We recently **wrote about** the Civilian Board of Contract Appeals decision in the matter of CH2M-WG Idaho, LLC (CWI's) appeal of a Department of Energy contracting officer decision regarding G&A expense allocation issues with respect to the Idaho Cleanup Project. It was a long article—about three times as long as the average blog article on this site. Still, there was more we could have written about. As we noted at the time, there were three issues at stake, but we were writing only about two of them.

This is the article about the third issue.

This article is about the Integrated Waste Treatment Unit (IWTU). The issue is interesting because it involves "color of money" and related funding issues. For those who don't know, "color of money" refers to the various categories of appropriated funding, each with a unique purpose and usage constraints. For example, each year DoD receives funding from Congress, but that funding is broken up into roughly 100 different "colors of money" that are differentiated by branch of military service, purpose, and duration (*i.e.*, how long the funding is available for obligation).

Congress has passed public laws that control how agencies of the Executive Branch are allowed to obligate the appropriated funding. For example, the Bona Fide Needs statute requires that Congressional appropriations may be used only for their intended purposes and that appropriations made for a definite period of time may be used only for expenses incurred during that time.

It's complicated. There's a whole volume of rules and guidance, published by the Government Accountability Office (GAO), and known as the **Red Book** , that deals with the topic. Contractors often roll their eyes at the government's internal bookkeeping challenges, but it matters quite a bit to government employees, such as contracting officers and finance offices—and auditors. It also matters to those contractors that operate Federal facilities, such as sites within the Nuclear Complex.

We found a link to a 20-year old GAO report, summarized as follows—

The Department of Energy (DOE) Inspector General asked whether DOE could use no-year departmental administration appropriations for official reception and representation (R&R) activities only during the first year of their availability or whether DOE could use unobligated amounts of R&R authority for activities after the end of the fiscal year (FY) of the act appropriating the no-year funds. GAO held that DOE: (1) R&R authority was not time limited to the first year of the departmental administration appropriation; and (2) could use any unused R&R authority in subsequent years to the extent that the cumulative unobligated balances of past year appropriations for departmental administration that were carried over each year were equal to or exceeded the cumulative unused authority for R&R activities.

As we said: it's complicated.

With that as background, let's look at the CBCA's decision regarding CWI's appeal of a DOE contracting officer's final decision, which involved disallowance of IWTU costs that CWI had transferred from one color of money to another. If you don't recall the details of the CWI contract, please refresh your memory by reading our prior article (link in first sentence) or by going to the CBCA website and reading the decision (link in the prior article).

CWI's contract prescribed certain funding categories (colors of money) as well as the process for making a determination regarding which color of money was appropriate to use for which expenditures. There were three basic funding categories: Operations, Capital Construction, and Capital Equipment. The distinctions were similar to how a contractor might describe the distinctions between capitalization and expense. Operations funds could not be used to create new assets for DOE. Capital Construction was used to fund all costs (including engineering, design, construction, inspection, and project management) of significant changes or additions to real property. Capital Equipment was used to fund the acquisition of all stand-alone personal property items that were not construction in nature. In order to fit into the Capital Equipment category, the items must have been valued at $50,000 or more, and have a useful life of at least two years; otherwise, they were to be funded with Operations money.

CWI was tasked with constructing the IWTU but, as the work progressed, it became evident that DOE may not have provided sufficient funding. As Judge Sheridan wrote for the Board—

The IWTU construction was funded though a capital project line item of $533,393,000. … During performance of the contract, CWI incurred costs associated with the IWTU construction and invoiced those costs to DOE against the capital project line item for the IWTU construction.

… CWI initially charged three cost items to the capital project line item for the IWTU construction: (1) costs for conducting pilot plant testing of a mineralized waste form; (2) costs for constructing a waste transfer line and tie-in and (3) costs for portable restrooms. CWI was reimbursed for those costs out of the IWTU capital line item appropriation. … In late 2009, forecasts for the IWTU construction showed that there was a risk of exceeding the capital project line item ceiling for the project. In November 2009, DOE requested that CWI review the costs that it had previously charged to the capital project line item in an effort to keep the IWTU costs below the congressional line item limit for the project. Once the funding limit was reached, the parties understood that DOE would have to ask Congress for additional funding, and neither CWI nor DOE wanted the IWTU project to be delayed or stopped while DOE's funding request was pending.

Importantly, this was not solely a CWI tasking. CWI and DOE "worked together" to identify costs that could be transferred from the IWTU construction line item to other areas where the funding constraints weren't as tight. They held joint "brainstorming sessions" devoted to identifying such costs. It was important to identify cost reductions, as DOE kept emphasizing—and CWI was directed to be "creative" in finding costs to transfer off the IWTU construction line item. Eventually CWI identified eight items for cost transfer. Three of them would turn out to be controversial: "(1) the mineralization study ($4 million), (2) the waste transfer line and tie-in ($3.8 million), and (3) the portable restroom facilities $107,000)." In total, $7.9 million in cost transfers would become controversial and form the basis of the dispute between CWI and DOE.

For its part, CWI hired outside consultants, including legal counsel to review the eight cost transfer items. DOE was happy with the outcome, and the contracting officer told CWI (in writing) that its efforts "to validate and support the funding determinations are commendable." The contracting officer told CWI—

Based on the above, DOE-ID supports the conclusions reached by CWI that its actions are proper and in compliance with Appropriations Laws and [CAS principles]. Should the CWI internal audit that is planned for June 2011 reveal anything to the contrary, this matter must be brought to the attention of DOE-ID, and may be reconsidered. Otherwise, this matter is considered closed, pending the receipt of a final close-out audit.

The aforementioned internal audit didn't raise any issues; however, other DOE entities began to raise their concerns, despite the fact that the contracting officer—the person with the certificate of appointment (warrant)—had already ruled on the matter. This situation is similar to the G&A expense allocation issue, in that DOE entities that were not part of local operations thought their opinion should matter. In some respects, that was a good thing, because it provided checks and

balances on local activities that might be overzealous in making decisions. On the other hand, it meant that local decision-making could not be trusted, since “other opinions” might surface after a matter had been negotiated and seemingly closed. It certainly put the contractor in a difficult situation, and we imagine that the local contracting officer didn’t care for it very much either.

On August 8, 2013, the DOE Office of Inspector General (OIG) issued **a report** that found three of the IWTU cost transfers were problematic, and should not have taken place. When DOE issued its final fee determination—

CO Mitchell-Williams reclassified the $7.9 million associated with the three IWTU cost transfers in issue, relying in part on the DOE-OIG’s report concluding that the three cost transfers were improper because they were direct costs of the IWTU construction phase. By reclassifying the IWTU costs as costs applicable to the construction phase of the IWTU project, CWI was unable to collect the costs in excess of the cap on the IWTU project ….

In other words, to the extent that the reversal of the cost transfers meant that CWI had overrun its funding for the IWTU project, those costs became unallowable and non-reimbursable.

But what about the fact that the overall contract was cost-type? we hear you asking. Doesn’t matter. A contractor cannot exceed authorized funding. In this case, the parties agreed to a “cost cap” on the IWTU construction line item, which essentially converted that cost-plus-incentive-fee work to firm, fixed-price. And now CWI had exceeded that FFP amount.

CWI argued that it was unfair for DOE to accept the transfers and then turn-around—after contract performance when CWI would have no chance to find cost savings in other areas—and reject them. CWI asserted that “DOE breached the implied covenant of good faith and fair dealing by improperly reclassifying and disallowing the IWTU cost transfers which were consistent with applicable financial requirements supporting CWI’s classification of the costs.”

The Board didn’t agree.

The decision made much of the contracting officer’s language (quoted above) about “pending

receipt of a final close-out audit." In other words, DOE was reserving the right to change its mind at a later date. Further, when CWI executed the contract mod establishing the IWTU cost cap, Judge Sheridan noted that "there is no indication in the record that CWI wished to make modification 163 in any way contingent on the reclassified cost transfers remaining intact." (We suspect that was because they took the contracting officer's word that the matter was "closed.")

In the words of Judge Sheridan:

There is no compelling reason for us to ignore the plain language of modification 163 and revisit the cap agreed to for the IWTU project. CWI's claim for $7,904,961 associated with certain cost transfers is denied.

In order to reach that conclusion, we believe that the Board needed to ignore the fact that DOE's hands were unclean. They had to overlook the pressure being applied to CWI, including the direction to get "creative" at finding costs to transfer out of the IWTU construction project. They had to overlook the contracting officer's decision that the matter was "closed" and focus on the words "pending receipt of a close-out audit." Because the Board didn't address that issue substantively, DOE was able to get nearly $8 million worth of IWTU construction for free.

Quite a nice windfall.

But the lesson here is manifest. Contractors must resist pressure from their government customers to cut corners and to get creative in order to live within budgets. Remember, those budgets were created by the government customers and they—and only they—are responsible for living within them. Any contractor that caves into pressure and transfers (or reports) costs in a manner that it knows is inaccurate is running a risk, a risk that it may end up holding the bag while its government customers shrug their shoulders and blame the contractor for following their directions.