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Contractors Continue to Face Unreasonable Time Frames for Addressing DCAA ICP Findings

By Darryl Walker, CPA, CFE, CGFM Senior Director at Redstone Government Consulting, Inc.

Government contractors continue to deal with unrealistic DCAA imposed time frames for contractors to analyze and respond to incurred cost proposal (ICP) findings, notwithstanding the agency's attempt to more effectively communicate with contractors during the audit (real-time finding disclosure), the effect of which would be to theoretically reduce the amount of time required for contractors to respond to ICP audit results at audit completion.

Although the agency has improved its professional image in communicating interim issues with contractors during the audit, to include insufficient supporting accounting data, potential questioned costs, and internal controls deficiencies, the agency still falls short in adhering to its own contract audit manual guidance and "rules of engagement" in taking a reasonable and respectful approach in yielding to contractor requests for adequate time to review and respond to findings.

DCAA Contract Audit Manual (DCAAM) guidance pertinent to contractor and audit communication during interim and exit meetings require auditors to thoroughly communicate audit issues with contractors on a "real-time" basis rather than holding issues and the basis of questioned costs or system deficiencies until the exit conferences. For example, CAM 10-206.2 (release of audit report) states that following exit conferences, contractor time required to respond to findings should be "minimal" "since the audit results were provided on a real-time basis to the contractor"; and CAM 6-708.1 (incurred cost audits) conveys a similar message—contractor time allowed to resolving data issues should be "minimal since the audit results were provided to and responded by the contractor during the audit."

THIS ISSUE:

Feeding the DCAA push to demand "right now" written responses to audit findings after the exit meeting is a fairy tale notion based on the false premise that DCAA auditors are always diligent in providing sufficient information to contractors (on a real-time basis) that will allow a contractor the ability to analyze and respond to those findings prior to an exit meeting. Thus, the exit meeting should represent nothing more than confirmation of those discussions or resolution of open issues in which case little time is required for the contractor to issue a formal response or agree to the findings without further conferences.

Really? DCAA always discloses all audit findings on a real-time basis? Many of our clients attending ICP exit meetings with DCAA learn, for the first time, the real breadth of DCAA questioned costs and the regulatory rationale behind those costs; or where some costs questioned were indeed disclosed "real-time" during the audit, contractors find out after perusing the first draft audit report presented to them (just before or during the exit conference) that the interim findings discussed months ago have changed entirely and many more added questioned cost transactions, never before discussed with the contractor, glaringly stare at them from the 120 page draft audit report presented during the exit briefing.

A couple of real client experiences illustrate audit unreasonable expectations for contractor responses to ICP findings:

- Company submits 2006 ICP in June 2007, audit commences in January 2011, but discontinues in February due to other priorities. Audit resumes with new audit team in January 2012 and field work ends in June, after which auditors inform client that two findings will be reported amounting to $46K questioned G&A costs. Auditors notify company of exit meeting in June 2013, one year after audit is completed, and draft report presented identifies $560K in questioned G&A costs which is comprised of 160 different transactions. Following the exit meeting, company receives email from DCAA demanding a written response 3 days after exit meeting, and in the absence of any formal response, the report will be issued anyway and DCAA Form 1s will go into effect.

- Small business submits 2007 ICP in March 2008; ICP includes only two CPFF contracts, the total claimed costs of which are $2.5 million. DCAA begins audit in late 2012, and chooses to perform audit without site visit, requesting client to submit information electronically. Client hears nothing from auditors until January 2014; DCAA sends email notifying contractor that $85K has been questioned, but basis for findings is not provided within the email, nor is draft report submitted to company. Auditor requests a response in two days via email and implies that billing system could be considered deficient if time line for response is not met. DCAA forgot to note that the two reimbursable contracts subject to 2007 audit were physically completed in 2009 and all costs for the two contracts had been invoiced.

Driving DCAA's insistence on short turnaround dates for response to audit reported findings comes from pressure on agency management to beat the six-year statute of limitations clock in which the government is allowed to file a claim under the Contracts Disputes Act (CDA) (6 years after "accrual of claim", the date the ICP was submitted) if the contractor disagrees with audit findings. Also placing stress on the agency to complete audits and finalize indirect rate letter agreements is an agency goal for closing out contracts, specifically those identified in joint initiatives established between DCAA and DCMA.

Contractors are at the butt-end of the government's internal problems and self-inflicted wounds in getting ICP audits completed in a timely manner. Insufficient audit resources, stop and go audits due to agency scheduling dilemmas, never-ending transaction testing, changing of audit team members, pressure to meet Department of Defense contract close-out goals, DCAA delays in management reviews of ICPs, and the CDA statute of limitation factor are all problems borne of the government's doing. Although contractors are sometimes culpable in delaying completion of audits timely, they cannot be held responsible for government agency internal issues such as those noted above, and should not be penalized with unrealistic ICP response time frames since they did not create the internal government procurement monster which impairs the timely completion of ICP audits.

It should be noted that DCAAM does leave to the judgment of auditors to determine the length of time a contractor should be given to prepare responses and/or present additional supporting data, and in one section of DCAAM, a thirty day period is cited (6-708.1(b)). Although DCAA management is

frequently empathetic to contractor's request for extended time periods to prepare written responses to audit reports, we still see a broad-based mindset of challenging the contractor to hurry-up and respond, before backing away and acquiescing to a thirty day, or more, time allowance for further discussions with the responsible DCAA FAO (Field Audit Office) and submission of a written response to findings.

Unfortunately DCAA's process of not allowing contractors sufficient time to respond to DCAA draft audit reports is merely "kicking the can down the road" as fact-finding and resolution will become one more expanded responsibility for the administrative contracting officer. This is not a strategy which efficiently or effectively contributes to the goal of contract close-out; however, it is often perceived by the contractor community as a DCAA strategy of shifting the blame to someone else.

When presented with unrealistic due dates for responses to government ICP audits, we encourage our clients to push back and request the length of time they feel necessary to carefully evaluate the audit findings and prepare a well-written rebuttal for those questioned costs with which the company disagrees. Additionally, where auditors assert that the absence of certain accounting or other data is the basis for the questioned costs, contractors should determine if the information is indeed available or if alternative data would otherwise corroborate the nature, purpose, and allowability of the expense.

Recent Contract Disputes – Decisions on: IDIQ Ceilings, Flawed Solicitation Pricing Source, and GSA Contractor Recovery of Equitable Adjustment Claim

By Darryl Walker, CPA, CFE, CGFM Senior Director at Redstone Government Consulting, Inc.

Our continued tracking of court case outcomes affecting government contractors yielded three decisions over the past few weeks, which we believe could be of interest to our newsletter readers. A brief synopsis of each case is provided below for your reading pleasure:

ASBCA 59014—Thefaf Al-Rafidain Contracting Company

The ASBCA affirmed that the government is not responsible for awarding any additional tasks under an IDIQ (Indefinite-Delivery Indefinite-Quantity) contract that exceed the stipulated minimum award value, even though a contractor anticipates further delivery orders (DO) and incurs significant expense in expanding and enhancing its facilities in preparing for future work under the contract.

The government awarded Al-Rafidain (appellant) a DO for 250 T-walls in July 2009 for $87,500 under the IDIQ contract which included explicit terms that the government would order no less than $10K and no more than $300 Mil in items during the contract life. In 2013, having not received any further orders after the 2009 DO, the appellant asserted that contract terms implicitly required the government to issue future orders, and filed a claim with the contracting officer (CO) for over a $1 Mil, which was incurred for the expansion of facilities designed to accomplish future DOs. The CO denied the claim on the basis that the government had met its obligation for ordering items above the contract minimum award value. The ASBCA upheld the CO's decision stating that once the government had met its legal obligation in ordering items meeting the contract stipulated minimum value, the legal terms of the contract and obligation to the contractor have been satisfied. Quoting a previous case, the contractor should have no reasonable expectation that the government would have future needs once orders hit the minimum contract guaranteed order amount.

Federal Circuit Court of Appeals, No. 2013-5094—Lakeshore Engineering

The court ruled that a construction contractor was not entitled to an equitable adjustment on an IDIQ fixed-price contract because the original pricing guide data provided by the Army for use in calculating proposed prices was out of date and inaccurate. The government solicitation required Lakeshore to calculate its price estimates using the "Universal Unit Price Book" (UUPB), but the solicitation instructions clearly stated that those prices were not guaranteed to reflect current or actual market prices for the services requiring pricing bids. In addition, the contractor was permitted to add amounts using "coefficient factors" to cover other items over and above those costs for services calculated using the UUPB, with one notable possible coefficient factor element being "other risks of doing

business". Two years after award, Lakeshore noted its incurred costs for work performed was higher than payments from the government and requested an equitable adjustment for losses that largely occurred because the UUPB pricing guide that the Army required Lakeshore to use in its estimates reflected prices below the market values at the time of negotiation. The contracting officer denied the appeal and the Federal Circuit concurred with the contracting office.

The Court noted that the solicitation/contract was clear that the UUPB was a government estimate and stated the "language of the contract does not promise that the prices in the UUPB were accurate or place on the government the risk that they will turn out to be inaccurate." In other words the pricing risk is that of the offeror/contractor, and sufficient solicitation instructions and guidance was provided during the bidding phase to enable Lakeshore to hedge its risk in the bids, one example of which was that the risk of potential UUPB inaccuracies could have been factored within Lakeshore's estimated coefficient add-on factors. Message to government contractors: although solicitations stipulate baseline data as a starting point for calculating fixed price bids, it is the contractor's responsibility to mitigate those risks with appropriate adjustments. The court stated that a condition of an equitable adjustment claim is that is must be "the result of a change to the contract made by the government", and losses occurring due to costs incurred over negotiated prices in this case does not meet that criteria.

CBCA 1849, 2386—Moshe Safdie and Associates (MSA)

The Civilian Board of Contract Appeals (CBCA) agreed that MSA was entitled to certain design and construction contract costs arising from building a court house under a GSA contract, and rejected GSA's appeal that MSA should pay "consequential damages" due to MSA's late delivery of the project. MSA alleged in its appeal that GSA owed additional compensation due to (1) added design work during the original design scope, (2) added scope due to a government directed redesign, and (3) post construction contact services GSA requested not originally contemplated. The CBCA found that MSA was entitled to costs for changes in the original design and costs for post construction effort, but determined costs for redesign should be largely borne by the appellant except for added design tasks created outside the original scope that were tied to redesign effort.

The court dismissed GSA's claim for consequential damages purportedly caused by the late start of construction, since GSA could not "establish professional negligence on the part of MSA."

Obama Issues Four Executive Orders Impacting Wages and Compensation for Government Contractors

By Michael E. Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

In March and in April, President Obama signed four executive orders which will ultimately impact the compensation policies of government contractors. When implemented, the executive orders will tend to increase compensation costs oddly enough at a time when Government agencies continue to struggle with budgetary reductions. Hence, the Government will be receiving even fewer goods and services as a result of increased compensation directly attributable to the actions of Obama. In terms of the four executive orders, they include the following:

- Updating the Fair Labor Standards Act in terms of the application of overtime compensation to salaried employees; specifically, the Department of Labor is to propose a new salary threshold below which employees are eligible for compensated overtime (e.g. premium pay for hours exceeding 8 per day or 40 per week). The current threshold is $455/week and based upon preliminary statements, this could be doubled. In promoting a higher threshold, the Secretary of Labor noted that the existing threshold "actually makes it possible for salaried employees to make less than the minimum wage". More to the point, the President stated: "It's not right when business owners who treat their employees fairly can be undercut by competitors who aren't treating their employees right". (Editor's note: Apparently compensation in full compliance with existing labor laws "is not right" in the view of the President who would apparently prefer mandated compensation which would all but eliminate meaningful competition.)

- Increasing the minimum wage to $10.10/hour on government contracts effective in 2015. This will only apply to government contractor personnel and many of these contractors are already subject to certain labor rate minimums which are significantly higher than $10.10 per hour (e.g. The Services Contract Act). The Department of Labor promoted this increase by quoting small business owners who have less employee turnover by currently paying more than the minimum wage. (Editor's note: Apparently the small business owners fail to understand that if the minimum wage is universally increased, the small business owners will be forced to further increase their employee compensation to maintain a wage rate advantage critical to retaining employees.)

- Non-retaliation for disclosure of compensation information to fellow workers because "express or tacit employer prohibitions restrict the amount of information available to participants (employees) in the Federal contracting labor pool which tend to diminish the market efficiency and decrease the likelihood that the most qualified and productive workers are hired at a market efficient price". Allowing employees to discuss their compensation with fellow workers will contribute to contractors and their employees the ability to detect and to remediate unlawful discriminatory practices. (Editor's note: Apparently the President is unaware of the fact that Department of Labor Administrative Judges have already determined that it is unlawful for a company policy to prohibit employees from discussing their compensation. We also struggle with the expectation that this will somehow improve "market efficiency and result in the most qualified and productive workers being hired at market efficient prices" unless Obama assumes that existing employees will also be discussing their compensation with potential employees.)

- A push for equal pay eliminating the so-called gender pay gap which is widely reported to be that on average, women earn 77% of salaries paid to men. Ignoring the fact that many studies have demonstrated that the pay gap is much narrower and/or there are reasons for statistical variation (e.g. length of time on the job or level of education), President Obama has directed the Secretary of Labor to create new regulations requiring federal contractors to report salary summary data to the government including sex and race breakdowns. The hope according to the President: "this "will encourage employers to submit data voluntarily, enabling more targeted government enforcement". (Editor's note: Apparently the President's definition of "voluntary" is slightly different than the dictionary definition because "requiring" federal contractors to report salary data is obviously "involuntary". We do have to admit that it sounds much better if the President (disingenuously) categorizes this as a voluntary action as if government contractors will be anxiously awaiting the opportunity to be the first in line to voluntarily provide the required data in hopes of receiving targeted government enforcement.)

Corporate Confessions – The New Norm of Government Contracting

By Guest Author: Jerry Gabig, Attorney, Wilmer & Lee

Corporate officers have a fiduciary duty of care to their company. Hence, if they become aware of any wrongdoing that might have an adverse impact on the company, they are expected to investigate the alleged wrongdoing and take appropriate corrective action.

Often, rather than perform the investigation themselves, the officers appoint an impartial third party to perform the investigation and prepare a written report. Upon reviewing the report, the corporate officers then collectively decide what action is in the best interest of the company. Over the years, the Government has become more aggressive in seeking a copy of these impartial investigations. For example, the Defense Contract Audit Manual (DCAM) Sec.1-504.4g(3) has been modified to state:

> If a contractor asserts the attorney-client privilege or the attorney-work-product doctrine, the auditor should ask the contractor to explain in writing (i) the basis of the assertion and (ii) why the contractor cannot provide the requested information or some alternative, non-privileged information that will meet the auditor's needs. Auditors with questions on whether the contractor's assertion of attorney-client privilege or attorney-work-product doctrine is appropriate in their

> specific situation should contact DCAA-DL for assistance. If the contractor continues to deny access and does not provide alternative, non-privileged information, the procedures in DCAAI 7640.17 should be followed until such time as a high level executive from the company asserts the privilege in writing.

DCAM Section 1-504.4g(3).

To retain their prerogative of not providing the report to the Government, corporate officers have increasingly hired lawyers to conduct the investigation since the attorney-client privilege has long been recognized as a means of preventing the Government from obtaining the reports.[1] However, this tack of having lawyers perform the investigation and prepare the report is no longer a guarantee that the Government will not eventually obtain a copy of the report.

First, the Government has become more assertive in challenging whether the report truly falls under the attorney client privilege. Indicative of this trend is the decision of the United States District Court for the District of Columbia in *United States ex rel Barko v. Halliburton Company*. In that decision, Mr. Barko was an employee of Halliburton Company working in Iraq in 2004. Mr. Barko filed a *qui tam* law suit under the False Claims Act against Halliburton claiming the Government had been defrauded. During the pre-trail discovery phase, Barko's attorney sought the Halliburton internal investigation of the alleged wrongdoing. The investigation was undertaken pursuant to FAR Subpart 3.10 "Contractor Code Of Business Ethics And Conduct." Under FAR § 3.1002(b)(2), a contractor is responsible for the "timely discovery and disclosure of improper conduct in connection with Government contracts."

The investigation was performed by non-attorney investigators who transmitted the report to the Halliburton Law Department. Halliburton refused to release the report claiming it was protected by the attorney-client privilege. The District Court applied the following test for determining whether the report fell within the attorney-client privilege: "The party invoking the privilege must show the communication would not have been made 'but for' the fact that legal advice was sought." The court held that the report was "undertaken pursuant to regulatory law and corporate policy rather than for the purpose of obtaining legal advice." Hence, Halliburton was ordered to release the report. The lesson from the decision is not to acknowledge that an underlying reason for preparing the report is FAR Subpart 3.10. It would also strengthen the contractor's argument if the investigation was actually performed by an attorney.

Second, it is important to recognize that FAR Subpart 3.10 is a sea change in terms of mandatory disclosures. In November 2008, the FAR was amended to "amplify the requirements for a contractor code of business ethics and conduct, an internal control system, and disclosure to the Government of certain violations of criminal law, violations of the civil False Claims Act, or significant overpayments."[2] FAR § 3.1003(a) warns that a contractor can be suspended and/or debarred for knowing failure to disclose in a timely manner certain violations of criminal law, violations of the civil False Claims Act, or significant overpayments.

The implementing clause for FAR Subpart 3.10 establishes a duty of full cooperation "with any Government agencies responsible for audits, investigations, or corrective actions." FAR § 52.203-13(c)(ii)(G). The definition of full cooperation in the clause mentions that the clause "does not require … a Contractor to waive its attorney-client privilege." Id. However, as a practical matter, the risk of potential debarment or suspension often sways contractors to error on the side of disclosure. As explained in one scholarly publication, "When facing a mandatory disclosure rule and limited prohibition against Privilege waiver, most corporations would voluntarily waive the Privilege."[3]

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[1] According to the U.S. Supreme Court, "[t]he attorney-client privilege exists to "encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

[2] Contractor Business Ethics Compliance Program and Disclosure Requirements, FAR Case 2007-006, 73 Fed Reg. 67,064, 67,064 (Nov. 12, 2008).

[3] J.Goldman, *New FAR Rule on Compliance And Ethics: Hidden Assault On the Corporate Attorney-Client Privilege New FAR Rule on Compliance And Ethics: Hidden Assault On the Corporate Attorney-Client Privilege,* 39:1 Public Contract Law Journal (2009).

Given this new norm, savvy lawyers now prepare the written investigation with the assumption that it will eventually be disclosed. Hence, although remaining factually correct, the facts are presented in a manner most favorable for the contractor. Also, to the extent possible, factors favorable for the contractor that a Debarment Official must consider under FAR § 9.406-1(a) are weaved into the analysis. However, when the Officers and members of the Board of Directors are briefed, a more candid and poignant assessment is given by the investigating attorney. For that briefing, no written record within the corporation should be retained.

In summary, if there is corporate wrongdoing that may be reportable under FAR Subpart 3.10, any internal investigation performed on behalf of the company will probably have to be released to the Government unless the contractor takes appropriate precautions. The appropriate precautions should begin before appointing a third party to perform the investigation.

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