The **recent article** about Lockheed Martin Integrated System's appeal of an egregiously bad Contracting Officer's Final Decision, which was based on an egregiously bad DCAA audit "finding," proved to be a fairly popular article, even though it was egregiously long and included lots of commentary. We suggest you follow the link and read that article before continuing with this one, since we will be making points that assume familiarity and knowledge of that decision.

For those of you who are just too lazy to click on the link and read the article—or who did but gave up because it was so freakin' long—then here's a quick summary of the issues:

DCAA did what was obviously a half-assed audit of LMIS' claimed subcontract costs. Because DCAA waited nearly six years to perform its audit, much of the records and supporting data that it would have liked to use didn't exist anymore (if they ever had). DCAA issued an audit report that claimed LMIS had overstated its claimed subcontract costs on "flexibly priced" prime contracts by $103.3 million, mostly because of a "legal theory, originated by an auditor," that LMIS had somehow violated some contractual duty that was not actually in its contract. The DCAA auditor's legal theory was accepted and approved by their Supervisory Auditor, even though there was no basis in the DCAA Contract Audit Manual for taking such a position. The audit report was reviewed and approved by the Branch Manager and perhaps by the Regional Audit Manager (and perhaps by others) as being a legitimate and GAGAS-compliant audit report, even though there was zero evidentiary support for "conclusions" being expressed. The cognizant ACO accepted the DCAA audit report as being correct, even though LMIS provided an "extensive" rebuttal that should have persuaded a reasonable and reasonably independent adjudicator, and even though the ACO decided (for some unexplained reason) that "unresolved costs" somehow equated to "questioned costs." The attorneys assigned to the case thought they had a winnable position. The entire cast of characters on the government's side of the case was … mistaken in their beliefs.

As Judge O'Sullivan wrote in her decision: The Government "has gone forward with a claim for over $100,000,000 that is based on nothing more than a *plainly invalid legal theory*." (Emphasis added.)

We added some thoughts of our own at the end of the original article and we thought that was that. But upon reflection, we think we should have said more. There was too much stuff we left unsaid. Thus, this article corrects the omissions, and says more stuff.

About DCAA

1.

The audit report in question is problematic. It is really, *really* problematic. If you remember back to 2008 and 2009, DCAA was under fire by GAO and DoDOIG for really bad audit reports. The quality of the audit reports was poor and there were Congressional hearings discussing how bad they were. Since then, DCAA has worked hard to improve its audit quality. This particular audit report shows how far DCAA still has to go. There were a number of issues raised in the GAO and DoD OIG reports, but the main issue—the most fundamental issue—was that DCAA was reaching conclusions (and changing conclusions) without sufficient evidentiary support. GAGAS required evidentiary support for conclusions. Ergo, DCAA was not complying with GAGAS. This particular LMIS audit report was issued in the middle of 2014—a full five years (at least) after the audit agency refocused its efforts on audit quality. The audit report contained conclusions without sufficient evidentiary support. As Judge O'Sullivan wrote: "The [Government's] complaint offers no legal theory for its claim of disallowance nor does it provide any allegations of fact. It states conclusorily that there were questioned costs and some variances that entitle the government to disallow subcontract costs. Our pleading standard requires factual assertions beyond bare conclusory assertions to entitlement. *The audit report, which was incorporated into the complaint, states that some assist audits questioned costs but does not explain on what grounds. It also states there were differences between amounts in LMIS's proposal and costs under subcontracts but provides no facts regarding these differences.* More importantly, the COFD does not cite a single actual fact, only the audit report's unsupported conclusions." (Emphasis added.) In a nutshell, this is the *same complaint* expressed by GAO and DoDOIG regarding DCAA audit quality in 2008. It is the *same complaint* aired in Congressional hearings at that time. It is the *same complaint* that DCAA vowed to fix. It is the *same complaint* that led to the revamping of DCAA's entire approach to audit procedures. Given the obvious fact that this audit report was egregiously non-compliant with GAGAS, how can DCAA leadership claim, with a straight face, that anything has changed at the audit agency?

2.

The math is wrong. Assuming, *arguendo*, that DCAA was correct and that LMIS had overstated its claimed subcontract costs by $100 million or so, then that would mean that LMIS' G&A expense allocation base was overstated by that same amount (assuming that LMIS allocated G&A to its subcontract costs, which it would under a Total Cost Input allocation base). If LMIS reduced its G&A expense allocation base by $100 million, that would increase

its G&A rate. (Numerator stays the same; denominator shrinks; indirect cost rate goes up). That increased G&A rate, allocated to the exact same “flexibly priced” government contracts from which DCAA was questioning claimed subcontractor costs, would tend to offset some of that $100 million. So the correct government claim would be less than $100 million because of the offset of the G&A allocation increase. How much less? We don’t know. But some; perhaps a lot. Apparently, the DCAA audit report didn’t calculate such an offset. Either LMIS didn’t allocate G&A expense to its subcontractors (possible), or else DCAA was in such a hurry to generate questioned costs for HQ to report to Congress that nobody stopped to think about the math.

About Prime Contractors

1.

We have reported several issues connected with T&M subcontracts. Prime contractors have been accused of violating the False Claims Act (along with their subcontractors) when subcontractor personnel failed to meet the labor category qualifications of the T&M subcontract. Here, we have unfounded DCAA allegations that amounted to a lot of money and that required litigation to solve, connected with T&M prime and/or subcontracts. As Judge O’Sullivan correctly noted, there are very specific, expressly listed, support requirements connected with T&M prime and subcontractors. (See 52.232-7.) A prime contractor can avoid substantial audit and litigation risk—not to mention burdensome compliance requirements—simply by avoiding issuance of T&M subcontracts. At this point, if a prime is going to be issuing a T&M subcontract, there had better be a compelling business reason. Because if there is no compelling business reason then it would seem to be a really bad idea.

2.

Further to that thought, it would seem to be less risky to issue a pure cost-type subcontract than it would be to issue a T&M type subcontract. But wait! Doesn’t issuance of a cost-type subcontract require the subcontractor to have an adequate accounting system? Yes; sure. But what makes you think issuing a T&M type subcontract alleviates that need? Bottom-line is that the subcontractor needs to have an accounting system adequate to meet the requirements of the subcontract; T&M subcontracts carry their own requirements and therefore the subcontractor’s accounting system needs to be adequate to meet them. More to the point, the accounting system requirements for a T&M subcontract would not seem to be significantly different from the requirements for a cost-type subcontract. If you are going to be issuing T&M subcontracts you had better make sure that the subcontractor can meet the requirements. All of them. And you had better be prepared to manage that subcontractor to ensure that it is meeting them.

So that's all the stuff that we remembered we forgot to say. We are now at some 4,500 or so words on one legal decision. We trust it's been worth the read(s).