Recently we **published** an article criticizing DCMA for over-reliance on DCAA auditors. In that article, we noted that a Contracting Officer cannot use the fact that they are awaiting a DCAA audit report as a pretext for failing to issue a Contracting Officer's Final Decision (COFD) as required by the Contract Disputes Act. The DCAA audit report might address the amount of the costs at hand but cannot address whether or not the contractor is *entitled* to those costs. Determining entitlement is the CO's job.

And now comes a story about a CO who failed to rely on DCAA. She failed to listen to DCAA, to incorporate the audit findings into her decision, and, as a result, the government may have overpaid a subcontractor's Termination Settlement Proposal (TSP). Maybe.

For those who don't know, a TSP is what happens when your contract has been terminated for convenience (T4C). We've discussed terminations before – see, for example, **this article** . As we noted in that article, when a contractor receives a T4C notice, it needs to take certain actions. The first action is (perhaps obviously) stop work. We wrote—

Now, that doesn't mean turn off the lights and walk out the door. To the contrary, you must cease ongoing contract performance in a reasonable, prudent, and measured manner. For example, you don't tell your procurement staff to stop work—because they need to flow down the T4C Notice to your contract suppliers and subcontractors, and they need to administer the supplier termination efforts. You also don't stop the production machines, leaving materials in the middle of fabrication.

Instead, you take measures to shut down production like a prudent business person, and you protect the government's interest. That means finishing production at a reasonable stopping place, carrying the finished and unfinished goods to property storage, and logging them in. That means saving all work and logging/indexing what's been done and what's not been done. Doing all this may take a few days. As we used to say, 'You can turn off a faucet, but there's still a few drops left to go.'

Remember, you're going to have to justify all this work to Government auditors. So it's not a license to permit employees to keep charging numbers beyond that which is necessary and prudent. Consider it a rapid ramp-down, or perhaps a safe landing without power. Approach the

situation in a business-like and prudent manner.

In this story, which comes courtesy of a formal DoD OIG report (link **right here**), it appears that neither the contractor nor the subcontractor read our article on terminations. As a result, the subcontractor had problems passing its DCAA audit.

But let's start at the beginning—at least, the beginning as the DoD OIG told the story. On August 11, 2009, the USAF issued a "stop work" notice to the contractor with respect to purchases of titanium for the F-22 fuselage. That stop work order including, obviously, all subcontractors connected with that activity. On December 18, 2009 that activity was formally terminated for convenience. Now the DoD OIG didn't address the issue, but it would have been interesting to know the chronology of the prime contractor's communications with its subcontractor(s). While we don't know that, we do know that one subcontractor submitted a TSP to the Air Force, in the amount of $2,930,817, on August 27, 2010. That TSP was updated twice, once to remove more than one million dollars in "unallowable costs," and again to provide "updated supporting documentation." The final version of the subcontractor's TSP was dated October 11, 2011—more than a year after initial submission.

Less than a month later (November 5, 2011), the USAF Terminating Contracting Officer (TCO) requested a DCAA audit of the subcontractor's TSP. DCAA issued its report on April 29.2014. In other words, the audit report was issued two years and five months after the request was issued. Yes, you read that correctly: *DCAA took 29 months to audit a TSP valued at $1,860,001* .

In that audit report, DCAA questioned $825,910 of the claimed $1,860,001—or more than 44 percent of the TSP value. DCAA questioned several aspects of the TSP, including $353,577 in costs incurred after issuance of the "stop work" order. DCAA also questioned $472,333 in claimed costs, asserting that they were unallowable. (Remember, the subcontractor had already removed more than a million dollars' worth of unallowable costs before DCAA received the audit request.)

With respect to the costs incurred after receipt of the "stop work" order, the DCAA audit report apparently questioned subcontractor costs incurred after receipt of the stop work order by the prime contractor, ignoring the date on which the subcontractor received a stop work order from the prime. The DoD OIG report stated "The DCAA audit report questioned $353,577 in subcontractor costs that were incurred up to 109 days after the Air Force termination contracting

officer issued a stop-work order for all activities associated with the purchase of titanium for the F-22 aircraft." Though we are not lawyers, we bet a skilled government contracts attorney could exploit that audit report position. It is very possible that, if the prime contractor were negligent in transmitting the stop work notice to the subcontractor, the costs would be allowable for the subcontractor but unallowable for the prime contractor. Interestingly, the DoD OIG report ignored this potential issue.

With respect to the alleged unallowable costs, DCAA questioned $86,691 in claimed costs "because the proposed costs were not based on current market prices at the time of the settlement proposal." That's weird, right? Because presumably the costs were already incurred, so what impact could current market prices have on historical costs? Anyway, we don't know. Perhaps there was a contract clause that would have required revision of historical costs to current costs (e.g., a "mark to market" requirement). But absent such a clause, that seems to be a weird finding.

Also, DCAA questioned $84,023 in claimed costs because they were not "allocable" to the terminated portion of the subcontract. They were costs that the subcontractor "did not incur as estimated at the time of the settlement proposal" and they were "overstated when calculating the proposed direct costs." That tells us that we are dealing with indirect costs. Somehow the subcontractor was using estimated final indirect rates instead of actual rates (perhaps because it hadn't yet calculated its actual rates). Further, since DCAA was questioning allegedly overstated direct costs, then obviously indirect costs allocated to that figure would also be questioned.

Finally, DCAA questioned $301,619 in raw material costs (titanium, we presume) that the subcontractor had acquired and processed "before the Air Force contracting officer exercised a contract option to authorize the material." Again, a weird finding. It makes it sound like the subcontractor had a prime contract directly with the Air Force, instead of a subcontract with the prime contractor. Who cares what the USAF CO did or did not exercise? Instead, the question should be what direction did the prime contractor provide to the subcontractor? Unfortunately, the DoD OIG report didn't address that question.

To sum it up, the DoD OIG treated the DCAA audit report as if it were Gospel, whereas we might have picked a few nits with its conclusions.

But the real issue here is the DCMA Contracting Officer, and how she treated the DCAA audit

report. The DoD OIG report stated that—

In the price negotiation memorandum, the DCMA Contracting Officer indicated that she would uphold all of the DCAA-questioned costs totaling $825,910. However, in another section of the price negotiation memorandum, the DCMA Contracting Officer authorized reimbursement of the full proposed amount of $1,860,001 in subcontractor termination costs. The price negotiation memorandum did not address the inconsistency or explain why the DCMA Contracting Officer authorized full payment of the $1,860,001 subcontractor's termination settlement proposal.

Oops!

The DCMA TCO signed the PNM; the TCO's Supervisor signed the PNM. Nobody noticed the discrepancy. On April 28, 2016, the prime contract was modified and the subcontractor's TSP was approved as submitted for 100% reimbursement. The DCMA TCO notified DCAA on May 3, 2016. And the DoG OIG Hotline received a complaint on August 22, 2016, alleging that the TCO "failed to comply with the [the FAR and the contract] when she did not uphold any of the [DCAA] questioned costs of $825,910 [and] authorized full payment of the $1,860,001 subcontractor's termination settlement proposal."

Needless to say, the DoD OIG substantiated those allegations.

But what's interesting is what the TCO said during her interviews with the DoD OIG. According to the DoD OIG report, the TCO stated that she lacked experience and knowledge in how to deal with the issues involved with settling a TSP, including negotiating and documenting her evaluation of DCAA questioned costs. She stated that she "did not have any experience with contracting actions greater than $750,000 because prior to this termination, she only handled contracting actions below $750,000, which did not require negotiations involving DCAA audits…" The DoD OIG folks checked and confirmed that she had the requisite training; however, that training apparently didn't stick. They would also have checked with the TCO's supervisor, to try to figure out why he would have approved that PNM—but he retired a few months after the Hotline report had been submitted.

The TCO had her Warrant rescinded.

What about the contractor and the subcontractor, who had allegedly received $825,910 in cost reimbursements to which they were (allegedly) not entitled? According to the DoD OIG report—

[The TCO] issued a request for a voluntarily refund to the prime contractor. However, the contractor declined the request because the signed contract modification settling the termination costs was final and the contractor had already paid the subcontractor. DCMA determined that, because the DCMA Contracting Officer acted within the scope of her official duties, the Government is bound by the finality of her actions and, as a result, the funds cannot be recouped.

So that, it seems, was that.

One final thought:

The DoD OIG report didn't really address the issue of the prime contractor's role in this *brouhah a* . In fact, the report seemed to confuse the roles and responsibilities of the various parties involved in the termination process. For the record, FAR 49.107(b)(2) requires the prime contractor to review its subcontractors' TSPs—even if they are also being reviewed by a governmental audit agency. The TSP Certification, executed by the prime contractor, states "The contractor has examined, or caused to be examined, to an extent it considered adequate in the circumstances, the termination settlement proposals of its immediate subcontractors..." There is a real question, at least in our minds, as to whether the prime contractor fulfilled its responsibilities in this situation.

Which leads us to this conclusion:

Readers, if you are a prime contractor or subcontractor in receipt of a "stop work" order or formal T4C Notice, we urge you to do a couple of things right away: (1) stop work, and (2) contact people who understand the termination process and know what to do. If you try to figure it out on your own, you may find yourselves the topic of your very own DoD OIG audit report.