

Risk Management for Government Contractors

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"All courses of action are risky, so prudence is not in avoiding danger (it's impossible), but calculating risk and acting decisively. Make mistakes of ambition and not mistakes of sloth. Develop the strength to do bold things, not the strength to suffer."

– Niccolo Machiavelli, The Prince

Risk Management = Good Business



- Risk management is fundamental to good business
- Unique and evolving risks
- Risk management Plan
- Be prepared to deal with risks
- Efficiently and effectively mitigate potential problems

Agenda

- Risk Management
- TINA
- Labor Laws
- State and Local Tax
- Cybersecurity and Cyber Risk

TINA

Truth in Negotiation Act – TINA (FAR Subpart 15.4 – Contract Pricing)

‘To Disclose or Not Disclose’
Is **Not** the Question

What Is TINA (P.L. 87-653)?

- Federal Law enacted on September 10, 1962
 - Renamed Truthful Cost or Pricing Data (FAC 2005-73) effective May 29, 2013
- Protects the Government from defective pricing when negotiating:
 - Non-Competitive Contracts and Change Orders
 - Sole Source Contracts
 - Valued at a cumulative \$750,000 or more
- Subject of DCAA Post-Award Audits

What Does TINA Require?

- Submission of full and fair disclosure of **cost or pricing data**, in support of proposals, certified to be:
 - Accurate
 - Current
 - Complete

As of the date of agreement on price.
- Contractors and their subcontractors are to provide the Government with current, good faith estimates of the cost to perform the contract.

What Is the Purpose of TINA?

- Gives the Government the right to obtain a remedy due to defective contract cost terms relied on to their detriment
- Levels the playing field for contract negotiation
- Places the burden of compliance on the contractor
- Allows for flow down to any and all subcontractors

When Does TINA Apply?

- Any negotiated contract
- Modification of a negotiated or sealed-bid contract
- Award of a subcontract (if the prime/higher tier contract requires compliance)
- Modification of a subcontract involving a price adjustment
- Expected to be a cumulative \$750,000 or more

What Needs to Be Disclosed?

- Cost and Pricing Data

“All facts that a prudent buyer or seller would reasonably expect to affect the negotiations of price significantly. The factual information must be accurate, complete and current as of the date of agreement on price, or on another date that is agreed upon by the parties. All cost and pricing data must be factually useful and cannot be judgement by the submitting party.” FAR 2.101

- Facts that support judgements are cost and pricing data – NOT the judgement

When Must C&PD Be Disclosed?



- As of the date of handshake and agreement on price
- C&PD that becomes available after the handshake/agreement on price date need not be disclosed

Exceptions to C&PD Submission



- When there is adequate competition
- When pricing is set by statute or regulation
- When the contract is for a commercial item
- When a waiver has been given
- When modifying a contract or subcontract for commercial items
- Exercise of options priced during initial negotiations

Consequences of Non-Compliance/Defective Pricing



- Submission of inaccurate, incomplete, or non-current data subjects the contractor to civil, and possibly criminal liability, including fraud.
- Government reliance on defective data to their detriment can result in reductions in contract price and interest on any defective payments
- If determined and proven to be fraudulent the contractor is subject to fines, debarment and potentially jail time

- Perform a SWEEP before data certification
 - Do not provide certification at the negotiation table
 - Request a reasonable amount of time to verify that most accurate, current and complete data has been provided (i.e. 30 days)
 - Canvass all personnel on whether new data has been received prior to the date of agreement on price
 - Require internal certification
 - Submit any new data to the Government explaining how it might impact the agreed pricing

Defensive Measures

- Prepare a Negotiation Report defining how the pricing was established
 - Defines what cost and pricing data was disclosed
 - When it was disclosed
 - Whether the Government relied on the subject data in establishing the negotiated pricing
- Prove that the Government should have know the data provided was defective
- Establish that the agreement was on TOTAL cost

Ensure Compliance



DISCLOSE!
DISCLOSE!
DISCLOSE!

and when in doubt...

DISCLOSE!

LABOR LAWS

Equal Employment Opportunity Commission



- Contractors with 50 or more employees must prepare and file:
 - Annual EEO - 1 report
 - Includes data on race, ethnicity and gender by occupational category
- Typically no risk in filing this

EE0-1 Reporting for Federal Contractors



- In 2016 EEOC published a notice of its intent to begin collecting compensation information as part of the annual EEO-1 reporting
- EEO-1 reports are annual but beg with 2017 report, the new report including compensation will be due by March 31, 2018 - **Suspended**

SCA Compliance



- Compliance is complicated
- If you were audited by the DOL would you be 100% compliant?
- Pricing – LPTA price is very important
- Are your labor categories correctly classified under the contract?
- Misclassifications can lead to labor law violations
- Is your base pay correct?
- Are you paying the correct fringe rate?

Monitoring Subs

- This flows down to subs
 - Do they have correct labor categories?
 - Using the correct base wages?
 - Using the correct fringe rates?
 - It's the responsibility of the prime for subcontractors compliance

Service Contract Labor Standards (Formerly SCA)



- Sets minimum wages and fringe benefits that contractors and their subcontractors must pay service employees working on covered contracts
- Why
 - Remove wages as a bidding factor and provide wage protection
- Who
 - Generally > \$2.5K and principally for services, using service employees in USA

How Do You Know It Applies?



- RFPs or contracts will have clauses:
 - FAR 52.222-41 Service Contract Labor Standards Or
 - 29 CFR Part 4, Section 4.6 Labor Standards clauses for Federal service contracts exceeding \$2,500 &
 - Area Wage Determination (AWD) in exhibit or reference

Why Comply?

- Enforced by the DOL
- Withhold payment for the contract to pay back wages or fringe to underpaid employees
- Legal action for underpayment
- Contract termination
- Debarment up to 3 years

SCA Compliance



- Is SCA applicable
 - Review contracts
- Gather WD
 - Search applicable requirements - each is different
- Identify service employees covered by the SCA
- Map the positions to the DOL's directory of occupations
 - Look at description
- Test min wages
 - Each employee receives correct min wage

SCA Compliance (concluded)



- Test vacation on applicable WD on length of service
- Test holidays
 - Each employee received for the applicable WD
- Test H&W-complex
 - Correct hourly amount
- Any shortages? Make retroactive payments
 - Clear communications
- Be ready for inquiries from SCA employees
 - Don't have them going to the DOL

SALT

State and Local Tax Risk



- Why State and Local Tax?
 - Federal Tax well documented, publicized, only one tax code for the entire country

State and Local Taxes

- Multitude of jurisdictions making and enforcing tax laws
 - Generally coordinated within state
 - State Laws allowing for certain taxation
 - Virginia: BPOL, PPT, Meals tax
 - Little coordination across the states, though there are some efforts

SALT Statistics



- 50 States
- District of Columbia
- 3009 counties nationwide
- 64 Parishes
- 41 independent municipalities or cities

SALT Statistics (concluded)

- Virginia
 - 95 Counties
 - 38 independent cities (county equivalents)
- Maryland
 - 24 Counties (Baltimore City is considered a county equivalent)
- District of Columbia

Types of Taxes

- Income, Franchise
 - Based on net income
- Transaction
 - Sales & Use, Meals, RE transfer, etc.
- Privilege
 - Gross Receipts, BPOL, Commercial Activity Tax (Ohio)
- Property
 - PPT, RE
- Fees . . .

Background on SALT Laws

- Most state tax regimes created when economy was brick and mortar and involved physical presence to conduct business
- Today's environment:
 - Service Based
 - Digital
 - Remote
 - Cloud
 - Virtual
 - Complex

Background (concluded)

- Emergent View
 - Economic Presence: Availing oneself of the benefits of the market place
- Trends
 - Income Tax
 - Sales based on market place or receipt/benefit of services: Where is the Customer?
 - Sales & Use Tax
 - More services being taxed, either by identification or limited exclusion

Big Brother & Big Data

- Big Data = Big Issue for Gov Cons
 - Exchange of information allows tax authorities to hone in on non-compliance
 - Exchange of information within state
 - Employment tax filings
 - Vehicle Registrations
 - Sales Tax filings
 - Audits of other entities (vendor invoices, 1099's, other documents)
 - Income tax filings >> PPT filings
 - Federal tax information
 - Information exchange across states
 - Websites, Blogs

Big Brother is Watching!

- Low Tech
 - Trucks crossing border
 - Perusal of Store shelves
 - Conversation!
- Compliance verification/certification – during bid process, again during payment process
 - Have you filed all required returns, paid taxes?
 - Check of state databases before payment for filings/payments, payment withheld until resolved
- Government bodies freely exchange/provide information

How to Comply

- Wait until they come to you . . .
 - Result: Reactive, Penalties, Multiple years, Statute of Limitations issues, Expensive
- Be PROACTIVE
 - Identify exposures, respond accordingly
 - Filings where required
- Analyze Risk, exposure in grey areas, be informed
 - Voluntary disclosure agreements, mitigate exposure, costs.

Taxes with Most Risk

- SALES TAX!
 - Impacts *Subcontractors* most – The government itself is normally exempt, however presence of government contract does not automatically exempt everyone else through the supply chain. Only state statutory exemptions apply such as resale exemptions, or sales exempt from sales tax
 - Based on Gross Receipts
 - Designed to be passed/paid to Customer
 - When seller fails to collect when required, seller becomes liable
 - Liability will extend to owners if business is unable to make payment
- Taxes based on Gross Receipts

Key Concepts to Determine Risk



- Nexus
 - Presence in the state which subjects you to tax
 - Sales Tax
 - Controlled by “Quill” Case
 - » Must have a minimum level of physical presence in the state to be obligated to collect and remit sales and use tax
 - Barriers being challenged in several states
 - Income Tax
 - Controlled by Commerce Clause & Due Process
 - » Economic presence sufficient in most states

Key Concepts to Determine Risk (concluded)



- Physical Presence
 - Some level of physical presence in the state:
 - Employees, offices, warehouses, property, company delivery trucks, telephone book listings
- Economic Presence
 - Availing the benefits of the market place
 - Customers, benefits of receipt of services, agents,
- Service based entities typically trip nexus through customers or employees in the state

Managing SALT Risk



- Work with CPA knowledgeable in the Nuances of State Taxation
- Be conscious of establishing “offices” investigate local tax requirements
- Common concern in GovCon space - watch out for those home offices!
- Ensure operating activities, contracts, invoices, websites, are consistent with tax position

Managing SALT Risk (continued)



- Develop Accounting systems to capture essential data to optimize SALT compliance
 - Sales Sourcing:
 - Place of Performance
 - Customer location
 - Benefit of service
 - May require interaction with customer to determine
 - Type of sale/industry
 - Some states have different sourcing rules for different industries
 - efforts to improve economy

Managing SALT Risk (continued)



- Accounting Systems (cont'd)
 - Payroll sourcing:
 - Place of work (daily basis)
 - “Home base” for each employee
- Sourcing of Property
 - Fixed Asset accounting by location
 - Lease/rent expense by location

Managing SALT Risk (concluded)



- Proactively determine apportionments to optimize tax impacts
- Seek opportunities to optimize tax efficiency by apportioning activity to a non-tax state vs. a taxable one
 - Market based, where is customer receiving benefit
 - Contract location vs. ultimate use
- Entity Formation
 - S-Corporations not recognized in D.C.

CYBERSECURITY

- Cybercrime
 - Any illegal activity that involves a computer or network-connected device

“...the greatest threat to every profession, every industry, every company in the world...”

– Ginni Rommetty, IBM President and CEO

Cybercrime Statistics

- Global cost of cybercrime will reach **\$2 trillion** by 2019
- Average cost of a data breach in 2016 = **\$4M**
- In the US = **\$7M!**
- Cost of a security breach is always higher than the cost of protection

Cybersecurity and Cyber Risk



- **Cyber Risk** - the potential of loss or harm related to technical infrastructure or the use of technology within an organization.
- **Cybersecurity** - the protection of systems, networks and data in cyberspace

Data Breach Is Inevitable

- The prevailing thought among data security experts is that no matter the size or scale of your business, a data breach is inevitable.
- In fact, there's a good chance your data has already been compromised and you don't even know it.

Why is Cybersecurity Important?



- Protection of government/ agency information that can affect national security
- Compliance with regulations
- Protection of proprietary information
- Potential litigation
- Contract compliance and related reporting
- Increased costs and revenue impact

Federal Cyber Statistics



- 77,183 cyber incidents reported by Federal agencies in 2016
- 18 agencies identified as having “high-impact systems” – hold information that if lost could cause “catastrophic harm”
- During 2014 – 11 of the 18 agencies reported 2,267 incidents affecting their high-impact systems

Regulations

- EO 13636 – Improving Critical Infrastructure Cybersecurity
- The federal Information Security Management Act of 2002 and 2014 update (FISMA)
- Guidance promulgated by NIST
- DoD and other agencies regulation that impacts cybersecurity requirements

NIST Cybersecurity Framework



- Framework Core – help org identify at a high level the management of cybersecurity risk
- Identifies 5 Functions to organize cybersecurity efforts
 - identify, protect, detect, respond, recover
- Each function has categories and subcategories to identify tasks/challenges and specific objectives

NIST Cybersecurity Framework (concluded)



- Four Implementation Tiers
 - To characterize cybersecurity management practices
 - 4 tiers
 - Partial, Risk Informed, Repeatable and Adaptive
- Profiles - Outline of current cybersecurity status and a roadmap toward goals

NIST Guidance – Special Publications



- NIST SP 800-171
 - *“Protecting Controlled Unclassified Information in Nonfederal Information Systems and Organizations” (CUI)*
- CUI
 - Controlled unclassified information that is to be protected from public disclosure
- NIST SP 800-53
 - Intended for internal use by the Federal Government

DoD Regulations

- DFARS clause 252.204-7012
- Mandatory 72 hour reporting requirements
- No exception for small business
- Clause flows down to subs when CDI is necessary for performance of the subcontract
- Establishes min security controls for safeguarding CDI
 - Contractors storing or using “covered defense information” must provide “adequate security” for that information

CDI – What is it?

- Unclassified Controlled technical information that requires safeguarding or dissemination controls and is
 - Marked or otherwise identified in the contract, task order, or delivery order and provided to the contractor by or on behalf of DoD in connection with the performance of the contract, or
 - Collected, developed, received, transmitted, used, or stored by or on behalf of the contractor in support of the performance of the contract

DFARS Compliance 252.204-7012



- CDI must provide adequate security using controls in NIST SP 800-171 by no later than Dec 31, 2017
- Must be able to detect and respond to incidents
- Prime and subcontractors must comply
- NIST SP 800-171 - More than 100 security requirements – 30 “basic” and 79 “derived”

DFARS Requirements



1. Access Control
2. Awareness and Training
3. Audit and Accountability
4. Configuration Management
5. Identification and Authentication
6. Incident response
7. Maintenance
8. Media Protection
9. Personnel Security
10. Physical Protection
11. Risk Assessment
12. Security Assessment
13. System and communication Protection
14. System and information Integrity

Other Guidance

- FAR final rule May 16, 2016 – Safeguarding of Contractor Systems (52.204-21)
- DHS proposed rules – “safeguarding of controlled unclassified info – by third party – 1-19-17
- DOT, NASA
- Dept. of Commerce
- HUD
- IRS

Compliance Approach

- Company wide coordination with all departments
- Update policies and procedures with changing requirements
- Flow down requirements to subs
- Inventory of types of information you have and binding contracts with applicable clauses
- Assess 3rd party agreements
 - Consulting, cloud service providers and their cyber compliance
- Educate employees

Managing Cyber Risk



“The only truly secure system is one that is powered off, cast in a block of concrete and sealed in a lead-lined room with armed guards.”

– Gene Spafford

PBMares Cybersecurity Services



- IT Audits
- Government Contracting Cybersecurity Compliance
- Cyber Risk Assessments
- Vulnerability scans (internal and external)
- Incident Response planning
- Consulting
 - Employee Awareness Training
 - Review of Insurance Policies
 - Assistance with Policy and Procedure Development
 - Social Engineering Testing

Contact



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