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Iraq Reconstruction Contracting: Widespread Difficulties In Record- Keeping And The Contractor's Burden Of Proof

In an article published a year ago, I wrote that the rapid build-up of reconstruction contracting activities in Iraq was generating a wave of audits and investigations at almost every level in the contracting process. The article further observed, "Time charging has been particularly difficult in the wartime situation, where employees often do not work a regular schedule. Nevertheless, a contractor that cannot substantiate its expenses runs the risk of having them denied for reimbursement by the Government." Nichols, *FEATURE COMMENT: Emerging Issues In Iraq Reconstruction Contracting—Audits, Investigations, And The Transition of Sovereignty*, 46 GC ¶ 185.

One year later, a series of audit reports by the U.S. Special Inspector General for Iraq Reconstruction (SIGIR) has proven that the difficulties of contract administration and record-keeping in a wartime environment are widespread. According to the SIGIR and other sources, both the U.S. Government and contractors routinely have been unable to maintain accurate and complete contract documentation. As this article describes, the key difference is that contractors are being held financially accountable for their lack of internal accounting controls, often because of the application of unrealistic and impermissible audit standards by the Government.

Administering Iraqi-Funded Contracts—In its audit report entitled *Administration of Contracts Funded by the Development Fund for Iraq*, the SIGIR found widespread inadequacies in the Government's record-keeping functions, resulting in cost discrepancies in the hundreds of millions of dollars. Report

No. 05-008 (April 30, 2005) (DFI Audit Report), available at http://www.cpa-ig.com/pdf/SIGIR_Audit_Administration_of_DFI_Funded_Contracts.pdf.

From April 2003 through June 28, 2004, the United Nations designated the Coalition Provisional Authority (CPA) as the lawful government of Iraq, pursuant to U.N. Security Council Resolution (UNSCR) 1483. See S/RES/1483 (May 22, 2003), available at <http://www2.unog.ch/unccl/resolutio/res1483.pdf>. In May 2003, the CPA established the Central Bank of Iraq-Development Fund for Iraq account at the U.S. Federal Reserve Bank of New York, for the purpose of meeting cash payment requirements in Iraq for the benefit of the Iraqi people. The DFI money was comprised primarily of proceeds from oil sales, U.N. Oil for Food program surplus funds and other assets of the former Iraqi government.

The CPA committed itself to rebuilding all aspects of Iraqi infrastructure, using funds from the DFI and U.S. appropriations. In November 2003, the CPA commissioned the Program Management Office (PMO) to oversee and direct the contracting process for the rebuilding effort. This included the award by the CPA of DFI-funded reconstruction contracts pursuant to CPA Order No. 4, which established "procedures applicable to the execution of contracts and grants for the benefit of the Iraqi people using Iraqi Funds. ..." See CPA Memorandum No. 4, *Contract and Grant Procedures Applicable to Vested and Seized Iraqi Property and the Development Fund for Iraq, Implementation of Regulation Number 3, Program Review Board* (Aug. 19, 2003). Memorandum No. 4, as well as later iterations of Iraqi contract regulations, was skeletal in terms of substantive rules for contracts administration.

On June 28, 2004, the CPA transitioned sovereignty, including responsibility for the DFI, to the Interim Iraqi government. Three relevant activities occurred in anticipation of that event. First, the Iraqi minister of finance requested the PMO, on a going-forward basis, to monitor and confirm performance, make payments and otherwise administer continuing contracts that the CPA awarded using DFI funds. Second, President Bush established the project and con-

tracting office (PCO) within the U.S. Department of Defense to provide acquisition and project management support for activities in Iraq. See *United States Government Operations in Iraq*, National Security Presidential Directive No. 36 (May 11, 2004), available at <http://www.fas.org/irp/offdocs/nspd/nspd051104.pdf>. Third, the deputy secretary of defense directed the PCO to provide support for the close-out of the CPA. With these features in place, the PCO became responsible for the continuing CPA-awarded, DFI-funded contracts following the transition of sovereignty.

On April 30, the SIGIR issued the DFI Audit Report discussing the contract administration provided by the PCO for those contracts. The audit was divided between accounting functions and contract administration functions. For both functions, the audit concluded that the PCO “lacked the necessary controls and adequate documentation to effectively perform its responsibilities to monitor and administer contracts funded by the DFI.” DFI Audit Report, at 3.

Of the 2,304 outstanding contracts, the accounting audit covered 225 contracts valued at more than \$327 million. The auditors found that the PCO lacked control over contract payments and could not accurately identify the current value of obligations, payments and unpaid obligations. According to the DFI Audit Report, the PCO’s financial records overstated gross contract obligations by \$11 million, understated payments by \$108 million and overstated unpaid obligations by \$119 million.

The contract administration audit covered 300 contracts with an award value of \$333 million. The SIGIR focused its review of contract files on whether the PCO was adequately monitoring contractor performance and payments. The SIGIR found that, for 198 of the 300 contracts, documentation was not available in the contract file to make this determination. The files did not contain evidence that goods and services had been received for 154 of the contracts, that invoices had been submitted for 169 of the contracts or that payments had been made for 144 contracts.

As a consequence of these findings, the SIGIR concluded that there was no assurance that fraud, waste and abuse did not occur under the PCO’s management and administration of contracts funded by the DFI, or that DFI funds were used for the purposes mandated by Resolution 1483.

Administering U.S.-Funded Contracts—Similarly, in its audit report entitled *Administration of Iraq*

Relief and Reconstruction Fund Contract Files, the SIGIR identified “significant deficiencies in contract administration processes and controls” of the PCO relating to contracts funded with U.S. appropriations. Report No. 05-007 (April 30, 2005) (IRRF Audit Report), available at http://www.cpa-ig.com/pdf/SIGIR_Audit_Administration_of_IRRF_Contracts.pdf.

By way of background, Title II of P.L. 108-106, “Emergency Supplemental Appropriations Act for Defense and the Reconstruction of Iraq and Afghanistan, 2004,” authorized \$18.4 billion for security, relief, rehabilitation and reconstruction projects in Iraq, funded through the IRRF. Both U.S. Government agencies and the CPA awarded contracts with these funds. The contracts awarded by the U.S. agencies are U.S. Government contracts subject to the Federal Acquisition Regulation. Additionally, contracts awarded by the CPA with U.S. appropriated funds routinely incorporated FAR clauses, making them subject to certain FAR requirements as a matter of contract law, regardless of whether they are subject to the FAR as a matter of administrative law. (The legal status of the latter contracts—as U.S. Government contracts or Iraqi government contracts—has not been settled. See, e.g., *The Coalition Provisional Authority: Origins, Characteristics, and Institutional Authorities*, Congressional Research Service Report for Congress (April 29, 2004)).

FAR pt. 4, Administrative Matters, establishes requirements for the establishment, maintenance and reporting of unclassified procurements and records in excess of \$25,000. It provides guidelines for the types of documentation that each Government contract file should contain, to ensure a complete history of each transaction. Additionally, the PCO Contracting Activity (PCO-CA) has a standard operating procedure (SOP) and policies that apply to its contracting personnel, stressing the importance of proper contract file management and maintenance to justify the Contracting Officer’s actions regarding procurement activities. The PCO-CA SOP establishes the minimum documentation requirements for contract files.

On April 30, the SIGIR issued the IRRF Audit Report discussing the administration provided by the PCO for reconstruction contracts funded by U.S. appropriations. The audit covered 37 contracts and 11 associated contract files valued at more than \$184 million. The SIGIR found that most of those contract files, like the DFI-funded contracts, were not

being adequately maintained to support transactions relating to contract performance.

Of the 48 contract files randomly selected for review, the PCO-CA could not produce 10 (21 percent) of the files. The files that the SIGIR was able to review were “sparse, missing and incomplete.” IRRF Audit Report, at 3. Seven of the files lacked copies of the signed contract award, six contained no information as to whether the contract was awarded competitively or sole-source and 18 had two or more instances of inadequate documentation, such as performance evaluation criteria. Additionally, one contract lacked an adequate statement of work, one lacked specific contract deliverables and one lacked clearly negotiated terms.

The SIGIR found these documentation inadequacies to be the result of inadequate administrative processes, controls or capabilities to maintain proper contract files. Additionally, the PCO-CA had contracting personnel who were assigned on a temporary basis, from four to 12 months, preventing continuity of contract administration when each tour of duty expired. Because of administrative difficulties and other problems, “there was no assurance that the contract file data was available, complete, consistent, and reliable or that it could be used to effectively monitor and report the status of contracted project activity. ...” *Id.* at 3.

The SIGIR also reported that, after the audit field work, the PCO-CA attempted to locate the previously unaccounted-for contracts with some success and was continuing to search for the remaining missing contract files. During the review, the PCO-CA also appointed a new principal assistant responsible for contracting, who instituted a “file clean-up day and required all contracting personnel to search desk drawers and surrounding areas for all contract files.” *Id.* at 11. Because management actions were still ongoing at the time the SIGIR concluded its audit work, the IRRF Audit Report did not assess the effectiveness of those remedial actions.

The SIGIR concluded the IRRF Audit Report with the following indication of potential ramifications of this situation:

The lack of dependable information may also adversely affect the U.S. Government’s ability to properly administer contracts, enforce contractor compliance, and defend its interests in disputes involving:

- contactor noncompliance or nonperformance

- false claims
- recoupment of overpayments
- underpayment claims

These significant deficiencies could result in the loss by the U.S. Government of a historical accounting of the efforts conducted to provide relief and reconstruction to the people of Iraq.

Id. at 11-12.

In response to the SIGIR’s findings, the commander of the joint contracting command—Iraq and head of contracting activity, which is responsible for the PCO-CA’s activities, provided the following explanation:

The Contracting team has always acted in the best interests of the mission at hand. During Operation Iraqi Freedom, the organization faced many challenges typically not encountered in a stateside environment and under peacetime conditions. The environment here in Iraq during the war had a debilitating affect [sic] on the quality of the statements of work and contracts in general. Additionally, the Contracting operation lacked a homogenous and stable work force, a legal office to review all solicitations, adequate office space with enough office supplies to manage all of the administrative requirements, and the right type of office equipment and normal business hours with well rested staff. Things taken for granted as normal business procedures such as site visits were virtually impossible due to the ever-present security threats. Contracting Officers could not investigate site conditions prior to writing the Statements of Work or in exercising low level oversight on a project. Also, acceptance and management of supplies and services was difficult and at times impossible due to travel restrictions and security issues. This hampered every facet of the acquisition process, not to mention the language barriers in theater. Finally, crisis management was the order of the day manifested in extremely short Procurement Acquisition Lead Times (PALT) times effectively inhibiting standard contract procedures for over 700 contract awards in the month of June 2004 alone.

Indeed if it were not for a professional, can do, dedicated workforce from every branch of service, reserve component, civilian government agency, and outsourced contractor sup-

port, the needs of the Warfighter would not have been fulfilled.

Id. at 25-26 (Enclosure A: General Comments to Memorandum from MG Urias to SIGIR, April 29, 2005).

Audits of Contractors—While the SIGIR has recognized the contract administration difficulties that the PCO has encountered in the context of Iraq reconstruction, DOD and the Defense Contract Audit Agency have strictly continued to apply the highest standards of contract administration to contractors involved in the reconstruction activities.

As the former undersecretary of defense (comptroller) told the U.S. Congress last year: Many contractors that have not had problems in performing their domestic DOD contracts are having difficulties in adjusting to the unique environment in Iraq and to their own firms' influx of new business. We believe that contractor financial and internal control problems will resolve themselves, but in the meantime, we will take whatever actions are necessary to protect the Government's financial interests. DOD has enforced and will continue to enforce the highest standards for contracts in Iraq and anywhere else.

Contracts for Rebuilding Iraq: Hearing of the House Committee on Government Reform, March 11, 2004 (statement of D. Zakheim).

DCAA has acted in accordance with this mandate when providing contract audit services for the procurement activities involved in the Iraq reconstruction effort. This has included the CPA, U.S. Army Materiel Command and Corps of Engineers, U.S. Agency for International Development, U.S. State Department and PCO. As the DCAA director stated in testimony before Congress last year, "The Department will not tolerate the billing of costs that are not properly documented and supported. If internal control systems are deficient, we will continue to use protections, such as contract withholdings and cost suspension to safeguard the Department's interests." *Contracting and the Rebuilding of Iraq: Hearing of the House Committee on Government Reform*, June 15, 2004 (statement of W. Reed).

As a result, DCAA has been applying strictly the contract administration standards normally followed in the U.S. to contractors operating in the wartime environment of Iraq. Despite the lessons learned from

the PCO's experiences, DCAA, in some instances, has questioned most or all contractor costs based on state-side record-keeping standards. DCAA's approach has become problematic for both contractors and COs: once DCAA issues a final audit report, a CO is faced with a difficult decision of rejecting DCAA's written findings or accepting DCAA's recommendations, denying contract payments and possibly facing a formal contract dispute.

Clearly, contractors have the burden of proving the costs for which they seek reimbursement under a Government contract. See *Service Engineering Co.*, ASBCA No. 40274, 93-1 BCA ¶ 25,520, modified on reconsideration, 93-2 BCA ¶ 25,885. This includes establishing the actual incurrence of claimed costs, the reasonableness of the costs and their causal connection to the event on which the claim is based. *Delco Electronics Corp. v. U.S.*, 17 Cl. Ct. 302 (1989), *aff'd*, 909 F.2d 1495 (Fed. Cir. 1990). However, the recordkeeping requirements contemplated by the contract and applicable regulations may not always be accomplished in the manner prescribed. *Joseph Osoro Consultant Assocs., Inc.*, LBCA No. 84-BCA-13, 87-1 BCA ¶ 19,627.

The rule is well established that, if entitlement is shown, but "proof is not so positive as to permit an absolute determination of the precise costs, an approximate and reasonable determination may be made on the basis of the facts and circumstances and the best available evidence." *Wilner Constr. Co.*, VABCA No. 1436, 79-2 BCA ¶ 14,180. Such evidence may include testimony or secondary documents, such as contemporaneous business records. See *American Mechanical, Inc.*, ASBCA No. 52033, 03-1 BCA ¶ 32,134. The contractor must produce evidence that is "probative," although not necessarily exhaustive, and it must have sufficient reliability for the court or board to find it credible. See *Delco Electronics Corp.*, *supra*; *Mediatrix Interactive Technologies, Inc.*, ASBCA No. 43961, 99-1 BCA ¶ 30,318.

Once the contractor makes a prima facie showing of facts to establish its quantum recovery, the Government is then required to come forward with evidence to contest the prima facie case. *Environmental Safety Consultants, Inc.*, ASBCA No. 53485, 05-1 BCA ¶ 32,905. If the Government fails to do so, the prima facie case stands uncontroverted, and the contractor will have established its case by a preponderance of the evidence. See *Frank Lill & Son, Inc.*, ASBCA No. 44523, 96-1 BCA ¶ 27,951. The

boards have admonished the Government *not* to disallow all contractor costs merely because of inadequacies in the contractor's internal accounting system, where entitlement is otherwise established:

It is not permissible for the Government contracting officer to disallow the major part of a contract price, after receiving the benefits of performance, solely because of some deficiency, such as the failure to maintain some of the records contemplated in the contract agreement. Such an approach constitutes the imposition of a penalty, is totally unwarranted and would establish an undesirable precedent which should be avoided in the future. In the case of *Cohan v. Commissioner of Internal Revenue*, 39 F.2d 540 (1930), Judge Learned Hand prescribed a rational approach in a, not dissimilar, tax situation. There, speaking for the U.S. Court of Appeals, he held "... the Board should make as close an approximation as it can, bearing heavily if it chooses upon that taxpayer whose inexactitude is of his own making." In determining the allocability of costs and the basis for an equitable adjustments, contracting officers, the Boards of Contract Appeals, and the Court of Claims have frequently resorted to a jury verdict-type approach where exact amounts cannot be ascertained from records. In any event, disallowance of all costs in a given category where performance is acknowledged, is not justified.

Tom Cleveland Assocs., DCAB No. OMBE-10-76, 78-2 BCA ¶ 13,388 (citations omitted). See also *LA Ltd., LA Hizmet Isletmeleri*, ASBCA No. 53447, 04-1 BCA ¶ 32,478.

Given this standard applied by the courts and boards, Government auditors should consider accommodating their inquiries to the realities of record-keeping in the Iraq reconstruction context. While Iraq contractors should not be given a "free pass" in establishing their costs under Government contracts, DCAA should be open to considering supporting documentation that may not necessarily conform to the contract administration standards demanded in the U.S.



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