



## Complying with the Government's “Business Systems Rule”

How a proven approach can reduce exposure to penalties and add value to  
your Business Model

By John Stunson

The benefits of working with the Federal Government can be significant, but the consequences of not complying with regulatory requirements can devastate a business. It is imperative that any company expecting to continue working with the Federal Government or any company interested in entering this market be aware of what the Government requires from them and how they can avoid penalties.

The Federal Acquisition Regulation, or FAR, as it is more commonly known, consists of regulatory requirements established by the Federal Government that impose stringent rules through which the government will purchase goods and services. These regulations are applied to most companies, public or private, that desire to conduct business with the Federal Government. State Government projects often include Federal “flow down” provisions, since the state has received funds from the Federal Government (e.g. Stimulus funds for infrastructure, highways, etc).

In addition to the FAR, companies may need to comply with Cost Accounting Standards (CAS). CAS are a set of 19 standards and rules promulgated by the Federal Government for use in determining costs on negotiated procurements. CAS differs from the FAR in that the FAR defines which costs are eligible to be charged to Government contracts (i.e. Allowable costs). CAS dictates how to charge the costs to a Government contract, (i.e. “Allocable” costs). FAR and CAS help to create a consistency in cost estimating, accounting and reporting of costs for Federal Government contracting purposes.

## “The Business System Rule”

On May 18th, 2011, the Department of Defense (DoD) issued the Business Systems--Definition and Administration; Interim Rule,. This was a supplemental regulation to the FAR (FAR 52.203-13) labeled “The Contractor Code of Business Ethics and Conduct,” commonly referred to as “The Business Systems Rule” which sets forth substantial compliance requirements for qualifying entities. This rule generally applies to Federal contractors receiving awards that are CAS or Modified CAS (Cost Accounting Standards) covered, contains applicable business system clauses, and / or bills the government off a schedule of values. It also may apply to State contractors who have Federal “flow down” contract provisions included within their award contract. Among other requirements, this rule will necessitate an internal control system that adheres to special requirements of Government Contracting.

## Applicable Business Systems

Federal regulations will require effective internal controls and “special requirements of government contracting” for the following six business systems:

- **Accounting**

Applies to Billing, Budgeting, Labor, Compensation, Indirect Costs, and EDP Controls

Clause has 17 specific system requirements cited

- **Estimating**

An acceptable system provides for use of appropriate source data, sound



estimating judgment, consistent approach, and adherence to established policies and procedures

- **Purchasing**

Requires Purchasing and Subcontracting System to include make or buy decisions, vendor selection justification, price negotiation, internal audits, training, and management reviews.

- **Government Property**

Ensure compliance with the Government Property clauses of the contract

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

Describes the company's approach to program organization, scheduling and budgeting, work authorization, accounting, indirect cost management, managerial analysis, and corrective actions

- **Material Management (MMAS)**

Describes the system for planning, controlling, and accounting for the acquisition, use, issuing, and disposition

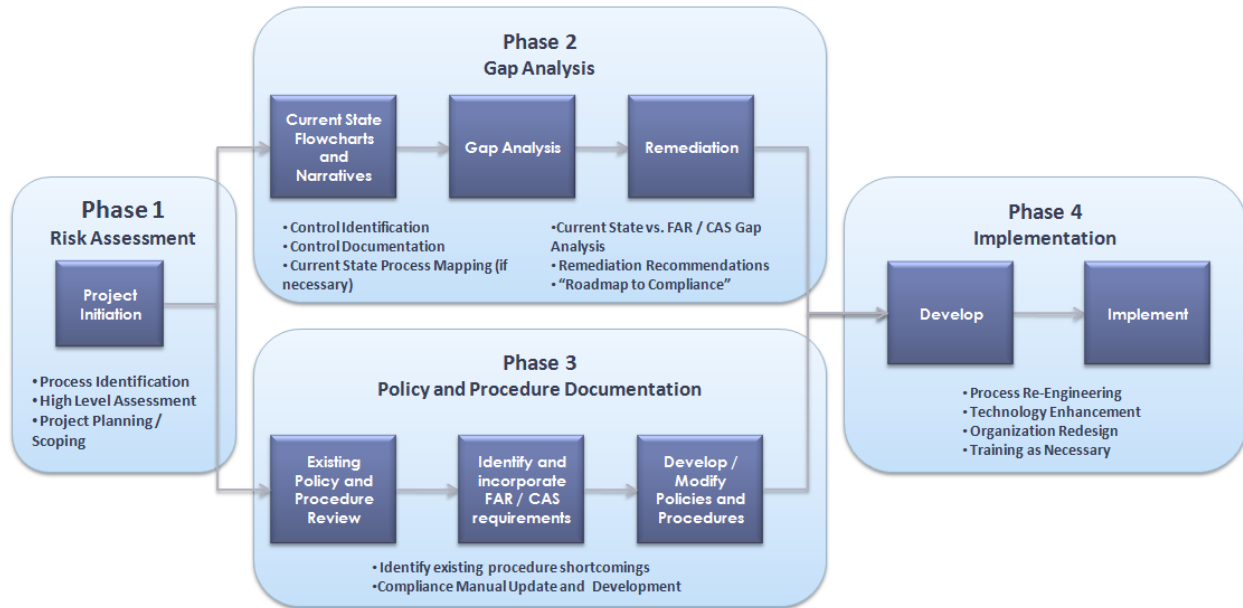
of material. Must comply with the "Ten Key Elements" of an adequate system

### **Rule Enforcement Procedure**

The Government has defined **over 100 Control Objectives** applicable to the aforementioned six business systems. Each **Control Objective** has various key internal controls that are required to be operationally effective to achieve the **Control Objective**. The Interim Rule makes consequences for significant deficiencies against the key internal control objectives severe. The Government defines a deficiency as "shortcoming in the system that materially affects the ability of DoD officials to rely on information produced by the system and needed for management purposes.". **Each significant deficiency may result in 5% withholding of contract payments, up to a cumulative 10% for multiple system deficiencies.** Payments may be withheld on interim payments, progress payments, or performance-based payments and the Federal Government has literally "Hundreds" of key internal controls to choose from and to test.

## What should be done?

Becoming FAR and CAS compliant is generally not an easy task, but if done correctly, companies can benefit from enhanced business processes, increase in sales and improved project profitability. Auxis has developed a proven methodology for helping companies achieve compliance with the new Business Systems Rule. The approach is detailed below:



### Phase 1 – Risk Assessment

The first step in ensuring compliance is to perform a high level assessment of the company's overall compliance with the Business Systems standards. This high level analysis should include discussions with subject matter experts and a review of relevant process and internal control documentation. The assessment will result in an initial rating of the current risk exposure level by functional areas (i.e. Accounting, Estimating, Purchasing, etc.) and a more detailed understanding of the level of effort required to perform a more thorough Gap Analysis and documentation of procedures. Typically, this initial

assessment takes approximately two weeks to perform.

### Phase 2 - Gap Analysis

Under Federal contracts, documentation must exist of policies and procedures that properly reflect actual practices occurring within the company. A key step in achieving compliance is to focus on enhancing and documenting the current set of administrative processes and practices related to the U.S. Government business system activities. This phase of work generally involves the compilation and review of existing procedural documentation. If there is not adequate documentation then it will need to be created. This typically involves the creation of flowcharts and narratives through inter-

views of subject matter experts and process walkthroughs within each business system.

The current practices of the company must then be compared to the individual government control objectives of each effective business system. Applicable gaps, if any, should be identified and documented. Recommendations then are developed to remediate identified gaps, and comply with Government regulations. Finally, a “Roadmap for Compliance” should be created that outlines all remediation steps with proper sequencing and timing considerations.

Upon completion of this gap analysis, executive management will have a clear understanding of how their operating practices comply with Federal regulations, what gaps exist and recommendations on how to remediate those gaps. This analysis will often prove to be a key data point to an overall cost-benefit determination regarding whether the company should continue to engage in future / further pursuit of government projects or exit the government sector

altogether. On one hand, deficiencies identified could severely impact a contractor since the government reserves the right to withhold payments. Conversely, a company that is able to become compliant with these federal regulations will gain the advantage of operating in a generally less competitive and likely more profitable niche market.

### **Phase 3 – Policy and Procedure Documentation**

This phase of the compliance effort is often performed in parallel with Phase 2. The primary objective of this work stream is to develop standard policies and procedures that address all government requirements. Without a functional set of policies and procedures documentation, Federal auditors will often dismiss a company immediately for non-compliance and discontinue an audit. Having this documentation at the ready allows a company to have a credible story to tell. These procedures will incorporate current company practices with any additional requirements for compliance with the business systems rule. This documentation will serve as a baseline to support the company’s internal control structure and overall business operations. The documentation typically includes: policies, procedures, manuals, flow diagrams and narratives that document the processes in sufficient detail. This will demonstrate



each system to knowledgeable auditors and support Federal system audits.

#### **Phase 4 - Implementation**

The final stage for achieving compliance as a “Responsible Contractor” and comply with the business systems regulations can often require a wide range of potential process and technology changes depending on the nature of the gaps identified in Phase 2. Individual companies will likely have different types of gaps in different functional areas, with varying degrees of implementation complexity. Common implementation efforts include indirect accounting system enhancements, establishing systematic interfaces, and procurement process enhancements.

Frequently, compliance implementation activities can be combined with a business improvement opportunity. For example, establishing key systematic interfaces between systems not only complies with required government control objectives, but reduces manual effort from input and error resolution. In many cases, im-



## How Auxis can Help

Whether its business processes, internal controls or information technology improvement, Auxis professionals bring the level of “real world” expertise and experience required to ensure our clients’ success. Our team has over a decade of proven success in helping organizations create more value for their operations.

Auxis’ ability to help companies both assess and remediate their gaps provides a more cost effective and value added result. Additionally, as a management consulting versus attestation firm (such as a CPA firm that performs audits), Auxis has no “independence” issues in the performance of implementation services. This allows Auxis to work with the company through all four phases of Business System compliance and avoid additional learning curves associated with “on-boarding” new vendors.

Although our approach focuses on compliance with government standards, there are often additional benefits of going through this review process with Auxis. Auxis’ methodology and experience ensures that the focus of the analysis extends beyond strict compliance by also incorporating the identification of potential cost savings, revenue enhancement and best practice opportunities. These items often result in significant value creation for the business.



## Contact Us

For more information about our business process services, please contact one of our firm’s professionals. 305.442.0060

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