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## Decision

**Matter of:** McKissack+Delcan JV II

**File:** B-401973.2; B-401973.4

**Date:** January 13, 2010

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Daniel R. Forman, Esq., Richard W. Arnholt, Esq., and Gunjan R. Talati, Esq., Crowell & Moring LLP, for the protester.

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### **DIGEST**

Agency improperly rejected the proposal of a joint venture offeror for a cost reimbursement contract because the indirect cost rate structure included in the joint venture's accounting system was considered unacceptable, where the agency has provided no supportable or reasonable bases for its determination.

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### **DECISION**

McKissack+Declan JV II (MD-JV) of Vienna, Virginia protests the Department of Transportation (DOT), Federal Transit Administration's (FTA) rejection of its proposal for failing to provide an adequate accounting system under request for proposals (RFP) No. DTFT60-08-R-00010 for program management oversight (PMO) services.

We sustain the protest.

On June 26, 2008, FTA issued a RFP soliciting proposals for PMO services to provide support for select capital projects with continuous review and evaluation of grantee and FTA processes to ensure compliance with statutory, administrative, and regulatory requirements, and to monitor the projects to determine whether the projects are progressing on time, within budget, and in accordance with approved grantee plans and specifications. AR at 2. The solicitation contemplated the award of multiple (approximately 15 to 25) cost-reimbursement, indefinite-delivery, indefinite-quantity (ID/IQ) task order type contracts. RFP at 2, 94. Award was to be made to responsible offerors whose proposals contained the combination of criteria offering the best value to FTA, considering the following the evaluation criteria,

listed in descending order of importance: Technical and Management, Cost/Price, and Socioeconomic Status. Id. at 95.

MD-JV<sup>1</sup> submitted a timely proposal to FTA on September 3, 2008. The agency evaluated MD-JV's technical proposal, determined it was among the most "highly rated" technical proposals, and invited MD-JV to participate in oral presentations on December 15. Agency Report, Tab 6D-3, FTA Request to Attend Oral Presentations (Dec. 15, 2008), at 1. MD-JV's oral presentation took place on January 7, 2009. Id. After oral presentations, the agency rated MD-JV's technical proposal as technically acceptable. AR, Tab 4B, Source Selection Decision, at 8.

The RFP also requested that offerors complete and submit a cost proposal utilizing Attachment J-6, Contract Pricing Summary, included in the RFP. RFP at 87. Offerors were further required to state whether or not the federal government currently approves their accounting systems without conditions and whether proposed indirect rates have been "audited and accepted by any Federal Audit Agency." RFP at 89, 93. Additionally, all offerors had to "make [their] records available for pre-award or post-award audits." RFP at 89.

MD-JV included a completed Attachment J-6 with its cost proposal. The completed attachment identified the various direct labor rates for required personnel, listing alongside each labor rate the joint venture partner from which the employee would be assigned--Delcan Corporation or The McKissack Group--and calculated a total direct labor cost for each partner. In the "Labor Overhead" section of Attachment J-6, MD-JV provided a labor overhead rate for each joint venture partner that was applied to each of the joint venture partner's total direct labor costs. Additionally, MD-JV's Attachment J-6 provided costs for various subcontracted consultant services. MD-JV's Attachment J-6.

On March 18, 2009, FTA sent MD-JV's cost proposal for a pre-award audit to the Defense Contract Audit Agency (DCAA). As part of the audit, DCAA reviewed MD-JV's direct labor, escalation, and indirect rates to determine if they provided an acceptable basis for negotiation of a fair and reasonable price and issued its report to FTA on September 21. AR, Tab 4C, DCAA Audit Report (Sept. 21, 2009), at 1. DCAA determined that there were "significant issues effecting [DCAA's] examination" as follows:

The Joint Venture Agreement states that Delcan will maintain the accounting records. Delcan maintains its computerized accounting

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<sup>1</sup> MD-JV, a newly formed joint venture of Delcan Corporation and The McKissack Group, Inc., was formed as an unincorporated joint venture under the laws of the State of Delaware in order to perform this and other contracts with FTA. AR, Tab 6D-2, MD-JV Joint Venture Agreement, at 3.

system in Ontario, Canada and maintains its financial records in accordance with Canadian generally accepted accounting principles (GAAP). FAR 31.201-2 – Determining Allowability, states that “generally accepted accounting principles and practices appropriate to the circumstances” are used to determine allowability. . . . Since the accounting system is located at Delcan’s facility in Ontario Canada, there is no assurance that the joint venture will follow U.S. GAAP as required by the FAR.

The proposal submitted to the Government does not show that the joint venture is an independent entity. An independent joint venture for Government contracting purposes would have employees committed from each company and the indirect rate structure would be unique to the joint venture. . . . In addition, the indirect rate structure proposed is Delcan’s; the proposal should contain an indirect rate structure specific to McKissack & Delcan Joint Venture II.

The contractor has not prepared budgetary forecasts for the entire proposed period of contract performance. The contractor proposed the same indirect [rates] for all years of the proposed effort. . . .

Id. at 2. Thus, the DCAA concluded:

We do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price. . . . To make the cost or pricing data adequate, the offeror must have an accounting system that incorporates U.S. GAAP located at the princip[al] place of business in Vienna, Virginia; commit specific employees to the joint venture and compute average labor rates that are representative of each company in the joint venture; develop an indirect rate structure specific to the joint venture; and develop a comprehensive budget to facilitate the preparation of reliable cost estimates during the entire period of contract performance.

Id. at 3.<sup>2</sup>

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<sup>2</sup> While the DCAA report states that it “discussed factual matters concerning” its findings with a Delcan representative on May 19, 2009, MD-JV’s denies that it was advised of the reasons now advanced by DCAA for finding its cost proposal unacceptable, and was notified only of an issue not regarded as “major.” AR, Tab 4C, DCAA Audit Report (Sept. 21, 2009), at 3; Tab 5A, MD-JV’s Comments on Audit Report (Oct. 9, 2009), at 7-9. DCAA does not rebut MD-JV’s assertion here. AR, Tab 5A, DCAA Comments Concerning MD-JV’s Comments on Audit Report, at 9.

Based on the DCAA audit, the contracting officer determined that MD-JV's proposal was unacceptable. AR, Tab 5, Contracting Officer (CO) Determination and Findings. Id. at 5. On September 22, the contracting officer advised MD-JV of the rejection of its proposal for the following reasons:

Issue 1: . . . Since the accounting system is located at Delcan's facility in Ontario, Canada, there is no assurance that the joint venture would follow the U.S. GAAP guidelines as required by the FAR.

Issue 2: The proposal as submitted by the Joint Venture (JV) does not show that the JV is an independent entity, which for Government contracting purposes would have employees committed from each company and the indirect rate structure would be unique to the JV. It is noted that the JV proposal did not contain an indirect rate structure specific to [MD-JV].

Issue 3: The JV has no prepared budgetary forecasts for the entire proposed period of contract performance but has proposed the same indirect rate for each year of the proposal contract effort.

AR, Tab 1B, FTA Letter to MD-JV (Sept. 22, 2009), at 2.<sup>3</sup>

MD-JV received this letter on September 24, and filed a protest with our Office on October 5, specifically challenging each of the three reasons given in FTA's rejection letter; providing documentation to support its claim that MD-JV is an independent entity;<sup>4</sup> and explaining why its proposed overhead rate structure was proper, particularly considering that it is a newly formed joint venture. Protest at 7. After receiving a copy of DCAA's report, MD-JV supplemented its protest on October 19, arguing that FTA's reliance on DCAA's report was unreasonable because DCAA's report contained numerous factual errors and DCAA's audit did not conform to Generally Accepted Government Auditing Standards (GAGAS) as it was required to do.<sup>5</sup>

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<sup>3</sup> The only communication that FTA had with MD-JV prior to the rejection of MD-JV's proposal, which was in any way related to this matter, was its letter of February 3, where FTA requested that MD-JV provide a copy of the joint venture agreement and provide a revised representation and certification pertaining to its joint venture status. AR, Tab 6D-1, FTA Letter to MD-JV (Feb. 3, 2009).

<sup>4</sup> MD-JV is registered in the Central Contractor Registration, and has a Tax Identification Number and a Data Universal Numbering System number. AR, Tab 6D-2, MD-JV Response to FTA Request, at 1.

<sup>5</sup> For example, MD-JV asserts that DCAA failed to comply with the GAGAS requirements regarding disclosing audit findings to responsible officials of audited entities.

On November 4, the agency submitted its agency report and relevant documents in response to the initial protest.<sup>6</sup> In response to MD-JV's allegations, FTA stated that exclusion notice issues "(1) and (3) were not the reason for Protestor's exclusion from the competitive range and elimination from further consideration for contract award. . . . Even if true, they would be minor correctable errors on the part of the Protester which would be acceptable to the contracting officer when corrected. . . . [Issue] (2) in the Protests is an un-correctable error on the part of the Protestor, one that does form the sole basis for this protest." AR at 4. In the report, the agency also provides further explanation regarding "Issue 2." In this regard, FTA explains that while FTA's exclusion notice provides that MD-JV was excluded because "[t]he proposal as submitted by the Joint Venture (JV) does not show that the JV is an independent entity, which for Government contracting purposes would have employees committed from each company and the indirect rate structure would be unique to the JV," the agency no longer disputes that there is substantial evidence that MD-JV is an independent entity. AR at 7. Instead, FTA now states "None of the arguments presented in the Protest or the Protest Amendment address the real issue in this case, and that is, MD-JV's failure to submit a single overhead rate in their Cost Proposal. The basic failure of MD-JV is compliance with Cost Accounting Standard (CAS) 401."<sup>7</sup> AR at 6.

MD-JV filed comments noting that the agency had abandoned its contemporaneous basis for rejecting MD-JV's proposal, CAS 401 had not been previously mentioned as the basis for rejection, CAS 401 would not be applicable to it under this procurement, and CAS 401 did not prohibit a joint venture offeror from proposing the type of dual overhead rate approach included in MD-JV's accounting system. The GAO attorney handling this case for our office, after a complete review of the entire record, conducted an outcome prediction alternate dispute resolution (ADR) conference, during which she stated that the agency had not provided a reasonable basis for excluding MD-JV's proposal based on the documentation in the record. The agency did not initiate corrective action in response to the outcome prediction ADR, but provided further argument as to the applicability of CAS 401 and submitted a statement from a DCAA representative addressing this issue.

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<sup>6</sup> The agency did not specifically respond to the supplemental protest (although a document contained in the report responded to some of the MD-JV comments on the DCAA report that were provided to the agency prior to the supplemental protest). Since we have otherwise sustained this protest, FTA and DCAA may want to consider these issues as the recommended corrective action are implemented.

<sup>7</sup> This was the first time that CAS 401 was mentioned by FTA or DCAA as the basis for the rejection of MD-JV's proposal.

We first note that FTA's rejection of MD-JV's proposal due to evaluated problems in its accounting system concerns a matter of a prospective contractor's responsibility, not technical acceptability. See Pacificon Productions, Inc., B-196371, July 22, 1980, 80-2 CPD ¶ 58 at 4. In this regard, Federal Acquisition Regulation (FAR) § 9.104(e) provides that "to be determined responsible, a prospective contractor must . . . have the necessary organization, experience, accounting and operational controls, and technical skills, or the ability to obtain them." FAR § 16.301-3(a)(1) requires that cost-reimbursement contracts are only used when a contractor's accounting system is adequate for determining costs applicable to the contract.

Responsibility is to be determined based on any information received by the agency up to the time award is proposed to be made. FAR § 9.105-1(b)(3); American Tech. & Analytical Servs., Inc., B-282277.5, May 31, 2000, 2000 CPD ¶ 98 at 3. The determination of a prospective contractor's responsibility rests within the broad discretion of the contracting officer, who, in making that decision, must necessarily rely on his or her business judgment. We therefore will not question a negative determination of responsibility unless the determination lacked any reasonable basis. Oertzen & Co. GmbH, B-228537, Feb. 17, 1988, 88-1 CPD ¶ 158 at 3. In this respect, while a contracting officer has significant discretion in this area, a negative responsibility determination will not be found to be reasonable where it is based primarily on unreasonable or unsupported conclusions.<sup>8</sup> Decker and Co.; Baurenovierungsgesellschaft, m.b.H., B-220807 et al., Jan. 28, 1986, 86-1 CPD ¶ 100 at 7. Moreover, an agency's reliance upon the advice of DCAA does not insulate the agency from responsibility for error on the part of DCAA. See ASRC Research & Tech. Solutions, LLC, B-400217, B-400217.2, Aug. 21, 2008, 2008 CPD ¶ 202 at 11 n.12.

As noted, during the development of this protest, FTA has abandoned many of the reasons it previously advanced regarding why it believed MD-JV's accounting system was inadequate. FTA now asserts that MD-JV's accounting system is inadequate because MD-JV's failure to submit a unique indirect rate for the joint venture violates CAS 401.

CAS 401 states:

- (a) A contractor's practices used in estimating costs in pricing a proposal shall be consistent with his cost accounting practices used in accumulating and reporting costs.

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<sup>8</sup> An agency can and should reverse a previous non-responsibility determination based on additional information brought to its attention prior to award. Henry Spen & Co., Inc., B-183164, Jan. 27, 1976, 76-1 CPD ¶ 46 at 4. Exchanges with an offeror that pertain to its responsibility are appropriate and reasonable attempts to address agency concerns about the offerors ability to perform do not constitute discussions. Luhr Brothers, Inc.-Recon., B-248423.2, Nov. 9, 1992, 92-2 CPD ¶ 328 at 3-4.

(b) A contractor's cost accounting practices used in accumulating and reporting actual costs for a contract shall be consistent with his practices used in estimating costs in pricing the related proposal.

(c) The grouping of homogeneous costs in estimates prepared for proposal purposes shall not per se be deemed an inconsistent application of cost accounting practices under paragraphs (a) and (b) of this section when such costs are accumulated and reported in greater detail on an actual cost basis during contract performance.

48 C.F.R. § 9904.401-40 (2009). That is, CAS 401 requires a contractor's accounting practices in estimating costs for a proposal to be consistent with cost accounting practices used by the contractor in accumulating and reporting costs. 48 C.F.R. § 9904.401-20. This requirement is imposed because "[c]onsistency in the application of cost accounting practices is necessary to enhance the likelihood that comparable transactions are treated alike," so that, among other things, there is "financial control over costs during contract performance." Id.

FTA has provided a DCAA memorandum from the Branch Manager of DCAA's Reston, Virginia branch office in support of its argument that MD-JV's failure to submit a unique indirect rate for the joint venture violates CAS 401. DCAA simply states that "the contractor's proposal did not comply with CAS 401 because the contractor's proposal did not contain a unique rate structure, which an independent and professional operated organization would have in the regular course of business. . . . The CAS/FAR noncompliance issue is not the number of indirect rates," but rather that "MD-JV does not have its own indirect rate structure for allocating costs to Government contracts." DCAA Memorandum (Dec. 15, 2009) at 2.

Except for the foregoing conclusory statements, neither FTA nor DCAA has provided any analysis or legal authority as to why the MD-JV indirect rate structure, which adopts the individual overhead rates of the joint venture partners for MD-JV's own use and describes how the rates will be applied, violates CAS 401.<sup>9</sup> Nor is it apparent to our Office why this would violate CAS 401, given that neither agency has explained why the particular dual overhead rate structure proposed by MD-JV would lead to an inconsistency in the application of cost accounting practices or a loss of financial control over costs during contract performance. In this regard, it is notable that DCAA's audit report and FTA's determination and findings supporting the rejection of MD-JV's proposal because of its unacceptable accounting system did not

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<sup>9</sup> There is some dispute between DCAA and MD-JV as to whether CAS 401 would be applicable to this procurement, which we need not resolve here because the agencies have not reasonably explained why MD-JV's proposed indirect rate structure is inconsistent with CAS 401.

make any mention of a CAS 401 violation.<sup>10</sup> Moreover, we have found no other authority that prohibits MD-JV's proposed dual overhead rate structure.<sup>11</sup>

While the agency acted properly in choosing to investigate whether or not MD-JV had an adequate accounting system to support this cost-reimbursement contract, FTA has not provided on this record a reasonable explanation why MD-JV's accounting system was unacceptable, and we sustain the protest on this basis.<sup>12</sup>

We recommend that FTA reevaluate MD-JV's accounting system to determine whether it is adequate. In so doing, we note that if the agency has problems with MD-JV's accounting system, it may open a dialogue to resolve these issues without such dialogue necessarily being considered discussions, given that this is a matter relating to MD-JV's responsibility, so long as MD-JV does not change its proposed cost or otherwise materially modify its proposal. If MD-JV's accounting system is found adequate, the agency should determine whether MD-JV's proposal is otherwise in line for award and if so award should be made to that firm. We also recommend that the agency reimburse the protester for the reasonable costs of filing and pursuing the protest, including reasonable attorneys' fees. Bid Protest Regulations, 4 C.F.R. § 21.8(d)(1)(2009). The protester's certified claims for cost, detailing the time expended and costs incurred, must be submitted directly to the agency within 60 days of receiving this decision. 4 C.F.R. § 21.8(f)(1).

The protest is sustained.

Lynn H. Gibson  
Acting General Counsel

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<sup>10</sup> While DCAA asserts that there are provisions in FAR Part 31—which was cited as the general authority for finding MD-JV's indirect rate structure improper in DCAA's audit report—that address the objectives of CAS 401, the fact is that CAS 401, unlike some other CAS provisions, has not been incorporated into FAR Part 31. See The Future Role of the Cost Accounting Standards Board, Cost Accounting Standards Board Review Panel Report to Congress, GAO SP-99-1, Apr. 2, 1999, at 106-107.

<sup>11</sup> It may be that there are legitimate legal or accounting reasons for questioning MD-JV's indirect rate structure that have not been provided to our Office.

<sup>12</sup> As noted above, the agencies modified the reasons that MD-JV's accounting system was regarded as unacceptable and did not contemporaneously advance CAS 401 as the reason why the agencies were concerned with MD-JV's accounting system.