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Can the Government Assert CAS Noncompliance After Prolonged Audit Delay and Contracts Awarded Based on Disclosed Practices?

By Amanda J. Sherwood and Sonia Tabriz*

Contractors performing work subject to the Cost Accounting Standards ("CAS") often deal with delayed audits, alleged noncompliance determinations and payment demands. The authors of this article discuss a Court of Federal Claims case, the final decision of which will be of interest to all CAS-covered contractors, as it could limit the government's ability to recoup payments made long ago under contracts that were awarded based upon disclosed accounting practices the government only later deems problematic.

Federal contractors performing work subject to the Cost Accounting Standards ("CAS") are all too familiar with delayed audits, alleged noncompliance determinations and payment demands—often arising years after the contractor has been operating under the same, disclosed accounting practices.

The Court of Federal Claims ("COFC") recently denied[1] the government's attempt to dismiss Sikorsky Aircraft Corporation's ("Sikorsky") challenge to such a demand for payment, noting that an "open . . . question" remains as to whether the government has waived its claim for contract adjustment based on an alleged CAS noncompliance when the government unduly delayed evaluating the contractor's disclosed practices, and entered into contracts based upon those disclosed practices in the interim. The court will presumably answer that important question at the merits stage of the litigation.

The court's final decision in *Sikorsky Aircraft Corporation v. United States*[2] will be of interest to all CAS-covered contractors, as it could limit the government's ability to recoup payments made long ago under contracts that were awarded based upon disclosed accounting practices the government only later deems problematic.

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[1] https://ecf.cofc.uscourts.gov/cgi-bin/show_public_doc?2021cv2327-38-0.

[2] No. 21-2327.

BACKGROUND

Sikorsky entered into several CAS-covered contracts with the federal government between 2007 and 2017, and set out in its Disclosure Statement its method for allocating independent research and development ("IR&D") and bid and proposal ("B&P") costs to its contracts. Sikorsky also entered into a Forward Pricing Rate Agreement ("FPRA") with the government, consistent with its disclosed practices.

In 2012, the Defense Contract Audit Agency ("DCAA") issued a Statement of Conditions and Recommendations ("SOCAR") finding the company's IR&D and B&P allocation method violated CAS 420. In 2014, DCAA issued an audit report finalizing this conclusion. Yet, not until December 2020 did the Defense Contract Management Agency ("DCMA") issue a contracting officer's final decision ("COFD") demanding repayment of IR&D and B&P costs Sikorsky allegedly improperly billed the government from 2007 through 2017.

Sikorsky appealed to the court seeking a declaratory judgment that its accounting practices complied with CAS 420 as well as alleging breach of contract, on the basis that Sikorsky had disclosed its accounting practices, the government had not objected to those practices, and those practices were thereby incorporated into its contracts.

The government moved to dismiss Sikorsky's challenge, asserting (among other things) that the contracts' inclusion of Federal Acquisition Regulation ("FAR") 52.230-2, Cost Accounting Standards, which requires the contractor to agree to a price adjustment in the event of a CAS noncompliance, precluded the contractor's novel breach of contract theory.

THE COURT DENIED THE MOTION TO DISMISS

The court denied the government's motion to dismiss. The court recognized that the government may require contractors to comply with both CAS and their disclosed practices, but held that existing precedent "does not address [] the government's ability to issue compliance determinations years after entering into contracts or even after a notice of potential noncompliance." Citing the duty of good faith and fair dealing that applies to both parties to a contract, the court reasoned that there must be some "connection between the government's duty to act in good faith by not allowing Sikorsky to incur costs it would later be expected to bear alone and Sikorsky's regulatory and contractual obligation to accept changes."

As support, the court cited the FAR's instruction that a "contracting officer shall not award a CAS-covered contract until the [CFAO] has made a written determination that a required Disclosure Statement is adequate," and that

"[a]fter the notification of adequacy, the auditor shall conduct a detailed compliance review to ascertain whether or not the disclosed practices comply with CAS."[3]

The court also cited the DCAA Audit Manual's instruction that DCAA's audit responsibility is "a continuous requirement" and explanation that a CAS noncompliance will "typically be detected during audits" to "suggest [] that the regulations intend for compliance determinations to be made early during the course of the procurement."[4]

Given these authorities, the court observed that the government "accepted Sikorsky's accounting practices for five years before it issued" the SOCAR "and another two years after that before issuing an audit report." The court characterized as "uncertain" the government's argument that "it is allowed to wait years after entering a contract before making a compliance determination, allowing a contractor to accrue years of associated costs without any notice from the government that it views such practices as noncompliant."

These open questions, including whether the government's decision to enter into the FPRA and award numerous contracts based upon Sikorsky's disclosed practices, which it now alleges to be noncompliant, "constitutes a waiver or otherwise obligated the government in some fashion," required fact finding not available at the proceeding stage.

Viewing the facts "in the light most favorable to Sikorsky" at this stage, the court refused to dismiss Sikorsky's breach of contract claim. The court concluded:

> The record and the regulatory scheme leave open the question of what rights the government has—and whether it has waived any such rights—by entering into contracts based on disclosed practices that it assertedly did not evaluate for compliance until years later (or, as Sikorsky contends, the potential that the government found the practices compliant by entering into the contracts or the FPRA in the first place).

CONCLUSION

This decision should serve as a warning to government auditors and contracting officers attempting to impose liability on contractors for a supposed CAS noncompliance years after the fact, despite multiple intervening opportunities to examine the contractor's CAS compliance and disclosed practices, as well as contracts awarded on the basis of those disclosed practices.

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[3] FAR 30.202-6(b); FAR 30.202-7(b)(1)(i).

[4] Citing DCAAM 8.302.1(b); DCAAM 8-302.2(b).

A final victory for Sikorsky in this case would provide contractors justified ammunition to rebut such attempts to effectively change the rules of the game long after contract performance began, and in many cases, ended.