

## Delayed Audits Cause Ripple Impacts, Part 1

Written by Nick Sanders  
Tuesday, 02 August 2016 11:46

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Respected practitioner Stephen A. Avery, leader of *DCAA Compliance* (headquartered in New Mexico), recently published

[an article](#)

that focused on a decision by the Civilian Board of Contract Appeals (CBCA). You should follow the link and read his thoughtful article.

Stephen drew two conclusions from the CBCA decision: (1) A contractor under audit has no obligations to make copies of documents for the auditor(s), and (2) A contractor under audit has no obligations to make electronic copies of documents available to the auditor(s), except for certain documents related to electronic billings. Stephen emphasized the obligation to support the audit and to respond to auditors' reasonable requests, and to make documents available to an auditor. But he also encouraged contractors to "stand up for your rights."

We read Stephen's article and wanted to look at that [CBCA decision](#) for ourselves. When we looked at it, we saw other lessons we wanted to share with our readers.

But first, the acronyms. You gotta know the acronyms because there are a lot of acronyms in the decision. The prime contractor was Group Health Incorporated (GHI) and its subcontractor was Douglas Consulting and Computer Services (DCCS). GHI had a contract with the Department of Health and Human Services (DHHS), Centers for Medicare & Medicaid Services (CMS). Part of GHI's contract related to management of Initial Enrollment Questionnaires (IEQs).

Got all that? Let's check. How well do you understand the following?

DCCS had previously developed IEQs, which were paper documents, in another CMS contract. GHI's prime contract with DHHS required that DCCS be a subcontractor, in order to handle the IEQs. Thus, pursuant to its prime contract, GHI entered into a subcontract with DCCS on November 1, 1999.

How did you do? Did that make sense? If not, go back and review the acronyms. If you got all that, then let's rock on.

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Now for the facts, which come from the CBCA decision. On May 18, 2011, DHHS partially terminated GHI's prime contract to eliminate paper-based IEQs. In response, GHI terminated its subcontract with DCCS in its entirety, on May 20, 2011. "On June 8, 2011, DCCS submitted to GHI a termination settlement proposal in the amount of \$1,608,278. GHI provided a copy of DCCS's proposal to CMS on June 13, 2011, and requested a meeting with CMS and DCCS to resolve the open cost issues."

What were the "open cost issues" to be discussed? According to the decision, the open cost issues were related to audits that had been performed in 2011 by the Defense Contract Audit Agency (DCAA). DCAA had performed Incurred Cost audits on DCCS for the years 2003 through 2007. Although the audit had been performed, the indirect cost rates for those years had not yet been "finalized"—that is to say, CMS had not yet issued a determination as to whether the final rates would be the rates that DCCS had submitted, the rates that DCAA had recommended, or somewhere in between. Without those final rates (which FAR 52.216-7 calls "final billing rates") DCCS couldn't close out its contracts. More to the point, without those final rates, DCCS and GHI could not reach agreement on DCCS' proposed termination settlement costs.

Let's note here that the lack of final billing rates was identified by GHI as an issue impeding timely negotiation and resolution of DCCS' termination settlement proposal within one week of its receipt. Despite early identification, apparently there was never any discussion of the open cost issues. Instead, DHHS/CMS then started to audit DCCS' incurred costs for the years 2008 through 2010. Granted, those years needed to be audited, but there was no apparent nexus between finalizing rates for FYs 2003 through 2007 and the completion of audits for other years. Each year needs to stand on its own (absent a dispute) and the decision to audit later years instead of using the existing audit reports to finalize the earlier years is ... *puzzling*.

Another puzzle is why didn't DCAA continue to perform the audits on DCCS' claimed costs? Why did DHHS/CMS suddenly decide, in 2011, that it should perform contract audits with its own resources? The decision didn't say.

The DHHS/CMS audit approach was somewhat puzzling, as well. As noted in the decision, "At CMS's request, DCCS on September 9, 2011, submitted its incurred cost proposals for 2003 through 2010 to the CMS auditors, *even though the incurred cost proposals for 2003 through 2007 had already been audited by DCAA.*" (Emphasis added.) We are unable to conceive of any reason to expand audit scope to encompass

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previously audited years, unless the reason is that DHHS/CMS was simply rejecting the DCAA audit findings for some unstated reason. Or, perhaps, DCAA did the type of "audit" that it's now doing for "low-risk" contractors--which is to say, no audit at all. It's possible DHHS/CMS had to "reperform" DCAA's audits because DCAA didn't actually do any audits. (Obviously we don't know the actual reason.)

Anyway, the expanded audit continued for some period of time; the parties differed as to when it actually started, but seemed to agree that that audit ended in October 2013. (We suspect the differences in start dates relate to the performance of risk assessment activities versus audit procedures. To a contractor being audited, an auditor Request for Information is a Request for Information, regardless of the auditor's purpose in asking. And, as we've noted before, the line between risk assessment and performance of audit procedures is really rather blurry.)

Interestingly, even though DHHS/CMS spent years auditing DCCS' claimed costs, the one thing it didn't audit was DCCS' proposed termination settlement costs. The proposal was not within scope, apparently.

Meanwhile, DCCS kept a small staff on hand to support the DHHS/CMS audits and to support final contract close-out. On May 7, 2012 (nearly a year after termination) the following communication was noted by the CBCA—

... in response to an inquiry from the CMS contracting officer, GHI stated that while 'all DCCS operational work under the contract has been completed, DCCS was continuing to incur costs to support final closeout.' GHI's email message further stated: 'We are awaiting CMS's determination as to whether these costs are allowable. Therefore, the termination settlement costs have not been fully paid. In addition, the costs for 2003-2007 have not been finalized and the costs from FY 2008 on are still awaiting audit and settlement.'

On May 11, 2012, GHI "requested the contracting officer extend the one-year period for submission of GHI's final termination settlement proposal until completion of the audit of DCCS's indirect cost rates for 2008 through 2011." In other words, GHI believed it couldn't submit its own termination settlement proposal (which would be for a partial termination for convenience from its point of view) until it could negotiate a final settlement with DCCS; and it couldn't negotiate a final settlement with DCCS until DHHS/CMS finished the ICS audits and finalized DCCS' rates.

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Was that a valid position? The CMS contracting officer didn't think so. He wrote to GHI –

*I have been advised that the final settlement of termination and the audits are two separate items. We do not have privity of contract with DCCS other than to audit and settle their rates. ... I cannot provide you an estimate when the audits will be complete. After the audits are complete then we have to settle the results of the audits.*

GHI interpreted the CMS contracting officer's response as expressing an intention to disallow any continuing DCCS costs. Among other things, GHI requested from DCCS "an explanation for DCCS's position that the costs incurred since cessation of work under the subcontract are allowable, as well as an explanation why those costs are reasonable."

Perhaps the GHI interpretation was correct, because the CMS contracting officer subsequently notified GHI that "costs submitted on behalf of DCCS associated with maintaining staff after the termination for the purpose of [supporting] the DHHS indirect rate audits would be deemed unreasonable and unallowable."

Meanwhile DCCS was submitting interim payment requests (as one does when terminated for convenience) and most of those were getting paid. However, two payment requests were denied reimbursement. To be clear: CMS wasn't going to reimburse GHI for two payment requests and therefore GHI told DCCS that it wasn't going to pay DCCS.

Long story short: GHI submitted a sponsored claim in the amount of \$815,128 and the CMS contracting officer denied it. GHI and DCCS appealed the denial to the CBCA. It was at this point that the CMS contracting officer "unilaterally" established final billing rates for DCCS for the years 2003 through 2007. The CBCA decision didn't discuss whether or not that was a valid determination and, apparently, DCCS was not disputing that unilateral determination. In any case, that still wasn't sufficient to move the termination settlement forward, because final rates were still lacking for 2008 through 2012, and there was still a dispute regarding the propriety of who needed to pay for the delayed audit support.

Before the CBCA were cross-motions for summary judgment. We'll discuss the parties'

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arguments and resolution of the issues in the next article.