



# Adequate Accounting System for Flexibly Priced Contracts – Who Determines Adequacy?

GAO finds that HHS reasonably excluded a proposal for failing to demonstrate an “adequate accounting system.”



BY IRVIN GRAY AND JAMAAL VALENTINE

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**T**his article examines a Government Accountability Office (GAO) bid protest filed by a small business applying to the U.S. Small Business Administration 8(a) Business Development program whose proposal was excluded from consideration. The GAO found that the Department of Health and Human Services (HHS) reasonably excluded the proposal because it failed to submit a verification of an adequate accounting system as required in the request for proposals (RFP).

We will summarize the case, the factual background, the protester's arguments, the government's arguments, and the findings from the GAO. This article recommends that agencies and contractors be clear about the requirement for an adequate accounting system in solicitations for federal cost-reimbursement contracts.

### Case Summary

In *Matter of Shivoy Inc.*, B-413104.36 (April 8, 2019), the GAO denied the protest because the HHS reasonably excluded the protester's proposal for not submitting the required verification of an adequate cost accounting system required for cost-reimbursement and time-and-materials task orders.

### Background

The HHS National Institutes of Health (NIH) issued an RFP in March 2016 for a 10-year indefinite-delivery, indefinite-quantity (IDIQ) contract for the NIH Chief Information Officer – Solutions and Partners 3 (CIO-SP3) governmentwide acquisition contract (GWAC) as a small-business set-aside.

## Federal Acquisition Regulation 16.301-3 - Limitations [on Cost-Reimbursement Contracts]

(a) A cost-reimbursement contract may be used only when

- (1) The factors in 16.104 have been considered;
- (2) A written acquisition plan has been approved and signed at least one level above the contracting officer;
- (3) The contractor's accounting system is adequate for determining costs applicable to the contract or order; and
- (4) Prior to award of the contract or order, adequate Government resources are available to award and manage a contract other than firm-fixed-priced (see 7.104(e)). This includes appropriate Government surveillance during performance in accordance with 1.602-2, to provide reasonable assurance that efficient methods and effective cost controls are used.

(b) The use of cost-reimbursement contracts is prohibited for the acquisition of commercial products and commercial services (see parts 2 and 12).

### FAR 16.104(i)

(i) Adequacy of the contractor's accounting system. Before agreeing on a contract type other than firm-fixed-price, the contracting officer shall ensure that the contractor's accounting system will permit timely development of all necessary cost data in the form required by the proposed contract type. This factor may be critical:

- (1) When the contract type requires price revision while performance is in progress; or
- (2) When a cost-reimbursement contract is being considered and all current or past experience with the contractor has been on a fixed-price basis. See 42.302(a)(12).

The IDIQ was for Information Technology (IT) solutions and services.

The RFP contemplated up to 35 awards, and reserved the right to award fewer or more. The RFP contemplated future task orders that would be priced as fixed-price, time-and-materials, or cost-reimbursement. The maximum order

amount was \$20 billion with a guaranteed minimum of \$250 per awardee.

The RFP provided for two phases. Phase one included four go/no-go requirements: a compliant proposal, verification of an adequate accounting system, IT services for healthcare, and capability in a

health-related mission. Proposals found acceptable under phase one would proceed to phase two. Phase two used a best-value tradeoff method, considering price and three non-price factors: technical capability, management approach, and past performance.

The RFP stated that the NIH would evaluate the proposals to determine if “the offeror, and all contractor teaming arrangement members ... have an adequate accounting system ... If the [o]fferor and all CTA members ... fail to furnish verification of an adequate cost accounting system will result in an unacceptable rating, the proposal will be determined unacceptable and ineligible for further consideration for award.”

The RFP continued: “Because of the need for contractors to respond to cost reimbursement task orders, to be eligible for award under the GWAC, offerors must have verification from the Defense Contract Audit Agency, the Defense Contract Management Agency, any federal civilian audit agency, or a third-party certified public accounting (CPA) firm of an accounting system that has been audited and determined adequate for determining costs applicable to this contract.”

The NIH received 552 proposals including 167 for the 8(a) small business group including Shivoy’s proposal. The NIH found Shivoy’s proposal unacceptable in phase one for failing to provide verification of an adequate accounting system.

In December 2018, the NIH notified Shivoy that its proposal was excluded from consideration, and provided a debriefing. After the

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debriefing, Shivoy filed a protest at the GAO.

### Arguments

The protester argued that the NIH unreasonably found its proposal unacceptable because its teaming partner submitted documentation to meet the solicitation's requirement for an adequate accounting system.

The NIH argued that the documentation submitted by the teaming partner was only a standard auditor's report for a financial audit of the teaming partner's parent company and its subsidiaries. The audit report stated that the audited financial statements were done in accordance with generally accepted accounting procedures (GAAP). The

audit report did not state that the accounting system was adequate for determining costs applicable to a cost-reimbursement contract.

### Case Study Findings

1. The evaluation of proposals is a matter within the procuring agency's discretion.
2. The GAO will question the agency's evaluation only where the record shows that the evaluation does not have a reasonable basis or is inconsistent with the solicitation.
3. The GAO found that the NIH evaluation was reasonable and consistent with the solicitation.
4. The solicitation required verification of an accounting system that has been audited and determined

adequate for determining costs applicable to the contract.

5. The verification submitted by Shivoy did not provide any verification of the accounting system for determining costs applicable to the future cost-reimbursement task orders.

### Tips for Offerors Responding to Solicitations for Cost-Reimbursement Contracts

1. Obtain an audit from a third-party CPA firm that verifies that your accounting system is adequate for determining costs applicable to the federal contract.
  - a. If the accounting system is not adequate, consider a "no-bid" decision on flexibly



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priced federal contracts until the accounting system can be brought up to the FAR standard.

- b. If the accounting system is adequate, submit the CPA's audit and verification when solicitations require one.
2. If the agency requires that the audit come from the DCAA, DCMA, or a federal civilian audit agency, submit a request for information (RFI) during the solicitation period asking if the agency will accept a verification from a third-party CPA firm. The FAR does not limit the verification to federal audit agencies.
3. If there is no evaluation factor, agencies may evaluate the adequacy of the cost accounting system as a responsibility factor. See FAR Part 9.104-1. If an agency that finds a small business to not be responsible, the Contracting Officer must request a certificate of competency from the Small Business Administration. See FAR Subpart 19.6.

### Tips for Agencies Awarding Cost-Reimbursement Contracts

1. Plan out the process for verifying that the awardee's accounting system is adequate for determining the costs applicable to the federal contract. The NIH did that as the first step of the evaluation.
2. Avoid relying on the myth that only a federal audit agency (e.g., DCAA, DCMA) can verify the adequacy of an offeror's accounting system. The NIH allowed for third-party CPAs to provide the required verification under the FAR.

## Avoid relying on the myth that only a federal audit agency can verify the adequacy of an offeror's accounting system.

3. An evaluation factor requiring verification by a federal audit agency (and not a third-party CPA) could be viewed as unduly restrictive of competition, and lead to a Competition in Contracting Act (CICA) stay on the solicitation process, and a sustained protest against the solicitation. The NIH received 552 proposals from small businesses.
4. When an offeror fails a go/no-go evaluation factor, they are ineligible for award. In general, an offeror that fails a go/no-go factor may still be part of the competitive range, informed of the deficiency during discussions, and allowed to address the failure in their final proposal revision. If the solicitation states that the offeror is "ineligible for further consideration," then the agency must follow the solicitation and exclude the offeror.
5. Clarify whether an adequate accounting system is required for flexibly priced contracts other than cost-reimbursement contracts (e.g., the materials portion of a time-and-materials contract, or a fixed-price-incentive contract). It can be difficult for offerors to tell what the agency requires in order to submit an offer on a flexibly priced contract other than cost reimbursement. **CM**

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