



DENTONS

Essential Updates in Government Contracting for 2024

October 23, 2024

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Agenda

1:00–1:30 p.m.		Registration
1:30-1:35 p.m.		Welcome <i>Jamie Sybert, HKA</i>
1:35-2:35 p.m.	UPDATES	Legislative/Regulatory Developments <i>Tom Reynolds, HKA and Joe Martinez, Dentons</i> <i>Followed by Q&A and break</i>
2:45--3:45 p.m.		Contract Performance Issues <i>Julia Alcaarez, HKA and Phil Seckman, Dentons</i> <i>Followed by Q&A and break</i>
3:55-4:55 p.m.		Cost and Pricing <i>Jennifer Flickinger, HKA and Steve Masiello, Dentons</i>
4:55-5:00 p.m.	CONCLUSION	Closing Remarks
5:00-6:00 p.m.		Reception



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Essential Updates in Government Contracting for 2024

Legislative and Regulatory Developments

Tom Reynolds, HKA and Joe Martinez, Dentons

October 23, 2024

Agenda

- FAR/DFARS Updates
- The White House & Executive Orders
- Agency Memoranda & Reports
- Legislative Updates

FAR/DFARS Updates

DoD Final Rule on Non-Mandatory Contract Clauses

- On November 17, 2023, DoD issued a final rule amending DFARS 252.244-7000 to prohibit prime contractors from flowing down non-mandatory contract clauses.
- DFARS 252.244-7000 now states, in relevant part, that contractors shall not include the terms of any FAR or DFARS clause in subcontracts for commercial products or commercial services unless:
 - (1) for DFARS clauses, it is so specified in the particular clause; or
 - (2) for FAR clauses, the clause is listed at FAR 12.301(d) or it is so specified in paragraph (e)(1) of the clause at FAR 52.212-5 or paragraph (b)(1) of the clause at FAR 52.244-6, as applicable.
- This marks a significant change from the previous framework, and may raise a need for contractors to revisit their standard flowdowns to assess how to handle non-mandatory clauses that have historically been deemed necessary to perform the prime contract, meet compliance requirements, or otherwise manage risk

DoD Final Rule Consolidating DFARS Gov't Property Clauses

- On December 22, 2023, DoD issued a final rule to amend the DFARS to consolidate four DFARS property clauses into a single clause.
 - Follows a proposed rule issued on April 27, 2023 and creates a new clause, DFARS 252-245-7005, Management and Reporting of Government Property
 - Will be included in DoD contracts containing the FAR 52.245-1 Government Property clause
- The four DFARS clauses that were consolidated are:
 - 252.211-7007, Reporting of Government-Furnished Property
 - 252.245-7001, Tagging, Labeling, and Marking of Government-Furnished Property
 - 252.245-7002, Reporting Loss of Government Property
 - 252.245-7004, Reporting, Reutilization, and Disposal
- References DoD's Government-Furnished Property (GFP) module "to house the GFP life-cycle reporting requirements to provide end-to-end accountability for all GFP transactions within a single, secure, integrated system."

FAR Council Proposed Rule on Pay Equity and Transparency in Federal Contracting

- On January 30, 2024, DoD, GSA, and NASA proposed a rule amending the FAR to implement a proposed Governmentwide policy developed by the Administrator for Federal Procurement Policy (OFPP Administrator), pursuant to the Administrator's authority that would prohibit contractors and subcontractors from seeking and considering information about job applicants' compensation history when making employment decisions for certain positions.
- Under the proposed policy and the proposed regulatory amendments, contractors and subcontractors would also be required to disclose the compensation to be offered to the hired applicant in job announcements for certain positions.

DoD Final Rule on the Buy American Act

- On February 15, 2024, DoD issued a final rule to amend the DFARS to implement the Ensuring the Future is Made in All of America by All of America's Workers Executive Order.
- The final rule addresses increasing the impact of the Buy American Act and supplements a FAR final rule issued on March 7, 2022 to address DoD-unique requirements.
- The final rule increases the domestic content threshold to 65% in calendar years 2024–2028 and 75% for items delivered starting in calendar year 2029.
- The final rule permits a “fallback threshold” of 55% until January 1, 2030 if domestic products at a higher level are not available or the acquisition cost is unreasonable.

DoD Final Rule on Sustainable Procurement

- On April 22, 2024, DoD, GSA, and NASA issued a final rule amending the FAR (follows December 8, 2021 Executive Order and became effective May 22, 2024)
- Restructures and updates the regulations
 - Focus on current environmental and sustainability matters
 - Implement a requirement for agencies to procure sustainable products and services to the maximum extent practicable.
- FAR changes include the following:
 - Dedicates FAR 23 to environmental matters (moves content on drug-free workplaces and banning texting while driving to FAR Part 26)
 - Adds definition of “sustainable products and services” to FAR 2.101
 - Consolidates/updates environmental purchasing requirements in FAR subpart 23.1, Sustainable Products and Services
 - Creates new omnibus FAR clause at FAR 52.223-23, Sustainable Products and Services
 - Dedicates FAR subpart 23.2 to energy savings performance contracts
 - Consolidates requirements related to hazardous and radioactive material in FAR subpart 23.3
 - Consolidates and updates Federal facility and pollution prevention requirements in FAR subpart 23.4

DoD Final Rule – Data Requirements for Commercial Products of Major Weapon Systems

- May 30, 2024 final rule implements section 803 of the NDAA for FY 2023
- Clarifies “the data to be provided for certain procurements related to major weapons systems”
- Guidelines contractor must follow for weapons systems proposed as commercial that have not previously been determined to be commercial:
 - Identify the comparable commercial product that it sells to the public
 - Provide a comparison of the physical characteristics and functionality
 - Provide the national stock number for the comparable commercial products and for the subsystem or spare part
- Contractor must provide a representative sample of prices paid under similar or comparable terms and conditions
- If insufficient to establish price reasonableness, or sales data indicates price is not reasonable, contracting officer shall seek approval to obtain data other than certified cost or pricing data
- Effective May 30, 2024

DoD Proposed Rule Defining Material Weakness

- On June 27, 2024, the DoD published a proposed rule to amend the DFARS to implement section 806 of the NDAA for FY 2021 (Pub. L. 116-283), which amends section 893 of the NDAA for FY 2011 (Pub. L. 111-383), to enable clear classification of deficiencies according to their severity, consistent with generally accepted auditing standards
- This proposed rule replaces the term “significant deficiency” with “material weakness” in multiple DFARS contract clauses.
 - “Material weakness” is defined as “a deficiency or combination of deficiencies in the internal control over information in contractor business systems, such that there is a reasonable possibility that a material misstatement of such information will not be prevented, or detected and corrected, on a timely basis”

DoD, NASA, and GSA Proposed Rule – Greenhouse Gas Emissions and Climate-Related Risks (November 14, 2022)

- Require major federal suppliers to “disclose their greenhouse gas emissions and climate-related financial risk and set science-based targets to reduce their greenhouse gas emissions”
 - Significant contractors – received between \$7.5 million and \$50 million in federal contract obligations during the previous fiscal year
 - Scope 1 – emanate from sources that are owned or controlled by the contractor
 - Scope 2 – Purchased for the contractor’s consumption but occur at a source that is owned or controlled by another entity (e.g., electricity, heating and cooling, etc.)
 - Major Contractors – received more than \$50 million in federal contract obligations in the previous fiscal year
 - Scope 3 – emissions that occur at a source other than those owned or controlled by the contractor but are a consequence of the contractor’s operations
 - Science-based target represents a target for reducing GHG emissions deemed sufficient to meet the Paris Agreement goals to limit global warming
- Comments on the proposed rule were due February 13, 2023
- Final rule report date extended to October 23, 2024

DoD, NASA, and GSA Proposed Rule – Greenhouse Gas Emissions and Climate-Related Risks (November 14, 2022) (cont'd)

- Section 318 of National Defense Authorization Act (NDAA) for FY 2024
 - Prohibits nontraditional defense contractors from disclosing greenhouse gas inventories or emissions as a condition of contract award
 - Prohibits traditional defense contractors from disclosing greenhouse gas inventories or emissions until December 22, 2024
 - Waiver may be granted on a case-by-case basis if the data is directly related to performance of a contract
- February 25, 2024 class deviation
 - Addresses limitations set forth in Section 318 of the FY 2024 NDAA
 - Data that may otherwise be required as part of annual representations and certifications will not be considered when awarding contracts

DoD Proposed Rule on OTAs

- On September 4, 2024, DoD released a proposed rule to revise regulations related to Other Transaction Agreements (“OTAs”).
- The rule would make the following changes:
 - Allow for follow-on production OTAs
 - Change the use of OTAs for prototype projects so it does not require a cost share from a performer when at least one nontraditional defense contractor is participating to a significant extent
 - Provide authority for the senior procurement executive of the agency to make an exceptional circumstances justification to use such a prototype OTA transaction
 - Apply procurement ethics requirements to covered OTAs: Post-government employment restrictions
 - Promote competition to the maximum extent practicable
- Comments on this proposed rule close on November 4, 2024

DoD Proposed Rule Preventing Conflicts of Interest for Certain Consulting Services

- On September 26, 2024, DoD published a proposed rule to amend the DFARS to implement Section 812 of the FY 2024 NDAA, which prohibits contracting officers from awarding contracts assigned certain North American Industry Classification System (NAICS) codes (management, scientific, and technical consulting services) to offerors that perform consulting service contract with certain covered foreign entities including Russia, China, and other covered countries.
- Offerors responding to solicitations for consulting services would have to certify whether or not they (or their subsidiaries and affiliates) hold contracts that involve consulting services with one or more covered foreign entities and if so, they must disclose and implement a conflict-of-interest mitigation plan.
- This change coincides with a GAO report released on September 19, 2024, finding that the current regulations do not address the risks posed by the federal government's consultants who also provide consulting services to China. The report recommended that DoD take steps to ensure this risk is mitigated.
- Comments on this proposed rule close on November 25, 2024

DoD Final Rule Establishing the Cybersecurity Maturity Model Certification (CMMC) Program

- On October 15, 2024, the DoD released a final rule to establish the CMMC 2.0 program
- CMMC 2.0 provides a framework for assessing contractor implementation of cybersecurity requirements and enhancing the protection of unclassified information within the DoD supply chain.
 - It "will allow the [DoD] to confirm a defense contractor or subcontractor has implemented the security requirements for a specified CMMC level and is maintaining that status...across the contract period of performance."
- The CMMC Program contains three key features:
 - Tiered model - cybersecurity standards must be implemented at progressively advanced levels
 - Assessment requirement - DoD can verify contractors' implementation of cybersecurity standards
 - Phased implementation - Contractors handling Federal Contract Information and Controlled Unclassified Information must achieve a certain CMMC level as a precondition of contract award in accordance with a "4-phase implementation plan over a three-year period"

The White House & Executive Orders

White House Better Contracting Initiative

- On November 8, 2023, the Biden-Harris Admin announced a “Better Contracting Initiative” designed to “ensure that the Federal Government is getting better terms and prices when purchasing goods and services.”
- Although the Administration acknowledges that the government purchases unique and highly customized goods and services, it expressed concern that it is often paying high and inconsistent prices. The Administration hopes government agencies performing as an organized entity can achieve at least \$10 billion in additional annual savings and cost avoidance.
- The Better Contracting Initiative includes the following four recommendations:
 - (1) Leverage data across federal agencies to get lower prices and better terms
 - (2) Negotiate common enterprise-wide software licenses
 - (3) Save money and avoid waste by getting contract requirements right the first time
 - (4) Get better value from sole source and other high-risk contracts
- The Better Contracting Initiative indicates that agencies will be increasing the use of hybrid contracts “to better align with levels of risk during different parts of the lifecycle of a large acquisition for development and production”

White House Small Business Guidance Under Multiple-Award Contracts

- On January 25, 2024, the White House introduced new guidance from OMB with the goal of increasing small business participation on multiple-award contracts.
 - Multiple-award contracts afford small businesses the opportunity to “compete for work under the reduced administrative burden and simpler evaluation procedures used to support order competitions rather than pursuing competitions on the open market.”
 - Certain multiple-award contracts have been set aside for small businesses.
- The guidance is designed to address the goals set forth in the February 2023 Executive Order and the November 2023 Better Contracting Initiative. Ultimately, to increase opportunities for small businesses, the January 25 guidance suggests the following:
 - (1) Engage agency small business specialists early in the acquisition process.
 - (2) Use “on-ramps” as part of acquisition strategy (i.e., allows small and large businesses to be added during contract performance)
 - (3) Avoid applying “off-ramps” to remove businesses when their size status changes (except as part of a merger or acquisition)
 - (4) Apply the rule of two (i.e., contracting officer anticipates at least two competitive offers from small businesses)
 - (5) Maximize orders to small businesses under the simplified acquisition threshold

Agency Memorandum and Reports

DCAA Memoranda

- Contract Compensation Cap (November 21, 2023)
 - Provided the Office of Federal Procurement Policy contract compensation cap of \$646,000 for costs incurred from January 1, 2024 through December 31, 2024
 - Increase of \$27,000 from the 2023 compensation cap of \$619,000 (\$57,000 increase in the past two years, driven primarily by inflation)
 - DCAA updated its Contract Audit Manual
- Updated Guidance on Scanned Images (February 22, 2024)
 - Revised Section 3-204.21 of DCAA's Contract Audit Manual to indicate that “[a]nnual testing of scanned images is now optional and should be performed where contractors and auditors plan to place reliance on scanned images....” Additionally, the mandatory step for assessing scanned images within the 10100 Incurred Cost audit program has been removed.
 - Does not impact the need for audit opinions to be supported by reliable evidence.
 - If DCAA intends to rely on scanned images as audit evidence, it should continue testing a contractor's scanned images on an annual basis.

DCAA Memoranda (cont'd)

- Updated Guidance on Reporting Questioned Direct Costs on Incurred Costs Audits (September 10, 2024)
 - Aligned to March 22, 2023 DFARS final rule
 - Procuring Contracting Officer (PCO) is responsible for negotiating or settling questioned direct costs in an incurred cost audit, but the PCO may delegate such authority to the DCMA Administrative Contracting Officer (ACO) in certain circumstances
 - DCAA updated its Contract Audit Manual (DCAM) to reflect these changes including DCAM 6-708.5, Writing the Audit Report, and DCAAM 10-210.1, Audit Report Distribution and Restrictions
 - Provides guidance for PCO communication with DCAA and the ACO and emphasizes that DCAA should take steps to ensure that the “PCO is correct before reporting on questioned direct costs”
 - Will this guidance continue to blur the lines of the scope of an incurred cost audit (i.e., audit of indirect rates vs. direct costs)?

DoD Memorandum: National Defense Industrial Strategy

- In January 2024, the DoD released its first-ever National Defense Industrial Strategy (NDIS). The overarching goal of the NDIS is “to make the industrial ecosystem dynamic, responsive, state-of-the-art, resilient, and a deterrent to our adversaries.” To accomplish this goal, the NDIS seeks to address/implement:
 - Resilient supply chains
 - Workforce readiness
 - Flexible acquisition
 - Economic deterrence
- With respect to flexible acquisition, the NDIS lays out initiatives designed to help small businesses and nontraditional contractors work with DoD.
 - Addresses the need to reduce barriers to entry to expand and diversify the Defense Industrial Base
 - Acknowledges the benefits that commercial off-the-shelf procurements bring to DoD
 - DoD can use both FAR and non-FAR-based contract types to make its acquisition process more flexible.

DoD Inspector General Report: Cost-Plus-Award-Fee (CPAF) Contracts

- The DoD Inspector General released a report dated February 13, 2024 addressing the audit of DoD's oversight of CPAF contracts.
- The report concluded that DoD provided adequate oversight and justification of contractor award fees on most of the CPAF contracts that were audited, but in certain instances, contracting officials "did not properly justify award fees paid." DoDIG cited a lack of adequate controls as the primary driver for overpayments and improper payments on certain CPAF contracts.
- The report also cited concerns regarding DoD's ability to track award fees paid to contractors, which may make it difficult for DoD to assess the effectiveness of CPAF contracts.
- DoDIG put forth 12 recommendations, which included "recommendations for contracting officials to recalculate the award-fee amounts earned by the contractors, pursue compensation for overpayments, and not allow contractors to begin work without an approved award-fee plan."
- Going forward, contractors who are performing on, or may perform on, CPAF contracts should be cognizant of the fact that contracting officials may more closely scrutinize award-fee determinations.

DOJ Report: False Claims Act (FCA) Settlements and Judgments

- In a press release dated February 22, 2024, the DOJ released its report on FCA settlements and judgments for the government's FY 2023. DOJ recovered approximately \$2.68 billion in fines and penalties resulting from 543 settlements and judgments (highest number ever in a single year).
- Interestingly, this amount was slightly higher than the \$2.2 billion recovered in fiscal year 2022 but still significantly lower than the \$5.6 billion recovered in FY 2021. Breaking down the \$2.68 billion in FY 2023 recovery, more than \$2.3 billion arose from lawsuits filed under the qui tam provisions of the FCA, and approximately \$1.8 billion related to healthcare recovery.
- In addition to healthcare, other FCA recoveries involved procurement fraud, COVID-related fraud, and the cyber-fraud initiative.
- With respect to procurement fraud, several of the largest settlements involved allegations related to improper government contracts billings for costs incurred to support commercial and international contracts, duplicate inclusion of equipment costs in proposals, and failure to meet contract manufacturing specifications regarding composite components.

DoD Memorandum: Whistleblower Protections in Defense Contracts

- On March 20, 2024, DoD released a memo related to whistleblower protections in defense contracts.
- The memo addresses findings from a July 2023 DoDIG audit that found contracting officers generally included the DFARS clause 252.203-7002, Requirement to Inform Employees of Whistleblower Rights, in contracts, but contracting officers “did not verify that contractors informed employees in writing of their whistleblower rights and protections.”
- The memo instructs contracting offices to perform the following:
 - Review existing contracts to ensure they include the DFARS clause 252.203-7002 and to modify contracts if the clause is not included
 - Communicate the importance of whistleblower programs to contracting officials through training programs
 - Apply a risk-based approach to assess whether contractor compliance shall be verified and addressed as part of the contract’s surveillance plan

Legislative Updates



National Defense Authorization Act for Fiscal Year 2024

- Section 801 – Commercial Nature Determination Memo Available to Contractor
- Section 802 – Modification of Truthful Cost or Pricing Data Submissions and Report
- Inflation / Economic Price Adjustments
 - Section 824 – Modification and Extension of Temporary Authority to Modify Certain Contracts and Options Based on the Impacts of Inflation
 - Section 826 – Modification of Contracts and Options to Provide Economic Price Adjustments
- Section 857 – Department of Defense Notification of Certain Transactions
- Section 862 – Payment of Subcontractors
- Section 874 – Pilot Program to Incentivize Progress Payments
- Section 875 – Study on Reducing Barriers to Acquisition of Commercial Products and Services

S. 4638, National Defense Authorization Act for Fiscal Year 2025

- On July 8, 2024 Senator Jack Reed (D-RI) introduced the NDAA for FY 2025 (S. 4638)
- The proposed FY 25 NDAA authorizes a topline of \$919.9 billion for national defense programs and would:
 - Provide significant support for technologies like counter-drone defenses and AI
 - Enhance protections for whistleblowers of DoD contractors
 - Identification of contractors who denied multiple requests for submission of uncertified cost or pricing data
 - Updates to earned value management requirements
 - Appeals process for non-commercial determinations
 - Report on impact of merger and acquisition activity on Defense Industrial base
 - Authorize the development of contractors with a history of poor performance on space procurement contracts or nonprocurement transactions such as grants and cooperative agreements
- This legislation currently awaits a vote before the floor of the Senate

H.R. 8070 Servicemember Quality of Life Improvement and National Defense Authorization Act for Fiscal Year 2025

- Section 809D – Review Panel on Fair and Reasonable Pricing and Contract Oversight
 - Six-member committee
 - Sample of fixed-price contracts
 - Compare negotiated prices to actual prices – fair and reasonable determination
 - Assess accuracy of contractor estimating systems
 - Focus on spare parts
 - Report due within a year of establishing review panel
- Section 811 – Modification to Exception for Submission of Certified Cost or Pricing Data for Certain Components and Parts of Commercial Products
- Section 813 – Elimination of Late Cost and Pricing Submission Defense
- Section 818 – Extension of Temporary Authority to Modify Certain Contracts and Options Based on the Effects of Inflation
- Section 872 – Pilot Program on Payment of Costs for Denied GAO Bid Protests

Government Contracting Election Update



Election Update – How the Presidential Election Could Impact Government Contractors

- What government contractors can expect from a future Harris Administration:
 - Harris has stated her administration would aim for one third of all government contracts to go to small businesses
 - Harris has stated she'd "stand strong" with Ukraine and "stand up for Israel's right to defend itself" if elected
- What government contractors can expect from a second Trump Administration:
 - Based on the first Trump presidency, contractors can expect rollback of DEI requirements such as requirements to implement racial sensitivity trainings. Trump has also vowed to prioritize deregulation generally.
 - Trump promised to end the war on Ukraine before his inauguration and when asked about Gaza, he's stated he would get it "settled, and fast"
- Both candidates have signaled that their administrations would target strengthening domestic supply chains and domestic energy supplies.
- Neither candidate has spoken about the specifics of funding defense programs, but Trump has been critical of costs of several major programs

Questions





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Contract Performance Issues

Julia Alcaez, HKA and Phil Seckman, Dentons

October 23, 2024

Agenda

- Introduction – The REA Process (Quick Overview)
- Methods for Addressing Quantum, Explored through Recent Cases and Lessons Learned
 - Quantum Methods
 - Total Cost
 - Modified Total Cost
 - Detailed Cost Build-Up
 - Other Issues
 - Disruption or Loss of Productivity
 - Schedule Delay Analysis
 - Home Office Overhead

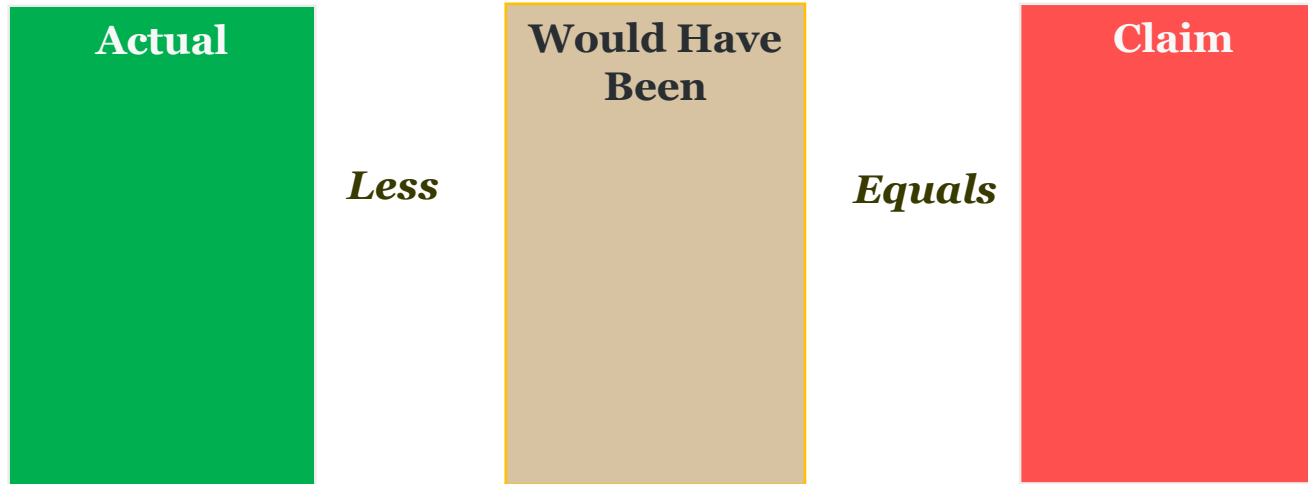
REA Process Overview

- At its core, any REA begins with the terms of the contract
 - The government reserves rights to unilaterally take certain actions, and agrees that it will pay the contractor fair/equitable compensation and/or make other changes to terms and conditions to keep the contractor whole
 - The government reserves rights via standard contract clauses (e.g.):
 - Changes – Fixed Price, FAR 52.243-1
 - Changes – Cost Reimbursement, FAR 52.243-2
 - Changes and Changed Conditions, FAR 52.243-5
 - Security Requirements, FAR 52.204-2
 - Differing Site Conditions, FAR 52.236-2
 - Suspension of Work, FAR 52.242-14
 - Government Property, FAR 52.245-1
 - The government action or order can be formal/written or the order can be constructive
 - Contractors generally must perform, subject to an REA and/or claim under the disputes clause

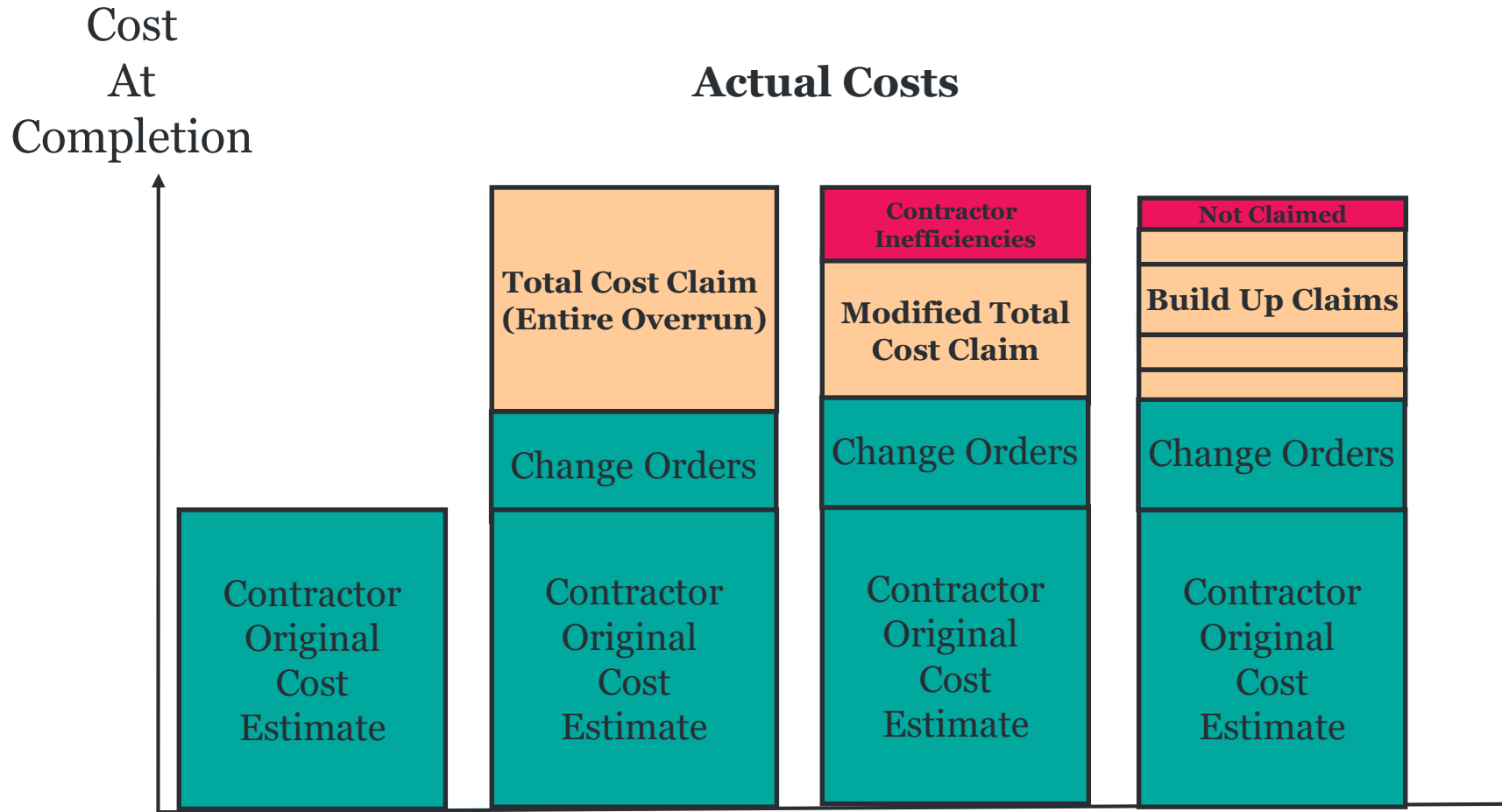
REA Process Overview (cont.)

- Notification Obligations
 - Formal change: within 30 days of receipt of a written change order (though typically not strictly construed, unless government is prejudiced)
 - *Gazpromneft-Aero Kyrgyzstan LLC v. United States*, 132 Fed. Cl. 202 (2017) (rejecting a contractor request for equitable adjustment under FAR 52.229-6(j) for failure to provide prompt notice that prejudiced the government)
 - Note the potential applicability of FAR 52.243-7
 - May shorten the notice period and increase the amount and type of information that must be submitted
- Best practices for dealing with orders from individuals other than the contracting officer
 - Look to the written notice criteria in FAR 52.243-4(b) & FAR 52.243-7
 - Ensure that the notice includes all the material facts with respect to the direction and seek written confirmation from the contracting officer as to how to proceed
 - *See North Am. Landscaping, Constr. and Dredge, Co., Inc.*, ASBCA No. 60235, 2018 WL 4016632 (Aug. 9, 2018)

Quantum Methods



Quantum Methods (cont.)



Recent Case Example

- *Herman JCG Co. JV*, ASBCA No. 63235, 2024 WL 2698017 (May 9, 2024)
- Holding:
 - The Board found that the government constructively accepted the phased proposal as a VECP and returned the matter to the parties to resolve quantum
- Key Takeaway:
 - Government conduct, including internal communications, can amount to a constructive acceptance of a VECP despite the government's failure to classify the proposal as a VECP

Quantum Methods - Total Cost

- Total Cost (“TC”) Claim = Actual Costs Incurred less Bid Amount
 - Benefits:
 - Easy to explain
 - Project personnel typically default to it
 - Downsides:
 - The TC method is a top-down approach that is disfavored by Courts/Boards and requires Claimant to satisfy four requirements to prove quantum
 - Often imprecise and can create the possibility that some extra costs included in the claim are not causally connected to entitlement

Quantum Methods - Total Cost (cont.)

- Courts/Boards have required contractors to establish four elements prior to using the TC method to calculate quantum:
 - Nature of losses make it impossible/impracticable to determine them with a reasonable degree of accuracy (i.e., other methods of proof not available)
 - Bid estimate was realistic
 - Actual costs were reasonable; and
 - Defendant was responsible for additional costs (i.e., casual link)
- In our experience, the causal link (item 4 above) is frequently the most debated aspect of a total cost or modified total cost claim

Quantum Methods - Modified Total Cost

- MTC claims typically start as TC claims, and are adjusted downward to address possible deficiencies in the four pillars
- MTC claims are less aggressive and allow for greater precision than TC claims in that they account for some potential liability of the Claimant. They are the most common methodology for REAs and claims (DCAM Chapter 12-704.5).
- MTC claims are still developed using a top-down or deductive methodology
- Be sure to document and adequately support adjustments made to the claim baseline

Quantum Methods - Detailed Cost Build-Up

- Customers and courts strongly prefer the detailed cost build-up method to TC or MTC claims
- Detailed cost build-up claims require significant up front preparation effort, but they are often the least costly method in the long run as they generally have a higher recovery percentage than TC or MTC methods
- These types of claims also typically lead to faster settlement as there is less customer resistance
- Detailed cost build-up claims require a level of documentation and insight that may not exist in all instances (e.g., depending on the accounting system, contemporaneous documentation, etc.)
- The ultimate difference between TC/MTC and discrete cost build-up methods is the level of specificity

Examples of Potential Sources of Information and Data

Schedules

- RFP
- Bid
- Contract
- Project Updates
- Internal Budget and Forecasts
- Other

Project Records

- Contract
- Change Orders
- Status Reports
- Cost/Quantity Reports
- Daily Reports/Tickets
- Procurement Documents
- Other

Correspondence

- Letters
- E-mails
- Memos
- Phone Logs
- Other

Fact Witnesses

- Interviews
- Depositions
- Affidavits
- Other

Recent Case Example

- *Tri Vet Contracting Co. v. Dep't of Veterans Aff.*, CBCA 8030, 2024 WL 3221519 (June 25, 2024)
- Holding:
 - The Board held that contractor failed to state a claim regarding material price increases caused by COVID-19 because contractor assumed the risk of increased prices under its fixed-price contract. The VA did not constructively change the contract.
- Key Takeaway:
 - Generally, contractors that enter fixed-price contracts without an economic price adjustment clause assume the risk that circumstances may change during performance and the contractor is responsible for the increased costs of performance

Other Issues - Disruption or Loss of Productivity

- Loss of productivity on original scope of work can result from changes in working conditions, resources, or manner of performing work
- Change orders can affect work not otherwise thought of as changed
- Example causes include:
 - Changed work (e.g., rescheduling of planned work, excessive overtime to avoid schedule slippage, less than optimal work sequencing, changes in manufacturing or design work methods, excessive rework, loss of learning)
 - Customer delays (e.g., unnecessary starts and stops to contract activity, more loss of learning, underutilization of work force, loss of economies of scale)
 - Acceleration (e.g., excessive overtime, congestion in the workplace, sequencing of work performance)

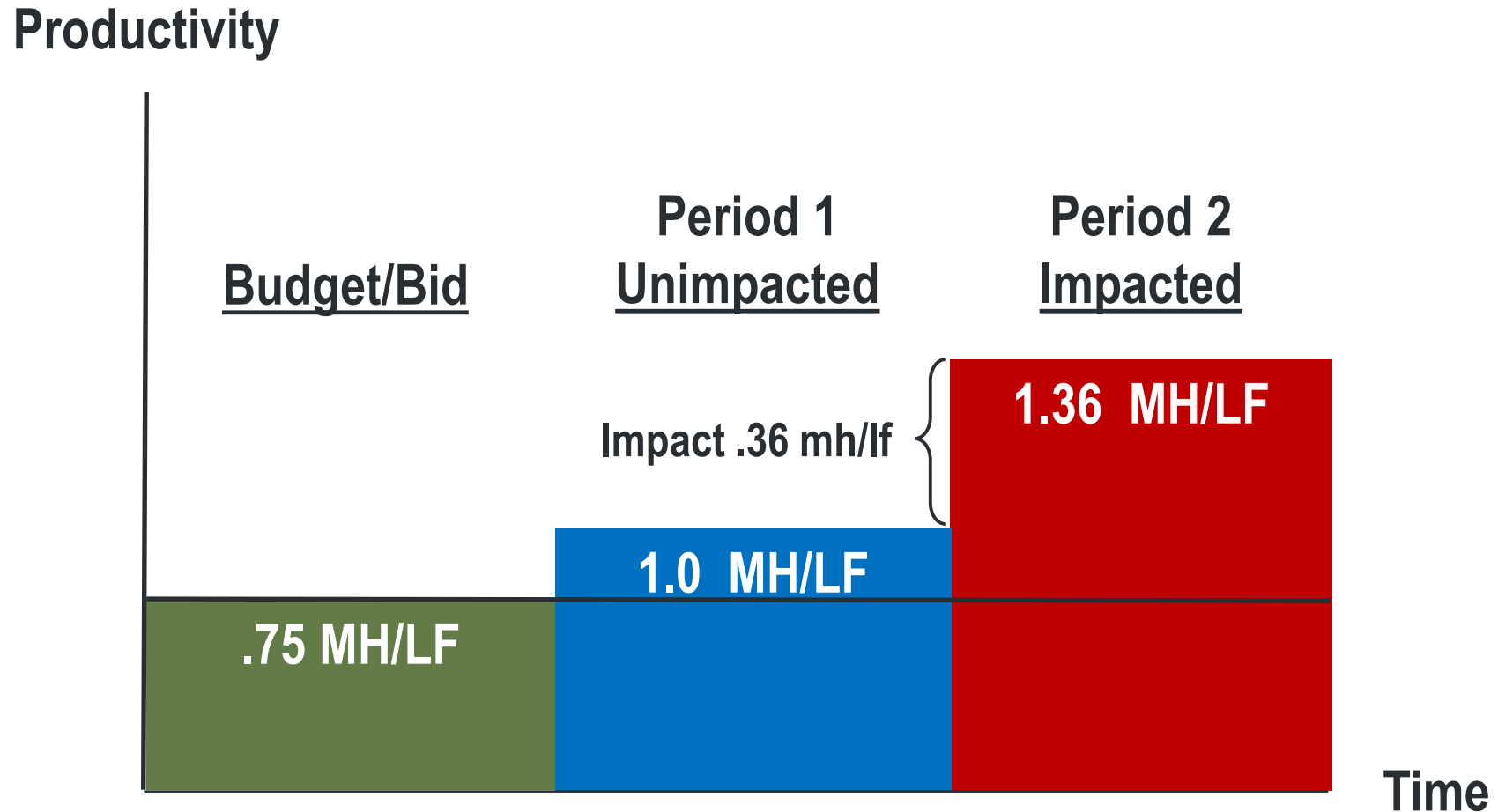
Other Issues - Productivity Claims and Recommended Approaches

- Project specific studies (e.g., Measured Mile)
- Project comparison studies
- Specialty or general industry studies
- Cost basis (e.g., total unit cost, modified total cost)
- Productivity impact on schedule (i.e., schedule impact analysis)

Other Issues - Recent Case Example

- *Lockheed Martin Aeronautics Co.*, ASBCA No. 62209, 2024 WL 2927162 (Apr. 23, 2024)
- Holding:
 - The Board found that the Air Force's statute of limitations defense did not apply, and that Lockheed Martin was entitled to compensation for the additional work performed to address the legacy defects
- Key Takeaway:
 - The Board validated the measured mile method as a viable approach to calculating quantum

Other Issues - Measured Mile Example



Other Issues - Measured Mile Example (cont.)

Claim Calculation:

Linear Feet Installed In Period 2	22,485
"Should Have Been" MH/LF	1.00
"Should Have Been" MHs	22,485
Actual MHs	<u>30,671</u>
Claimed MHs	8,186
Actual Labor Cost Per MH	<u>\$ 25.93</u>
Labor Claimed	\$ 212,261
Markups (7% OH, 5% Fee)	<u>15,601</u>
Claim	\$ 227,862

Other Issues - Recent Case Example

- *Patricia I. Romero, Inc. DBA Pac. W. Builders*, ASBCA No. 62627, 2024 WL 1011175 (Feb. 13, 2024)
- Holding:
 - The Board granted the Navy's motion for summary judgment in part, dismissing the claim related to the unforeseen asbestos, but allowing PWB's delay claims to proceed
- Key Takeaway:
 - The Board will not find a differing site condition if contract documents (such as the hazardous materials report showing the potential presence of asbestos) sufficiently alert the contractor to the potential differing site condition

Other Issues

- Schedule Delay Analysis
 - The role of the critical path
 - Importance of schedule evidence and artifacts
- Home Office Overhead
 - Home office overhead represents the cost to the project for support from a remote home or division office, which provides some services to the project. Also called General & Administrative (“G&A”) costs.
 - The Eichleay Formula is often used as a means of allocating some portion of home office overhead to projects that have been delayed by owner-caused interference, and is currently the only acceptable method for recovering unabsorbed overhead at the ASBCA and COFC
 - DCAM notes that the existence of substitute work could preclude recovery of Eichleay damages. If replacement work exists, contractors must demonstrate that the replacement work did not absorb the same amount of overhead as the delayed work would have absorbed, but for the delay (see *Melka Marine v. U.S.*, 187 F.3d 1370 (Fed. Cir. 1999)).

Questions





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Essential Updates in Government Contracting for 2024

Cost and Pricing Updates

Jennifer Flickinger, HKA and Steve Masiello, Dentons

October 23, 2024

Agenda

- Validity of FAR “Increased Costs”
- CAS Change and Noncompliance Offset Status
- Pricing Compliance and TINA Update
- Underutilized Facilities and Office Space
- Organization Costs
- False Claims Act (FCA) and Accounting Fraud Risk Mitigation

Validity of FAR “Increased Costs”



Validity of FAR “Increased Costs”

- Background
 - In 2011, Boeing made eight unilateral changes to its cost accounting practices that resulted in cost impacts to certain of its government contracts
 - Net effect of the changes was a decrease in costs to the government
 - Government, however, refused to offset the increased and decreased costs based on FAR 30.606, Resolving Cost Impacts, and demanded that Boeing pay the government the increased costs plus interest
 - In 2019, the COFC did not address the merits of Boeing’s argument, but instead, dismissed Boeing’s claim on procedural grounds; the COFC determined Boeing had waived its challenge to the lawfulness of FAR 30.606 because it failed to challenge the regulation before signing the contract
 - Federal Circuit reversed and remanded in 2020

Validity of FAR “Increased Costs” (cont.)

- In 2022, the COFC again dismissed the case, holding that it lacked jurisdiction over Boeing’s contract claims because the “gravamen” of the claims was a “challenge to the validity” of the regulation and that such a claim is subject to jurisdiction under the Administrative Procedures Act
- The COFC also held that it lacked jurisdiction over Boeing’s illegal exaction claim, stating that the claim must be made under the CDA, instead of as an illegal exaction
- On October 4, 2024, the Federal Circuit once again reversed the COFC’s dismissal and remanded the case to the COFC
- Federal Circuit stated the COFC “has jurisdiction under the CDA to resolve this contract dispute and the validity of the underlying regulation”

Validity of FAR “Increased Costs” (cont.)

- 48 CFR 9903.201-6
 - “Contracting Officer shall make a finding that the contemplated contract price and cost adjustments will protect the United States from payment of increased costs, in the aggregate; and that the net effect of the adjustments being made does not result in the recovery of more than the estimated amount of such increased costs.”
- FAR 30.606, Resolving Cost Impacts
 - Prohibits offsetting of increased and decreased cost impacts that result from multiple changes in a contractor’s cost accounting practices
 - CO “[s]hall not combine the cost impacts of [o]ne or more unilateral changes,” “unless all of the cost impacts are increased costs to the Government” (see FAR 30.606(a)(3)(iii))

CAS Change and Noncompliance Offset Status



CAS Change and Noncompliance Offset Status

- On Oct. 3, 2023, DCAA issued a Memorandum for Regional Directors (MRD) revising its audit guidance relating to the aggregate cost impact calculation after a unilateral cost accounting practice (CAP) change
 - Unilateral cost accounting practice changes
 - Change in cost accounting practice from one compliant practice to another compliant practice
 - Has not been deemed a desirable change
- FAR 30.603-2(a)(2) and 48 C.F.R. 9903.201-6(b) stipulate that the government will not pay an aggregate increase in costs caused by a unilateral CAP change
- The MRD identifies and explains four scenarios in which a unilateral CAP change causes differences in estimates to complete (ETC) across a set of fixed- and flexibly-priced contracts, and the effect of those differences on the increased aggregate cost to the government

CAS Change and Noncompliance Offset Status (cont.)

- Only authoritative guidance for resolving unilateral CAP changes is found in 48 CFR 9903.201-6(b)(1) – not a detailed set of instructions
- CAS Board amended 48 CFR 9903.201-6, effective June 14, 2000, to provide guidance for determining price and cost adjustments for unilateral CAP changes:
 - “Contracting Officer shall make a finding that the contemplated contract price and cost adjustments will protect the United States from payment of increased costs, in the aggregate; and that the net effect of the adjustments being made does not result in the recovery of more than the estimated amount of such increased costs” (emphasis added)

CAS Change and Noncompliance Offset Status (cont.)

- DCAA and DCMA identify four separate unilateral CAP change scenarios and provide guidance on how to calculate the increased cost to the government in the aggregate
- Broadly, the DoD guidance instructs auditors and contracting officers not to simply add together the impacts for all fixed price and flexibly priced contracts
- Rather, auditors shall assess the nature of the unilateral CAP changes (i.e., an evaluation that represents more than just a mathematical exercise)

CAS Change and Noncompliance Offset Status (cont.)

	Change in ETC Cost Accumulation	Increased/(Decreased) Cost (FAR 30.604(h)(3)(i)–(iii))	Increased Cost in the Aggregate
Scenario 1	Increased ETC on Flex, Decreased ETC on Fixed	Increased Cost on Flex and Fixed	Increased cost to the government is calculated by combining across contract/subcontract groups, less duplicated cost due to cost shifts
Scenario 2	Increased ETC on Flex and Fixed	Increased Cost on Flex, Decreased Cost on Fixed	Increased cost to the government on flexibly priced contracts/subcontracts
Scenario 3	Decreased ETC on Flex and Fixed	Decreased Cost on Flex, Increased Cost on Fixed	Increased cost to the government is calculated by combining across contract/subcontract groups
Scenario 4	Decreased ETC on Flex, Increased ETC on Fixed	Decreased Cost on Flex and Fixed	None

CAS Change and Noncompliance Offset Status (cont.)

- The three steps that Contracting Officers must follow when determining whether to adjust the price of one or more contracts and how to process the adjustment(s):
 1. Determine the amount of increased costs to the government, if any.
 2. Determine the increased costs, if there is any, in the aggregate by calculating the net effect of the adjustments being made.
 3. Protect the government from payment of the increased costs in the aggregate.
- Only Scenario 4 appears to follow these three steps appropriately

CAS Change and Noncompliance Offset Status (cont.)

<u>Contract Group</u>	<u>ETC</u> After <u>Change</u>	<u>ETC</u> Before <u>Change</u>	<u>Change in</u> <u>ETC</u>	<u>Increased</u> <u>Cost to the</u> <u>Gov't.</u>	<u>Decreased</u> <u>Cost to the</u> <u>Gov't.</u>	<i><u>Increased</u></i> <i><u>Cost in the</u></i> <i><u>Aggregate</u></i>
Fixed Price – CAS-covered	\$ 50	\$ 100	\$ (50)	\$ 50	\$ -	
Flexibly Priced – CAS-covered	125	100	25	25	-	
Non-CAS-covered	<u>125</u>	<u>100</u>	<u>25</u>	<u>-</u>	<u>-</u>	
Total	<u>\$ 300</u>	<u>\$ 300</u>	<u>\$ -</u>	<u>\$ 75</u>	<u>\$ -</u>	<u>\$ 50</u>

- Proper determination of increased costs (Step 1)
- Proper calculation of increased costs in the aggregate (Step 2)
- Improper determination of payment protection (Step 3)
 - Guidance does not explain why adjustment is needed
 - Government is partially protected from payment higher costs because \$25 is allocated to non-CAS-covered contracts

<u>Contract Group</u>	<u>ETC</u> After <u>Change</u>	<u>ETC</u> Before <u>Change</u>	<u>Change in</u> <u>ETC</u>	<u>Increased</u> <u>Cost to the</u> <u>Gov't.</u>	<u>Decreased</u> <u>Cost to the</u> <u>Gov't.</u>	<i><u>Increased</u></i> <i><u>Cost in the</u></i> <i><u>Aggregate</u></i>
Fixed Price – CAS-covered	\$ 50	\$ 100	\$ (50)	\$ 50	\$ -	
Flexibly Priced – CAS-covered	75	100	(25)	-	25	
Non-CAS-covered	<u>175</u>	<u>100</u>	<u>75</u>	<u>-</u>	<u>-</u>	
Total	<u>\$ 300</u>	<u>\$ 300</u>	<u>\$ -</u>	<u>\$ 50</u>	<u>\$ 25</u>	<u>\$ 25</u>

- Proper determination of increased costs (Step 1)
- Proper calculation of increased costs in the aggregate (Step 2)
- Improper determination of payment protection (Step 3)
 - Guidance does not explain why adjustment is needed
 - Government is protected from payment of higher costs because \$75 is allocated to non-CAS-covered contracts

CAS Change and Noncompliance Offset Status (cont.)

<u>Contract Group</u>	ETC After <u>Change</u>	ETC Before <u>Change</u>	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	<i>Increased Cost in the Aggregate</i>
Fixed Price – CAS-covered	\$ 125	\$ 100	\$ 25	\$ -	\$ 25	
Flexibly Priced – CAS-covered	125	100	25	25	-	
Non-CAS-covered	<u>50</u>	<u>100</u>	<u>(50)</u>	<u>-</u>	<u>-</u>	
Total	<u>\$ 300</u>	<u>\$ 300</u>	<u>\$ -</u>	<u>\$ 25</u>	<u>\$ 25</u>	<u>\$ 25</u>

- Proper determination of increased costs (Step 1)
- Improper calculation of increased costs in the aggregate (Step 2)
 - Increased costs need to be offset against decreased costs
 - No CAS exemption justifying the exclusion of decreased costs on fixed price contracts
 - Government would recover \$25 more than increased costs in the aggregate
 - Step 3 consideration unnecessary after correcting Step 2

<u>Contract Group</u>	ETC After <u>Change</u>	ETC Before <u>Change</u>	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	<i>Increased Cost in the Aggregate</i>
Fixed Price – CAS-covered	\$ 125	\$ 100	\$ 25	\$ -	\$ 25	
Flexibly Priced – CAS-covered	75	100	(25)	-	25	
Non-CAS-covered	<u>100</u>	<u>100</u>	<u>-</u>	<u>-</u>	<u>-</u>	
Total	<u>\$ 300</u>	<u>\$ 300</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 50</u>	<u>\$ -</u>

- Proper determination of no increased costs (Step 1)
- No consideration needed for Step 2
- No consideration needed for Step 3

CAS Change and Noncompliance Offset Status (cont.)

- Additional Thoughts:
 - Scenario 3 recognizes that the government is harmed when ETCs decrease on fixed price contracts, however Scenario 2 disregards the benefit received by the government on fixed price contracts when the ETC increases
 - Scenario 2 guidance directs the government to disregard certain decreased costs in determining the net effect of increased and decreased costs, conflicting with the Step 2 of 48 CFR 9903.201-6(b)(1)
 - Scenario 2 also appears to conflict with and FAR 30.604 which states that the government experiences a decrease in cost resulting from increased ETCs on fixed price contracts
 - Although there is no CAS requirement to consider decreased costs on fixed price contracts, there is also no CAS requirement to consider increased costs on fixed price contracts resulting from unilateral cost accounting practice changes

Pricing Compliance and TINA Update



Pricing Compliance: Increased Enforcement

- Defective pricing audits are on the rise
- The government bears the burden of proof for claims of defective pricing; to do so, the government must prove three elements by a preponderance of the evidence
 - Disputed information in question is cost or pricing data;
 - Prime contractor failed to meaningfully disclose the data prior to price agreement; and
 - Government relied to its detriment on defective cost or pricing data such that nondisclosure adversely impacted the negotiated price.

Pricing Compliance: Increased Enforcement

- May 2023 *60 Minutes* segment may lead to a renewed interest on Capitol Hill to seek regulatory changes to increase contractor oversight
- DCAA has been performing more defective pricing audits in recent years
 - Generally low return on investment (per annual DCAA Reports to Congress)
 - DCMA Defective Pricing Pilot Team
- Recent government / legislative action

Scrutiny of contractors earning “Unreasonable profit” and achieving high profit margins

Increased efforts to obtain other than certified cost or pricing data (Section 802 of NDAA for FY 2024)

Requirements for additional contractor disclosures (pricing strategy, margin data, etc.)

Understanding Cost or Pricing Data

- Disclosure of certified cost or pricing data
 - FAR 15.408, Table 15-2 includes instructions for submitting proposals when certified cost or pricing data are required
 - Note 1 to Table 15-2 addresses the disclosure of certified cost or pricing data
 - Clear distinction between submitting certified cost or pricing data and merely making books and records available without identification
 - Requirements for submission of certified cost or pricing data are met when all accurate certified cost or pricing data reasonably available have been submitted to the Contracting Officer in one of the following manners:
 - Actual submission
 - Specific identification
 - “Later data” should be submitted promptly “in a manner that clearly shows how the data relate to the offeror’s price proposal” (emphasis added)
 - Requirement for submitting certified cost or pricing data continues up to the time of agreement on price
 - Grants the Contracting Officer the right to examine records that formed the basis of the proposal

Understanding Cost or Pricing Data(cont'd)

- Practical issues – disclosure of certified cost or pricing data
 - Giving the government access to relevant systems and/or providing a “data dump” may not satisfy a contractor’s disclosure obligation in the absence of actual submission and/or specific identification
 - Contractor is not obligated to create cost or pricing data or provide cost or pricing data in the exact format requested by the government (i.e., is the data reasonably available?)
 - Method of disclosing actual costs on relevant prior contracts and/or letter contracts must be meaningful
 - Courts have interpreted and expanded the definition of certified cost or pricing data to include:
 - Information held by the contractor, at any location, even if unknown by the persons preparing the proposal
 - Data in print, electronic, and other forms
 - Data disregarded in the proposal process
 - Known data even if the contractor does not believe it to be reliable or accurate

Pricing Compliance: Common Conflicts

- Some common conflicts that arise as it relates to whether cost or pricing data was disclosed include
 - Adequate and meaningful disclosure
 - Failure to use data
 - Government's knowledge of data
 - Inadequate time

Defective pricing

- Red flags and key indicators of defective pricing:
 - Significant increase between bid profit and actual profit¹, especially on high dollar, sole-sourced, firm-fixed price contracts
 - Significant increase in profit margin immediately following contract definitization
 - Recent DCAA / DCMA estimating and purchasing system audits identified internal control deficiencies
 - Previous allegations and/or findings of defective pricing
 - Lack of management oversight over the proposal process
 - Inconsistent estimating and pricing practices
 - Contractor does not factor the impact of negotiations with suppliers into its proposed material cost
 - Extended undefinitized contract action (“UCA”) period
 - Failure to update cost or pricing data

¹ FAR 15.407-1(c) states that the “contracting officer shall not reprice the contract solely because the profit was greater than forecast or because a contingency specified in the submission failed to materialize.” (emphasis added)

Certified Cost or Pricing Data – Five Points of Defective Pricing

- Section 14-102, Truth in Negotiation Compliance Audit, of DCAA's Contract Audit Manual specifies that "to show that defective pricing exists", a defective pricing audit must establish each of the following five points:

The information in question fits the definition of certified cost or pricing data

Accurate, complete, and current data existed and were reasonably available to the contractor before the agreement on price

Accurate, complete, and current data were not submitted or disclosed to the contracting officer or one of their authorized representatives

The Government relied on the defective data in negotiating with the contractor

The Government's reliance on the defective data caused an increase in the contract price

Reducing Defective Pricing Risk through effective estimating system internal controls and practices

- Contractors that are subject to DFARS 252.215-7002 requirements typically implement and maintain estimating practices and internal controls to achieve certain benefits:
 - Avoid payment withholds prescribed under DFARS 252.242-7005 and 252.215-7002
 - Maintain an approved estimating system
- However, implementing and maintaining strong estimating practices and internal controls as listed below can also reduce the risk of defective pricing
 - Policies, procedures, and other relevant compliance tools
 - Consistent estimating practices
 - Use of and/or disclosure of historical, actual cost data
 - Structured and well-documented bases of estimates (“BOEs”)
 - Integration with other business systems, particularly purchasing and accounting systems
 - Thorough cost and price reasonableness reviews of vendor and subcontractor costs
 - Robust sweep and certification process
 - Management oversight and review
 - Training and periodic monitoring

Further push for uncertified cost or pricing data

- November 2023 – two Democratic lawmakers pressured Transdigm to explain how it charges DoD for certain spare parts
- Request for “price transparency” after an insufficient response for previous requests for pricing and cost data
- Requested Transdigm to “detail how many times it had withheld an official request for information”
- Raised concerns that Transdigm could be “exploiting a loophole” when asserting commerciality on contracts that were “too low in value for a cost reporting obligation to kick in”
- Insinuated that Transdigm was gaming the process
- Issued separate letter to DoD asking how the agency was protecting itself against contractor price gouging
- June 30, 2024 – three Democratic lawmakers authored letter to DoD expressing concerns over two recent Transdigm acquisitions

Legislative pushes for uncertified cost or pricing data

- Pricing with Cost Transparency Act of 2022 (January 19, 2022)
 - Legislation would have increased requirements for submission of uncertified cost or pricing data
 - Significant industry pushback; did not pass
- Stop Price Gouging the Military Act (June 9, 2022)
 - Enhance government's ability to obtain cost or pricing data if lack of competition
 - Removes “of a type” language from definition of commercial item
 - Additional disclosures
 - Volume of goods or services sold
 - Changes in average price and gross margins
 - Pricing strategy narrative
 - Did not pass

TINA Update

- The Truthful Cost or Pricing Data Statute (formerly TINA), 41 U.S.C. § 35
 - Requires contractors/subcontractors to meaningfully disclose current, accurate, and complete cost or pricing data for certain contracts/subcontracts exceeding a certain dollar threshold
- Implemented at FAR Subpt. 15.4
 - Obligation to provide "certified cost or pricing data"
 - Creates potential for price reductions when defective pricing can be proven

TINA Update: DoD Proposed Rule

- Section 811(b) requires offerors to submit data other than certified cost or pricing data upon CO request
- Section 814 establishes a \$2M threshold for the Truthful Cost or Pricing Data statute requirements with respect to contract modifications, subcontracts, and modifications to subcontracts
- Section 804 of the NDAA for FY 2022 augments the requirement at 10 U.S.C. 3702(f), for COs to modify contracts to reflect the relevant TINA threshold
 - Proposed rule would amend DFARS 215.403-4 to add six different clauses specifically for use when modifying contracts in accordance with 10 U.S.C. 3702(f)
- Defense Federal Acquisition Regulation Supplement: DoD Cost or Pricing Data Requirements, 48 C.F.R. §§ 212, 214, 215, and 252 (2024).

Underutilized Facilities and Office Space Overview



Allowability of Restructuring Costs

- DoD treats external restructuring costs as allowable costs, so long as the restructuring is approved as it is expected to result in overall reduced costs to DoD or expected to preserve a critical DoD capability
- Common examples of restructuring costs
 - Personnel relocations
 - Severance pay
 - Early retirement incentives
 - Sign-on bonuses
 - Equipment relocations
 - Facility closings
 - Lease terminations

Cost Allowability: Leases

- Government contractors must claim only allowable costs under flexibly-priced contracts and must include only allowable costs in cost proposals/estimates under noncommercial fixed-price contracts
 - FAR 31.201-2: a cost is allowable when it is
 - Reasonable
 - Allocable
 - Consistent with CAS or, if CAS is not applicable, GAAP, or other appropriate standards
 - Consistent and compliant with the terms of the contract
 - Compliant with FAR Subpt/ 31.2 cost principles and applicable agency supplements
- Generally, the costs of the rent payments made under “operating leases” are allowable to the extent they are reasonable and compliant with FAR 31.205-36

Operating Leases vs. Capital Leases

- FASB ASC 840 was superseded by ASC 842 in 2019, which became effective in 2021; nevertheless, ASC 840 remains relevant by virtue of its incorporation into the FAR cost principles
- Under FASB 840, the relevant question is whether the lease arrangement may be characterized as effectively a purchase of the underlying asset for accounting treatment purposes
 - Operating lease: leases where the lessee obtains the right to use the underlying asset but not treated as a financing arrangement for the purchase of the underlying asset
 - Capital lease: leases that are treated as financing arrangements effectively for the purchase of the underlying asset by the lessee

Capital Leases and Depreciation

- Under FAR 31.205-11(h), capital leases must be treated similar to a tangible capital asset
- This means the capitalized value of such asset must be amortized (similar to depreciation) over its useful life and charged as expense
 - Under FASB ASC 840, capital leases should be recorded as assets and liabilities (or capitalized) at the lower of the present value of the minimum lease payments at the beginning of the lease term or the fair value of the leased property at the inception date
- Since capital leases are treated like tangible capital assets, contractors can charge the amortized costs on capital leases

Impairments of Leases: GAAP vs. FAR

- FAR treatment of impairments on leases
 - Under FAR 31.205-16, Right of Use (“ROU”) impairment costs are likely unallowable
 - ROU impairment costs also may be unallowable under FAR 31.205-17 if they are idle facility costs
 - This impairment would permit acceleration of amortization expense to reflect more appropriately the impaired value of the asset
 - Accelerated expense in excess of the permitted lease expense is likely unallowable
- In contrast, GAAP provides for the impairment of ROU assets

Cost allowability – Idle Capacity

- FAR 31.20517(a) defines idle capacity as the "unused capacity of partially used facilities."
- Under FAR 31.205-17(c), the costs of idle capacity are viewed as normal costs of doing business and are considered as a factor in the normal fluctuations of usage or overhead.
 - Allowable proved the capacity (a) "is necessary" or (b) "was originally reasonable and not subject to reduction or elimination by subletting, renting or sale."
 - Widespread idle capacity in a plant or group of assets may be considered idle facilities, subject to the same rules as idle facilities.
- There have been some cases ruling on when capacity is considered idle but there is no clear guidance.
 - In *AVCO Corp. (ASBCA 10858)*, 13 percent of the company's capacity was considered idle and hence unallowable.
 - In *Cook Electric (ASBCA 17100)*, the Appeals Board ruled that buildings with less than 25 percent idle capacity did not give rise to unallowable costs but higher amounts did.
 - *Stanley Aviation Corp. (ASBCA 12292)* the board ruled that high overhead rates, in themselves, did not establish the existence of idle capacity.

Organization Costs



Organization Costs

- Restructuring costs vs. reorganization costs
 - Under FAR 31.205-27, “Organization Costs,” reorganization costs are unallowable (i.e. ,the costs of planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, as well as resisting the reorganization or change in controlling interest or planning to resist it)
- Common examples of unallowable organization costs
 - Incorporation fees
 - Attorneys' fees
 - Costs for accountants, brokers, promoters and organizers
 - Costs for management consultants and investment counselors

Organization Costs – Case Application

- *Secretary of Defense v. Raytheon Co.*, 56 F.4th 1337 (Fed. Cir. 2023)
- Raytheon had an established policy that drew a bright line for accounting for costs depending on whether its Acquisition Council decided to formally pursue an acquisition.
 - The Board found Raytheon’s policies were “facially inconsistent with the FAR.”
 - Even if FAR 31.205-27 only applied to a “specifically identified acquisition,” the policy still drew the line too close given costs related to identifying potential acquisitions were considered allowable costs under Raytheon’s policy.
 - The Board found these costs were unallowable under FAR 31.205-27.

FCA and Accounting Fraud Risk Management

FCA, 31 U.S.C. §§ 3729-3733

- FCA liability
 - Imposes liability on any person that “knowingly”
 - Submits or causes another person to submit a false or fraudulent claim for reimbursement to the federal government
 - Makes a false record or statement in support of a false claim
 - Avoids or decreases an obligation to pay the government
- Mandatory disclosure requirements
 - Contractors are required to timely disclose, in writing, credible evidence, that a principle, employee, agent, or subcontractor:
 - Violated the federal criminal law involving fraud, conflict of interest, bribery or gratuity
 - Is in possession of a significant overpayment
 - Violated the civil FCA or is in possession of a significant overpayment

Notable Case – Comingling of Costs

- Settlement Agreement
 - In 2023, Booz Allen and DOJ entered into a settlement agreement through which Booz Allen will pay \$377 million to resolve a qui tam relator’s allegation that it violated the civil False Claims Act by improperly billing costs to its government contracts allegedly allocable to its commercial and international business.
 - The settlement agreement included a list of allegedly noncompliant practices which appears to muddy the concept of cost allocability, particularly with respect to indirect functions that may support the overall management of a contractor and may be interpreted by some as a signal that contractors are required to establish a myriad of discrete indirect cost pools to separately accumulate indirect costs that may benefit both government and commercial work.
- Impact for Contractors
 - Ensure creation of cost accounting structures that adequately manage indirect cost pools to ensure government and commercial work costs are not comingled
- Additional Material on Comingling of Costs
 - [Dentons - To Commingle or Not to Commingle Indirect Costs, That is the Question](#)

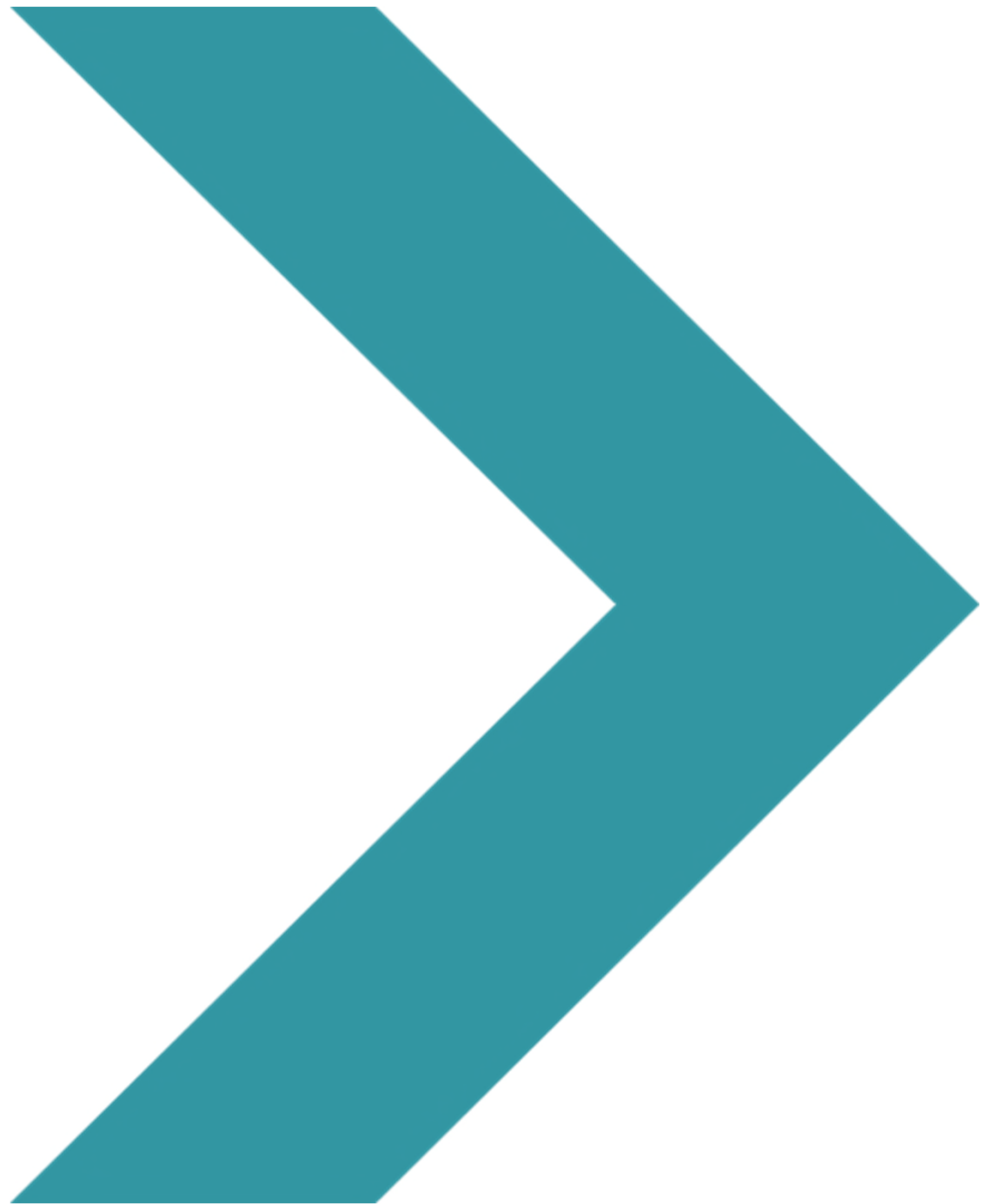
Notable 2024 Cases and Recent Enforcement Activity of FCA

- *United States ex rel. Craig v. Georgia Tech Research Corporation*
 - Takeaways:
 - This case is the first under the DOJ's Civil Cyber-Fraud Initiative, emphasizing the need for government contractors to review and comply with cybersecurity obligations
 - Georgia Tech and GTRC are set to file a motion to dismiss by October 21, 2024
 - We may see more cases arise under the DOJ's Civil Cyber-Fraud Initiative, specifically with the roll out of the CMMC, and the FCA.

Accounting Fraud Risk Mitigation

- Government Accountability Office (GAO) [Recommendations](#)
 - The GAO made 11 recommendations to DoD and the DoD OIG, including
 - Establishing data analytics as a method for fraud risk management and incorporating it into their strategy
 - Enhancing the usability of investigative data for fraud risk management
 - Obtaining and analyzing information from adjudicated procurement fraud cases.
 - Additionally, the GAO recommends that the DoD OIG collaborate on developing leading practices to improve the usability of investigative data for fraud risk management; DoD agreed with some of these recommendations, but not all

Questions



Thank you

Legislative/Regulatory Developments

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