

We have written about this issue before, notably here and here. In fact, those two posts prompted us to write a full article

on one poor small disadvantaged business that was denied award based on an unreasonable basis (according to the GAO decision)..

Recently, we came across a <u>recent GAO bid protest decision</u> that caught our attention. We think it's worth sharing with our readers.

Sygnetics is a Service Disabled Veteran-Owned Small Business (SDVOSB) located in Michigan. It has a history of winning Government contracts, and its client list includes both Government agencies and prime contractors. We couldn't tell from its website, but some of those contracts may have some cost-reimbursement components to them. In any case, the company (apparently) knows what it's doing in the Government contracting arena.

At least, until it came to a DCAA audit of Sygnetics' accounting system. At that point, things seemed to fall apart for the SDVOSB.

In April, 2009, the U.S. Army issued an RFP for "personnel support services". According to the GAO, "The RFP anticipated awards of multiple indefinite-quantity/indefinite-quality (ID/IQ)

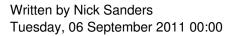
Written by Nick Sanders Tuesday, 06 September 2011 00:00

cost-reimbursement contracts, with base periods of 1 year with four 1-year options." Moreover, "the RFP required offerors to have a [cost accounting system] CAS that was approved by the Defense Contract Audit Agency (DCAA) within the last 2 years."

Let's stop for a moment to ponder that last statement. Since when does DCAA "approve" any contractor's business systems? "*Never*," we hear you chorusing back to us. And, like a Greek chorus should, you foreshadow one of Sygnetics' biggest problems—it had to have DCAA "approve" its system and it had to make its auditors happy in order to get that approval.

According to the GAO decision, DCAA came in to audit Sygnetics and, in November 2009, found its "cost accounting system" to be inadequate. In the words of the decision, "DCAA advised that Sygnetics' most recent audit ... concluded that the company did not have an approved CAS." (Remember that "CAS" means "cost accounting system"—not Cost Accounting Standards—to the Army and to the GAO adjudicators.) Again, let's ponder what that particular sentence might actually mean. Might it mean that DCAA auditors found that Sygnetics did not have an accounting system that had been officially approved by the cognizant Contracting Officer? (Which would make some sense because perhaps Sygnetics had never had its system reviewed before the current audit.) Or might the sentence mean that DCAA concluded that Sygnetics' accounting system was inadequate and recommended that it not be approved? Or might it mean that DCAA tried Sygnetics and convicted the company of having an inadequate accounting system, and that the Contracting Officer had nothing to do with that decision?

We're not really sure, but we think it might mean the third interpretation. But let's move on.

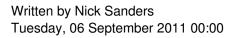


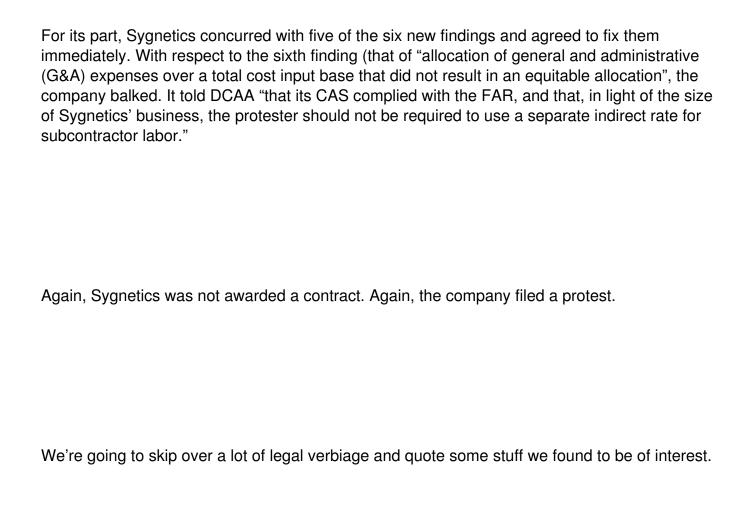
The Army received 16 proposals, and used the fact that Sygnetics had an unapproved accounting system to remove the company from the competitive range. The Army then made award to 14 of the bidders—but not to Sygnetics.

Sygnetics protested that, "that DCAA had not updated its November 2009 audit findings to reflect responses provided by the protester to DCAA in December 2009, and that the CO was required, under the terms of the RFP, to seek such an update from DCAA." The Army agreed to send DCAA back in to reaudit Sygnetics. In the reaudit—

DCAA advised Sygnetics that it viewed the deficiencies identified in Sygnetics November 2009 audit to have been addressed. ... DCAA further advised, however, that it had identified six additional deficiencies, which rendered Sygnetics' CAS unacceptable: (1) lack of adequate procedures for segregating and eliminating unallowable costs from claimed costs; (2) inadequate procedures to support the proper classification of costs; (3) allocation of general and administrative (G&A) expenses over a total cost input base that did not result in an equitable allocation; (4) costs billed in non-compliance with contract terms; (5) untimely notification under the limitations of funds clause; and (6) costs billed not in accordance with the allowable cost and payment clause.

Well, there you go, then. Sygnetics fixed everything DCAA found the first time, so it came back and found more things that, in DCAA's view, rendered the company's accounting system inadequate.





Here's an important part of the GAO's decision:

In any event, to the extent that Sygnetics argues that the information it provided to the Army demonstrates that its CAS was acceptable, we do not agree. While Sygnetics argues that the January 20, 2011, audit report indicates that it had addressed all of the deficiencies identified by DCAA, the audit report in fact stated that Sygnetics disagreed with the G&A finding; for this reason, the report stated that DCAA did not consider this issue to have been addressed. ... The report also stated that while Sygnetics had agreed to correct five of the deficiencies, DCAA recommended future monitoring of the protester's responses to these deficiencies. ... For these

Contractor Learns Importance of Having DCAA-Approved Cost Accounting System the Hard Way

Written by Nick Sanders Tuesday, 06 September 2011 00:00

reasons, the DCAA concluded that, notwithstanding Sygnetics' responses, "the six current conditions listed above are outstanding, and, as a result, the accounting system is considered inadequate."

Importantly, notice in the above where DCAA's recommendation of "future monitoring" was sufficient to sway both the Army Contracting Officer and the GAO adjudicators that Sygnetic's accounting system remained inadequate. In other words, lack of a positive finding was construed as a negative finding. This interpretation, of course, makes no sense.

Here's another bit.

With regard to the G&A allocation deficiency, the protester does not explain why DCAA's concern was incorrect, or how it has otherwise addressed this deficiency. DCAA expressed concern in its initial report and exit interview that Sygnetics' CAS applied G&A rates in a manner that did not reflect an "equitable distribution of indirect costs." ... DCAA recommended that the protester "allocate G&A expenses over a base that is representative of benefits realized in accordance with FAR [§] 31.203," and that "Sygnetics should be properly tracking and classifying labor spent directly managing specific subcontracts as direct in accordance with FAR [§] 31.202." Id. While Sygnetics argued to DCAA that "setting up a separate indirect rate for subcontractor labor will not result in a more accurate allocation of costs," so that no corrective action was required, ... the DCAA disagreed and reiterated the recommendation that the protester "revise their allocation practices to result in an equitable distribution ofindirect costs to cost objectives." On this record, we conclude that the Army reasonably relied on DCAA's advice that the protester's CAS was not acceptable, in light of Sygnetics' failure to acknowledge or correct this evaluated deficiency.

Written by Nick Sanders	
Tuesday, 06 September 2011	00:00

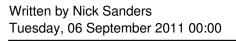
Wow. There's a big bucketful of fail right there in that paragraph. How many errors can you find?

- 1. In any allegation of inequitable cost allocation, the burden is on the Government to show the allocation in inequitable, and not on the contractor to show why it is. GAO reversed the burden of proof.
- 2. FAR 31.203 does not require that G&A expenses be allocated on a base that is "representative of benefits realized." What is does say

The contractor shall accumulate indirect costs by logical cost groupings with due consideration of the reasons for incurring such costs. The contractor shall determine each grouping so as to permit use of an allocation base that is common to all cost objectives to which the grouping is to be allocated. The base selected shall allocate the grouping on the basis of the benefits accruing to intermediate and final cost objectives. When substantially the same results can be achieved through less precise methods, the number and composition of cost groupings should be governed by practical considerations and should not unduly complicate the allocation.

In other words, the FAR provision is *permissive*, not restrictive.

- 1. DCAA believes that Sygnetics should charge certain indirect functions (e.g., "labor spent directly managing specific subcontracts") as direct functions. There is no requirement in FAR or CAS that a contractor must adhere to DCAA's view of how it should manage its business.
- 2. Sygnetics correctly pointed out that, according to FAR 31.203 itself, if a separate rate did not materially affect contract costs, then it was not required to establish that rate. DCAA disagreed with that position and the GAO adjudicators accepted DCAA's disagreement on its face, without evaluating whether it was correct. (Note for GAO: DCAA was wrong.)



In our view, this was not the best GAO protest decision we've ever seen. We've pointed out several errors and we are disappointed that nobody else called-out GAO on this one. Sygnetics, a SDVOSB, deserved better treatment.

.