Time and Material (T&M) contracts have always been the least preferred contract type, whether you are a Government customer or contractor.

From a Governmental viewpoint, a T&M contract does not require performance; it requires delivery of hours. The contractor delivers the hours and it gets paid at the specified contractual rates, regardless of whether or not those hours actually lead to the desired program outcome. In addition, there are cost-reimbursement aspects (on the "M" side) which means audits and negotiated final rates … which means it's going to take quite some time to actually close-out that contract after performance.

From a Government contractor perspective, a T&M contract requires juggling a number of variables to ensure a profit is generated. Employee salaries need to be estimated in advance, as do indirect rates. If somebody gets an unexpected raise, or if the indirect rates unexpectedly jump, then there is going to be immediate profit degradation. In addition, the T&M Payment clause (52.232-7) imposes a number of relatively onerous compliance requirements and the Allowable Cost & Payment clause (52.216-7) also imposes a number of definitely onerous compliance requirements. And the fact that actual allowable indirect cost rates are allocated to the "M" side means audits and auditors and protracted final rate negotiations … which means it's going to take quite some time to actually final-bill and close-out that contract after performance.

The profit negotiations on T&M contracts are difficult. Officially the contractor should not bill profit/fee on the "M" side of its contract. Officially subcontractor hourly billing rates (which include billing rates for other affiliated divisions of the contractor) do not bear any prime contractor profit. But of course the contractor expects to be paid a reasonable profit, not only on its own contract hours, but also on the hours billed by its subcontractors. Given that the only

way to bill profit on those other hours (and materials and travel and Other Direct Costs) is to bake them into the contractor's hourly billing rates, what seems like a reasonable bottom-line profit percentage to the contractor seems egregiously rapacious to the Government Contracting Officer trying to negotiate a price.

For the foregoing (and other) reasons, neither contractors nor their Government customers should desire to enter into a T&M contract.

That warning doesn't keep far too many T&M contracts from being awarded each day. The Government keeps issuing 'em and contractors keep signing up for 'em, even though both parties know going in that there are going to be difficulties and risks, and at the end of the period of performance somebody is likely to be upset.

And the risk/reward equation of T&M contracts just skewed once again, as DCAA issued **new audit guidance** on May 22, 2014. The audit guidance reminds auditors of old 2007 guidance (issued in conjunction with the revision of the 52.232.7 T&M Payment clause) that said-

Labor hours incurred to perform tasks for which labor qualifications were specified in the contract will not be paid to the extent the work is performed by employees that do not meet the qualifications specified in the contract, unless specifically authorized by the Contracting Officer.

The audit guidance recognizes that each hourly labor category not only has a fixed billing rate, but also has a definition as to which contractor (or subcontractor) employees are allowed to bill at that particular rate. (We should note that is yet another variable the contractor needs to manage: making sure that its mapping of employees to labor categories/hourly billing rates complies with contractual definitions.)

The DCAA audit guidance tells auditors that a contractor's failure to properly map its employees to the contract-defined labor categories/hourly billing rates is not just an opportunity to question costs. It is also an opportunity to question the adequacy of a contractor's accounting system. The audit guidance states-

If the audit team determines that the contractor has a material amount of T&M billings that include hours that do not meet the labor qualifications specified in the contract, a significant deficiency related to DFARS 252.242-7006(c)(12) should be reported. The contractor has failed to establish adequate internal controls to exclude from costs charged to Government contracts, amounts that are not allowable in terms of contract provisions in the FAR 52.232-7 T&M Payment Clause. An adequate accounting system would include procedures for a contractor to ensure that they get the Contracting Officer's specific authorization prior to the delivery and billing of hours that do not meet the qualifications specified in the contract.

Consequently, a T&M contract not only includes most of the "normal" risks associated with government contracting plus unique profit risks plus unique personnel risks, it now also includes the risk that if you get anything wrong and DCAA notices your mistake, you may have to deal with a "deficiency report" and a recommendation that your accounting system be deemed to be inadequate for cost-reimbursement and/or T&M contracting.

But readers may notice something in the new DCAA audit guidance: it isn't new. It's essentially a rehash of the 2007 audit guidance plus a bolt-on paragraph related to the DFARS Business Systems administration/compliance regime. So why did DCAA issue it?

Well, we don't know the answer to that question. But we did notice a May 19, 2014 **article** in the Washington Post that reported on the findings of a DOD Inspector General audit report. The DOD IG report was FOIA'd by POGO (the Project on Government Oversight) and would not otherwise have been published had POGO not FOIA'd the DOD IG.

The not-for-publication DOD IG audit report found that from October 2007 through March 2013 Northrop Grumman "did not properly charge labor rates" for a counter-narcoterrorism contract. WaPo reported that "the Army agency in charge of the contract did not ensure that the people performing the work had the necessary qualifications. The agency also did not review invoices for millions of dollars of overtime."

Moreover (according to WaPo)-

… the IG found $21.7 million in 'potentially excessive payments' for overtime, including one employee who billed $176,900 for 1,208 hours in a 12-day period. That caught investigators'

attention, since the employee was billing for more than 100 hours a day. The IG found that out of the charges submitted over nearly six years for 460 DynCorp employees working for Northrop Grumman, 360 did not meet the specified labor requirements, leading to $91.4 million in questionable costs. In one case, a program manager who billed 5,729 hours over a year and a half, totaling $1.2 million, did not have a bachelor's degree, which was a requirement of the position. Another employee billed 16,270 hours' worth $2 million over five years but was qualified for only 161 hours of the work.

Is there a connection between the May 19, 2014 Washington Post story about mismatches between contractor employee qualifications and contract-defined labor categories with individually specified hourly billing rates, and the May 22, 2014 reminder to DCAA auditors to check for matches between contractor employee qualifications and contract-defined labor categories with individually specified hourly billing rates?

We don't know but, if there is no official connection, then it's surely a strange coincidence, is it not?