

DCAA Plans Significant Increase in Defective Pricing Audits, Highlighting Risks for Defense Contractors

Having recently eliminated its backlog for incurred cost audits, the Defense Contract Audit Agency (DCAA) is now focusing on another type of audit: defective pricing.

DCAA intends to triple the number of defective pricing audits of contractors in Fiscal Year (FY) 2020, according to *Bloomberg News*. DCAA reportedly plans to complete as many as 60 Truth in Negotiations audits in the coming fiscal year compared to 20 in FY 2019 and 21 in FY 2018.

DCAA's focus on defective pricing marks an important shift that highlights risks for defense contractors that submit certified cost or pricing data to the government. This update provides an overview of defective pricing and why DCAA's increased attention is significant.

TINA and Defective Pricing Audits

The Truthful Cost or Pricing Data Act, commonly referred to as TINA based on the pre-existing Truth in Negotiations Act, is intended to improve the government's ability to negotiate contracts and contract modifications by giving the government access to the contractor's cost or pricing data at the time of negotiations. 10 U.S.C. § 2306a; 41 U.S.C. §§ 3501-3509.

TINA and the regulations set forth in FAR 15.403, require that, when a specific dollar threshold is exceeded and if no exception applies, contractors must submit cost or pricing data to the contracting officer and certify that the data is accurate, complete and current. DCAA is charged with conducting audits of contracts that are subject to TINA.

Defective pricing occurs when a contractor, prior to reaching a price agreement with the government, fails to submit or disclose data that is accurate, complete and current. In a defective pricing audit, DCAA seeks to determine, post-award, if the contract's negotiated price was defective and, if so, whether a significant price increase resulted. When DCAA finds that these conditions are met, the government has a price reduction remedy under TINA and the Price Reduction Clause, FAR 52.215-10(a), which includes interest and penalty provisions. DCAA's spokesman told *Bloomberg News* that large firm, fixed-price contracts are the most prone to risk of "excess profits."

Chapter 14 of DCAA Contract Audit Manual (DCAAM) sets forth procedures and guidelines for DCAA's administration of TINA compliance audits. To demonstrate defective pricing, the audit must establish five points:

- The information in question fits the definition of cost or pricing data;
- Accurate, complete and current data existed and were reasonably available to the contractor before the agreement on price;
- The cost or pricing data were not submitted or disclosed to the government;
- The government relied on the defective cost or pricing data when negotiating with the contractor; and
- The government's reliance on the defective data caused an increase in the contract price.

The DCAAM directs auditors to exercise professional judgment to determine whether a defect is material. DCAA auditors will examine not only the prime contractor's pricing, but also that of any subcontractors. The manual specifies that "the prime contractor is liable for subcontract price reductions even when it had no knowledge of the defective data."

Significance of Increased Defective Pricing Audits

DCAA's renewed focus on contractors' cost and pricing data is significant, in several respects.

- It reflects that the audit agency is turning its attention to agency missions besides incurred cost audits, which determine the accuracy of a contractor's annual allowable cost representations to the government. In its FY 2018 report to Congress issued in March of this year, DCAA announced that it had eliminated its backlog of incurred cost audits and would be "returning to a more balanced mix of audits" in areas that include business systems, TINA, Cost Accounting Standards, pre-award surveys and terminations.
- It is the latest indication that contractor profits, particularly under sole-source contracts, are coming under scrutiny within the U.S. Department of Defense (DoD) and Congress. In response to a DoD Inspector General (IG) report issued earlier this year, DoD pledged to examine requirements for "other than certified" cost or pricing data and appointed a team of functional experts to analyze contractors deemed to be "at high risk for unreasonable pricing." In addition, the U.S. House version of the pending FY 2020 National Defense Authorization Act includes provisions that would make it easier for the government to obtain cost or pricing data from contractors.
- DCAA's focus on defective pricing may result in increased claims and litigation. When DCAA finds defective pricing, it may recommend that the contracting officer issue a final decision adjusting the contract price under the Price Reduction Clause (FAR 52.215-10). Contractors may challenge such final decisions by appealing to the relevant Board of Contract Appeals or to the U.S. Court of Federal Claims. With more audits, it is plausible that there will be more litigation challenging agency determinations of defective pricing and the amounts of contract adjustments.
- DCAA also may refer more defective pricing matters to other agencies for investigations and enforcement under the False Claims Act (FCA), 31 U.S.C. §§ 3729-3730, or other fraud-related statutes. DoD policy (DoDI 7600.02) requires that auditors refer to the appropriate investigative organization any indications of potential fraud or other criminal acts discovered while performing an audit. Defective pricing audits are historically a source of further investigations and litigation under the FCA, which imposes treble damages and penalties against persons that knowingly submit false and fraudulent claims for payment. Liability under the FCA arising out of defective pricing can be based on an allegedly false Certificate of Current Cost or Pricing Data.

DCAA's focus on defective pricing provides a useful opportunity for contractors to reevaluate their compliance programs and familiarize (or re-familiarize) themselves with TINA and related certified cost or pricing data requirements.

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Authors



Alexander O. Canizares

Partner

ACanizares@perkinscoie.com [202.654.1769](tel:202.654.1769)



Richard W. Oehler

Partner

ROehler@perkinscoie.com [206.359.8419](tel:206.359.8419)

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