Keep Up Your Dukes - Benchmarking and Maintaining Your System (2:15 – 3:45)

Session Moderator: James Thomas, Partner, PwC Government Contracts Practice

Panelists: Cliff Greenblatt, General Counsel and Vice President, TASC Inc.

Barbara Michael, Director Government Compliance & Internal Audit, The SI Organization Inc.

Suzanne Roske, Director, PwC Government Contracts Practice
Monitoring requirements are a key element of a comprehensive internal control environment

Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control Integrated Framework

- 1992 a holistic framework introduced to address internal control requirements
  - Designing
  - Implementing
  - Conducting systems of internal controls
- 2013 COSO framework update addresses changes within the business environment:
  - Regulatory scrutiny
  - Increased reliance on technology
  - Expectations for additional reporting
  - Complex, interconnected business
  - Accelerating pace of business
  - Greater complexity in management models and legal structures

source: www.coso.org

COSO Cube (2013 Edition)
Monitoring requirements are a key element of a comprehensive internal control environment

Defense Industry Initiative (“DII”) on Business Ethics and Conduct

**Goals & Objectives:**

- **Promote the highest ethical values** as expressed in written codes of business conduct, nurture an ethical culture through communications, training, and other means, and comply with and honor all governing laws and regulations.

- **Establish and sustain effective business ethics and compliance programs** that reflect our commitment to self-governance.

- **Share best practices** with respect to business ethics and compliance -

source: www.dii.org
**Method of detecting wrong doing**  
*Corporate Controls and Culture are critical*

**Method of Detection**

<table>
<thead>
<tr>
<th>Method of Detection</th>
<th>2014 Global</th>
<th>2011 Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suspicious Transaction..</td>
<td>25%</td>
<td>18%</td>
</tr>
<tr>
<td>Internal Audit (routine)</td>
<td>12%</td>
<td>14%</td>
</tr>
<tr>
<td>Fraud Risk Management</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>Corporate Security..</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Rotation of Personnel</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Tip-off (Internal)</td>
<td>11%</td>
<td>11%</td>
</tr>
<tr>
<td>Tip-off (External)</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Whistle-Blowing System</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>By Accident</td>
<td>7%</td>
<td>8%</td>
</tr>
<tr>
<td>Other Detection Methods</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>4%</td>
<td>10%</td>
</tr>
<tr>
<td>By Law Enforcement</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>Investigative Media</td>
<td>2%</td>
<td>2%</td>
</tr>
</tbody>
</table>

% of respondents who experienced economic crime over the survey period

*source: PwC’s 2014 Global Economic Crime Survey*
Monitoring and Compliance

Overall Risk Based Approach

- Initial Compliance Assessment
  - Perform baseline risk assessment
  - Documentation of internal controls
  - Conduct gap analysis
  - Perform compliance testing
  - Identify and develop a remediation plan

- On-Going /Periodic Assessments & Monitoring (Maintenance Stage)
  - Compliance reviews
  - Management reviews / Self-Assessments
  - Internal audit reviews
Holistic risk assessment
Business environment impact risk

37% of global organizations suffered from economic crime in the past two years

53% of global CEOs reported being concerned about bribery and corruption

67% of U.S. organizations currently have or plan to have operations in high risk markets

71% of U.S. respondents perceived an increased risk of cybercrime over the past 24 months

source: PwC’s 2014 Global Economic Crime Survey
Holistic risk assessment
Business environment impact risk

Types of economic crime reported

Asset misappropriation: 69%
Procurement fraud: 29%
Bribery and corruption: 27%
Cybercrime: 24%
Accounting fraud: 23%
Human resource: 24%
Money laundering: 22%
IP infringement / data theft: 21%
Mortgage fraud: 20%
Tax fraud: 19%
Illegal insider trading: 19%
Competition law / antitrust law: 18%
Espionage: 17%
Accounting fraud: 16%
Cybercrime: 15%
Procurement fraud: 14%
Other: 14%

% of all respondents who experienced economic crime over the survey period

source: PwC's 2014 Global Economic Crime Survey
**Holistic risk assessment**

**Contractual requirements impact risk**

**Contractor Code of Business Ethics and Conduct – FAR 52.203-13**

Requires contractors’ internal control system provide for:

- Standards and procedures to facilitate **timely discovery** of improper conduct;
- Periodic reviews of business practices, procedures, policies, and internal controls for compliance with the Contractor’s code of business ethics and conduct and the requirements of Government contracting, including:
  
  (1) **Monitoring** and auditing to detect criminal conduct;
  
  (2) **Periodic evaluation of the effectiveness** of the business ethics awareness and compliance program and internal control system; and
  
  (3) **Periodic assessment of the risk** of criminal conduct.

- An internal reporting mechanism, such as a hotline, where employees can report instances of suspected misconduct.
## Monitoring and Compliance – Practical Guidance

### Risk Assessment Matrix

<table>
<thead>
<tr>
<th>LEGEND:</th>
<th>High Risk</th>
<th>Medium Risk</th>
<th>Low Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>H</td>
<td>M</td>
<td>L</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Accounting System</th>
<th>Results of Recent Government Audits</th>
<th>Results of Recent Internal Audits</th>
<th>Audit Tracking &amp; Monitoring</th>
<th>Changes in FAR/DFARS /CAS Regulations</th>
<th>Changes in USG Audit Approach</th>
<th># of IT Business Systems</th>
<th>Last Major System Change</th>
<th>Senior Management Tenure &amp; Changes in Key Personnel</th>
<th>Policies, Procedures and Standard Work</th>
<th>Training</th>
<th>Ethics Advantage Cases</th>
<th>Mgmt Feedback</th>
<th>Overall Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting Practices, including CAS and Disclosure</td>
<td>M</td>
<td>M</td>
<td>L</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>L</td>
<td>L</td>
<td>M</td>
<td>M</td>
<td>L</td>
<td>L</td>
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<tr>
<td>Billing</td>
<td>H</td>
<td>M</td>
<td>L</td>
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<td>M</td>
<td>L</td>
<td>L</td>
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<tr>
<td>Labor</td>
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<tr>
<td>Indirect/ODC</td>
<td>L</td>
<td>L</td>
<td>L</td>
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<td>L</td>
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<tr>
<td>Compensation</td>
<td>L</td>
<td>L</td>
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<td>L</td>
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<td>L</td>
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<td>M</td>
<td>L</td>
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</tr>
<tr>
<td>Information Technologies</td>
<td>M</td>
<td>L</td>
<td>L</td>
<td>M</td>
<td>L</td>
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<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
</tr>
<tr>
<td>Estimating System</td>
<td>L</td>
<td>M</td>
<td>M</td>
<td>L</td>
<td>M</td>
<td>M</td>
<td>L</td>
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<td>M</td>
<td>L</td>
</tr>
<tr>
<td>Purchasing System</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>M</td>
<td>H</td>
<td>L</td>
<td>L</td>
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<td>L</td>
<td>M</td>
<td>M</td>
<td>M</td>
</tr>
<tr>
<td>Material Management &amp; Accounting Systems (MMAS)</td>
<td>L</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>H</td>
<td>M</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>M</td>
<td>M</td>
<td>M</td>
</tr>
<tr>
<td>Earned Value Management System (EVMS)</td>
<td>L</td>
<td>M</td>
<td>L</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>L</td>
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<td>L</td>
<td>H</td>
<td>H</td>
</tr>
<tr>
<td>Government Property Management System</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>L</td>
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<td>L</td>
</tr>
</tbody>
</table>

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**Accounting System**

- **Accounting Practices, including CAS and Disclosure**
  - High Risk
  - Medium Risk
  - Low Risk

- **Billing**
  - High Risk
  - Medium Risk
  - Low Risk

- **Labor**
  - Medium Risk
  - Low Risk

- **Indirect/ODC**
  - Low Risk

- **Compensation**
  - Low Risk

- **Information Technologies**
  - Medium Risk

- **Estimating System**
  - Medium Risk

- **Purchasing System**
  - High Risk

- **Material Management & Accounting Systems (MMAS)**
  - Medium Risk

- **Earned Value Management System (EVMS)**
  - Medium Risk

- **Government Property Management System**
  - Low Risk
Risk Assessment by Issue

The diagram illustrates the risk assessment for different issues based on their impact and likelihood.

- **Issue 1**: Low impact, high likelihood.
- **Issue 2**: Medium impact, medium likelihood.
- **Issue 3**: High impact, low likelihood.
- **Issue 4**: Very high impact, very high likelihood.
- **Issue 5**: Low impact, low likelihood.
- **Issue 6**: Medium impact, high likelihood.
- **Issue 7**: High impact, medium likelihood.

The diagram categorizes the issues based on their impact (0-10) and likelihood (0%-100%).
**Contractual monitoring requirements**

**DFARS Business System Final Rule (DFARS 252.242-7005)**

Requires that contractor’s management team perform periodic monitoring of each Business System

<table>
<thead>
<tr>
<th>System</th>
<th>DFARS Clause</th>
<th>Monitoring Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting</td>
<td></td>
<td>• Management reviews or internal audits of the system to ensure compliance with the Contractor’s established policies, procedures, and accounting practices;</td>
</tr>
<tr>
<td>• Indirect / ODC</td>
<td>252.242-7006</td>
<td></td>
</tr>
<tr>
<td>• Control Environment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Billing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Labor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• General IT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earned Value Management</td>
<td>252.234-7002</td>
<td>• Management procedures that provide for generation of timely, reliable, and verifiable information for the Contract Performance Report (CPR) and the Integrated Master Schedule (IMS)</td>
</tr>
<tr>
<td>Estimating</td>
<td>252.215-7002</td>
<td>• Adequate supervision throughout the process</td>
</tr>
<tr>
<td>• Budget / Planning</td>
<td></td>
<td>• Management review, including verification of compliance with policies, procedures, and practices</td>
</tr>
</tbody>
</table>
# Monitoring requirements

**DFARS Business System Final Rule (DFARS 252.242-7005)**

<table>
<thead>
<tr>
<th>System</th>
<th>DFARS Clause</th>
<th>Monitoring Requirement</th>
</tr>
</thead>
</table>
| Material Management & Accounting | 252.242-7004     | • Periodic internal reviews to ensure compliance with established policies and procedures.  
                             |                  | • Provide a mechanism to identify, report, and resolve system control weaknesses and manual override |
| Property Management           | 252.245-7003     | • Establish and maintain procedures necessary to assess its property management system effectiveness and shall perform periodic internal reviews, surveillances, self assessments, or audits |
| Purchasing                    | 252.244-7001     | • Perform internal audits or management reviews, training, and maintain policies and procedures for the purchasing department to ensure the integrity of the purchasing system; |
# Monitoring and Compliance – Practical Guidance

## Business System Compliance Dashboard

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Applicability of DFARS Clause</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Current approval status</td>
<td>Not evaluated</td>
<td>Not evaluated</td>
<td>Not evaluated</td>
<td>Disapproved</td>
<td>Not evaluated</td>
<td>Approved</td>
<td>N/A</td>
</tr>
<tr>
<td>Status of Government Audits</td>
<td>N/A</td>
<td>DCAA identified several finding during 2016 audit</td>
<td>DCAA follow-up audits are pending</td>
<td>Withholdings as a result of recent audit</td>
<td>No on-going or anticipated audits</td>
<td>Audit completed March 16, 2012</td>
<td>N/A</td>
</tr>
<tr>
<td>System Prior Approval/Date</td>
<td>N/A</td>
<td>No</td>
<td>Yes July 2010</td>
<td>No</td>
<td>Yes April 2008</td>
<td>Yes February 2009</td>
<td>N/A</td>
</tr>
<tr>
<td>DCAA/DCMA audit anticipated or ongoing?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>N/A</td>
</tr>
<tr>
<td>Observations on actions to address requirements</td>
<td>1) Enhance compliance, especially with respect to estimating and purchasing systems to prevent further withholdings</td>
<td>1) Estimating system is not documented</td>
<td>1) Policies and procedures need to be updated</td>
<td>1) Purchasing files do not contain adequate documentation</td>
<td>1) Policies and procedures exist, but have not been updated since 2004</td>
<td>1) Policies and procedures should be updated on a regular basis</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>2) Policies and procedures do not exist</td>
<td>2) Self-assessments are not performed consistently</td>
<td>2) Subcontractor oversight is not performed</td>
<td>3) Material purchases are not significant</td>
<td>2) Monitor property movement closely</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Priorities/Areas of Focus</td>
<td>1) Map process documentation to DFARS requirements</td>
<td>2) Develop documentation that is aligned with DFARS requirements</td>
<td>3) Focus on DCMA findings</td>
<td>4) Should develop long-term action plan to align existing documentation and policies with DFARS requirements</td>
<td>5) Periodically evaluate whether policies and procedures need to be update</td>
<td></td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>2) Maintain awareness of compliance requirements</td>
<td>2) Institute formal review procedures</td>
<td>2) Establish self-assessment schedule</td>
<td>2) Ensure adequate documentation is maintained</td>
<td>2) Maintain awareness of DFARS rules</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Monitoring and Compliance – Practical Guidance
Compliance Testing and Monitoring

- Develop a test plan that specifically relates to the Contractor’s control environment and perform and document the results of that testing

  - Contractor Test Plan & Results
    - Using the existing DCAA control framework, DFARS requirements and Contractor documented control activities (identified in the control matrix), develop a test plan that will assess if the controls identified by the contractor are operating effectively
    - Results are documented in a pass/fail format
    - A remediation plan is developed for any control activity that fails
## Monitoring and Compliance – Practical Guidance

### Risk Assessment Matrix Example for the Estimating System

<table>
<thead>
<tr>
<th>Control Objective (DCAA)</th>
<th>DCAA Example Control Activities / Audit Procedures</th>
<th>Regulation / Guidance Reference</th>
<th>Contractor Specific Control Activities</th>
<th>Control Reference No.</th>
<th>Control Owner</th>
<th>Policies and Procedure Reference</th>
<th>Compliance Observations/Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. SYSTEM DESCRIPTION</td>
<td>Establish and maintain an Estimating System description including policies, procedures, and operating instructions compliant with FAR and DFARS.</td>
<td>DFARS 252.215-7002(4)(i), (ii) CAS 401 DCAA Internal Control Requirement &amp; CAM 5-1207</td>
<td>The Proposal Manager defines the roles and responsibilities related to the preparation, review and approval of cost estimates to be used in the proposal. The Proposal Manager completes pre-kick-off checklist which outlines all required items &amp; issues of concern prior to the kick-off meeting.</td>
<td>C1 Proposal Manager</td>
<td>Estimating System Manual - Section 2.1.2</td>
<td>Compliance Observation: The roles and responsibilities defined in the Estimating System Manual related to organizations outside of Estimating who contribute to the Estimating Process are not defined. Compliance Recommendation: The Contractor should consider developing an overall system description which defines the roles and responsibilities of all groups involved in the Estimating Process, even if they remain independent of the Estimating Group.</td>
<td></td>
</tr>
<tr>
<td>3. TRAINING</td>
<td>Provide training to employees (including technical employees) involved in the estimating process in the application of estimating techniques including appropriate proposal file documentation procedures.</td>
<td>DFARS 252.215-7002(4)(iii) DCAA Internal Control Requirement &amp; CAM 5-1208</td>
<td>Estimator training is provided for major proposals and includes training on pricing tools, documentation of basis of estimates (BOEs), estimating ground rules/methodology and any proposal specific information. The Contractor provides both formal and on-the-job training for personnel in the Estimating Group. New employees are given on-the-job training as it relates to their current assignments and to understand group responsibilities. In addition, all employees of the Contractor are required to take yearly training related to U.S. Government Contracting Fundamentals.</td>
<td>C2 Estimating Manager</td>
<td>Estimating System Manual - Section 2.1.8</td>
<td>Compliance Observation: There is no stated requirement for Truth in Negotiations Act (TINA) training in the Estimating Manual, which should be a requirement for all estimating personnel. Compliance Recommendation: Define and document training requirements for estimators as it relates to proposal pricing. This training should consist of basis of estimate development and documentation. Currently, basis of estimate training is only provided &quot;when required&quot;.</td>
<td></td>
</tr>
</tbody>
</table>
Monitoring and Compliance – Practical Guidance

Compliance Testing and Monitoring

• Design Effectiveness
  • Degree to which a system or process is logically designed to meet compliance requirements

• Operational Effectiveness
  • Degree to which system of process operates as designed

• Efficiency
  • Captures the cost of the process or system → beyond financial cost
  • Human capital efficiency

• Responsiveness
  • Cycle time
  • Flexibility

Business objectives should include program metrics and measurement so that management can understand how the program enhances the enterprise goals.
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