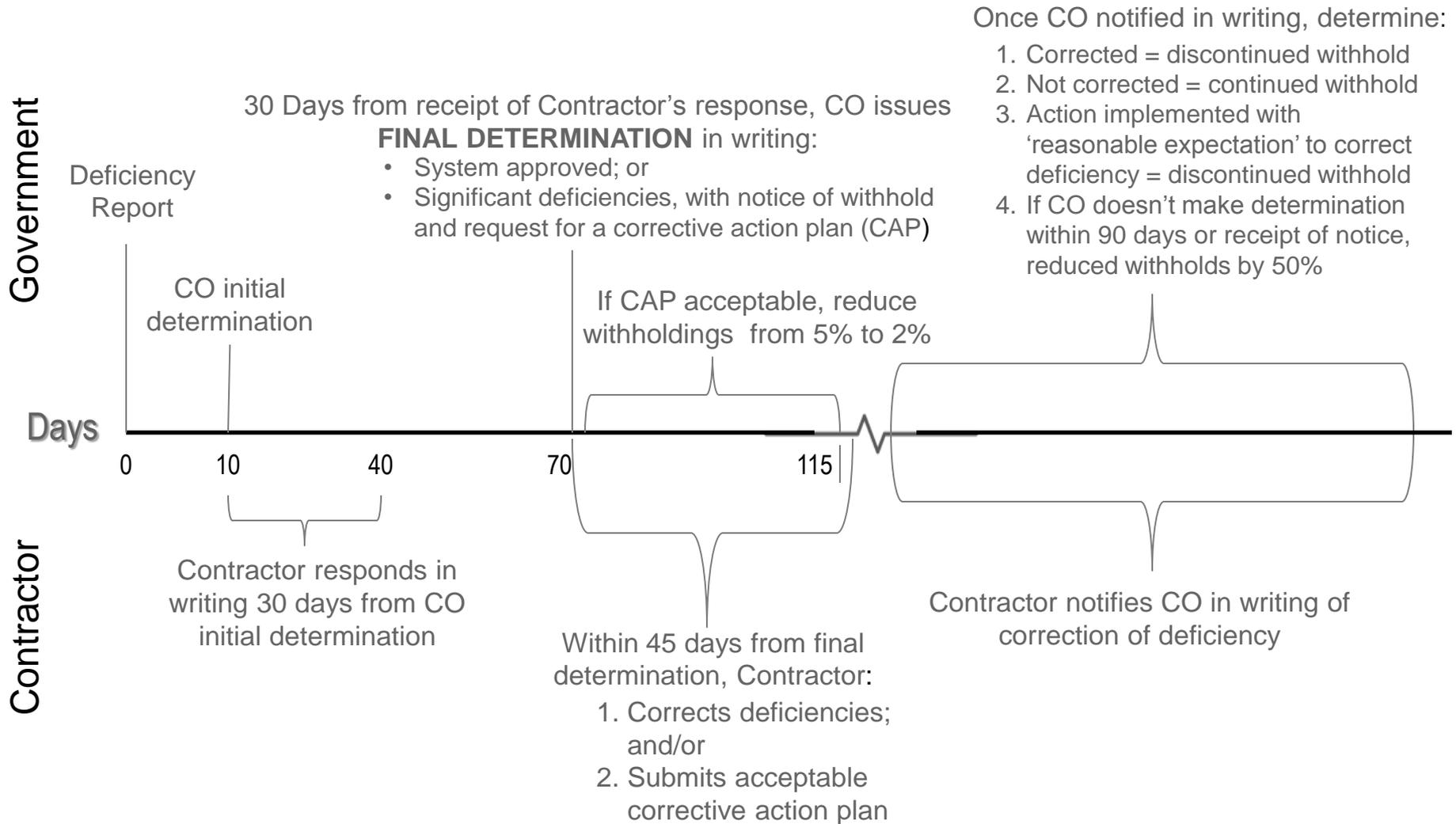
- ▶ Withhold only be applicable to billings submitted after the date of the final determination
- ▶ Withholdings **only** apply to contracts with the clause
- ▶ Complicates billing – two sets of rates/rules
- ▶ FFP contracts are liquidated upon delivery of product and no longer subject to withhold after delivery (clarified in the final rule)

DFARS Business Systems - Corrective Action Plan (CAP) and monitoring

- ▶ An acceptable CAP will:
 - ▶ Address the cause of the significant deficiency
 - ▶ Include milestones and action(s) to eliminate the significant deficiency
 - ▶ Target date(s) for implementation of planned action
- ▶ If disapproved, the CO will also withhold payments in accordance with DFARS 252.242-7005, Contractor Business Systems, if the clause is included in the contract
- ▶ CO and auditor/functional specialist monitor progress in correcting deficiencies against CAP
- ▶ If CO, with verification from auditor/functional specialist, determines all significant deficiencies corrected, ACO will **discontinue withholds**
- ▶ Contractors are authorized to bill for any monies previously withheld for a particular significant deficiency once the withhold is discontinued

DFARS Business Systems

Timeline of events for business system reviews



DFARS Business Systems - Contractor Best Practices

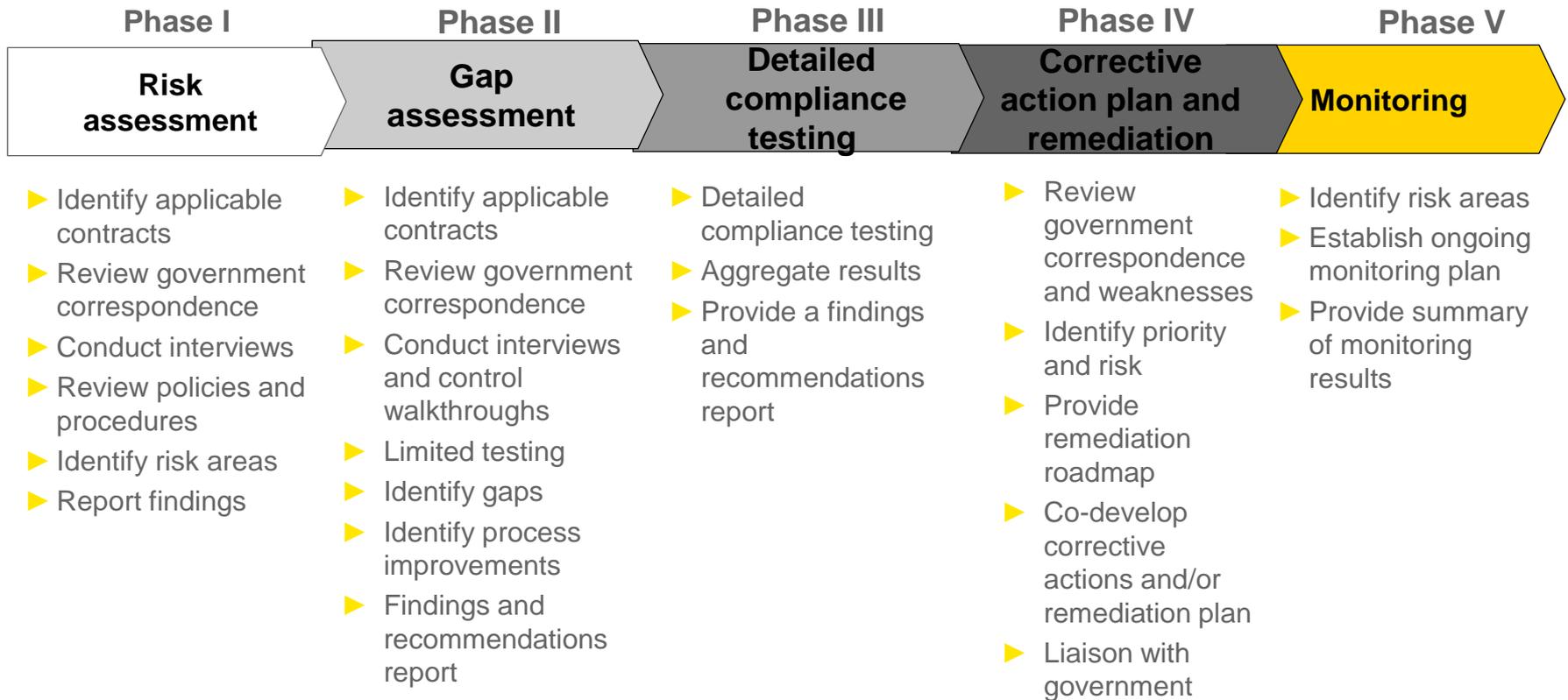
- ▶ Develop a strategy framework - Contractors also must be prepared to show their compliance with the business system requirements.
 - ▶ Perform a risk assessment
 - ▶ Perform a gap assessment
 - ▶ Perform testing
 - ▶ Perform corrective action and remediation plan
 - ▶ Perform Monitoring

- ▶ Key actions – Ties into the above strategy
 - ▶ Identify key stakeholders
 - ▶ Create a team with a focused mission
 - ▶ Identify key policies & procedures and processes
 - ▶ Identify key manual and automated controls
 - ▶ Map key policy/procedure/processes to DFARS business system criteria
 - ▶ Flow chart key process
 - ▶ Documentation, documentation, documentation
 - ▶ Build binders or similar documentation for each system which include supporting information with mapping to DFARS business systems criteria

DFARS Business Systems - Contractor Best Practices

- ▶ Business Strategy .
 - ▶ Be proactive
 - ▶ Stay current on regulatory changes
 - ▶ Do your homework
 - ▶ Be cooperative with government auditors and respond to their specific inquiries
 - ▶ Identify key internal personnel to talk to government auditors that understand the business systems
 - ▶ IMPORTANT – When it comes to Business systems policies / procedures / processes and associated key internal controls.....**"It's a journey not a destination" ...need to stay current and focused**

DFARS Business Systems Compliance – EY GCS Framework Approach



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