

Risks and Costs Associated With Public Contracting

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BUSINESS RISKS

Government Contract Cost Principles

FAR, Part 31

- Not all costs legitimately incurred are allowable, including many costs incurred in the normal course of business.
- An accounting system that clearly and consistently distinguishes between direct and indirect costs is necessary.
- Factors in determining cost allowability under government contracts are: (i) reasonableness, (ii) allocability; (iii) application of generally accepted accounting principles; (iv) contract terms; and (v) statutory and regulatory limitations.

Contract Formation

- Government agencies typically issue very detailed RFPs. Responding with the specific information requested is critical.
- For example, even if you have related experience on a government contract with the contracting activity issuing the RFP, if you do not include that information in your proposal it will not be considered in scoring your proposal.

Protests

- Once you win the award, your award can be protested by a losing offeror.
- Competing contractor may protest for many reasons, the most common being
 - (1) the solicitation for the bid or proposal itself was flawed (usually must be filed pre-proposal;

Or

(2) some element of the government's source selection process was not done properly.

- Can be at the agency, GAO, or the U.S. Court of Federal Claims.
- “Interested parties”, which always includes the selected awardee, can intervene to defend their award (or opportunity for award).
- Can be significant costs involved.
- An unsuccessful offeror has a very high burden in most cases, especially if performance has begun, and must therefore carefully consider whether it makes sense to file a protest.

Authority Issues

- Contract awards and modifications can be made only by warranted contracting officers acting within the limit of their authority and available funding.
- Contractor must know the scope of authority of the government official with whom it deals.
- If a company incurs costs based upon the directions or promises of government personnel without appropriate authority, it does so at its financial peril.

- BEWARE: Many government ACO's, TCO's, program managers, etc., do not have contracting officer authority, but can reasonably be perceived as having such authority.
- THERE IS NO APPARENT AUTHORITY, and ratification is highly unlikely.

Government Good Faith – An (Almost) Absolute Presumption

- Government contracting officials enjoy a presumption that they act in good faith.
 - Including decisions to terminate a contract for convenience.
- Contractors do not enjoy a similar presumption.
- The burden of proving bad faith by government persons is exceptionally high.
- While contractors may often perceive such treatment, sometimes with justification, it is almost impossible to prove.

Government Audit Rights

- The government has the right to audit contractor books and records in specific circumstances.
- Most common audit situations are:
 - (i) pre-award audits of the proposed price or estimated costs;
 - (ii) functional systems reviews, such as purchasing and subcontracting systems;

- (iii) incurred cost audits prior to final payment and closeout; and
- (iv) defective pricing audits to enforce the Truth in Negotiations Act.
- Services contractors who provide services on a time and materials basis or labor hour basis are also subject to audit.
- These rights have been expanded under ARRA and the FAR mandatory disclosure clause.

Contract Changes

- Government has the unilateral right to direct changes within the general scope of the contract.
 - It cannot direct cardinal changes.
- On “commercial item” contracts, agreement to the change by both parties is required.

- Contractor is almost always required to continue performance under the contract as changed.
 - But, the contractor is entitled to an “equitable adjustment” for the provable and allowable cost consequences of the change.

Special Contractual Obligations

- Examples: A government contractor with 50 or more employees must develop an affirmative action plan covering minorities and women.

A government contractor must annually report on its hiring of certain categories of veterans, regardless of the contractor's size.

- In many circumstances, these contract requirements are required to be passed – or “flowed down” – to subcontractors.

Consequences of not complying with these requirements:

- Contract may be terminated for default for the contractor's knowing failure to implement required policies.
- Contractor may be threatened with debarment from government contracting to induce compliance.
- Contractor's failure to flow down required clauses to subcontractors also exposes the contractor to sanctions.

Certifications

- Government contractors are required to provide a number of certifications to the Government,
- Some must be submitted with the bid or proposal to enter into the contract.
- Other are required with requests for equitable adjustment and claims
- Pay attention to detail and be accurate – you could be liable under the False Statements or False Claims Acts for incorrect certifications

Furnishing Cost or Pricing Data

- Unless exempted (*e.g.*, a “commercial item” contract or “adequate price competition” exists), the Truth in Negotiations Act requires a contractor to
 - 1) submit and certify the accuracy, currency and completeness of its cost or pricing data,
 - 2) before the award of a covered prime contract or contract modification expected to exceed \$650,000.

- Cost or pricing data must be “accurate, complete, and current” and be certified – if it’s not, there is a risk that the government will claim a dollar-for-dollar price reduction under the contract because it has discovered “defective cost or pricing data.”
- If the government believes the contractor deliberately provided flawed or incomplete data, the matter may be referred for civil or criminal prosecution.

Warranties

- FAR provides for a number of warranties that may be incorporated into prime contracts, including
 - warranty of services and warranties of systems and equipment.
- Generally, they provide that the prime contractor warrants that all supplies or services are free from defects and will conform to all requirements of the contract.

- Beyond the warranty period, the government may pursue a claim against the contractor for “latent defects.”
- If the contractor’s warranty to the government depends on the integrity of subcontracted items or services (e.g., a roof, boiler, etc.), the prime contractor should obtain a warranty from the subcontractor, vendor or supplier.

Strict Compliance Under U.S. Government Contracts



- Government is entitled to “strict compliance” with the technical requirements of the contract.
- This is not like the commercial world where industry standards are acceptable – the government contract specifications trump industry standards.
- It does not matter that the service or item actually furnished is equal to or superior to that described in the contract specifications. Strict compliance means exactly that, and there are serious risks for noncompliance.

- On the other hand, the doctrine of “economic waste” does apply.

Federal Supply Schedule Contracting

- Supplies: Feds spend billions every year on technology, supplies, and services for purchase by federal agencies through federal supply schedules maintained by the General Services Administration and Department of Veterans' Affairs.
- Schedules identify technology, supplies, and services available to authorized buyers, allowing federal agencies to buy essentially “off-the-shelf” items by issuing purchase orders instead of contracts.
- Ordering agencies order directly from the schedule, with delivery of the order being made directly to the agency at the price stated on the schedule, or lower price if negotiated.

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- Schedule contract awards are indefinite-quantity, indefinite delivery, fixed-priced contracts to commercial companies for a fixed time period.
- To get a Schedule contract, a company is required to submit information about its current commercial sales practices, including pricing provided to commercial customers.
- Subject to limited exceptions, the contractor is required to give its most favored discount price to the government.
- Failure to provide accurate, current, and complete commercial pricing information or to provide the best price to the government will result in a re-pricing of government sales under the contract.

Risks of Penalties and Sanctions

- Risks of penalties and sanctions in performing a government contract are substantial.
- Typical sources of allegations of contract fraud and contractor improprieties are:
 - Government audits, inspections, and investigations
 - Government regulators' (e.g., OSHA) reports
 - Internal employee reports
 - Whistleblower suits filed against the company by current or former employees or other individuals (*Qui tam* complaints)
 - Competing contractor allegations/suits

The biggest risk areas:

- **Mischarging.** A government contractors may charge the government only that amount which is allowed under the contract, the law, and regulations.
- A contractor must be prepared to prove its charges to the government, often being subject to a rigorous post-contract audit.
- There are serious criminal, civil, and administrative remedies available for the government to pursue in circumstances where the government has reason to believe that mischarging has occurred.

Anti-Kickback Act

Foreign Corrupt Practices Act

Procurement Integrity Act

Business Courtesies

Conflicts of Interest

Collusive Bidding

Products or Services Substitution

Extra Costs of Being a Government Contractor

Cost Accounting Standards.

- FAR requires government contractors with certain government contracts above a specified dollar amount must ensure that their cost accounting system complies with the Cost Accounting Standards.
- There are 19 Standards to ensure uniformity and consistency in measuring, assigning, and allocating costs to contracts with the federal government that must be learned and understood before taking on substantial government work.

Contract Financing

- Contractor must finance its own performance, but can obtain progress payments based on costs, and can obtain contract funding through payment assignments to lending institutions.
- The cost of pursuing funding under these circumstances must be taken into consideration.

Code of Business Ethics and Mandatory Disclosures

- Contractors with large contracts are required to have a company code of business ethics and conduct.
- Also required to disclose to the government instances when the company believes it or its subcontractor has violated certain federal criminal laws or the False Claims Act.
- Failure to make such a disclosure can result in serious penalties for the contractor, including debarment.
- Even if this does not apply, the lack of a plan can be considered in debarment and responsibility determinations.

Disputes and Appeals

- Must file a claim and then an appeal for a denial at a Board or the CFC.

Quality Assurance

- A government contractor must establish and follow specified levels of quality assurance in the performance of government contract work.

Labor Laws

- Contractors are required to comply with a number of labor laws unique to government contracts, including those that establish wage requirements and safety standards, and the new E-Verify requirement.
- If a government contract includes the E-Verify clause, the contractor must use the Government's on-line system to determine the employment eligibility of certain of its employees.

Foreign Acquisition

- Certain statutes — such as the Buy American Act and the Trade Agreements Act — make impracticable for to acquire materials and services from certain foreign sources, resulting in a limitation on the purchase of government contract materials and components from sources outside of the United States, and a corresponding cost increase.

Conclusion

- Know the pitfalls.
- Identify additional costs.
- Establish systems to comply with contractual requirements.

Questions?



Thank You.

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