

How DOD Exploits and Abuses Its Small-Business Contractors

Written by Nick Sanders

Wednesday, 15 August 2012 00:00



In our [last post](#), we discussed the problems faced by Quimba Software, a small business that was awarded a Phase 2 Small Business Innovation Research (SBIR) contract by the Department of Defense—and who ran into problems with DCAA audit findings, a DCMA Administrative Contracting Officer (ACO) Final Decision, and an appeal before the Armed Services Board of Contract Appeals (ASBCA) that was rejected without a hearing on the merits because it was filed one day too late. We understand that Quimba is currently pursuing its case at the U.S. Court of Federal Claims.

What makes Quimba different from most small businesses is that they know how to publish a blog and get their story out on the internet. The Quimba blog is well-written and clearly explains the problems that the company has experienced. More importantly (as we reported) the blog is chock-full of “lessons learned” that should be a “must-read” for any other small business that is seeking to do business with the DOD. We published some of those hard-won pearls of wisdom in the last post (link in the first sentence of this article).

Quimba’s experience with DCAA and DCMA is not unique. In fact, Apogee Consulting, Inc. has recently advised two other small businesses that have had difficulties with Phase 2 SBIR contracts. In one case, the company---involved in innovative medical technology that could ultimately save lives of injured warfighters—was able to get us into the picture *before* any pre-award SF 1408-related activities were undertaken by the government. We informed the company that it had *under* calculated its indirect cost rates, and the company had to decide whether or not to bring that fact to the attention of its Contracting Officer. (It could have made a perfectly legitimate business decision to “eat” the rate overrun.)

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In the other engagement, the company was told by DCAA that its accounting system was inadequate because it didn't structure and allocate its indirect costs in the manner that DCAA thought it should. (Note that the SF 1408 requirement is that indirect costs must be pooled and allocated in a "logical and consistent" manner—which provides the contractor with considerable latitude to choose its own methodology, so long as that methodology is not actually prohibited by any other applicable regulation.) The DCAA auditor (and the Supervisory Auditor) did not care *at all* about what the SF 1408 form actually required of the contractor; instead, they were very concerned about imposing a full CAS-compliant methodology on this contractor that was expressly exempt from CAS. Any push-back from the company would lead to a DCAA recommendation that its accounting system be determined to be inadequate, regardless of the facts and merits of the contractor's actual practices. If the accounting system was found to be inadequate—regardless of the lack of regulatory support for that finding—then the company would lose its Phase 2 SBIR contract award.

Such is the life of a small business contractor that seeks to do business with the Defense Department.

This is not a particularly new concern for us. We have published several blog articles about DOD's cavalier (and, in some cases, adversarial) treatment of its contractors, both large and small. For example, in [this article](#), we discussed a mash-up of DCMA and DCAA policy positions that seemed problematic—especially if you were a DOD contractor. In a [more recent article](#)

, we noted that the number of DOD suppliers had fallen by 14 percent, even as the Obama Administration implemented efforts to increase competition. In that article, we reported on discussions between senior DOD acquisition leadership and industry, in which the DOD leaders clearly stated that they did not consider themselves to be in a partnership with their suppliers—which was a 180 degree reversal from the express description of the Pentagon's relationship with its suppliers during the late 1990's and early 2000's.

What changed? We assert that nothing changed except the attitudes of the Defense Department's acquisition senior leadership.

But it's not just Quimba or Apogee Consulting, Inc. discussing the problematic business environment fostered by the acquisition leaders at the Pentagon. No, this is not just "sour grapes" by some disappointed contractor and an outside consultancy. It's also the opinion of House Armed Services Committee (HASC), who [told](#) the Pentagon to "improve the Defense business environment." We quoted extensively from the HASC Report, including this bit—

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The Panel also found that a number of hurdles make it challenging for companies to compete for defense contracts. The plethora of regulations specific to government and defense contracting dissuades many companies from competing for government contracts. The acquisition process is often bureaucratic and rigid, with insufficient flexibility to allow appropriate application of management, oversight, and monitoring of small businesses. The defense business environment is also complicated, and some argue hindered, by current export control requirements. The high rate of personnel turnover in government acquisition personnel, from program managers to Defense Contract Audit Agency (DCAA) auditors affects the quality and consistency of policies. Oversight and management agencies such as DCAA are under-resourced and lack consistently trained, skilled personnel, hampering the ability of these agencies to provide appropriate contract oversight and management. In addition, a backlog of audits has caused DCAA to prioritize work on high dollar contracts, leaving unresolved many of the open audits of small businesses who are holding small dollar contracts.

There were many anecdotes offered as support for the HASC Panel's findings and recommendations. We published many of them. For this article, we note this one—

Several participants expressed frustration with DCAA's failure to close out incurred cost audits in a timely manner. One company was last audited in 2005 and the audit was still open, costing the company an estimated \$3-4 million in lost business over the last six years. *The participant noted that the contracting officers requested indirect rate audits but DCAA was non-responsive and the company was prohibited from moving forward from a successful SBIR Phase II contract because the audit was still open.*

It was suggested that the Panel should consider mandating maximum turn-around times for audits such as 60 days for rate audits, and 6 months for incurred cost audits. It was also suggested that contracting officers should be allowed to issue letter contracts so that they can proceed with a contracting action while an audit is still open and make adjustments, if necessary, after the audit is closed. Another participant felt that turnover and inexperience with DCAA auditors was part of the problem. It was stated that every year they get a new auditor and they have to start all over because the new auditor uses different processes and has different audit requirements. In order to address this issue, it was suggested that DCAA should be required to report performance metrics in order to highlight regional shortcomings and more uniform [military member] involvement at DCAA was needed to balance the inexperienced civilian workforce.

(Emphasis added.)

Among the many recommendations given to the Secretary of Defense from the HASC Panel, we noted the following—

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Congress should direct the Secretary of Defense to establish a small business advocacy office and a contract close out unit in DCAA and DCMA to ensure that the needs of small businesses are safeguarded and that all contracts are closed out in a timely fashion. Closing out contracts in a timely fashion is a key element in having auditable financial statements.

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The Directors of DCMA and DCAA should ensure coordination between their agencies and the SBA when conducting audits that include factors of interest to or duplicative of reviews conducted by SBA. For example, SBA's Commercial Market Representatives visit large contractors with subcontracting plans to assess compliance with the subcontracting plan. However, DCAA also looks at subcontracting as part of its cost audits, especially when subcontracting performance is related to a company's award fee. Furthermore, DCMA also reviews subcontracting performance and processes. These three entities should coordinate their reviews to more efficiently conduct audits and to potential reduce the number of audits performed.

So, clearly, it's not just us and it's not just Quimba. The Pentagon has an attitude problem at its senior leadership level, and that bad attitude has infected the ranks of auditors and Contracting Officers who execute oversight on the thousands of DOD contractors, both large and small. The attitude is driving away suppliers—especially small business who pursue SBIR funding in the hope of developing innovative products.

What might be done to address the problem?

Well, we can't change the attitudes of Messrs. Assad, Williams, and Fitzgerald. But we can offer some potential regulatory solutions, including—

1.

Exempt contract awards to small businesses from the requirements of FAR

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16.303-1(a)(3). In other words, permit small businesses to receive cost-type contracts without the need to have “adequate” accounting systems.

2.

If you don't like that one, then perhaps the SF 1408 should be revised, such that there are two Standard Forms for documenting the adequacy of a contractor's accounting system—one for large businesses and one Form for small businesses. The small business SF 1408 should have relaxed requirements.

3.

Require DCAA to revise its 17740 Assignment (Pre-Award Survey of Prospective Contractor Accounting System). Direct auditors that if they are going to challenge a contractor's indirect cost allocation, they must provide a regulatory citation to support their position. If there is no regulation that prohibits an allocation methodology, it should be accepted.

4.

DCMA and DCAA should offer an avenue of appeal for contractors who believe they have been wronged—particularly with respect to the results of a pre-award accounting system survey. There should be an SF 1408 “center of excellence” and it should be staffed by personnel well-versed in the SF 1408 requirements. The center of excellence should review disputed findings, just as a DCMA Review Board reviews disputed findings in other areas.

With respect to that last recommendation, we note that DCMA has created a portal for contractors to elevate concerns. It's [right here](#). That's a good start. We wonder where DCAA's equivalent “customer complaint” portal is located? But the fact of the matter is that many contractors (especially small businesses) will be intimidated and too worried about potential retaliation to use the function provided. (Which is a shame, actually.) So we question the ultimate utility of the portal while we applaud its existence.

To wrap this up, after decades of dealing with DCAA and DCMA as they provide oversight over both large and small contractors in just about every industry you can imagine, we are convinced that the current oversight environment is by far the worst and most adversarial that we have ever experienced. That adversarial environment is exacerbated by far too many

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inexperienced and poorly trained oversight officials, as well as the increasingly adversarial attitudes of those in senior civilian leadership positions.

It's bad. And for small businesses like Quimba, it's almost unimaginably bad. The companies that need assistance the most, either don't know from where to obtain it, or can't afford to pay top-notch advisers. The result is a tsunami of litigation and the flight of innovative suppliers from the defense industrial base.