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President's Column

Peter A. McDonald
CPA, Esq.

This is my last President's Column.

This past year has been a very worthwhile experience. My sincere thanks go to the many, many people who have given willingly of their time to support BCABA activities, and I am very grateful to them all: officers, governors, committee chairs, and dozens of members. My many thanks also go to all the BCA judges who voluntarily participated in our meetings.

Over the last year, these combined efforts contributed to the vitality of the BCABA and resulted in organizational growth, both in our individual memberships as well as our Gold Medal firms. Also on the plus side, our ratio of government attorneys remained about the same. This will be seen in the FY 2003 Directory, to be published and distributed next month.

My last project will be to revamp our rules of governance by updating our constitution and by-laws to reflect our actual practices. These proposed changes have been distributed to the Board of Governors (two changes to the constitution, and sixteen changes to the by-laws). With their approval, the membership will vote on these changes at the annual meeting [*Editor's Note: See page 43*].

I hope to see many of you at our annual meeting on October 23rd at the Army-Navy Club.

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Editor's Column

Clarence D. "Hugh" Long, III

This month we have another set of timely articles. We have two articles on problems in the accounting industry. This industry is now facing some of the problems traditionally faced by lawyers, and like lawyers, the problems were caused by people who took shortcuts. One article, by Steve Knight, describes how accountants can possibly be made to report on their clients. The other article, by Pete McDonald and Paul Pompeo, describes the new audit standards for fraud and how those standards will affect accountants, clients and government auditors.

We also have an extremely well thought out article by Judge Stephen Daniels on the problems caused by the largely successful attempts to streamline the procurement process in the last decade or so. The idea was, to some extent, to get lawyers out of the system. But at some point that created its own problems, as Judge Daniels points out.

Pete McDonald has contributed his draft of proposed changes to the Constitution and bylaws. All members are urged to read these with care and to contribute their thoughts to the Board of Governors, who will be voting.

Frank Peterson has written an excellent article on the difference between allocability and allowability, as defined by the recent *Boeing* decision. Rounding out this issue, Christopher Yukins has given us an informative article on the Canadian protest process.

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Annual Meeting

The BCABA annual meeting will be held on October 23rd at the Army-Navy Club on Farragut Square in Washington, D.C. You will soon receive an announcement.

'Recovery Auditing' and 'Overpayments': New Law Casts Contractors as Auditors and Agencies as Bounty Hunters

by
Stephen D. Knight*

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The terms "recovery audits" and "recovery activities" may be unfamiliar to many contractors and procuring agencies, but they will soon work their way into contracting jargon--and with hidden surprises, some of them unpleasant. A new layer of bureaucracy will be employed to ferret out suspected "overpayments"--a term broad enough to encompass most government claims. While the program is modeled on private sector initiatives, the manner of implementation will diverge from that followed in the private sector. Thus, the structure of the program makes it suspect from the outset. In addition, it is by no means clear the government will gain any benefit from this new round of red tape to be imposed on its contractors.

In any case, federal contractors should educate and prepare themselves now, for they will soon have to contend with increased audit scrutiny resulting from a number of statutory and regulatory changes, along with new audit guidance from the Defense Contract Audit Agency ("DCAA"). While these changes may appear innocuous, they hold the potential for imposing additional duties and penalties on companies doing business with the federal government.

I. The New Recovery Audit Legislation

Congress has passed legislation that requires agencies to use "recovery audits" and "recovery activities" to "recover amounts erroneously paid to contractors." The task of defining these terms and issuing regulations is the responsibility of the Director of the Office of Management and Budget ("OMB"). The legislation, however, fails to take into

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account provisions in the Federal Acquisition Regulation ("FAR") that impose restrictions and requirements on government claims for overpayments. The legislation, moreover, creates questionable incentives for auditors performing the recovery audits and agencies for which the audits are performed. Ultimately, contractors will be forced to deal with the untenable situation Congress has created in the National Defense Authorization Act for Fiscal Year 2002, Pub.L. No. 107-107, §831 ("FY '02 DOD Act" or "the Act").

Contained in §831 of the FY '02 DOD Act is a provision entitled "Identification of Errors Made by Executive Agencies in Payments to Contractors and Recovery of Amounts Erroneously Paid." This section requires every executive agency that enters into contracts with a total value in excess of $500 million during a fiscal year to "carry out a cost-effective program for identifying any errors made in paying the contractors and for recovering any amounts erroneously paid to the contractors." Congress now requires each such agency to use "recovery audits" and "recovery activities" as a part of the agency's program, and further requires the agency head to "determine, in accordance with guidance provided [by the Director of the Office of Management and Budget under § 831 of the Act] the classes of contracts to which recovery audits and recovery activities are appropriately applied."

Congress, however, left to OMB the task of defining the terms "recovery audits" and "recovery activities" and the classes of contracts to which they will apply. The Act requires the Director of OMB to issue guidance on:

(1) definitions of "recovery audit" and "recovery activities";

(2) the classes of contracts to which recovery audits and recovery activities are appropriately applied;

(3) protections for the confidentiality of sensitive financial information that has not been released for use by the general public, and information that could be used to identify a person;

(4) "policies and procedures for ensuring that the implementation of the [agency] programs does not result in duplicative audits of contractor records";

(5) policies regarding the contract types executive agencies may use for procuring recovery services, "including guidance for use, in appropriate circumstances, of a contingency contract pursuant to which the head of an executive agency may pay a contractor an amount equal to a percentage of the total amount collected for the United States pursuant to that contract";

(6) protections for a contractor's records and facilities "through restrictions on the authority of a contractor under a contract for the procurement of recovery services";

(a) to require "the production of any record or information by any person other than an officer, employee, or agent of the executive agency";

(b) to have a physical presence on the property of any private sector entity for the purposes of performing the contract; or

(c) "to act as agents for the Government in the recovery of funds erroneously paid to contractors."

In other words, Congress has imposed an additional layer of audits on contractors and left to OMB the task of defining the nature, scope, and manner of implementation of these audits.

Congress also mandated the disposition of any monies recovered through the recovery audits and recovery activities. Funds collected "shall be available to the executive agency...[t]o reimburse the actual expenses incurred by the executive agency in the administration of the program" and "[t]o pay contractors for services under the program" in accordance with OMB guidance on the use of contingency contracts. Any unused funds "shall be credited to the appropriations from which the erroneous payments were made, shall be merged with other amounts in those appropriations, and shall be available for the purposes and period for which such appropriations are available; or if no such appropriation remains available, shall be deposited in the Treasury as miscellaneous receipts."

In addition, agency heads must consider resources available to perform the agency's recovery audit and recovery activities program from "the executive agency," "other departments and agencies of the United States," and "private sector sources." However, before entering into a contract with a private sector source for the performance of a recovery audit, the agency head must comply with OMB Circular A-76 and "any other applicable provision of law or regulation with respect to the selection between employees of the United States and private sector sources for the performance of services."

This legislation had its genesis three years ago in H.R. 1827, "Government Waste Corrections Act of 1999," introduced by Rep. Dan Burton (R-Ind.) on May 17, 1999. As explained in General Accounting Office ("GAO") reports, recovery auditing was a technique that used proprietary software to examine *an agency's data* to identify missed discounts, price discrepancies, duplicate payments, and other overpayments. GAO Report No. GAO/NSIAD-99-12, "Contract Management: Recovery Auditing Offers Potential to Identify Overpayments" (December 1998). GAO stated erroneous or improper payments were a problem under federal entitlement and assistance programs, as well as federal contracts. According to one GAO report, however, improper payments appeared to be more of a problem under *entitlement and assistance programs* than contracts. GAO Report No. GAO/AIMD-00-10, "Financial Management: Increased Attention Needed to Prevent Billions in Improper Payments" (October 1999).

Rep. Burton sought to apply recovery audit practices used in the private sector to "payment activities" within government agencies, but defined "payment activities" to focus *only* on executive agency activities that made payments to government contractors. H.R. 1827 also defined "recovery audit" to include auditing for overpayments resulting from "duplicate payments, pricing errors, failure to provide applicable discounts, rebates, or other applicable allowances, or charges or payments that are not authorized by law, regulation, or other applicable requirements."

Section 831 is fundamentally a bad idea and poses numerous problems for contractors. It provides no definition of "recovery audits" and "recovery activities." It aims those audits at federal contracts when, according to GAO, the overpayments problem exists primarily in the assistance and entitlement programs. Section 831 appears to provide for the audit of *contractor* records, rather than *agency* records - exactly the opposite of how recovery audits are used in the private sector. While H.R. 1827 was clearly objectionable in its overbreadth ("charges or payments that are not authorized by law, regulation, or other applicable requirements"), at least H.R. 1827 appeared to focus on agency payment activities.

The misplaced focus of §831 is underscored by the guidance Congress requires from OMB. In addition to defining the terms "recovery audit" and "recovery activity," OMB must provide guidance on "the classes of contracts to which recovery audits and recovery activities are appropriately applied." Had Congress followed through on the private sector model--its original goal--§831 would have required OMB guidance on *agency* records of payments made under defined classes of contracts entered into by the agency. Moreover, while §831 requires OMB guidance on protection of a contractor's records and facilities when *a private contractor/auditor* performs the recovery audit (protection with respect to production of records, presence on the contractor's property, and the private contractor/auditor's ability to act as the government's agent in recovery of funds), the Act does not call for similar protections when *government employees* perform the recovery audit. In short, the contractor is not protected with respect to these burdens when the recovery audit is performed by government employees. Clearly, the focus has shifted squarely to audit of contractor records.

Despite §831's requirement that OMB provide guidance to ensure against duplicative audits of contractor records, duplicative audits are nonetheless bound to result. Even if the OMB guidance should clarify that recovery audits apply only to agency records, the practical result will be for agency personnel to ask contractors for support in responding to the recovery audit requests for documentation and information. Contractors will bear the burden of the additional audits, either directly or indirectly.[1]

Moreover, §831 fails to recognize the statutory, regulatory, and contractual processes already in place. Under applicable law, the contracting officer determines whether payments should be made to a contractor under a government contract. The government's various auditing functions, such as DCAA and agency Inspectors General, perform a variety of audits to examine whether contract prices are fair and reasonable, payments are made in accordance with contractual terms and conditions, and applicable cost accounting and cost allowability regulations are observed. With the aid of technical personnel, such as quality and audit personnel, the contracting officer determines whether the contractor's performance and delivery of goods and services is acceptable and whether payment under the contract is warranted. *See* FAR 52.215-2, 52.216-7, 52.216-16, 52.232-16.

If the contracting officer determines that payment is not authorized, the contracting officer withholds payment or asserts a government claim pursuant to the Contract Disputes Act, 41 U.S.C. §601 *et seq.* Section 831, however, makes no provision

for the coordination of recovery audits and recovery activities with established law concerning the assertion of government claims for improper payments.

Section 831 also fails to recognize the mandatory procedures of FAR 32.6. That section sets forth the requirements for the government to assert a debt against a contractor. FAR 32.602 provides examples of the ways in which contractor indebtedness can arise. FAR 32.602(d) and (f) explicitly address examples of overpayments. FAR 32.605(b) states in part: "For most kinds of contract debts...the contracting officer has the primary responsibility for determining the amounts of and collecting contract debt." FAR 32.606 provides additional, and specific, requirements concerning the government's determinations of contract debts. That regulation states in part:

(a) If any indication of a contract debt arises, the responsible official shall determine promptly whether an actual debt is due the Government and the amount....

(b) In determining the amount of any contract debt, the responsible official shall fairly consider both the Government's claim and any contract claims by the contractor against the Government...

In summary, FAR 32.6 sets forth specific requirements for the contracting officer, as the "responsible official," to assert a contract debt against the contractor. The contracting officer must determine the amount and collect the debt. In so doing, the contracting officer must consider the contractor's offsetting claims. Section 831 is silent on all these requirements. Further, §831 offers no clue as to how the undefined "recovery audits" and "recovery activities" are to be coordinated with the CDA requirement that contracting officers render final decisions on government claims against the contractor.

Other provisions of §831 are troublesome as well. For example, the Act sets up a "bounty hunter" mechanism for both the private contractor/auditor and the agency. Section 831 authorizes agencies to use "contingency contracts" under which an agency "may pay a contractor an amount equal to a percentage of the total amount collected for the United States pursuant to that contract." This built-in conflict will incentivize the private contractor/auditor to assert overpayments aggressively to boost its own returns. This program, substituting for independent, objective analysis, is bound to produce problems for contractors who will be forced to hire attorneys and accountants to combat the exaggerated or unfounded charges.

Yet, under the ignored FAR 32.6, "overpayments" must be determined in light of contractor claims against the government. What constitutes an "overpayment" and "the total amount collected for the United States" are significant open questions. By overlooking FAR 32.6 requirements, the agency will force the contractor to file its *own* claim to challenge the validity of the recovery audit and recovery activity.

Section 831 also sets up the agency as a "bounty hunter " in that it enables an agency to replenish its funding through recovery audits and recovery activities. The Act states that funds collected but not used to pay the expenses of the agency's recovery audit program "shall be credited to the appropriations from which the erroneous payments were made, shall be merged with other amounts in those appropriations; and shall be available for the purposes and period for which such appropriations are available." Like the private

contractor/auditor, the agency also will have the incentive to aggressively assert and collect the largest amount of "overpayments" it can determine. The integrity of each of these audits will be open to question.

II. FAR Changes Impose Duty on Contractors

Standing alone, the FY '02 DOD Act's provision for the recovery audit of "overpayments" would be enough to occupy contractors' attention for months to come. Yet, further developments will exacerbate the "overpayments" issue for contractors. Federal Acquisition Circular ("FAC") 2001-02, published on Dec. 18, 2001, is an example. 66 Fed. Reg. 65353 (Dec. 18, 2001). FAC 2001-02 added language to FAR 52.232-25 ("Prompt Payment"), 52.232-26 ("Prompt Payment for fixed-price architect-engineer contracts"), and 52.232-27 ("Prompt payment for construction contracts") that states:

> *Overpayments.* If the Contractor becomes aware of a duplicate payment or that the Government has otherwise overpaid on an invoice payment, the Contractor shall immediately notify the Contracting Officer and request instructions for disposition of the overpayment.

Comments accompanying FAC 2001-02 discussed the reasons underlying the new contract language, stating:

> *Implemented a General Accounting Office (GAO) recommendation.* In July 1999, the GAO published a report (GAO/NSIAD-99-131) entitled "Greater Attention Needed to Identify and Recover Overpayments." After examining the process for identifying and collecting overpayments, GAO concluded in their report that "Under current law, there is no requirement for contractors who have been overpaid to notify the Government of overpayments or to return overpayments prior to the Government issuing a demand letter" (*i.e.*, formal notification to the contractor to pay money owed to the Government). One of the recommendations of the report was that DOD require contractors to promptly notify the Government of overpayments made to them. Accordingly, the FAR rule adds a paragraph to the prompt payment clauses that requires the contractor to notify the contracting officer if the contractor becomes aware of an overpayment. 66 Fed. Reg. 65354.

Thus, the new prompt payment clause language imposes an additional duty on contractors to notify the contracting officer "immediately" of an "overpayment" and to request instructions on disposition of the "overpayment." The regulation contemplates that this additional contractor duty precede the procedures established in FAR 32.6. In addition, the contractor must perform this duty "if the contractor becomes aware" of an overpayment. For reasons that follow, the new contract language is fraught with potential problems.

First, "overpayment" is undefined. The new contract language speaks in terms of a "duplicate payment" or an instance in which the government has "otherwise overpaid"

the contractor. This could cover virtually any type of government claim. Typical government claims for overpayments include not only duplicative payments and failures to provide discounts, but also defective pricing claims and government claims for Cost Accounting Standards noncompliance. The promulgation comments indicate that the contractor is, to some undefined extent, responsible for spotting and acting upon government claims before *the government* might even become aware of the potential claim. The comments make clear that the intent of the prompt payment clause is to compel the contractor to act in advance of a contracting officer's demand letter. Stated otherwise, the new contract language is a shortcut to avoid the requirements of FAR 32.6.

Contractors may take little comfort in the new contractual language requiring the contractor to act "immediately" "if the contractor becomes aware" of an overpayment. Most contractors already have systems in place to match receipts with billings and to detect differences between the two. To the extent that such systems exist, the government may argue that the contractor now has the affirmative duty to search for overpayments of all types. If a contractor were to argue it need not search for potential government claims in a systemic manner, the government (or other third party, such as a *qui tam* relator) could respond that the contractor is acting in deliberate ignorance or reckless disregard of the falsity of its invoices. *See* 31 U.S.C. §3729 *et seq.*

Moreover, the contractor must perform this new duty "immediately"--whatever that means. Presumably, it means faster than "within a reasonable time." Otherwise, the new contract language would have stated that the contractor must act "within a reasonable time." The ramifications of this requirement are worrisome.

III. New DCAA Audit Guidance Overreaches

Adding to the complexity of the area of overpayments is DCAA audit guidance dated Nov. 2, 2001, entitled "Audit Guidance on Special Purpose Audits of Contract Overpayments and Progress Payments." DCAA grounded the need for audit guidance on GAO reports and the then-proposed additional prompt payment clause language later effected by FAC 2001-02. DCAA discussed its previous revisions to one of the DCAA Standard Audit Programs ("SAP") to:

> Ensure contractors have adequate written policies and procedures for comparing amounts billed to amounts received for contract payment and appropriately notifying the paying office if the amounts differ. If overpayments are received, the contractor should return the overpayment to the paying office.
>
> Review contractors' comparisons to ensure the written policies and procedures have been effectively implemented.

DCAA's audit guidance makes clear that the requirements of FAR 32.6 are of little concern in the area of "overpayments." DCAA states:

> Subsequent to the revision of [DCAA Standard Audit Program], the GAO conducted an evaluation of contract overpayments titled

"Excess payments And Overpayments Continue To Be A Problem" (GAO Report No. GAO-01-309, dated February 22, 2001). We assisted the GAO during the evaluation by obtaining and verifying contract information from selected contractors with significant contract payments and contract refunds in FY 1999. Based on our participation in the evaluation, we identified the need to enhance our audit coverage in this area. For example, several contractors did not identify and repay (refund) amounts due the government in a timely manner. Additionally, we found that some contractors' policies and procedures on the use of offsets were inconsistent and subjective. One contractor did not notify the government or refund a significant contract overpayment because the contractor believed that the contract was in an overall underpaid status, *i.e.*, the contractor had not been fully reimbursed for the total dollar value of progress payments and invoices previously submitted on the contract. *This is not a valid reason for not notifying the government and refunding overpayments. The contractor should notify the government of all significant overpayments, regardless* if the contract is in a net over or under paid status. [Emphasis added.]

DCAA's additional audit guidance states that "overpayments can occur because of payment mistakes (*e.g.*, duplicate payments) or because of contract administration adjustments." There will be an audit program to test a contractor's billing system internal controls "with particular emphasis on ensuring overpayments are promptly refunded or appropriately offset against billings." In addition, contractors should have written internal control policies and procedures that:

(1) require a listing of all significant offsets;

(2) require that significant offsets of government paying office errors and contract administration adjustments are made based on notification to and written instructions from the contracting officer and/or paying office;

(3) require review of subcontractors' accounting and billing systems for the identification and timely resolution of subcontract overpayments, refunds and offsets; and

(4) require timely response to demand letters issued by contracting officers and paying offices.

The new audit guidance states that auditors should notify the paying office immediately "if a significant contractor overpayment is disclosed during the audit and the contractor has not notified the government; or the overpayment is over 30 days old; or the offset was not done in accordance with written instructions from the contracting officer and/or paying office." Finally, according to DCAA, contract administration adjustments account for 77 percent of all refunds, and "[t]hese adjustments occur when contract payments are received in accordance with contract provisions but need to be reduced due to subsequent events or actions." DCAA clearly includes progress payments within the

audit for overpayments, focusing on loss positions, alternate liquidation rates, and changes in quantity or schedules.

The new DCAA audit guidance is problematic for both legal and practical reasons. From a legal perspective, DCAA is incorrect in objecting to a contractor's practice of considering an overpayment on a single payment request in the context of the entire record of contract payments. "Overpayment" only makes sense with reference to the total work performed by the contractor and the amount of money owed by the government under the contract. If the government fails to honor one payment request but pays twice on the *next* payment request, there simply is no "overpayment." In this example, the contractor has merely received the amount to which it is entitled. Moreover, as discussed above, FAR 32.606(b) requires the contracting officer to consider contractor claims against the government to fairly determine the net amount due the government.

The DCAA audit guidance also is problematic in extending the concept of "overpayment" to contract administration adjustments. The audit guidance states that "[t]hese adjustments occur *when contract payments are received in accordance with contract provisions but need to be reduced due to subsequent events or actions.*" (Emphasis added.) In this statement, DCAA admits that the payment received by the contractor accords with contract requirements but contends reductions must be made due to "subsequent events or actions." Far from auditing for overpayments, this would constitute second-guessing. To the extent that DCAA focuses on progress payment administration, DCAA intrudes into an area explicitly given to the Administrative Contracting Officer ("ACO") to administer pursuant to FAR 32.5.

DCAA's audit guidance further requires that the contractor review subcontractor accounting and billing systems for "identification and timely resolution of subcontract overpayments." DCAA's position that prime contractors must perform this function is at best questionable. The government has no privity of contract with subcontractors; accordingly, the government's ability to inquire into subcontractor billing systems and potential overpayments by the prime contractor to the subcontractor is debatable. Subcontractor performance has always been the prime contractor's responsibility, and (other than a few mandatory flowdown clauses) the manner in which the prime contractor chooses to perform that responsibility is for the prime contractor to negotiate with the subcontractor.

Practically, the DCAA audit guidance appears to be a case of the "audit tail wagging the procurement dog." With its emphasis on written notification to and instructions from the contracting officer regarding each instance of "overpayment," review of subcontractor accounting and billing systems, and contract administration adjustments made subsequent to payments that accorded with contract requirements, the DCAA position would increase the administrative burden in terms of delay and paperwork for both contractors and their government counterparts.

IV. Potential Impact on Contractors

Contractors are likely to see the effects of §831, FAC 2001-02, and the DCAA audit guidance in at least three areas: progress payments, provisional billing rates, and limitation on payments clauses.

As discussed above, DCAA's audit guidance views progress payments as a fertile hunting ground for "overpayments." DCAA intends to second-guess ACO administration of progress payments at least with respect to a contractor's loss position, alternate liquidation rates, and the effects of quantity or schedule changes. Although FAR 32.5 gives the responsibility to administer progress payments to the ACO, DCAA's audit guidance signals its intention to become more heavily involved in this area. Practically, the audit guidance will restrict the ACO's exercise of discretion.

With respect to provisional billing rates, contractors may find themselves under a new duty to adjust those rates with reference to actual rates during the course of contract performance in a fiscal year. Under FAR 42.704, the parties may agree on indirect rates for billing purposes. That regulation states in part:

> (b) The contracting officer... or auditor shall establish billing rates on the basis of information resulting from recent review, previous rate audits or experience, or similar reliable data or experience of other contracting activities. In establishing billing rates, the contracting officer ... or auditor should ensure that the billing rates are as close as possible to the final indirect cost rates anticipated for the contractor's fiscal period, as adjusted for any unallowable costs. When the contracting officer ... or auditor determines that the dollar value of contracts requiring use of billing rates does not warrant submission of a detailed billing rate proposal, the billing rates may be established by making appropriate adjustments from the prior year's indirect cost experience to eliminate unallowable and nonrecurring costs and to reflect new or changed conditions.
>
> (c) Once established, billing rates may be prospectively or retroactively revised by mutual agreement of the contracting officer ... or auditor and the contractor at either party's request, to prevent substantial overpayment or underpayment. When agreement cannot be reached, the billing rates may be unilaterally determined by the contracting officer ...

The new requirement for a contractor to return "overpayments" of which it "becomes aware" may be interpreted to require contractors to track actual rates against provisional billing rates and make a refund to the government whenever the billing rates exceed the actual rates during its fiscal year. The rationale would be that since the contractor is aware of its billing rates and its actual rates, the contractor must also be "aware" when the former exceed the latter resulting in an "overpayment." The prompt payment clause now requires that the contractor request disposition instructions from the contracting officer. In this manner the new "overpayments" requirements could obviate the usefulness of FAR 42.704.

A third example of the potential effect of the new "overpayments" requirements is in the area of limitation on payments clauses. Several contract clauses, such as the Incentive Price Revision clause, FAR 52.216-16, contain quarterly limitation on payments statement requirements. FAR 52.216-16(g) requires the contractor, on a quarterly basis, to submit a statement to the ACO essentially showing a comparison of (1) the total costs allocable to supplies delivered and accepted by the government and (2) the portion of target profit that is proportionate to supplies delivered and accepted by the government with (3) total amount of all invoices or vouchers for supplies delivered and accepted by the government. To the extent that the sum of (1) and (2) exceeds (3), the contractor must refund the difference as an overpayment.

As with provisional billing rates, the new "overpayments" requirement could force a contractor to perform the limitation on payments statement exercise more frequently than quarterly. Because the contractor has the cost and payment information available on a continuous basis, the contractor arguably is "aware" of an overpayment at least as frequently as every billing and payment cycle. Again, under DCAA's interpretation--and contrary to FAR 32.606(b)--the determination of an "overpayment" would be made without regard to any underpayments by the government, and the contractor would have the duty to "immediately" notify the contracting officer to request disposition instructions on this potential government claim.

Beyond questions regarding how the new "overpayments" requirements will work with existing contract requirements and procedures, an even more troubling prospect is the potential relevance of "overpayments" to issues of past performance, compliance, and contractor integrity. Notwithstanding the difficulty of the broad language of the new prompt payment clauses and the narrow (and legally suspect) DCAA interpretations, a contractor's failure to comply with the new "overpayments" requirement could reflect adversely on its integrity. The contractor could be accused of retaining monies to which it was not entitled. As a contract requirement, failure to abide by the "overpayments" requirement could implicate past performance issues and compliance issues as well.

V. Conclusion

Contractors will soon have to contend with new legislation, new regulations, and new audit guidance on overpayments that, coincidentally, mirror the heightened audit oversight that characterizes the post-Enron world. Absent a change in the direction of these developments, contractors will find themselves doing the government's work at their own expense. Accordingly, contractors should closely monitor the forthcoming OMB guidance, and actively participate in the rulemaking process in order to make recovery audits at least manageable. With respect to the new language in the prompt payment clauses, contractors should emphasize to contracting officers that "overpayments" are limited to instances such as inadvertent double payments by the government. Finally, contractors should firmly oppose DCAA's efforts to expand "overpayments" to include government claims and to evade the requirements of FAR 32.6.
