Haste Makes Waste – Handling the Fallout From Rushed DCAA Audits

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Speaker Biography:
Scott Hommer, Partner at Venable LLP

Scott Hommer is a partner in the Tysons Corner office of Venable LLP. He concentrates his practice in business counseling and litigation with an emphasis on technology companies and government contractors. He represents clients locally, nationally, and internationally on issues including negotiating contracts, doing acquisitions, protecting intellectual property rights, and litigating successfully. Mr. Hommer also has significant experience in counseling clients who do business with the Federal, state, and local governments and has represented clients on contract administration matters, contract claims and disputes, bid protests, contract terminations, teaming agreements, conflicts of interest issues, intellectual property rights issues, government socio-economic programs, and small business matters.

Mr. Hommer is committed to developing relationships with his clients that go beyond the usual role of legal advisor. He works closely with his clients on a proactive basis, developing strategic plans and managing legal issues that may arise, and more importantly, identifying potential problems before they develop. This approach is not only smart, but is efficient, cost effective and significantly enhances opportunities for success.
Speaker Biography:
Jim Thomas, Partner at PricewaterhouseCoopers LLP

Mr. Thomas is the U.S. Advisory Aerospace & Defense Sector Leader and a Partner in the Washington, DC office of PricewaterhouseCoopers in Washington, DC. In this role, he establishes the vision and strategy for advisory services in the A&D sector. With 25 years of industry experience, he has overall responsibility for delivering advisory services to A&D clients in areas such as operations, technology, internal audit, compliance, finance effectiveness, human capital, investigations and disputes. He is a frequent speaker at industry events, a subject matter expert in government contracting and an author of many industry publications.

Mr. Thomas provides advice to clients on the requirements of the Federal Acquisition Regulation and Cost Accounting Standards. He provides expert accounting services to law firms representing clients involved in government contract disputes such as quantification of damages, defective pricing, cost recovery claims, labor charging, business purchase price disputes and other accounting disputes. He has provided expert testimony in cases involving cost disputes and bid protests.

Mr. Thomas conducts training seminars for the public on government contracting topics including contract costs, internal auditing and financial accounting considerations. He is a member of the American Institute of Certified Public Accountants and associate member of the American Bar Association. He has a Bachelor of Science in Accounting from the Pennsylvania State University and is a Certified Public Accountant in Virginia and the District of Columbia. Prior to joining PricewaterhouseCoopers, he was with McDonnell Douglas Corporation.
Speaker Biography:
Becky Pearson, Partner at Venable LLP

Rebecca Pearson focuses on government contracts law. She assists clients in government contract litigation; contract award protests before the Government Accountability Office and federal courts; administrative claims before agency boards of contract appeals; representation before the Department of Justice and federal courts on civil matters involving government contractors; and civil litigation in federal courts involving government prime contractors and subcontractors. Ms. Pearson also counsels clients on matters involving contracts including defective pricing and cost allowance questions, teaming agreements, legal and regulatory compliance and ethics, and small business issues. She has significant experience with due diligence in connection with the merger and acquisition of government contractors, as well as post-transaction matters such as novations.

As a member of the firm’s government contracts group, Ms. Pearson represents a broad range of large and small clients involved in government contracts, including a major defense contractor and a large foodservice distributor. Ms. Pearson has prosecuted and defended bid protests before government agencies, the Court of Federal Claims, the GAO, and Federal District Court. Ms. Pearson has handled several matters that required sensitive negotiation or close coordination with counsel from Defense Supply Center Philadelphia.

Ms. Pearson's extensive experience as an Air Force attorney in federal litigation and client counseling, and in interfacing with other federal agencies, provides her with an invaluable "insider's" perspective and proven skills to render timely and effective assistance to clients in a wide variety of government contracts matters. Ms. Pearson is a member of the editorial board for the American Bar Association's *Public Contract Law Journal* (May 1996 to present).
Kevin Boyle is the Senior Vice President, General Counsel & Secretary of Alion Science and Technology, a privately-held, global engineering, technology and operational solutions company, a position he has held since January 2014. During his tenure, he has helped lead the company through a series of complex public and private transactions to refinance its debt and equity, including Alion’s first initial public offering, and recently completed the sale of the company to an affiliate of Veritas Capital, a leading private equity investment firm.

Mr. Boyle has also served as General Counsel for MCR, where he established the company’s first legal department and helped navigate the company through several important legal and regulatory challenges. Prior to that position, he served as General Counsel with Vangent, where he was critical to the success of both strategic acquisitions and the sale of that company to General Dynamics for $1 billion. Earlier in his career, he was Assistant General Counsel at Anteon International Corporation, where he completed numerous public stock offerings, developed the company’s first ethics and compliance training program and helped lead numerous M&A transactions, including Anteon’s $2.2 billion sale to General Dynamics. Mr. Boyle’s expertise includes public and private equity and debt financing, mergers and acquisitions, government contracts law, litigation, SEC compliance, intellectual property and corporate governance and ethics initiatives. He received his Juris Doctor degree from Tulane Law School and his Bachelor of Arts degree in history from Yale University.
Agenda

Introduction and Overview
- Scott Hommer, Partner, Venable LLP

“Managing the Clock” – Working with Auditors
- Jim Thomas, Partner, PWC

“Working the Appeals Process”
- Becky Pearson, Partner, Government Contracts Group, Venable LLP

Playing the Long Game” – Managing Risk from the In-House Counsel’s Perspective
- Kevin Boyle, Alion Science & Technology Corporation, Senior Vice-President, General Counsel, and Secretary
Statute of Limitations for Government Claims – 6 Years

• Government claims under the Contract Disputes Act, 41 U.S.C. § 7103(A)(4)(A), accrue from the date that the Government knew or should have known that it had a potential claim (i.e., all the events fixing the alleged liability were known or should have been known).

The clock starts when “the government knows, or has reason to know, that some costs have been incurred, even if the amount is not finalized or a fuller analysis will follow.” Raytheon Co., Space & Airborne Sys., ASBCA Nos. 57801 et al., 13-1 BCA ¶ 35,319.
Managing the Clock and Working with Auditors

Presented by:
Jim Thomas, Partner at PricewaterhouseCoopers LLP
Agenda

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Expressly Unallowable Costs 15
Recent Industry Developments 16
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DCAA’s Report to Congress (Selected Statistics)

**Figure 1 – Incurred Cost Years Closed FY 2010 – FY 2014**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Incurred Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 10</td>
<td>654</td>
</tr>
<tr>
<td>FY 11</td>
<td>487</td>
</tr>
<tr>
<td>FY 12</td>
<td>4,068</td>
</tr>
<tr>
<td>FY 13</td>
<td>8,536</td>
</tr>
<tr>
<td>FY 14</td>
<td>11,101</td>
</tr>
</tbody>
</table>

**Figure 2 – DCAA Net Savings FY 2004 – FY 2014 (billions)**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Net Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 04-09</td>
<td>$2.5</td>
</tr>
<tr>
<td>FY 10</td>
<td>$2.9</td>
</tr>
<tr>
<td>FY 11</td>
<td>$3.5</td>
</tr>
<tr>
<td>FY 12</td>
<td>$4.2</td>
</tr>
<tr>
<td>FY 13</td>
<td>$4.4</td>
</tr>
<tr>
<td>FY 14</td>
<td>$4.5</td>
</tr>
</tbody>
</table>
DCAA’s Report to Congress (Selected Statistics)
What’s New with the Audit Process

- Pressure to reduce audit completion times
- Heightened awareness of Statute of Limitations
- Risk based auditing: risk pool sampling and prioritization of proposals
- Allowable Cost and Payment Clause – Two Step Process
  - Adequacy assessment
  - Compliance audit

<table>
<thead>
<tr>
<th>Type of Audit Report</th>
<th>Elapsed Days</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY 2012</td>
</tr>
<tr>
<td>(1) Forward Pricing</td>
<td>110</td>
</tr>
<tr>
<td>(2) Special Audits</td>
<td>217</td>
</tr>
<tr>
<td>(3) Incurred Cost</td>
<td>1,184</td>
</tr>
<tr>
<td>(4) Other Audits</td>
<td>384</td>
</tr>
</tbody>
</table>
Managing the Audit Process

• Document and manage the process starting with the entrance conference
• Agree on escalation process before audit begins
• Establish channels for communications
• Track audit request and response times (including government response times)
• Confirm understanding of the facts throughout the process
• Request information on any recent government guidance or areas of focus
• Identify and manage expectations of the Administrative Contracting Officer
Incurred Cost Proposals

• Consistency with the Forward Pricing Rate Proposal
• Consistency with CASB Disclosure Statement
• Government requests for resubmission of Incurred Cost Proposals
• Other Areas of Concern:
  o Completeness
  o Consistency with policies and procedures
  o Identification of allowable cost grey areas
  o Recent interpretations of allowable costs (e.g., compensation)
  o Support for consultant costs, legal fees and travel costs

• Guidance for distinguishing between “unallowable” and “expressly unallowable” costs (subject to penalties)

• Provides interpretations of cost principles for purposes of identifying expressly unallowable costs.

• According to the guidance, in establishing a cost as expressly unallowable, the Government must show that:

  "it was unreasonable under all the circumstances for a person in the contractor’s position to conclude that the costs were allowable"

• The guidance does not reference the FAR definition of expressly unallowable costs:

  "a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable"
Recent Industry Developments

• DoD IG Report on DCAA Audit Quality (December 2014)
  • DoD hotline complaint alleging DCAA failed to follow professional standards
  • A 20% decrement factor was found to be arbitrary because DCAA lacked a legal, regulatory, or other appropriate basis for establishing the amount of questioned costs
• DOD IG (October 2015) found Contracting Officers take 252 days to issue final determinations business systems
• GAO Report on DCAA’s Use of Companies’ Internal Audits (Nov. 2014)
Practical Strategies for Contractors

• Obtain a clear understanding of the nature of the cost that is being questioned and the supporting rational (i.e., direct interpretation for regulatory requirements, reliance on audit guidance, lack of evidentiary support, etc.)

• Agree on the applicability of CAS / FAR / contract / other guidance

• Consider centralizing response efforts for consistency in approach

• Understand the potential for a precedent and implications on other years

• Consult with industry peers

• Resolve the issue through prospective changes
Practical Strategies for Contractors Continued

• Prepare allowability justification memos for large non-recurring transactions (e.g., mergers & acquisitions, reorganizations, mass severance, facility closures, land / building sales)

• As part of incurred cost submissions, consider including narrative descriptions of costs that may be questioned in audits (e.g., legal fees, organization costs, compensation expenses)

• Establish an escalation strategy at the government customer and audit organizations

• Understand potential for statute of limitations defense
Working the Appeals

Presented by:
Becky Pearson, Partner at Venable LLP
## Working the Appeals – Selecting the Field

<table>
<thead>
<tr>
<th>Boards of Contract Appeals</th>
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<tbody>
<tr>
<td>• Administrative Forum</td>
</tr>
<tr>
<td>• Less formal procedures</td>
</tr>
<tr>
<td>• Three judge panel provides greater consistency</td>
</tr>
<tr>
<td>• Historic expertise on cost issues</td>
</tr>
<tr>
<td>• Great flexibility to negotiate resolution informally or through mediation and a great choice for premature Government claims</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>U.S. Court of Federal Claims</th>
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<tbody>
<tr>
<td>• Federal rules of evidence and procedure</td>
</tr>
<tr>
<td>• Department of Justice controls the litigation for the agency</td>
</tr>
<tr>
<td>• Under Forfeiture of Fraudulent Claims Act (FFCA), a Contractor that brings a fraudulent contract claim against the government in the COFC may have to forfeit all of its claims under the contract</td>
</tr>
</tbody>
</table>
When does a Government claim accrue?

Pre-audit correspondence


Submission of Incurred Cost Proposal

- *Raytheon Missile Sys.*, ASBCA No. 58011, 13-1 BCA ¶ 35241.

Submission of supporting data from which the Government learned, or had reason to learn of its claims

- *Combat Support Associates*, ASBCA Nos. 58945 et al., 14-1 BCA ¶ 35782 (vacated on other grounds).
Events that the Federal Circuit and Boards have **rejected** as a predicate for claim accrual

**Submission of an Audit Report**

**Completion of Administrative Process for CAS Violation**
- *Sikorsky Aircraft Corp. v. United States*, 773 F.3d 1315 (Fed. Cir. 2014).
Continuing Claims

Claims filed within the 6 year SOL may still be barred by the SOL if they relate to a “seminal event” that creates a single cause of action. If a claim continues, each breach gives rise to a separate cause of action.

Continuing Claims

- Claims are not dependent on a discretionary finding
- Non-performance of an ongoing statutory duty
- Involves significant factual determinations
- Independent of administrative determination

Non-Continuing Claim

- “A single distinct event, which may have ill effects later on.”
- A single alleged breach
- A single taking
Preserving the Affirmative Defense on Appeal

• CDA SOL is an affirmative defense and not jurisdictional.
  
  *Sikorsky Aircraft Corp. v. United States*, 773 F.3d 1315 (Fed. Cir. 2014).
  
  – Waived if not timely pled.

• Did the decision in *Sikorsky* overrule prior case law holding that contracting parties may not establish a statute of limitations longer than that set forth in the Contract Disputes Act, where the Government is a party?
  
  *Raytheon Co. v. United States*, 104 Fed. Cl. 327 (2012) (citing 48 C.F.R. § 33.206(b)).
Impacts of *Sikorsky*

- Burden of proof rests with the party raising the SOL defense.

  *Coherent Logix, ASBCA No. 59725 (Apr. 2, 2015); Kellogg Brown & Root Services Inc., ASBCA No. 58175 (May 13, 2015).*

- Decision on the SOL defense may be made on summary judgment or even deferred to a decision on the merits.

  *The Ryan Co., ASBCA No. 58137 (May 27, 2015); Raytheon Co., ASBCA No. 58849 (May 27, 2015) (Judge declined to convert motions to dismiss to motions for summary judgment prior to discovery).*
“Playing the Long Game” – Managing Risk from the In-House Counsel’s Perspective

Presented by:
Kevin Boyle, Senior Vice-President, General Counsel, and Secretary at Alion Science & Technology Corporation
Impact of SOL as an Affirmative Defense

• Litigation against Government claims is now more expensive
  o Decision on SOL will be made after discovery, and could be deferred for a merits decision.

• The contractor bears the burden of proof that SOL bars Government claims (although the Government bears the burden of proof for contractor claims)
Defending Against Delay Tactics

Defensive Measures

Finding Proposal Inadequate
- Rebut finding and document approach, even if the contractor provides additional data

Asking for Data Previously Received
- Document when the data was previously provided
- If provide data again, forward from the original data.
Strategies for the Long Game

• Retain records provided to auditors.
  – Record date and content of each transfer to an agency auditor and archive it where it can be retrieved years later.

• Identify, track, and preserve the SOL for potential contractor claims/counterclaims.
  – The date that fixes liability, permits assertion of the claim, and begins accrual of the statute of limitations may be different for the contractor than the Government.

• Appeal premature Government claims to preserve the SOL and consider early mediation to preserve the relationship.
Managing Premature Government Claims

Mediation?

File timely appeal

Preserve the customer relationship

Will your company agree to toll SOL before CO’s final decision?
Questions or Comments?

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Thank you for your participation!