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Annual Review 2021

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Today's Event Supports



C A P I T A L A R E A
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DAY 2

12:00 p.m. Costs, Pricing & Audits

2:00 p.m. Grants and Cooperative Agreements

3:00 p.m. Cybersecurity & IT

4:00 p.m. Federal Contracting Overseas

TUESDAY, JANUARY 26, 2021

12:00 PM to 5:00 PM

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- Q&A – to ask a question of the panel, please type your comment in the Q&A box at the bottom of your screen. The panel will address as many questions as time allows.
- Materials
 - Available for download at <https://pubkgroup.com/pubk-6th-annual-year-in-review/>

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Pub K is applying for CLE approval for the Annual Review in Virginia, California, Texas, and Florida.

- Approval is expected but not guaranteed
- Pub K will notify participants of approval when received
- CLEs are available free of charge to Pub K subscribers
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SESSION 4

COSTS, PRICING & AUDITS

TUESDAY, JANUARY 26, 2021
12:00 PM to 2:00 PM



Mary Karen Wills
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Agenda - Major Topics

- DCAA Activity and Audit Guidance
- Other Audit Activity – OIG, GAO, 3PAO
- Cost Allowability Developments
- Cost Accounting Standards Developments
- TINA and Pricing Developments & Activity
- CARES Act - Cost Implications
- Q&A



■ DCAA & OTHER AUDIT ACTIVITY AND AUDIT GUIDANCE

DCAA Activity

DCAA's recently-reported audit activity

	Audit Reports		
	FY17	FY18	FY19
Forward Pricing	761	766	710
Incurred Cost	1,527	651	1,117
Special Audits*	936	2,027	822
Other Audits**	357	273	299
Total	3,581	3,717	2,948

	Audited Dollars (\$Billions)		
	FY17	FY18	FY19
Forward Pricing	\$ 51.4	\$ 58.7	\$ 118.9
Incurred Cost	226.1	349.0	239.7
Special Audits*	3.4	1.4	6.5
Other Audits**	0.9	0.1	0.1
Total	\$ 281.8	\$ 409.2	\$ 365.2

	Cost of Audits (\$Millions)		
	FY17	FY18	FY19
Forward Pricing	\$ 113.8	\$ 106.4	\$ 120.1
Incurred Cost	296.7	332.0	279.1
Special Audits*	44.2	31.0	45.5
Other Audits**	215.0	175.4	224.1
Total	\$ 669.7	\$ 644.8	\$ 668.8

	Sustention Rates		
	FY17	FY18	FY19
Forward Pricing	66.2%	61.6%	62.5%
Incurred Cost	28.6%	24.1%	29.5%
Special Audits*	41.8%	68.3%	58.3%
Other Audits**	43.4%	45.2%	29.1%
Total	50.4%	51.4%	51.0%

* Includes REA, claim, and termination proposal audits

** includes CAS, TINA, and business system audits

Source: DCAA Annual Reports to Congress

Recent Noteworthy DCAA Guidance

- April 10, 2020 – Auditing with limited access to contractor facilities due to COVID-19
- August 20, 2020 – DCAA (not OFPP) calculates compensation caps for 2019 and 2020
- September 29, 2020 – DCAA rolls out new Contractor Information Survey for smaller contractors with limited recent audit activity
- December 11, 2020 – Cost accounting and audit implications of COVID-19 relief

Closer to Different DFARS Accounting System Audits

- FY2021 NDAA Section 806 – replaces the term “significant deficiency” with “material weakness” at 10 U.S.C. 2302

“The term ‘material weakness’ means a deficiency or combination of deficiencies in the internal control over information in contractor business systems, such that there is a reasonable possibility that a material misstatement of such information will not be prevented, or detected and corrected, on a timely basis. For purposes of this paragraph, a reasonable possibility exists when the likelihood of an event occurring (A) is probable; or (B) is more than remote but less than likely.”

- Makes possible Section 809 Panel Volume 3 Recommendations (including Chapter 3 of the DOD Professional Practice Guide)

SRA Int'l, Inc. v. Dept. of State, CBCA Nos. 6563, 6564, 20-1 BCA ¶ 37543

- SRA held a task order and a contract, both subject to incurred cost audits under FAR 52.215-2 and 52.216-7.
- In a 2018 disclaimer opinion on SRA's FY 2012-15 incurred cost proposals, DCAA questioned \$29 million.
 - ▶ DCAA stated that SRA failed to timely provide supporting documentation to substantiate claimed costs for subcontractors and ODCs were reasonable, allocable, and allowable.
 - ▶ During negotiations, SRA attempted to provide supporting documentation it did not submit to DCAA.

SRA Int'l, Inc. v. Dept. of State, CBCA Nos. 6563, 6564, 20-1 BCA ¶ 37543

- The COFDs asserted claims against SRA for recovery of the \$29 million in disallowed costs & stated that SRA's failure to produce documentation during the audit violated FAR retention requirements.
 - ▷ DOS designated the COFDs as its complaints before the CBCA and attached the DCAA audit.
- SRA filed a motion to dismiss, alleging the COFDs (1) failed to provide adequate notice as to the basis and amounts of DOS's claims, and (2) failed to state a claim upon which the Board could grant relief.
 - ▷ CBCA denied both bases for dismissal, finding the audit report provided an explanation of DOS's claims and that DOS had asserted a plausible claim that SRA failed to support its incurred costs.

DCAA FY2021 Areas of Emphasis

- Business system audits – Accounting, Estimating, and Material Management Accounting System (MMAS)
- Real-Time Audit Procedures
 - ▷ Labor Reviews (Floor checks) MAAR 6
 - ▷ Material Reviews MAAR 13
 - ▷ Billing Reviews Paid Voucher reviews, Provisional Billing Rates
- Post Award/ TINA/ Defective Pricing Audits
- Cost Accounting Standards Audits
- Stay Current on Incurred Costs



■ COST ALLOWABILITY DEVELOPMENTS

DynCorp Int'l LLC, ASBCA No. 61950 (Sept. 29, 2020)

- DCMA determined that DynCorp improperly recovered costs of severance payments made to its former CEO that exceeded the FAR's cap on the recovery of compensation.
- DynCorp argued that severance payments do not meet the definition of compensation under FAR 31.205-6(p) and are thus not subject to the compensation cap.
- ASBCA found that severance pay is not compensation, but also that costs DynCorp incurred in making severance payments were not reasonable.
 - ▶ Severance payments were two times the CEO's salary, which itself exceeded the statutory cap on compensation.
 - ▶ "Bottom line: unallowable salary cost used in a severance pay calculation results in unallowable severance costs – unallowable in, unallowable out."

Kellogg Brown & Root Servs., Inc. v. Sec'y of the Army, 973 F.3d 1366 (Fed. Cir. 2020)

- KBR held contract for delivery of housing trailers to military camps in Iraq in 2003.
 - ▷ KBR subcontracted (FFP) with a Kuwaiti firm for manufacture and delivery of the trailers.
 - ▷ KBR alleged that the government breached the contract by failing to provide force protection for the convoys delivering the trailers in Iraq.
 - ▷ Resulted in idle trucks/drivers, and additional loading/unloading/storage of the trailers at Iraqi border.
 - ▷ KBR executed equitable adjustments with the subcontractor for these costs, then filed claim.
 - ▷ The COFD allowed only the costs for storing the trailers (\$3.7M of the claimed \$51.3M).

Kellogg Brown & Root Servs., Inc. v. Sec'y of the Army, 973 F.3d 1366 (Fed. Cir. 2020) (con't.)

ASBCA denied KBR's appeal, finding that KBR had not shown that its settlement costs with the subcontractor were reasonable.

- ▶ The equitable adjustment was based on the sub's estimated, rather than actual costs.
 - ▶ ASBCA found the damages models "unrealistic," "inconsistent," "flaw[ed]," "unreasonable" and assumed a "perfect world."

Fed. Cir. agreed with ASBCA that KBR's estimates were flawed & unsupported.

- ▶ However, Fed. Cir. rejected the government's position that KBR was required to submit the actual costs incurred by its subcontractor; KBR need only show that costs were reasonable.
 - ▶ Failure to collect actual costs "bears on the reasonableness," but is not a separate requirement.



■ COST ACCOUNTING STANDARDS
DEVELOPMENTS

Cost Accounting Standards Developments

- March 2020 – Updated Guiding Principles for CAS-GAAP Conformance
- September 2020 -- Staff Discussion Paper re: Conformance of CAS to GAAP
 - ▶ CAS 404, Capitalization of Tangible Capital Assets and CAS 411, Accounting for the Acquisition Costs of Material
- November 2020 – ANPRM re: Conformance of CAS to GAAP re: Operating Revenue and Lease Accounting
- December 2020 – New DCMA CAS Administration Manual

CAS - Boeing Co. v. United States, 968 F.3d 1371 **(Fed. Cir. 2020)**

- Boeing challenged the validity of FAR 30.606(a)(3)(ii), which prohibits offsetting increased and decreased cost impacts arising from multiple changes in cost accounting practices.
- Boeing claimed that application of FAR 30.606(a)(3)(ii) was a breach of contract and an illegal exaction.
- Government claimed that Boeing waived its right to challenge the application of FAR 30.606(a)(3)(ii) because Boeing did not challenge the regulation before entering into the CAS-covered contract.
- COFC agreed, dismissing the breach of contract claim – essentially incorporating the non-FAR part 52 provisions into a contract.
- COFC also dismissed illegal exaction claim because Boeing could not identify a money-mandating statute or regulation to support its theory.

CAS - Boeing Co. v. United States, 968 F.3d 1371 **(Fed. Cir. 2020)**

- Fed. Cir. reversed COFC on both claims.
- Boeing could not “waive” challenge to FAR 30.606(a)(3)(ii) where the CO had no ability to waive the mandatory regulation & the government could not say how Boeing could have challenged the regulation prior to entering into the contract.
- Boeing’s attempt to recover money already paid to the government conferred jurisdiction for the illegal exaction claim, without the need to identify a money-mandating statute or regulation.

CAS - Northrop Grumman Corp. ASBCA No. 61775 (Oct. 7, 2020)

- Northrup froze a defined benefit pension plan, triggering a CAS 413 requirement to calculate the difference between the plan's assets and liabilities.
 - The present value of liabilities exceeded assets by approximately \$98 million.
- Based on overhead costs allocated to the government, Northrup determined that the government owed \$74 million and submitted a claim for this amount.
- The government objected to Northrup's interpretation of CAS 413-50(c)(12), which it argued did not require it to make up the difference in the plan's future liabilities.
- The ASBCA disagreed, finding that the goal of CAS 413-50(c)(12) is to ensure the pension plan is fully funded.

CAS - Northrop Grumman Corp. ASBCA No. 61775 (Oct. 7, 2020)

- The government also objected to Northrup's use of updated mortality tables to calculate the plan's shortfall.
 - ▶ Citing the Prefatory Comments to the 1995 CAS, the government argued that Northrup was required to use the tables it had used in setting up the plan.
 - ▶ The ASBCA disagreed, finding that this rule was not intended to "prevent contractors from using assumptions that have been revised based on a persuasive actuarial study," such as updated mortality tables.
- The ASBCA also dismissed the government's objection to Northrup's method of accounting for tax liability on the plan's income: it had discounted them by 35% rather than accounting for tax paid.
 - ▶ While the Board agreed the CAS requires taxes on income from a pension plan to be treated as an administrative expense, the Board found the CAS violation resulted in no material cost difference.



■ TINA AND PRICING DEVELOPMENTS

Defective Pricing in Perspective

Decided Cases (2010-20)

- *Alloy Surfaces Co., 20-1 BCA ¶ 37,574 (2020)*
 - No Liability (4 out of 5 points of defective pricing)
- *Symetrics Indus., 15 BCA ¶ 36,070 (2015)*
 - No Liability
- *Lockheed Martin Aero, 13 BCA ¶ 35,220 (2013)*
 - No Damages

Defective Pricing in Perspective

Litigated Cases (2015-20)

- *Alloy Surfaces Co.*, 20-1 BCA ¶ 37,574 (no liability)
- *BAE Systems TVS LP*, 17-1 BCA ¶ 36,585 (COFD withdrawn)
- ASBCA Nos. 59940 *et al.* (resolved: 3%)
- ASBCA No. 59769 (resolved: 7%)
- *Symetrics Indus.*, 15 BCA ¶ 36,070 (no liability)
- ASBCA No. 58976 (COFD withdrawn)
- **\$95 Million Alleged vs. \$135 Thousand Recovered**

Defective Pricing – *Alloy Surfaces Co.*

Alloy Surfaces Co., 20-1 BCA ¶ 37,574

- 5 Points of Defective Pricing: Fight Them All
- Negotiation Story: Heart of a TINA Case
- Cost or Pricing Data Revisited: Unreliable & Judgmental
- Agency Reliance: Price Analysis, Certificate & Other Data
- Government Knowledge: Impact on Other Factors
- Litigation Strategy: Start Early & Build Your Record



■ CARES ACT – COST IMPLICATIONS

CARES ACT CONSIDERATIONS

- Section 3610 authorizes agencies to use any funds available to the agency to reimburse contractors for paid leave provided in connection with the COVID-19 public health emergency "to keep its employees or subcontractors in a ready state, including to protect the life and safety of government and contractor personnel."
- This section applies "[n]otwithstanding any other provision of law," meaning agencies can reimburse contractors for eligible "paid leave" costs regardless of any restrictions imposed by other statutes or regulations, including FAR Cost Principles, Cost Accounting Standards, appropriations restrictions, Uniform Guidance, etc.
- Section 3610 is not an exclusive remedy. Contractors may still request equitable adjustments under contract clauses, including stop-work, government delay, changes, and changes clauses.

CARES ACT CONSIDERATIONS

- Government auditors are highly attuned to double-recovery risks (see December 2020 DCAA MRD):
 - Double recovery via Section 3610 and PPP Loan forgiveness
 - Double recovery via contract performance and PPP Loan forgiveness
- Windfall profits from PPP forgiveness ripe for audit findings and potential false claims allegations
- Treatment of PPP forgiveness - credit

Challenge Question



Submit your answer to craig@pubklaw.com
Subject line: Panel 4 Challenge Question