

Delinquent Final Billing Rate Proposals

Written by Nick Sanders
Monday, 24 March 2014 09:30

Whether you call them “Incurred Cost Submissions” or “Incurred Cost Proposals” or “Proposals to Establish Final Billing Rates” they have become the eye of a hurricane around which many dangerous winds swirl, winds that have the potential to damage a government contractor’s competitive position as well as its financial health. You might say that the Final Billing Rate Proposals have risen to Level 4 or 5 on the [Saffir-Simpson Scale](#) of hurricane winds. That is to say, catastrophic damage *will* occur unless you prepare for the storm.

Hurricanes don’t care about the cost, in terms of either things or people. Like nature herself, the storm winds are indifferent as to who gets harmed. To wrap up the extended metaphor, the same storm winds that blow the contractor around can also damage government customers. We’ve discussed some of the damage suffered by the government on this blog. For instance, DCAA has suffered (at least reputationally) because it cannot seem to whittle down its astounding backlog of unaudited contractor submissions; and the audit agency has [had to admit](#) to Congress that it now takes far too long to audit a single submission—such that it seems the only way to reduce the backlog of contractor submissions awaiting audit is to resort to [bureaucratic reporting tricks](#).

The sad fact of the matter is, as DCAA itself has admitted, the audit agency dug its hole *intentionally*. According to the latest DCAA Annual Report to Congress (link above), the agency made a conscious policy decision to “defer” audits of contractor Final Billing Rate Proposals because “incurred cost audits were one of the few areas that could be deferred.”

Unfortunately, DCAA does not appear to have thought its cunning plan all the way through.

The problem with DCAA’s brilliant strategy, as most of us have come to learn, is the Contract Disputes Act (DCA) and its pesky Statute of Limitations (SoL). We’ve blogged rather extensively about the CDA SoL on this site, because it has emerged as perhaps the single most important issue in government contracting today. And because we’ve written so much about the topic we’re not going to belabor it again in this article. (You can just type “CDA” into the site’s keyword search feature and get a surfeit of articles if you need to catch up.) Suffice to say that, while the rules are still evolving, it’s fairly clear at this point that the government has six

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years from the time a contractor submits its Final Billing Rate Proposal to assert any findings with respect to alleged unallowable costs that were included in the rate calculations in violation of FAR requirements. If the government doesn't issue a Contracting Officer Final Decision (COFD) within six years, it's (generally) going to be out of luck.

Consequently, DCAA's inability to get audits of contractor Final Billing Rate Proposals out to DCMA Contracting Officers for action has left the Defense Contract Management Agency with a not-so-small mess on its hands. Not only are contractor billing rates not getting finalized (which potentially lets millions if not billions worth of unallowable costs slip through the government customers' fingers and into contractors' coffers), but without final billing rates physically complete contracts cannot be closed. Physically complete contracts that cannot be closed simply languish in an administrative purgatory. Funds expire. Paperwork is lost. Property vanishes. Nobody remembers who had administrative cognizance over what. The large number of unclosed contracts has affected the Defense Department's ability to get a clean opinion on audits of its financial statements.

In late 2012, the Under Secretary of Defense (Acquisition, Technology and Logistics) publicly commented that "the contract audit administration -- agency has a long backlog of both closeout audits at the end of contracts, which our industry doesn't get paid fully until they close out the contract" Thus, it's fairly clear (behind the word salad quoted in the previous sentence) that even DOD's top leadership echelon is feeling the pain of the lack of contractor final billing rates. Since then, the government stakeholders have been focusing on getting those rates finalized, even if it means doing so [without the benefit](#) of a full GAGAS-compliant DCAA audit.

Recently, DCAA issued [new audit guidance](#) that seems designed to streamline the process for establishing final contractor billing rates. Given the foregoing, that would seem to be a good thing, a "win/win" for all parties. But as with so much of the agency's guidance, it signals more trouble for contractors and we suspect it portends yet another increase in litigation between the Pentagon and its contractors.

The audit guidance addresses "delinquent" final billing rate proposals. It tells auditors what to do in the case where a contractor has failed to submit its annual proposal when required (generally, six months after the close of the fiscal year). It tells the auditors not to bother with sending a bunch of follow-up letters to a contractor, and to work directly with the cognizant Contracting Officer to obtain delinquent proposals. Seems kind of harmless, right? Most contractors know to submit their proposals on time and most contractors get a letter from the government reminding them about their obligation to do so if, somehow, the requirement

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slipped their minds. Not a big deal.

But the first question we need to ask is, why does DCAA care? It already has a pile of some 25,000 or so proposals that are not delinquent and which await audit. Why would the agency focus on what it doesn't have, when what it does have has become such an overwhelming problem for it? What's really going on here?

Well, what's really going on here is that it seems that DCAA is now classifying "inadequate" proposals along with non-existent proposals in its definition of "delinquent" proposals. So it appears to be the case that a contractor can have a "delinquent" final billing rate proposal even though the proposal was submitted on time. If we are correctly interpreting the guidance, then that means the contractor's submission *also has to meet DCAA's definition of adequacy in addition to being timely*. And that, gentle readers, is a big deal *indeed*.

The FAR does *not* give DCAA the power to determine whether or not a contractor's final billing rate proposal is adequate. That authority is reserved for the cognizant Contracting Officer. See FAR 42.705-1(b)(1), which states—

The required content of the proposal and supporting data will vary depending on such factors as business type, size, and accounting system capabilities. The contractor, contracting officer, and auditor must work together to make the proposal, audit, and negotiation process as efficient as possible. ... If the auditor and contractor are unable to resolve the proposal's inadequacies identified by the auditor, the auditor will elevate the issue to the contracting office to resolve the inadequacies.

As has become the new norm for DCAA, the audit guidance blithely ignores the FAR and simply assumes DCAA auditors, *and nobody else*, can determine whether or not a contractor's final billing rate proposal is adequate. That position is *flat-out wrong*

and even though that's just our opinion, we predict that someday soon a judge is going to make our opinion an official point of law in a judicial decision that goes against the government. In the meantime DCAA continues to think its proposal adequacy checklist defines the adequacy of a contractor's proposal. And the new audit guidance tells auditors what to do about such inadequate/delinquent proposals.

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It isn't pretty.

DCAA plans to give DCMA a list of all contractor proposals related to Fiscal Year 2011 (or earlier), and we are told that "DCMA plans to either obtain an adequate proposal (e.g., within 30 days), or unilaterally establish contract costs as authorized by FAR 42.703-2(c)(1) and FAR 42.705(c)(1)." As we interpret the guidance, it's telling contractors that they have 30 days to conform to DCAA's notion of proposal adequacy or else DCMA will "unilaterally" determine contract costs for them.

It is critical to note that the audit guidance clearly says that the Contracting Officer will unilaterally establish "contract costs" and *not* just final billing rates. That means that *both direct costs and indirect cost rates*

—
i.e.

, claimed incurred total costs as submitted in the proposal—will be subject to unilateral determination.

With respect to newer final billing rate proposals generated for FYs 2012 and later, the audit guidance tells auditors that DCAA will issue a list to DCMA annually that identifies proposals which are "more than six months overdue without a valid extension or considered inadequate for audit." At that point, DCAA will close its audit assignment in DMIS and will no longer track the proposals in its backlog of overdue audits.

Well, that's yet another way to reduce the backlog, right? Anything over six months in arrears will simply not be counted as backlog. It's no longer the audit agency's problem; now it's DCMA's problem. *That* ought to improve the audit backlog statistics reported annually to Congress!

The audit guidance provides details regarding how unilateral contract costs are to be determined. It states—

Whether to apply a unilateral cost decrement, and how much to apply, are judgments at the

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discretion of the contracting officer. Upon request, audit teams should provide support to assist the contracting officer with applying a unilateral contract cost decrement. ... Audit teams should provide the contracting officer with all information that is relevant to the contractor's delinquent CFY, including billing deficiencies and incurred cost audit experience, etc. Upon request, audit teams may offer for the ACO's consideration a calculated unilateral contract cost decrement based on relevant historical questioned costs.

But in those circumstances where "relevant history does not exist," then "as a last resort" DCMA may simply reduce proposed contract costs by 16.2%, which is a factor "based on Agency-wide analysis."

We have a couple of problems with the foregoing.

First, it's not at all clear that the government has the authority to unilaterally establish contractor costs. The FAR language cited by DCAA is meant for circumstances where a contractor refuses to certify that its rates are free of unallowable costs or when a contractor fails to submit a final voucher within 120 days after finalization of indirect cost rates. The FAR language simply does not apply to the situation where DCAA decides there are problems with the format of the contractor's proposal and, as a result, refuses to audit it. The FAR language does not authorize the government to take the actions outlined in the audit guidance.

Second, it's not at all convincing that both direct and indirect costs need to be reduced by the same decrement factor, given that direct and indirect costs tend to generate unallowable costs at vastly different rates. Any reasonable person who thinks that unallowable costs are uniformly distributed between direct and indirect cost objectives simply hasn't read any recent DCAA audit reports. Or any older ones either. Arbitrarily reducing direct costs—costs incurred for which the government inarguably received benefit—will generate a windfall for the government at the expense of the contractor. We suspect this is going to be a problem for the government, especially when *quantum meruit* arguments are made in court.

Third: about that unilateral decrement factor. For the past 12 years DCAA has used a 20% decrement factor and *only now* is a new, lower, factor being recommended to DCMA. What's changed? Are we to understand that DCAA has knowingly used an inflated decrement factor for more than a decade? Has the government obtained a windfall from use of that inflated decrement factor? If the 20% factor was overstated for 12 years and DCAA was silent about the overstatement, then how much confidence should Contracting Officers (and taxpayers) (and

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judges) have in the new, 16.2% unilateral decrement factor?

And to make matters worse, the audit guidance notes that the unilateral decrement factor will be updated annually. So today's 16.2% factor may be tomorrow's 15.0% factor, and so on. That's confidence-inspiring, *we're sure*.

The audit guidance reminds auditors that "whether to apply a unilateral cost decrement, and how much to apply, are judgments at the discretion of the contracting officer." That part is absolutely true. But DCAA's offer to provide those Contracting Officers with "relevant history" such as "billing deficiencies and incurred cost audit experience, etc." raises issues with how credible such history will be. As we've [noted before](#), DCAA's "questioned cost" metrics are more than a little suspect. We quoted one source that indicated more than half of DCAA's questioned costs fail to be sustained by a warranted Contracting Officer. We hope those Contracting Officers keep that little info-nugget in mind as they exercise their judgment and discretion.

Based on the audit guidance, it looks like DCAA is going to punt the workload over to DCMA (and the Contracting Officers of other agencies of the Executive Branch) and simply act as advisors. The Contracting Officers will get the dirty end of the stick, as they try to figure out how to deal with DCAA "recommendations" without litigation, while the CDA SoL clock continues to tick-tick-tick away.

Based on the audit guidance, this is not going to go well for contractors whose Final Billing Rate Proposals have been deemed to be inadequate by DCAA. We predict litigation will ensue.

The good news (for contractors) is that it is very likely that any unilateral action by a Contracting Officer is going to be made via COFD, which offers appeal rights under the CDA. We trust we've outlined in this article why such contractor appeals are likely to be meritorious and why the government's position is not likely to prevail when an appeal is made.

This was a fairly easy article to write, because we've written it before.

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Twelve years ago, when DCAA issued its original audit guidance regarding unilateral decrement factors, we didn't think much of it. It inspired us to write our very first article for publication (in the BNA *Federal Contracts Report*, if it matters at this late date). Twelve years have passed since DCAA first assayed the position that unilateral decrement factors were authorized by the FAR. Not much has changed in those intervening years, except the ice under DCAA's position has grown even more thin and untenable.