

Schedule I Strikes Again

Written by Nick Sanders
Monday, 16 January 2017 00:00

Another good one from the ASBCA!

In July, 2013, I was privileged to act as co-chair of the American Conference Institute's "DCAA Audit and Compliance Bootcamp." In addition to emceeing and making introductions, I made several presentations of my own. One of those presentations addressed the topic "Preparing an 'Adequate' Proposal to Establish Final Billing Rates." In that presentation I asserted:

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Many of the currently required Schedules used to be auditor working papers

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They are intended to facilitate the audit, not necessary to support incurred costs or indirect rate calculations

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Some of the toughest Schedules to prepare may have the least value to the contractor

In particular, I called out ICE Model Schedule I (pronounced "eye" and titled "Schedule of cumulative direct and indirect costs claimed and billed by contract and subcontract"--often abbreviated as "CACWS") as being "the worst Schedule" in terms of cost versus benefit. I pointed out a number of problems with that particular Schedule, and told the audience "We need to get DCAA to explain why this Schedule is necessary."

Because Schedule I is absolutely *not* necessary. It is not necessary for the audit of claimed incurred costs, nor is it necessary for the calculation of indirect cost rates. The primary reason a contractor submits an annual proposal to establish final billing rates is to *establish final billing rates*

. (You don't believe me? Check out the language in the contract clause that requires its submission—52.216-7.) A second—far lesser—reason is that an audit of claimed direct costs year-by-year can make it easier to audit contracts' final vouchers and officially close them out

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when that day comes, at long last, where a cost-type contract is both physically complete and has final billing rates established for all years of performance. But make no mistake: Schedule I is and always has been an *auditor working paper* that DCAA successfully managed to foist onto the contractor workforce for preparation. It is a schedule that DCAA auditors used to prepare by themselves. Now contractors are required to prepare it even though the Schedule adds *zero value* to the contractor and it is *completely unrelated* to negotiation of final billing rates.

But of course, contractors are required to submit a Schedule I because the FAR now says they must. And DCAA auditors review that Schedule as part of their initial proposal [adequacy review](#)

According to the current proposal review checklist, there are five questions related to Schedule I that must be answered by the auditor(s). If the answers to all five are “yes” then that Schedule is adequate for audit. If the answer to all the checklist questions for all the Schedules is “yes” then the proposal is adequate for audit. If the proposal is adequate for audit and the contractor is a “low-risk” contractor (as DCAA currently defines that term) then the proposal very likely will not be audited.

Yes, you read that correctly. In DCAA policy land, an adequate proposal submitted by a “low-risk” contractor is very likely to be accepted by DCAA without performance of an audit. In fact, if the value of the contractor’s claimed costs for its cost-type contracts is less than \$5 million, it is almost certain that proposal will not be audited. *Gotta keep that audit backlog down!*

A recent decision by the ASBCA highlighted the uselessness of Schedule I and it also highlighted how the government has treated it like some kind of important document, to its detriment. As always, the usual caveats apply: we are not lawyers, we are not offering legal advice, an ASBCA decision is subject to appeal, etc.

But we must tell you about it: it’s such an *interesting* case!

And it’s not really about Schedule I. Not really. It’s really about the Contract Disputes Act

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Statute of Limitations (CDA SoL) and how it was applied to a government claim that relied on alleged Schedule I data omissions. In that respect, it could be a very important decision and I am going to use it to write a separate article on the CDA SoL. So stay tuned for that one.

In the meantime, let us discuss the interesting [decision](#) by Judge McIlmail, writing for the Board, in the matter of Sparton DeLeon Springs, LLC's appeal of a Contracting Officer's Final Decision (COFD), ASBCA No. 60416, demanding \$577,415 of direct contract costs that the government had allegedly overpaid.

The dispute concerns two contracts between Sparton's predecessor company (SEFI) and the U.S. Navy. The first contract was awarded in 2001 and the second contract was awarded in 2004. Both contracts included the Allowable Cost and Payment clause (52.216-7) which, as we noted above, is a very important clause, in that it invokes the FAR Part 31 cost principles and requires submission of an annual proposal to establish final billing rates (among other things).

As Judge McIlmail found—

... by 10 January 2007 the government had paid interim vouchers that SEFI had submitted that included breakdowns of certain intra-company 'Jackson Engineering Support Costs' (Jackson Costs) that SEFI allegedly incurred at its Jackson, Michigan plant....” On 5 March 2007, Sparton submitted to the government its final indirect rate cost proposal¹ for its fiscal year 2006 (FY 06); on 29 January 2008, Sparton submitted its final indirect cost rate proposal for its fiscal year 2007 (FY 07).²

Both proposals included a 'Schedule I' ... In neither proposal (more specifically, in neither Schedule I) did Sparton include the Jackson costs.

(Internal citations omitted. Footnotes added for clarity and wistful humor.)

The dates recited above are important. To clarify a bit, Sparton had received cost-type contracts and, like all defense contractors, was submitting “interim vouchers” each month for reimbursement by its government customer. Those vouchers were based on (1) direct costs incurred by Sparton, plus (2) an allocation of indirect costs using “provisional” indirect cost rates. The interim vouchers were submitted during contract performance, each month.

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Provisional indirect cost rates were used until submission of the annual proposal to establish final billing rates. The proposal was submitted after the end of the Fiscal Year, in this case quite quickly after the end of Sparton's FY. (Contractors today would take six months or more to "scrub" the books for unallowable costs and to prepare the required Schedules.) The final billing rate proposal would be audited by DCAA (when they got around to it) and the results of that audit would be provided to a DCMA Administrative Contracting Officer, who would then negotiate and reach agreement with Sparton on the final billing rates to be used for that Fiscal Year. Then final vouchers would be prepared and submitted using those agreed-to final billing rates.³

A key point here is that Sparton's interim vouchers included the Jackson costs, whereas at least one Schedule in the final billing rate proposal omitted those costs.

As can happen, Sparton submitted revised proposals "during subsequent" DCAA audits. The revisions were submitted in 2011 and 2013, literally more than four years after the initial submission. We don't know what spurred the revisions, but in our experience that was the time that DCAA began to apply the new, more rigid, content and format requirements *retroactively*. DCAA did not apply the requirements that existed at the time of the initial submission (which one might reasonably have expected) but, instead, often required contractors to comply with additional requirements that did not exist at the time. We believe that, from a legal standpoint, DCAA's position was without merit but we never found a contractor that was willing to litigate the point. It was easier (and far cheaper) to sigh, roll one's eyes, and resubmit the proposal, adding to it whatever the local audit team demanded.

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In September, 2013, DCAA issued its audit reports on Sparton's two (revised) proposals, "noting that the proposals did not include the Jackson costs." Judge McIlmail found that "The parties eventually executed final indirect cost rate agreements for FY 06 and FY 07, and Sparton provided updated Schedule I forms reflecting the agreed-upon rates. On 2 April 2014, Sparton provided an updated Schedule I for FY 06; on 23 May 2014, it provided an updated Schedule I for FY 07. The updated Schedule I forms did not include the Jackson costs."

See? That's why the Schedule I is useless and should be dropped from the list of required Schedules. Sparton was (apparently) required to update its proposal after audit and after negotiation and after agreement had been reached. *Why?* To help the government. There is no other possible reason. The contractor is informing the government about contract costs. That used to be DCAA's role before they foisted it off on the contractors. More importantly, there is no hint in the language of 52.216-7 that the contractor has a duty that survives

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agreement on the final billing rates, except to submit final vouchers for completed contracts within 120 days after that agreement has been reached.

If the government asks you to update your Schedule I after you have submitted your final billing rate proposal and after the audit has been completed, our advice is to laugh loudly (perhaps holding your belly while doing so) and tell the government to go pound sand. Or, perhaps more diplomatically, ask which contract clause or which part of the FAR requires you to perform that action.⁵

Back to the Sparton story....

On 12 August 2014—more than six years after Sparton had submitted its original final billing rate proposals—the contracting officer requested that Sparton submit its final vouchers. We note that the CO should not have had to do this; the language in the 52.216-7 clause imposes a duty on contractors to submit their final vouchers for physically completed contracts within 120 days of reaching agreement on final billing rates and Sparton should have submitted those final vouchers automatically without the need for any CO request. Anyway, those final vouchers included the Jackson costs—which was not surprising because those costs had been included on the interim vouchers that SEFI/Sparton had been submitting during contract performance, even though those costs were not to be found on the updated Schedule I forms. *But it surprised the contracting officer!*

It surprised the CO so much that a Contracting Officer's Final Decision (COFD) was issued on 26 October 2015—more than eight (8!) years after SEFI/Sparton originally submitted its final billing rate proposal and more than two years after DCAA had issued its audit reports. The COFD demanded repayment of \$577,415 in costs that were allegedly not supported. As the CO wrote—

On August 26, 2014, after agreeing on final indirect rate costs, I requested final vouchers and supporting documentation, including the required Cumulative Allowable Cost Worksheet. [Schedule I.] After reviewing the final voucher submission, I noticed certain costs that were not included in SEFI's Incurred Cost proposals for CFY 2006 or CFY 2007. ... To date, despite repeated requests, your company has not provided information that establishes these additional costs were actually incurred or paid by SEFI. You have provided only a spreadsheet showing that the Government paid SEFI. There is no proof whatever that SEFI was billed for work, or more importantly, that SEFI paid these costs in connection with any Government

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contract.

Sparton appealed. Sparton won; the government's claim was dismissed. Let's look at why.

Judge McIlmail, for the Board, wrote—

There is no dispute that the contracting officer claimed the \$577,415.36 overpayment on 26 October 2015; consequently, to be timely, that claim must not have accrued earlier than 26 October 2009. The government contends that it was not put on notice of its overpayment claim until Sparton submitted its final vouchers in response to the contracting officer's 2014 request, because although the final vouchers included the already-paid Jackson costs, those costs were not included in the updated Schedule I forms of Sparton's revised final indirect rate cost proposals. ...

... there is no genuine dispute that the government knew or should have known of the Jackson costs as early as 10 January 2007, by when it paid those costs pursuant to the interim vouchers that, even according to the government's brief, included information related to the Jackson costs. ... there is no genuine dispute that the government knew or should have known by 29 January 2008 that Sparton had not included the Jackson costs in its indirect cost rate proposals, because that is the date by when Sparton first submitted the indirect cost rate proposals, each of which included a Schedule I that did not include the Jackson costs. There is no assertion that the revisions to the indirect cost rate proposals, the updates to the Schedule I forms, or the submission of the final vouchers change that basic picture. *Consequently, there is no genuine dispute that the government's claim accrued no later than 29 January 2008, when all events that fix the alleged liability of Sparton in this case, and permit assertion of the government's overpayment claim, were known or should have been known by the government.* ...

Looked at another way, the government's overpayment claim is based upon the contention that Jackson costs were 'insufficiently supported', and that, according to the contracting officer, there is no proof that [SEFI] paid those costs in connection with any government contract. However, if that is true, it was no less so on 10 January 2007, by when the government paid those costs pursuant to the interim vouchers. ...

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In other words, if (as the contracting officer found) there was ‘no proof whatever’ for the costs in 2014 and 2015, there cannot have been any less support for the same costs in 2007. ... Indeed, the government says that the interim vouchers ‘included accounting information related to the cost of labor provided by its Jackson, Michigan facility,’ but that ‘[t]his information did not contain the basis for the reported labor costs reflected in Sparton’s accounting system, such as certified time cards’. If it is the case that the interim vouchers lacked support such as certified time cards, the government knew or should have known that no later than 10 January 2007, by when it paid those interim vouchers. Consequently, even from the perspective of whether the Jackson costs are ‘insufficiently supported,’ there is no genuine issue that the government knew or should have known of its overpayment claim by 10 January 2007, again, more than six years before the 2015 assertion of the claim. For all these reasons, Sparton is entitled to judgment as a matter of law. ...

And although the government says that when it paid the interim vouchers it had not yet audited them, *delay by a contracting party assessing the information available to it does not suspend the accrual of its claim.*

(Emphasis added. Internal citations omitted.)

Some final thoughts on this interesting and important decision.

1.

The contracting officer thought there was some duty to review the contractor’s final vouchers and to request support for those vouchers. In fact, the contracting officer was wrong. Final indirect rates had already been established by agreement, and the only action to take was to verify that the final rates used to prepare the final vouchers agreed to the agreed-upon final rates as negotiated.⁶ Further, the direct costs had already been audited by DCAA during performance of its “incurred cost submission” audit procedures. (See paragraph 3 of this over-long article.) If there were any unallowable or unsupported costs, they should already have been caught by DCAA. (Indeed, DCAA pointed out in the audit reports that the Schedule I’s omitted the Jackson costs—which did not prevent the CO from negotiating final billing rates because Schedule I is not necessary to negotiating final billing rates.) If the CO thought there was some risk to the government that was being mitigated by *yet another* in-depth voucher review, then *what in the blue blazes is DCAA doing each year*?

Either the “incurred cost audit” actually audits incurred costs for the government, or it does not. Either the DCAA audit adds value and reduces government risk, or it doesn’t. You cannot have it both ways, as this contracting officer evidently believed.

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2.

Notice how the contracting officer required the contractor to update its Schedule I even after rates were agreed-upon, as if that were some kind of important step in the process, even though such a step was not required by any contract clause.⁷ Even though the “inaccurate” Schedule I didn’t hinder the negotiation of final billing rates in any meaningful way. And then, after years of audit and months of negotiation, the CO acted as if that revised Schedule I were some sort of critical document that carried weight and required accuracy, as if the revised Schedule I were somehow important to the contract close-out process. As this decision clearly shows, *none* of those beliefs was correct.

3.

But what about that 52.215-2 audit clause that gives the government the right to audit contractor costs up to three years after final payment? Sure. Absolutely correct. The clause requires that “The Contractor *shall make available* at its office at all reasonable times the records, materials, and other evidence ... for examination, audit, or reproduction, until 3 years after final payment under this contract or for any shorter period specified in [FAR Subpart 4.7], or for any longer period required by statute or by other clauses of this contract.” (Emphasis added.) Thus, the contractor has a duty to make documents available for audit and the government has the right to audit those documents, *but the government does not have the right to assert a claim* with respect to any audit findings related to costs that were invoiced and paid more than six years before. If the contractor’s final voucher doesn’t contain any new direct costs—*which it shouldn’t*—*then the 52.215-2 audit right is essentially worthless*—absent, perhaps, a claim of fraud.

4.

Given that we all now should understand that the Schedule I is a waste of contractor time and labor—expenses that tend to increase the cost of weapon prices and end up costing the taxpayers more, not to mention slowing down a DCAA audit—shouldn’t we all now insist that the FAR Councils revise the language in 52.216-7 to require a contractor to only prepare Schedules in its final billing rate proposal that actually contribute in a meaningful way to either (a) calculating indirect cost rates, or (b) providing information regarding claimed direct contract costs? Let’s get DCAA back to performing meaningful audits and preparing audit working papers—including the CACWS—which has always been the agency’s traditional role.

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As we said in the beginning of this article, this is another good decision from ASBCA.

¹ We love it when people correctly name the proposal! It is *not* an “incurred cost submission”.

² Back then it was easier to prepare such a proposal because the FAR wasn’t so rigid—and DCAA didn’t have an adequacy checklist. So it went more quickly. *Sigh*. Those were the days

³ It doesn’t always work that way. Smaller companies can have auditor-determined rates. But that is the general flow for the bigger companies. Again: see 52.216-7.

⁴ Smarter contractors added language to their revised proposals that specified exactly what had changed and what had not changed, in order to protect their position should they have to litigate a CDA SoL issue.

⁵ Or you will just update the Schedule because that’s easier than arguing, and your VP or Controller or CFO expects you to maintain good relations with your government oversight functions. *Wussies*.

⁶ If that sentence makes sense to you, you must have been doing this for a long time. We bet the n00bs won’t get it.

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⁷ If you missed that point you must not have been reading the article, because we ranted and railed about it.