

HPM Corp: The CBCA Grants Government Access to Fixed Price Contract Cost Information

January 9, 2024 Richard Johnson, John Pachter, Gregory Smith, Daniel Ramish

PRACTICES Government Contracts, Cost Accounting and Cost Allowability

HPM Corp. (HPM) performed a contract for DOE containing both fixed price and cost-type CLINs. In its 2020 audit of the cost-type CLINs, DOE asked HPM to provide a “final indirect-cost rate proposal” with all supporting data including “any firm fixed price data needed to evaluate the indirect cost pool and base costs used to calculate indirect cost rates.” The requested firm fixed-price data included costs incurred under the fixed price CLINs of the contract. DOE later supplemented its justification for the data stating that it perceived an unspecified “audit risk” of “misallocation and/or cost shifting” between direct and indirect cost categories.

HPM objected to DOE’s request to produce fixed price contract cost data and filed a non-monetary claim to block DOE’s access. When its claim was denied by DOE, HPM filed an appeal with the CBCA, contending DOE had no right of access to incurred costs of fixed price CLINs. The Board noted that the contract included a DOE departmental access-to-records and audit clause that substantially exceeded the scope of the standard FAR Audit and Access to Records clause (FAR 52.215-2). The DOE clause granted DOE broad access to the records sought and could have supported a decision in DOE’s favor. Rather than decide the case on that basis, the CBCA held that the FAR clause itself granted DOE an almost unlimited right of access to fixed price contract records, entrusting determination of the scope of the clause to the judgment of government auditors.

In so ruling the Board adopted the position that fixed price contract incurred costs are relevant to verification and audit of indirect costs, a position that is not consistent with basic principles of government contract cost accounting.

Incurred cost audits under cost-type contracts or CLINs¹ have two major components – direct cost review and indirect cost review. Cibinic, *et al.*, *Cost Reimbursement Contracting*, 4th Ed. 2014, at pp. 472-73 (hereinafter “Cost Contracting”). Audit of direct costs requires review of the allocability and allowability of the costs in relation to the particular requirements of that contract. See FAR 31.202. Cost experience under any other contract is irrelevant since each contract or CLIN stands on its own feet with respect to its direct cost determinations. *Id.* The matter ends at the determination of allocability and allowability of the direct cost of that contract or CLIN.² Since direct cost incurred under any other contract cannot affect the direct cost incurred under the subject contract, there is no justification for audit access to the direct costs incurred under any other contracts. FAR 52.215-2(b) (audit rights extend to all records “sufficient to reflect properly all costs claimed to have been incurred.”). The opinion in *HPM* does not appear to state otherwise since it focuses exclusively on indirect, not direct, costs.

However, the Board failed to recognize that the same result obtains in determining the scope of the government’s data access rights in audits of indirect cost. Indirect costs are allocated to contracts in the form of **rates** (overhead and G&A). *E.g.*, FAR 31.203; 42.704(d); *Cost Contracting*, at 598. A rate is determined mathematically by dividing a “pool” by a “base.” *Cost Contracting*, at 598. Indirect cost audit requires examination of the costs in both the pool and the base to determine if

the rate is correct, and the government's right of access extends to all records of costs included in the base and the pool.³ Cost Contracting, at 475. There is no suggestion that HPM denied access to any of these costs. The costs in the base, especially for G&A, will likely include direct costs of other contracts since the base aggregates many different types of direct cost. However, the costs in the base are not identified to any contract.

In this regard, government cost accounting does not require that the pool or the base identify any cost data by contract or CLIN. The pool contains all contractor indirect cost related to the activity to which the pool is identified. The base includes all contractor direct costs relating to the activity. None of this data is, or is required to be, identified by contract or CLIN. The pool includes all the relevant indirect costs of a branch of activity **of the contractor**; the base measures the activity against which the pool is to be applied. Cost Contracting, at 475-76, 598, 607. Audit determines whether the costs are appropriate in nature and amount and entitled to be included in either the pool or the base. Cost Contracting, at 475. Costs identified with other contracts or CLINs – whether cost type or fixed price – are irrelevant to this analysis.

Thus, since the CBCA declined to rely on the more expansive DOE records access clause, the better course was to rule in favor of HPM – that the Audit clause right of access to records, as applied to indirect cost determination, does not extend to cost records of fixed-price contracts or CLINs.

What, then, should a contractor do if a government auditor demands access to cost records pertaining to fixed-price contracts or CLINs? The simple solution is to rely on the language of the Audit Rights clause. On cost-reimbursement and other flexibly-priced contracts, FAR 52.215-2(b) grants the government audit rights in “all records and other evidence sufficient to reflect properly all **costs claimed to have been incurred or anticipated to be incurred directly or indirectly in performance of this contract.**” (Emphasis added). The government only has a right to access records directly pertaining to the costs on the flexibly-priced contract. Contractors should explain that fixed-price contract cost records are not germane to the costs incurred on the cost-type contract and are therefore outside the scope of the government's contractual audit rights.

¹ At first the Board appeared to emphasize that HPM was performing a “hybrid” contract containing both cost-type and fixed price CLINs but then noted that “DOE's auditors have not requested documents that would fall outside the context of a normal incurred cost audit in the absence of hybrid contract features.”

² We do not address the separate field of Cost Accounting Standards which functions under its own rules.

³ We do not mean to suggest that audit rights may not also extend to general corporate records such as tax returns. See *United States v. Newport News Shipbuilding and Dry Dock Co.*, 862 F. 2d 464, 489-470 (4th Cir. 1988).