

## Mistakes are Not Cost Accounting Practices

Written by Nick Sanders  
Monday, 29 October 2018 10:06

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Back from the Society of Corporate Compliance and Ethics (SCCE) annual Compliance & Ethics Institute (CEI). From my perspective, well worth the investment of three-and-a-half days of time. The focus was not on Government contractors, per se, but there was enough related content to keep it interesting. Some of the breakout sessions were full of wonderful content—content that made one think about it and how it could be applied to the day-to-day grind of work.

One of those breakout sessions was taught by a member of the Office of the Inspector General of the Department of the Interior (DOI), Daniel Coney. He had a slide so personally impactful that I took a picture of it with my phone.

When speaking about the discretion OIGs have, he stated (paraphrasing), “Most of our cases are not criminal. We don’t go after people for making mistakes. We don’t go after people when there’s no intent to commit a crime.” Which is good news for many of us!

But then he showed a slide that contained the following sentence:

### **A MISTAKE REPEATED MORE THAN ONCE IS A DECISION**

*Whoa.*

What I gleaned from that single sentence is that the more a mistake is repeated, the more it looks like intent—or, at least, like negligence.

Remember, the civil False Claims Act (as amended) has a different definition of intent than the criminal statute. To be liable, a defendant must have “knowingly” submitted a false claim; the civil statute defines “knowingly” as including either “deliberate ignorance” or “reckless disregard” for the truth. In our layperson’s interpretation, a defendant cannot claim that the false claim was the result of a mistake when the “mistake” was the result of ignoring (or not looking for) warning signs that the mistake was being made.

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But then we started thinking about cost accounting practices. Most of us know that a contractor subject to either modified or full CAS coverage has constraints over when it can make changes to its cost accounting practices. See, for example, the contract clause 52.230-2, which states (in pertinent part):

... the Contractor, in connection with this contract, shall -- Follow consistently the Contractor's cost accounting practices in accumulating and reporting contract performance cost data concerning this contract. If any change in cost accounting practices is made for the purposes of any contract or subcontract subject to CAS requirements, the change must be applied prospectively to this contract and the Disclosure Statement must be amended accordingly. If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) of this clause, as appropriate.

Similarly, the clause 52.230-4 states (in pertinent part):

... the Contractor, in connection with this contract, shall -- (i) Follow consistently the Contractor's cost accounting practices. A change to such practices may be proposed, however, by either the Government or the Contractor, and the Contractor agrees to negotiate with the Contracting Officer the terms and conditions under which a change may be made. After the terms and conditions under which the change is to be made have been agreed to, the change must be applied prospectively to this contract, and the Disclosure Statement, if affected, must be amended accordingly.

The mechanism(s) for disclosing changes to cost accounting practice are established by yet another contract clause (52.230-6).

Finally, see FAR 30.6 (CAS Administration) provides direction to government contracting officers regarding how to administer the requirements of the foregoing contract clauses.

In summary, if you are a CAS-covered contractor, then you need to become somewhat of an expert in the clause requirements and FAR guidance. However, that will only get you so far.

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Importantly, none of the foregoing clauses or the cited FAR language actually define the phrase “cost accounting practice.” The phrase is defined in the Cost Accounting Standards regulations themselves (see 48 CFR 9903.302-1) but that’s about it. In addition, you need to read certain court decisions (*e.g.*, *Perry v. Martin Marietta*) to understand how the courts have interpreted the CAS language.

The tension between the CAS contract clauses, the FAR regulations, and the desires of the contracting parties have led to disagreements regarding whether or not a cost accounting practice has been changed. More to the point of this article, in our experience there is also disagreement regarding whether or not a cost accounting practice has been followed consistently.

As required by the clause language quoted above, when they execute their CAS-covered contracts, contractors agree to follow their cost accounting practices consistently. (We discussed the nuances between “disclosed” and “established” cost accounting practices in [this article](#).) That’s the deal and, if a contractor fails to be consistent, then it may be alleged to have breached its contract. That’s not good.

But what about mistakes?

Does a simple mistake—somebody does something they’re not supposed to do—lead to a contract breach via an allegation that cost accounting practices were not followed consistently?

It depends, doesn’t it?

For a long time we argued that mistakes are not cost accounting practice. We argued that the cost accounting practice is what the contractor intends, not what some ill-trained employee actually does. But if that were literally true then a contractor would almost never have inconsistent cost accounting practices. There would need to be some type of direction from an authority figure in order to find inconsistent cost accounting practices. A smoking gun email would do it. A meeting behind closed doors would do it. But otherwise, not so much. If an

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employee violated policies and procedures and, as a result, the contractor treated something differently than it had told the government it was going to, that would not be an inconsistent cost accounting practice—because it would be a simple mistake.

Now, having seen and thought about Mr. Coney's simple sentence, we think a reasonable person could distinguish between a simple mistake and an inconsistency in cost accounting practice based on the number of transactions that were affected.

Obviously, there's no bright line in this line of reasoning. But we might assert (with some trepidation) the following general guidelines:

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One transaction out of many is not an inconsistent cost accounting practice; it is a mistake.

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One employee miscoding a transaction when many others in the same function are getting it right is not an inconsistent cost accounting practice; it is a mistake.

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Transactions escaping controls are also mistakes, assuming the controls were reasonably designed to prevent and/or detect mistakes.

Something for CAS-covered contractors to consider, perhaps?