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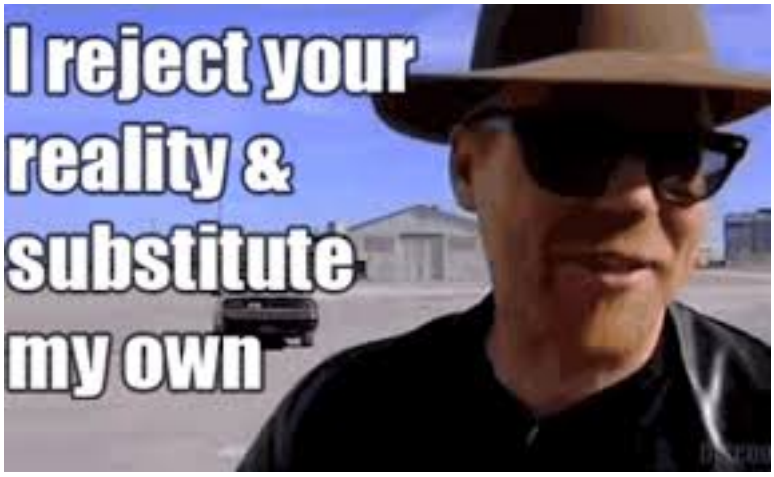

Of all the things to worry about right now—from the impacts of budget sequestration to DCAA's backlog of (at last count) 26,000 unaudited contractor final billing rate proposals, and from systemic corruption of government employees in multiple service branches to systemic contractor fraud in preferred socioeconomic contracting categories, and from GAO reports that DCMA has been mismanaged to GAO reports that DOD doesn't even know the training status of its acquisition workforce—the Director, Defense Pricing, has chosen to focus on an issue that he has admitted has already been "largely corrected" by the defense industry.

We are talking about the additional healthcare premium costs associated with ineligible dependents.

We've discussed this particular issue before. Nothing gets us as upset as the building of a political mountain from what has been proven to be a cost accounting molehill. You can search this site using the keyword "dependent" and get links to seven (7) blog articles focusing on this particular issue, plus links to three others in which the issue is at least mentioned. It's safe to say this is one of those buttons that, when pushed, sets us off.

Boom!

Today we report that the Honorable Mr. Shay Assad, Director, Defense Pricing, has gotten his wish, and that the DFARS Cost Principle at 231.205-6(m)(1) has **been revised** to make it *su per-duper clear*
that—

Fringe benefit costs that are contrary to law, employer-employee agreement, or an established policy of the contractor are unallowable.

Publication of the final rule marks the end of an eighteen-month effort by Mr. Assad and his associates to penalize contractors for inadvertent inclusion of such costs into their indirect cost rates. We **told you** it was coming.

In fact, we **also told you** that the DFARS rule change was going to be implemented, regardless of any public comment to the contrary. Indeed, that's pretty much what happened. A look at the promulgating comments, including responses to public input, indicated that public comments were disposed of with the usual cavalier disdain.

Comment: One respondent asserted that industry-wide ineligible dependent costs are immaterial, and thus have no impact on contract billing or pricing. The respondent suggested that DoD should review the DCAA findings in its policy memo 09-PSP-016(R), dated August 4, 2009, before proceeding with further rulemaking.

Response: Research indicates the rate of ineligible dependent claims can represent as much as 3 percent or more of total healthcare costs. The overall cost for ineligible dependent claims, which are often fraudulent, can be significant for large contractors that spend millions of dollars for dependent healthcare. …

We ask: where is that research? Why has it not been published? Also, if such ineligible dependent claims are indeed fraudulent, then the victims of the fraud are the contractors themselves, and not the Department of Defense—since most large defense contractors are self-insured to a very large extent.

Comment: One respondent asserted that the treatment of ineligible fringe benefit costs as expressly unallowable does not comport with Cost Accounting Standard (CAS) 405 and its preambles. In the preamble of the original publication of CAS 405, the CAS Board explained its use of the term "expressly" in the definition of "expressly unallowable cost" as". . . that which is in direct and unmistakable terms." The respondent believed that "fringe benefit costs . . . contrary to law, employer-employee agreement, or an established policy of the contractor" are not direct and unmistakable costs.

Response: The rule makes fringe benefit costs expressly unallowable when such costs are contrary to law, employer-employee agreement, or an established policy of the contractor. The Director of Defense Pricing Policy determined these conditions are direct and unmistakable.

We ask where the DAR Council and Mr. Assad in particular were granted the authority to

interpret the Cost Accounting Standards? We were under the impression that such interpretations were reserved by statute to the CAS Board.

Comment: One respondent asserted that the rule is unnecessary since the FAR cost principles already protect the Government. Contractors are currently required to exclude fringe benefit costs that do not meet the requirements for reasonableness per FAR 31.201-3.

Response: The results of the DCAA audits have made it clear that coverage is not sufficiently clear. …

As we have **pointed out** on this website, the problem with the DCAA audits is that they misinterpreted the regulations. The regulations were clear; DCAA couldn't read them. Neither could DCMA Leadership at Fort Lee. Neither could Mr. Assad. So obviously the correct fix is to revise the regulations to comport with DCAA's flawed interpretation.

The individuals involved in this rule-making are clearly among those who believe that when reality differs from one's personal point of view, then reality should change. Unfortunately for many of us, those individuals have the power to warp reality, at least in this particular area.

The only thing that changed between the proposed and the final rule was the elimination of the language that would have made estimating such costs expressly unallowable and subject to penalty. Even the DAR Council realized that language was impossible to enforce, since penalties only apply to costs claimed in contractors' proposals to establish final billing rates, which are based on actual, incurred, costs and not estimated costs. Nothing else changed.

So here's the thing. What do you do if you are a defense contractor, subject to the DFARS Cost Principles in addition to the already-onerous FAR Cost Principles? Do you implement expensive testing to make sure your employees don't include, intentionally or inadvertently, their ineligible dependents in their healthcare coverage?

Well, yes. You should do that. You should make sure that only eligible employee dependents are being covered by your healthcare plans. There are a number of ways to do that, and you should figure out which method results in the best return for your investment.

One other thing you can and should do is change your policies. You should clarify coverage of

employee dependents in your policies. For example, you might expressly grant your employees a one-year grace period in which to identify and remove otherwise ineligible dependents from their requested coverage. You might tie coverage to the Affordable Care Act’s **requirements** (*i.e.*
, cover dependents until age 26). In other words, since the allowability of dependent costs is tied to your policies, you should look at those policies and make dependent coverage as broad as possible. In that way, you will be reducing the risk that an auditor will allege you have expressly unallowable dependent costs in your healthcare premium costs.

You need to take this seriously, because those inside-The-Beltway Senior Executives with the power to make your life difficult have decided to take it seriously. DCAA auditors will be looking, and DCMA Contracting Officers will be eager to uphold audit findings, so as to show those Senior Executives how eager they are to do their bidding.