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Government Shutdown and Government Contractors

By Michael Steen, CPA, Senior Advisor

As the Government shutdown continues (and becomes more challenging with the new Democrat Majority in Congress), there are always questions and speculation concerning the impact on Government Contractors. Based upon past experience with Government shutdowns, most questions have been implicitly answered; however, speculation arises because of the number of blogs and other "unofficial" sources regarding contractual rights and remedies afforded Government contractors. The short answer (or more accurately an "unofficial" opinion) is that a Government shutdown does not provide any contractual remedies because it is a sovereign (Government) act versus a contractual matter.

One point of reference for this interpretation is a December 2008 U.S. Court of Appeals Decision which affirmed a 2007 ASBCA decision (07-02, BCA 33.703) that a construction contractor had no contractual remedy (delay claim) attributed to the contractor lack of access to a US Military Installation for 41 days after September 11, 2001. In the days following "9-11", military base commanders may have restricted access to some, but not all non-military personnel; however, those particular decisions were linked to a public and general act versus contract or contractor specific. Of passing interest, in deciding the appeal:

- It did not matter that other non-essential, non-military personnel were mistakenly allowed access to the base (confirming the adage, "two wrongs do not make a right"),
- The Government's sovereign act did not convey any economic advantage to the Government, and
- The construction contractor could not assert that the Government failed to satisfy the "impossibility" requirement of the sovereign act defense, having failed to argue that in the original ASBCA case (thus waiving that argument on appeal).

THIS ISSUE:

Some "unofficial" sources (e.g. blogs) have mentioned the possibility of a contracting officer (CO) issuing a stop-work order (in anticipation of the Government shutdown); however, that is more likely a "wish" versus a "reality". A stop-work order does open the door for contractual remedies (see FAR 52.242-15); that said, it would defy all logic for the CO on some contracts to issue a stop-work order when "doing nothing" avoids a potential contractor claim for economic harm. In fact, there are many government contracts which are not necessarily impacted by a Government shutdown; e.g. those whose funding is not impacted and/or those whose place of performance does not involve access to Government facilities.

In summary, at least in in the near term, a Government shutdown might be nothing more than an internal Government issue of little or no impact to most Government contractors. A long-term shutdown (which is apparently an acceptable alternative to the Government's CEO) is a different story (and one which will hopefully be avoided). There is one cardinal rule for any Government contractor, which is to avoid labor mischarging which could occur (during a Government shutdown) if employees continue to charge a Government contract which explicitly requires access to (temporarily inaccessible) Government facilities. Labor mis-charging is one of the most common violations of the FCA (False Claims Act) and an inaccessible Government facility coupled with otherwise idle employees is not an excuse for mischarging employee labor (there is no "get out of jail free card" and see the related discussion of an FCA settlement in the article: (DOJ False Claims Settlements: The Government Giveth but it Taketh Away More").

DOD (Possible) Lateral Reassignment of Shay Assad from Director Defense Pricing to a DCMA (Boston Area Office)

By Michael E. Steen, CPA, Senior Advisor

Although it has not shown up on any DOD website (most likely because of the Government shutdown/lack of website managers), a defense news source has reported that Shay Assad has been reassigned from Director of Defense Pricing (DDP) to a lateral position within the Boston Area. One stated reason for the reassignment was ongoing realignments within DoD, which included the express requirement for this position to be physically located in the Pentagon. Per the defense news source, Mr. Assad was not a resident in the Washington DC area because he retained his home in the Boston area, commuting to/from DC each weekend; an arrangement which was apparently allowed and reimbursed by DOD in-spite of the fact that Government employees are expected to relocate (subject to "PCS" reimbursements) versus perpetually traveling to/from a personal residence in another state. To be fair to Mr. Assad, there is a potential trade-off considering that the costs to permanently relocate (from Boston to Washington DC) are potentially in the hundreds of thousands; however, there simply isn't any policy permitting this perpetual travel arrangement in lieu of a permanent move (if there is a policy, we don't know of its existence or source).

From a contractor perspective, most would view this reassignment as "Ringing in the New Year" in a very favorable manor for contractors. Mr. Assad was responsible for DFARS regulations which were "contractor unfriendly" (e.g. solely at his direction, contractor health benefits paid for ineligible dependents were made expressly unallowable and subject to penalties even though it is almost impossible to totally avoid a small number of these payments). He was also noted for his public statements which were less than subtle in terms of his unfavorable view of government contractors (i.e. entirely driven by profit motives). Assuming Mr. Assad has been reassigned, it remains to be seen who replaces him and if he/she will present a more balanced view of DDP's role and responsibilities. And one last observation, assuming Mr. Assad is now over a DCMA Regional Office, his reassignment might be lateral in terms of being an SES position, but it is clearly a demotion in terms of responsibilities and influence on DoD procurement policies.

DoD-IG (Inspector General) Semi-Annual Reports for 2018: DCAA's Audit Productivity Skyrockets while DCAA's Audit Sustention Rates Hold at 30 Percent

By Michael E. Steen, CPA, Senior Advisor

The DoD-IG issued its Semi-annual Reports to Congress for Fiscal Year 2018 (combined covering the period October 2017 through September 2018). These reports continue to provide insight into contract oversight (contract audits and CO

dispositions of contract audits). The 2018 data is very similar to other recent years, including the following:

- COs dispositioned 824 audit reports (subject to tracking per DoD Instruction 7640.02) with sustention rates approximating 30% (29.1% for the six months ending March 31, 2018 and 32.1% for the six months ending September 30, 2018, respectively). Relatively stable sustention rates and better than the low-water mark of 22.8% for the six months ending September 30, 2014. Coincidentally, DCAA continues to report much higher sustention rates (in DCAA's Annual Reports to Congress) with the difference attributable to DCAA's self-generated reporting of much higher sustention rates on forward pricing/bid proposal audits (not in the universe tracked per the DoD Instruction). Equally coincidental, no authoritative source has ever reconciled or independently verified/audited any of these reported sustention rates.

- DCAA issued 3,717 audit reports for FY2018 (compared to 3,452 for FY2017 and 4,269 for FY2016, respectively). The uptick in 2018 (versus 2017) is most likely attributable to the 2018 NDAA wherein Congress now requires an incurred cost audit to be completed within 365 days of DCAA's determination that DCAA has an adequate contractor final indirect cost rate proposal. Although DCAA had been previously under pressure to get current on its incurred cost backlog, there were no audit specific timelines until the 2018 NDAA.

- DCAA examined $409.6B in FY2018, a remarkable increase from both FY2017 and FY2016 ($281.B and 286.8B, respectively). The FY2018 total dollars audited represents a 46% increase when the number of audits only increased by 7% (hence, dollars per audit improved significantly). Noting that dollars per audit is one indicator of audit efficiency, this data indicates that DCAA's audit efficiency (or productivity) has dramatically improved, a worthy accomplishment but for the fact the 2018 NDAA is probably the "root cause". But for Congressional interest and mandates, it remains to be seen if DCAA would self-initiate any significant improvements in its audit processes. (at least until FY2018, DCAA's only method of self-improvement on incurred cost audits was to stop auditing the majority of contractor indirect cost rate proposals by declaring them low-risk). DCAA's improvement in its audit efficiency may also be its recognition of the potential implications of out-sourced contract audits (in particular, the 2018 NDAA requirement for DoD to move toward incurred cost audits being performed by qualified independent public accounting/auditing firms).

- DoD-IG reported 21 defective pricing reports issued in FY2018 with total recommended price adjustments of $159M (an average of $7.8M per report (this statistical mean or average could be easily skewed by one or two reports with "big dollars" at issue). - For the previous two fiscal years, the number of reports was 26 and 35 for FY2017 and FY2016, respectively). The downward trend in number of reports is probably nothing more than a reflection of DCAA's focus on incurred cost audits although there is continued speculation that DCAA might shift audit resources to post-award (defective pricing) audits should the incurred cost backlog be within tolerable limits (as defined by continuing Congressional interests, although DCAA's biggest critic, Senator Claire McCaskill, was not re-elected).

- Appendix H of the DoD-IG reports provide a listing and a very high-level summary of significant DCAA audits issued during the six-month period. There tend to be more significant reports issued in the last six months of any given fiscal year, a reflection of inputs; a predominant number of contractor submissions are received on or about June 30 each year, determined to be adequate by August 30 and then subject to the 2018 NDAA requirement to complete the audit within 365 days. In terms of the questioned costs, the descriptions are terse to the point of providing little insight into the alleged regulatory non-compliance, but the fact that DCAA continues to question large amounts for direct material and direct subcontracts implicates DCAA's second-guessing the sufficiency of the underlying contractor procurement files and/or the prime contractor's "management" of subcontracts during subcontract execution. The single largest amounts questioned were $521M for a single contractor fiscal year (2012) and the limited description of regulatory issues suggests this involves a partnership with multiple business units, foreign operations (taxes). Of passing interest, if one aggregates the total questioned costs identified with the specific audit reports yielding significant questioned costs, it is obvious that DCAA's total questioned costs are

attributable to a relatively small percentage of the completed audits (in other words, overall results and simple averages are skewed based upon a few "big dollar" issues concentrated in relatively few audit reports).

- DoD-IG semi-annual reports also include a section on "Services" which included an Air Force OSI investigation (supported by DCAA) after a contractor's mandatory disclosure (FAR 52.203-13) indicated weaknesses in the contractor's billing system controls to reasonably ensure that employees (billed under labor categories in multiple T&M contracts) met the labor qualifications (contract specified). After the initial mandatory disclosure, DCAA apparently determined that at least eight employees did not meet the contractual qualifications and the contractor's more expansive internal audit determined that there were more than 300 instances of unqualified labor billed. The contractor repaid $10.6M ($8.3M in overpayments and $2.2M in interest). One can assume that this issue resolution also involved Government expectations for increased internal controls, training, and periodic internal audits with results shared with the Government. This issue and one discussed in the article on DOJ False Claims Act settlements is reminder of the consequences of improperly recording and/or billing employee labor.

Although it was issued after September 30, 2018 (thus not in the FY2018 semi-annual reports), the DoD-IG also issued a report (DODIG-2019-029) on *DoD Task Orders Issued Under One Acquisition Solution for Integrated Services Contracts* (OASIS). The purpose was to determine if the DoD was properly billed for contractor employees who met the labor qualifications stated in the OASIS contract. The IG concluded that approximately 91% did meet the requirements, but the remaining 9% did not meet the requirements (existing documentation and follow-up inquiry could not determine that these 9% met the qualifications as billed). A reminder that contracts for labor hours (T&M/OASIS and other GWAC vehicles) are subject to continuing interest (IG and/or DCAA) in terms of contractor documentation sufficient to demonstrate that an employee (whose labor hours are billed to a contractual labor category) meet the labor qualifications (education and relevant training). This issue was discussed more extensively in our blog dated November 28, 2019, link: DoD-IG Report Contractor Employees Failed to Meet Labor Qualifications on Task Order Contracts

DCAA's Annual Program Plan: No Longer "Annual" and No Longer with any Specific Details of Planned Audits

By Michael E. Steen, CPA, Senior Advisor

For years, DCAA's annual workload planning document (or program plan) had been issued annually in early August to facilitate Agency planning for the upcoming fiscal year (beginning October 1 and ending September 30 of the following year). This document has not been posted on DCAA's publicly accessible website, but it was considered a "releasable" document easily obtained through a FOIA request (Freedom of Information Act). All that quietly changed during FY2018, there is no longer an annual planning document and its replacement is "NR" (not releasable without redactions). DCAA's FOIA Officer has been and continues to be very responsive to a FOIA request for this document, in this case providing the new version within approximately 10 business days of our request. The only redaction was the "blacking-out" of specific employee names and telephone numbers; however, the new version is largely a conceptual plan which still includes a list of audit-type priorities as follows:

- Incurred cost audits (audits of contractor indirect cost rate proposals)
- Demand work including forward pricing (bid proposals and/or forward pricing rates), terminations, claims, and pre-payment voucher reviews
- Business Systems (Accounting, Estimating, MMAS) including paid voucher reviews
- Truth-in-Negotiations compliance audits (aka Defective Pricing audits)
- High-risk time sensitive labor and material reviews (aka MAAR 6 and 13)
- Local priority audits.

Completely missing are any lists of specific audits to be planned and performed at specific contractors (e.g. defective pricing audits and business systems). Additionally, the planning is now "SWRI" (Strategic Workload and Resources Initiative Guidance) which covers two fiscal years (i.e. FY2019 and FY2020). Initially, the SWRI involved four workshops from February to June 2018: i) Field Audit Office, ii) Geographical, iii) ESC Planning Committee, and iv) Executive Level (June 2018 ESC). At least by appearances, these seminars are a planning exercise involving auditors, managers and executives ("all-hands"). It remains to be seen if/how this will impact

contractors or contracting officers, assuming that most will see no real change because DCAA's conceptual audit priorities are essentially the same as for FY2017 and FY2016. Additionally, DCAA's structure includes "CADs" (Corporate Audit Directorates) for whom DCAA will presumably continue with its periodic meetings to inform contractors of planned audits as well as the status of ongoing audits. For the vast majority of government contractors (those not included in a "CAD"), the DCAA audit plans will continue to be less structured (than the CADs) and more sporadic. However, the good news for all contractors is that the 2018 NDAA has required DCAA to timely communicate incurred cost adequacy and (at least implicitly) incurred cost audit planning with each contractor.

DOJ FY 2018 Fraud Statistics: The Government Giveth but the Government Taketh Away More

By Michael E. Steen, CPA, Senior Advisor

In late December 2018, the DOJ (Department of Justice) issued its media release summarizing its FY2018 actions and recoveries under the FCA (False Claims Act). In addition to the one-year summary, the DOJ updated is historical data base which summarizes recoveries going back to 1987. The data is reported in total and by three subsets (DoD, DHHS, and All-Other) and further separated into Qui Tam and Non-Qui Tam actions/recoveries.

FY2018 is unremarkably similar to other recent fiscal years, in particular that the predominance of FCA recoveries involve healthcare fraud (allegations) and the majority of all FCA recoveries involve a Qui Tam (a relator who files a Qui Tam on behalf of the US Government). One side-note on Qui Tams, under the Trump Administration, the DOJ appears to be more actively rejecting Qui Tams (which don't merit Government involvement, in some cases actions coming from what are described as "professional" Qui Tam Relators). This trend (actively rejecting Qui Tams) may not be all that new, but it has been more publicized.

Although the specific cases described in the FY2018 read very similar to other recent years, there are undoubtedly some nuances embedded within the cases (in many cases, those "nuances" are buried in the non-public information). One aspect of DOJ media releases that is seemingly perpetual, the DOJ's almost hidden reference to the fact that most of the settlements are "allegations only, there has been no finding of liability". The statement identifies the fact that the case has not gone to trial and, thus, has not had a finding of liability. It is a statement most companies want in a press release when they settle a case. Therefore, this or a similar statement is at the very end of most DOJ media releases, in some case, with several pages describing the "the contractor or contractor employee's evil actions", the DOJ diligence in finding fraud, and the brilliant and highly cooperative investigation (lead by DOJ with some assistance from other agencies). Just slightly self-serving and perhaps inadvertently overlooking the fact that most investigations come from an insider, aka a Qui Tam Relator.

Somewhat related to the DOJ Media Release, the DOJ also participates in public outreach, for example, Assistant US Attorneys (AUSAs) who speak at government contractor and/or government employee/attorney seminars. In one recent case, the AUSA promoted the idea of contractor "voluntary disclosure", citing an unnamed case in which the DOJ was so grateful for the voluntary disclosure and full cooperation, that the DOJ decided not to prosecute the contractor (no discussion on prosecuting any particular employee or owner). We suspect that all AUSAs reference this same case in similar forums; all promoting the idea of voluntary disclosure, cooperation and open communications which will be favorably considered by the DOJ. Unfortunately, the case cited by the AUSAs may not be representative of the typical process and disposition of a contractor voluntary disclosure. Read on…

In a DOJ media release on November 2, 2018, the DOJ announced a $27.45 Million settlement with one of the largest government (defense) contractors. In the one-page summary, the DOJ credits itself (the FBI) and other agencies (AFOSI and DCIS) for their "incredible partnership…which uncovered this immense fraud against the government and returning the funds to the American taxpayer and is vitally important to ensuring our military receives the honest services they are due". The underlying issue was for labor hours purportedly billed between July 2010 and December 2013 by individuals stationed in the Middle East who had not actually worked the hours claimed. There were two settlements, $27.45 M (civil fraud) and $4.2 M (criminal fraud) and page two of the media release also credited other agencies including DCAA. And the very last statement, "except for the conduct admitted in connection with the criminal agreement, the claims resolved by the civil agreement are allegations only and there has been no determination of civil liability".

Did the DOJ media release overlook any other relevant details? That happens to be a rhetorical question because

DOJ's failure to accurately include relevant facts becomes obvious when one reads the October 31, 2018 memorandum (agreement) from DOJ to the contractor's attorney. On page two of that eight-page letter, the DOJ states that its decision to conclude the investigation takes into consideration the following:

- The Contractor's voluntary disclosure (emphasis added) of this matter to the Government in February 2013,
- The fact that the contractor employees acted in contravention of company policy and without knowledge of corporate management,
- The contractor's investment of significant resources to investigate, analyze and provide documents and other relevant information to the Government and to otherwise support the Government investigation including collecting over 25 million records from employees and producing over 1.3 million pages of documents and interviewing over 100 employees,
- The contractor's actions and plans to enhance internal controls and,
  The contractor's agreement to cooperate with DOJ on the investigation of individuals.

There is much more to the eight-page memorandum, but two statements are particularly noteworthy:

- The contractor agrees that it will not seek or knowingly accept, directly or indirectly, reimbursement or indemnification from any source with regard to the payments, and
- The contractor agrees that it will not issue a press release or any public statement or hold any press conference in connection with this agreement…which make any statements contradicting the taking of responsibility by the contractor.

This article's reference to the Government Giveth and the Government Taketh Away (much more than it giveth) is in reference to the net cost to the contractor which dwarf the amounts allegedly overbilled the Government. The net costs presumably include some "multiplier" applied to the measured or estimated overbilling (up to treble damages) along with the untold costs of the contractor's internal investigation and the continuing costs of enhanced internal controls and internal oversight. The Government wants to make sure that the contractor "feels the pain" by prohibiting the contractor from any direct or indirect recoupment of the settlement payments (thus prohibiting the contractor from any government contract cost reimbursement, but more oppressively, prohibiting the contractor from any indemnification from an insurance carrier). All of this started with the contractor's voluntary disclosure and exhaustive internal investigation, which was shared with the Government (thus significantly reducing the Government's resource investment). One other "minor" correction, in contrast to a statement in the DOJ eight-page memorandum that this did not start with a "voluntary disclosure", it started with a mandatory disclosure (FAR 52.203-13), but we acknowledge that "voluntary" simply sounds better.

One closing thought, in its public outreach activity, we suspect that the AUSAs will continue to reference "the one" action for which the DOJ "forgave and forgot" while "inadvertently" failing to mention any of the other actions such as the one announced on November 2, 2018.

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All Government contractor CFO's or Controllers are invited to participate. The meetings are held quarterly and will include lunch and networking from 11:30am – 1:00pm. The next meeting is January 9, 2019 at Radiance Technologies. The topic this quarter is "Government Property Management". Participants will be notified via email announcements for all future locations and seminar topics. The CFO Roundtable is **free** to attend. Sign up for CFO Roundtable here.

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