"*A cost-reimbursement contract may be used only when … The contractor's accounting system is adequate for determining costs applicable to the contract or order. …* " (FAR 16.301-3)

"*In the event that a contractor's accounting system contains deficiencies, even if it has been disapproved, a cost reimbursement contract is not prohibited if the contracting officer determines that the contractor's accounting system is adequate for determining costs applicable to the contract or order.* " (DFARS PGI 242.7502)

Most readers know that an "approved" or "adequate" accounting system is (generally) a prerequisite for obtaining award of a cost-type contract. In my recently completed SDSU-CES class "Financial Management of Government Contracts," I taught my 29 students that there are three levels of accounting systems adequacy.

The first level of adequacy is documented via Standard Form 1408. The SF 1408 contains yes/no questions; when the questions have been appropriately answered by an independent reviewer, then the contractor's accounting system is officially adequate.

The next level of adequacy is established by the DFARS clause 252.242-7006 (“Accounting System Administration”). That clause establishes 18 criteria for determining whether a contractor’s accounting system is adequate. Although the criteria are too often subjective and DCAA’s track record in consistently applying them is uneven, they are what they are. Hit them and you have an adequate accounting system. Miss them and you don’t.

The third and final level of adequacy is much the same as the second, in that adequacy is established by the 18 criteria in the DFARS contract clause. The only difference is that, in addition to that contract clause, the contractor also has another DFARS contract clause: 252.242-7006 (“Contractor Business Systems”). That additional clause prescribes mandatory payment withholds for inadequate or disapproved contractor business systems—including the accounting system. Any “significant deficiency” is sufficient to cause a business system to be inadequate, potentially costing the contractor millions of dollars in deferred cash flow.

As noted, many readers already know this. But we recently learned of another way of determining whether a contractor’s accounting system is adequate. It was so novel that we felt compelled to write about it here.

This new, innovative, approach was discussed in a recent bid protest **decision** at the U.S. Court of Federal Claims. In that decision a disappointed bidder, Citizant, protested its exclusion from the competitive range for the GSA’s Alliant 2 Small Business GWAC opportunity. Bidders were chosen based on verified scoring, with certain attributes carrying certain point scores. The higher the point score, the higher a bidder would be in the competitive range. An acceptable cost accounting system (“CAS” in the Alliant vernacular) was worth 5,500 points.

In order to earn the 5,500 points, bidders were required to “provide verification from the [DCAA, DCMA], or any other Cognizant Federal Agency of an acceptable accounting system that has been audited and determined adequate for determining costs applicable to the contract or order in accordance with FAR 16.301-3(a)(3).” Seems pretty straight-forward, right?

Not so fast.

According to the decision—

An offeror provided the necessary verification by submitting four pieces of information: (1) the contact information for its agency representative, (2) a letter from the auditing agency attesting that its CAS had been audited and determined adequate, (3) an averment that it had not materially changed its CAS since its last audit, and (4) its Dun & Bradstreet (“DUNS”) number and Commercial and Government Entity (“CAGE”) code. In lieu of submitting the letter from the auditing agency, an offeror could submit a statement of certainty in which it averred that it possessed an audited and adequate CAS. An offeror expressing such certainty to the CO triggered the CO’s obligation to contact the auditing agency to verify that the offeror’s CAS was acceptable, and the GSA agreed that it would only deduct the 5500 points ‘[i]f after reasonable efforts the [CO was] unable to obtain audit verification from the [auditing agency].’ Regardless of the verification method chosen by the offeror, it needed to submit the requisite materials in volume 4.

(Internal citations omitted.)

In its protest, Citizant asserted, and the Judge found, that two offerors who had been selected for award "attempted to validate their experience by submitting a letter from the DCAA addressing the adequacy of their incurred cost proposal ('ICP'). In those letters, the DCAA stated that each offeror's ICP was adequate and not selected for an audit…. Relying on those letters, the CO determined that both offerors had validated the points they claimed for their CASs."

In other words, the CO found that a contractor's ability to submit an adequate proposal to establish final billing rates, as required by contract clause 52.216-7, was tantamount to having its accounting system reviewed and determined to be adequate. According to the GSA contracting officer, "This is evidence that the contractor is engaged in cost reimbursement contracts and the determination of accounting systems adequacy is a requirement of cost reimbursement contracts."

Yeah, no. It's not the same thing at all.

And Chief Judge Sweeney knew that. She wrote that the contracting officer's evaluation —

… is irrational for two reasons. First, the DCAA's review of an ICP is not unequivocal evidence that the contractor has an adequate CAS. The DCAA's assessment of an ICP is evidence that the contractor has an adequate CAS only if the ICP was submitted in connection with a cost-reimbursement contract. Because the type of contract associated with [. ..] and [. ..] ICPs is not evident from their respective proposals, the CO could not rely on the DCAA letters to conclude that those offerors possessed an adequate CAS. Second, the DCAA letters do not indicate that [. ..] and [. ..] CASs were audited and found adequate by the DCAA or another CFA—as required by the solicitation—even if the ICPs were submitted in connection with a cost-reimbursement contract.

In sum, the CO could not rationally conclude that the DCAA letters unequivocally indicated that [. ..] and [. ..] possessed a CAS that the DCAA (or another CFA) had audited and deemed adequate. He therefore acted arbitrarily and capriciously when he relied on the letters to validate the points those offerors claimed for maintaining an acceptable CAS.

(Internal citations/footnotes omitted.)

So far, so good. But Chief Justice Sweeney wrote something that we believe is novel, in terms of evaluating a contractor's accounting system. She wrote (in footnote 14)—

With respect to assessing whether a contractor possesses an adequate CAS, the limited evidentiary value of an ICP is a function of the contract types that trigger a contractor's obligation to submit an ICP. An ICP must be submitted in connection with a cost-reimbursement contract or a time-and-materials contract. … The restrictions on those contracts are instructive here; a cost-reimbursement contract can only be awarded to a contractor with an adequate CAS… but there is no similar limitation on the award of time-and-materials contracts… . *Thus, a contractor's submission of an ICP for a cost-reimbursement contract reflects that it has an adequate CAS, but the same conclusion cannot be drawn when the contractor submits an ICP in connection with a time-and-materials contract.*

(Emphasis added.)

Thus, according to this decision, if a contractor has the ability to submit an adequate proposal to establish final billing rates for its cost-reimbursement contract(s), then by definition it must have an adequate accounting system. This is a new one for us.

Let's explore this a bit further. Earlier in the same decision, the Chief Judge wrote—

A government contractor can receive a cost-reimbursement contract without having a CFA provide an audit-and-adequacy determination. See, e.g., FreeAlliance.com, LLC v. United

States , 135 Fed. Cl. 71, 73-74 (2017). Indeed, the FAR is silent with respect to how a procuring agency must assess the adequacy of a CAS, see FAR 16.301-3(a)(3), and agencies have accepted materials other than a CFA audit-and-adequacy determination, see, e.g., FreeAlliance.com , 135 Fed. Cl. at 73-74 (describing a solicitation in which offerors could submit a determination from a Certified Public Accountant as evidence that they possessed an acceptable CAS).

Thus, it seems clear that a contractor can receive a cost-reimbursement contract without having DCAA, DCMA, or a cognizant Federal agency make an official determination that the contractor's accounting system is adequate. If, then, a contractor does receive a cost-type contract without that determination, and subsequently submits its proposal to establish final billing rates, and if DCAA then determines that proposal to be adequate but declines to audit it, under Judge Sweeney's logic that contractor would then have an accounting system just as adequate as a contractor that passed an SF 1408 or DCAA accounting system review.

It seems to be a bit of an assumption, doesn't it?

Look again at the second quote at the top of this article. As the DFARS PGI makes clear, a contractor can receive a cost-type contract even if its accounting system has been found to be officially inadequate by DCAA, DCMA or a cognizant Federal agency. Moreover, when you factor in DCAA's propensity for not auditing contractor proposals to establish final billing rates with the logic manifested above, you may come to the conclusion that the Chief Judge has made more than a bit of an assumption; you may well conclude that she's made an error of law.

On the other hand, it's buried in a footnote and, arguably, not material to the decision. Thus, it may be considered to be *dicta*. Unless you are one of those contractors with a cost-type contract but without an official accounting system adequacy determination—in which case, you may want to retain a link to this decision for future use.