

Time Charging Problems Haunt Northrop Grumman for Years

Written by Nick Sanders

Wednesday, 15 September 2021 00:00 - Last Updated Wednesday, 15 September 2021 17:09

In 2013, Northrop Grumman Mission Systems identified that certain employees stationed in OCONUS locations had perhaps mischarged some of their time between 2010 and 2013. For example, it was alleged that some employees charged labor hours to government contracts for time spent on recreational activities such as attending movies. Upon discovery of the issues, the company “took disciplinary action against those who we found acted improperly and violated company policy, and we took corrective action to strengthen our time-charging processes even further. We cooperated with the government as it investigated the issues over the following years.” (See [this article](#) .)

Upon discovering its time charging problems, Northrop hired outside attorneys (who likely hired forensic accounting consultants) to investigate. Normally, such investigations do more than simply quantify the amount of the problem; they also look at internal controls to see where they may have failed, and they attempt to identify those employees responsible for the alleged wrongdoing and the control breakdowns. Such investigations are never cheap. In this case, it appears that Northrop Grumman incurred roughly \$15 million over a four-year period related to this matter.

Think that’s a lot of shareholder money? Well, Northrop’s “support” of the government investigation involved “collecting more than 25 million records from employees in the United States, and overseas, producing over 1.3 million pages of documents, and interviewing over 100 employees.” Such efforts do not come cheaply.

In 2018, Northrop and the government entered into a settlement agreement, in which the company agreed to pay \$30 million, in addition to \$1.65 million in burdened labor costs it had already refunded to its US Air Force customer. The DoJ [press release](#) headline understates the settlement amount because it omits the \$4.2 million paid to the U.S. Attorney’s Office of the Southern District of California (as explained in the first article.) So: \$31.65 million would be the settlement amount—an amount that does not include the cost of hiring outside attorneys and consultants to investigate the problem and reach a settlement.

Flash forward to 2020—seven years after the initial wrongdoing was reported to the government—and Northrop’s DCMA contracting officer issued a Final Decision in which he “determined that from FY 2012 to 2016 NGMS had included expressly unallowable legal costs of more than \$15 million related to the BACN criminal matter in its final indirect cost proposals. Of this amount, \$10,120,681 had been allocated to covered contracts and had been reimbursed through interim billings. He assessed a penalty in this amount, plus interest of \$1,432,201, for a

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total claim amount of \$11,552,882.”

Note that this amount was in addition to the \$31.65 million that Northrop Grumman had already agreed to pay through its False Claims Act settlement.

The CO determined that Northrop’s costs were expressly unallowable under the 31.205-15 cost principle, which states that—

Costs incurred in connection with, or related to, the mischarging of costs on Government contracts are unallowable when the costs are caused by, or result from, alteration or destruction of records, or other false or improper charging or recording of costs. *Such costs include those incurred to measure or otherwise determine the magnitude of the improper charging, and costs incurred to remedy or correct the mischarging,* such as costs to rescreen and reconstruct records.

(Emphasis added.)

In addition, the CO found that the costs would also be unallowable under the cost principle at 31.205-47 (Legal Proceedings).

You may be wondering why Northrop claimed the costs in the first place. The answer is that the costs may have been allowable when incurred, but only became unallowable at a subsequent point in time. This is why the issue of allowability is so challenging: costs may be *retroactively* unallowable, based on what the contractor learns and how it interacts with the government.

For example, if you were to locate and read the FAR Council’s promulgating comments on 31.205-15, you’d learn that the cost principle does not make the normal operation of a contractor’s internal control system unallowable. The cost of evaluating internal controls and assessing whether transactions violated those controls is entirely allowable. Even when the outcome of such evaluations is a disclosure to the government under the contract clause 52.203-13 (“Contractor Code of Business Ethics and Conduct”), all the costs of getting to that disclosure (and supporting that disclosure through government review) are still normal

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operations and 100% allowable. (Despite what certain DCAA auditors may assert.)

It is only when the matter moves into the legal arena that the costs become unallowable. For example, if the government files a suit under the False Claims Act and the company enters into settlement agreement discussions, then those costs become unallowable from that point forward. And if the company enters into a settlement agreement, then it needs to look backwards at the costs it has incurred, and stratify those costs between allowable internal controls analyses and unallowable litigation support. Apparently, Northrop didn't do that in this situation, leading to the COFD.

The requirement to assess allowability retroactively is especially important when, as in this case, the settlement agreement expressly addressed the issue, and stated—

Within 90 days of the Effective Date of this Agreement, NGSC shall identify and repay by adjustment to future claims for payment or otherwise any Unallowable Costs included in payments previously sought by NGSC or any of its subsidiaries or affiliates from the United States. NGSC agrees that the United States, at a minimum, shall be entitled to recoup from NGSC any overpayment plus applicable interest and penalties as a result of the inclusion of such Unallowable Costs on previously-submitted requests for payment . . .

So here we are, in 2021, dealing with costs incurred between 2012 and 2016, related to alleged wrongdoing that took place between 2010 and 2013—wrongdoing that was the subject of an FCA settlement agreement in 2018. Lovely to see justice more forward so swiftly, isn't it?

Northrop appealed the COFD and, in its appeal, made a motion for summary judgment. In June, the ASBCA denied that motion. (ASBCA No. 62596, June 21, 2021.) The denial took only 11 pages.

At this point, the parties look to be moving towards a trial on the merits. However, given the Board's quick dismissal of Northrop's arguments, we suspect it's more likely that the next Board decision we'll be seeing is a statement that the dispute has been settled and is being dismissed with prejudice.

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This story is, unfortunately, a great example of how time charging problems can expand into a full-blown False Claims Act litigation matter. It also provides some insight into how government accounting and compliance folks ought to be looking at the costs incurred in evaluating internal control failures and supporting outside counsel.

As with so many of the blog articles on this website, the objective is to provide readers with lessons learned by other contractors, so that the readers can avoid similar situations. And, perhaps, save themselves a few million dollars in the process.