

Overcharged Overhead

Written by Nick Sanders

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Federal contractor Charles Stark Draper Laboratory, Inc. is a not-for-profit entity based in Cambridge, Massachusetts. Recently, Draper entered into a settlement agreement with the U.S. Government to resolve allegations that it “improperly overcharged the government under federal acquisition regulations (*sic*) for certain overhead costs.” The costs were recorded in 2016, and were identified during government audit.

The government alleged that Draper “improperly billed the government for costs associated with internal projects that Draper called ‘Opportunity Investments.’” It’s not clear exactly what Draper’s Opportunity Investments were. Were they akin to contractor Independent Research and Development (IR&D) efforts? Or perhaps they were internal projects intended to result in process efficiencies and/or cost reduction. We don’t know.

But we do know that Draper’s “Opportunity Projects” were audited, and the audit asserted that “Many Opportunity Investment projects were not of interest to the government, or Draper lacked sufficient documentation to justify the costs.” Readers are reminded of FAR 31.201-4, which discusses the concept of *allocability*. Costs may be allocated under one of three methods; the method that seems germane here is the notion that a cost is allocable to a government contract if the cost “benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received ...” In other words, when challenged, a contractor must be able to describe the beneficial relationship between the costs it has incurred and the amount(s) allocated to its government contracts.

We don’t know if Draper’s contracts contained additional DFARS cost principles, or if those cost principles were related to the “Opportunity Projects.” Assuming yes and also assuming that the Opportunity Projects were akin to IR&D projects, then DFARS 231.205-18 requires a “major contractor” (as defined in that cost principle) to analyze its IR&D costs for efforts “of potential interest to DoD.” IR&D expenses that are not of potential interest to DoD are not allowable costs with respect to contracts that contain the DFARS IR&D cost principle.

Again, there’s a lot we don’t know about the situation. However, the DoJ [press release](#) did offer the following additional information—

The audit also found that Draper lacked sufficient internal accounting controls concerning Opportunity Investments. When the Department of Defense requested additional information

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about the costs flagged by the audit, Draper, for months, did not reveal that it lacked documentation to support charging some of the Opportunity Investments to the government.

That additional bit points to some other issues that Draper allegedly had. First, most everybody should understand that DCAA probes for internal controls in most (if not all) of its Business System audits—including audits of a contractor's accounting system. (We've written about that aspect of accounting system audits on this blog.) If a contractor does not have robust (and documented) internal controls, then it will likely not do particularly well in its audits.

Second, Draper (allegedly) didn't tell the government auditors that it lacked documentation to support the allocation of its Opportunity Investment project costs to its government contracts. Readers are reminded that FAR 31.201-2 ("Determining Allowability") states—

A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported.

We don't know the total dollars involved, but we do know that Draper settled the allegations for \$3.5 million (not counting unallowable attorney fees). Gosh, we wonder how many internal controls could have been established and documented for that kind of money?

So there you go. Draper's costs were subject to disallowance on a variety of potential bases. As always, our intent here is not to castigate Draper, but instead to provide an opportunity for our readers to learn from Draper's mistakes, so as to avoid their own.