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Case Study…

CHALLENGING DCAA QUESTIONED COSTS AND RECOMMENDED IMPOSITION OF PENALTIES

(*Editor's Note. We are happy to report that we are finding a distinctly new trend of administrative contracting officers actually independently evaluating contractor challenges to DCAA findings. We have been highly gratified to see that in six recent consulting engagements ACOs have considered both DCAA's position and our clients' challenges where the result has been DCAA findings have either been partially or entirely reversed. The recent trend shows that a reasonable response to often erroneous findings are starting to get a fair, independent review by an increasing number of ACOs. This is as it should be. In keeping with our interest in presenting real world cases of responding to DCAA findings, we are providing a highly edited version of a response we helped prepare in response to a DCAA draft report sent to our client where DCAA questioned several types of claimed costs and recommended imposition of penalties on some of those questioned costs. Some of the facts and dollar amounts have been changed to disguise the identity of our client who is referred to as "Contractor."*.)

In its audit of Contractor's 2006 Incurred Cost Proposal (ICP) DCAA questioned about $127,000 from its proposed overhead pool and $22,000 from its G&A pool. The areas of questioned costs consisted of Contractor's bonus paid to its VP of Operations, vehicle lease costs of three of its officers, travel costs of the President which included both direct and indirect labor and travel costs. The audit report also recommended imposition of penalties on certain questioned costs.

VP of Operations Bonus

DCAA Position. The report questioned a total of $76,420 of bonus costs paid to the VP of Operations consisting of $68,000 of overhead pool costs and $8,420 of G&A costs. The report not only questioned those amounts but also recommended Level 1 penalties on $8,420 of the questioned costs. The report cited FAR 31.205-6(f)(1) being the basis for the questioned costs which states "Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered." The report continues stating "for the bonus to be allowable it must follow the contractor's bonus policy and the policy must be in place prior to services rendered" where Contractor did not have such a policy. The report states the auditor examined the VP's offer letter which had a start date of May 1, 2006 and the VP's incentive bonus which reads the VP "is eligible for an annual bonus equal to 5 percent of non-DOD revenue." DCAA questioned four months of the computed bonus because the VP was not an employee until May.

Contractor Response. We disagree that the VP bonus costs are unallowable and believe the audit report is attempting to impose conditions on our claimed costs that are not required by the FAR. The audit report is misinterpreting FAR 31.205-6(f)(1)(i) in as much as it does not require **both** an agreement and policy be in place but rather requires **either** an agreement or policy be in place. In addition, the offer letter clearly represents a good faith agreement between Contractor and the employee was in place. Finally, the agreement in place does not limit the eligibility of the bonus to a fraction of a year representing less than a full year of employment – it provides the entire bonus will be paid in the first year the employee starts with the company whether or not that is for a full or partial year.

Vehicle Lease Costs

DCAA Position. The report questioned $42,200 of vehicle lease payments for the President and two VPs, citing FAR 31.205-46(a)(1) and FAR 31.201-2(d). The questioned amounts represented the difference between amounts claimed and what they would be entitled to if they were reimbursed for mileage ($.0465 per mile times business related miles driven). The audit report also recommended Level l penalties be imposed on the

$5,020 of these costs that were charged to G&A. The audit report asserts the President and two VPs were entitled only to mileage allowances because the cars were leased to the President and VPs rather than the company. This arrangement made them personal owned vehicles (POVs), not contractor owned, which makes the costs subject to FAR 31.205-46(a)(2)(i) where the report states "This FAR clause describes allowability and reasonableness to travel costs if the contractor followed the Federal Travel Regulation (FTR) for CONUS travel."

Contractor's Response. First, the auditor erroneously assumes that the government cannot reimburse a contractor for a personal asset that the employee owns. Neither IRS requirements nor the FAR (we provided extensive quotations from IRS publications and several FAR cost principles) make a distinction between company-owned versus employee-owned assets where both deductions and costs charged to the government can be based on **either** company or employee owned assets. Second, the auditor is incorrectly assuming there is only one way that a contractor may bill the government for use of a vehicle owned by an employee. We do not disagree that a mileage allowance is one way for the company to bill the government but IRS and FAR 31.205-46(a)(1) provide for two ways – either a mileage allowance or the cost of ownership of that asset (again we quoted from the FAR cost principles cited by the audit report). Third, in its allusions to the Federal Travel Regulation, the audit report references an irrelevant set of rules that apply to government employees but not to government contractors. In support of its incorrect assertion the contractor is entitled to only mileage, the report references sections of the Federal Travel Regulation. The auditor apparently does not know the FTR applies only to government employees where their applicability to government contractors is limited to only three areas – combined per diem rates, definition of meals and incidentals and conditions justifying payment up to 300% of per diem rates. To insist that the FTR provides regulations or any guidance on when or how much a contractor can charge the government for privately owned vehicles is simply wrong.

President Foreign Travel

DCAA Position. DCAA questioned $37,400 of the President's foreign travel consisting of $22,680 of travel costs, $6,510 of questioned direct labor costs and $8,210 of indirect marketing labor costs while traveling. DCAA selected one account where these costs were charged and citing FAR 31.205-46(a)(1), travel costs and 31.201-3, determining reasonableness asserted these two FAR provisions also made the questioned costs subject to Level l penalties. Two travel vouchers were selected – one for a 22 day trip and the other for a 27 day trip to China – asserting there was insufficient support for documenting the business purpose of the trips. The report does state DCAA did possess timecards of the President that identified specific hours for direct labor, marketing and vacation.

Contractor's Response. We disagree that the purpose of the trip was not business related where the trips are essential for obtaining both current and future business, obtaining critical technologies for government and commercial work and recruiting highly skilled personnel needed to perform contract work as well as reviewing progress reports due on specific projects. DCAA has reviewed Contractor's timekeeping practices many times where in a floor check during the year being audited concluded "there are no deficiencies" indicating Contractor's timecards can be relied upon for accuracy. Our provision of timecards, expense reports, itineraries, explanation of activities, timeline and examples of documents worked on in China provide sufficient evidence the trip was business related. The extensive documentation we provided both support the claimed costs were incurred and the trip was for business (e.g. marketing, technical and recruiting activities, direct labor) but those costs are questioned because the auditor unreasonably asserts the trip was not for business purposes.

With respect to the questioned indirect *marketing labor costs*, we provided not only timecards on the marketing activities but explained why trips to China are necessary for Contractor's business and the types of activities the President engages in. The explanation we provided included an overview of business opportunities (e.g. China is the largest purchaser of US built defense products, the importance of meeting with key decision makers and potential new customers some of which actually generated company business). We also discussed the need to meet with top level researchers and institutions to understand the technological needs of potential customers as well as recruiting top level candidates to join Contractor. We are afraid these explanations may have fallen on deaf ears. With respect to the questioned *direct labor costs*, we provided the timecards documenting, in detail, the hours of direct time spent on specific contracts. We explained the na-

ture of the direct work to the auditor where by the comments in the report it appears the auditor did not understand us. The hours charged to direct contracts during the trip to China are no different than the same activities the President charges to contracts when he is not in China (e.g. review of progress reports). Those charges have been examined in detail during floorchecks, including one for 2006 and invoice reviews where such regular invoices are reviewed and approved by the federal Program Manager and presumably other people, possibly including DCAA

The audit report reaches unjustified conclusions (e.g. no business purposes for the trip) and because of this conclusion unjustly rejects documentation for the validity of costs incurred. We believe the only way out of this circular logic malaise is to review more thoroughly the documents for incurrence of expenses and the business nature of those expenses. This would entail a review of the documents we provided which was not conducted by the auditor - timecards, expense reports, itineraries, explanations of activities and timeline – which would unquestionably show the business nature of the trip.

Direct Consultant Costs

DCAA Position. The DCAA report is questioning $8,420 of direct consulting costs citing FAR 31.205-33(f)(1). It states that the consulting agreement for Job 101 does not state an hourly rate despite the government being billed at a rate of $110. The auditor decided to compute an alternative hourly rate. The agreement provided for both a maximum dollar amount ($60,000) as well as a maximum amount of hours to be billed per month (70) and for some inexplicable reason the auditor computed an alternative hourly rate by (1) computing an hour figure for the project by multiplying the 70 maximum hour monthly figure by the estimated period of performance of 16 months to compute a maximum number of hours of 1,120 and (2) dividing this number by the theoretical maximum figure of $60,000 to compute an hourly rate of $53. It then determined the number of hours actually billed and multiplied these hours by its computed rate of $53 per hour and questioned the difference between the amount billed versus the amount its computations indicated should have been billed using the $53 hourly rate.

Contractor's Response. We agree that the consulting agreement for Project 101 did inadvertently omit the hourly rate. However, all other consulting agreements for direct projects required the same type of services and did identify a $110 hourly billing rate. Rather than confirm the services by the same person and billings for Project 101 were consistent with all other services provided the auditor took a very unusual approach of computing a lower hourly rate of $53 for the one Job by dividing a theoretical maximum amount of billings by a theoretically maximum amount of hours. Considering the consultant's background (e.g. Stanford graduate, Pricewaterhouse consultant and VP for firms providing similar services) and the fact his compensation as a Contractor employee exceeded $110 per hour, one can only conclude the $110 billing rate was reasonable while a rate half that amount would be unreasonable. Finally, the FAR sections quoted stress that multiple factors must be considered in evaluating reasonableness of consultant costs not just one (e.g. absence of an hourly rate in one of many consulting agreements.

Penalties

DCAA Position. DCAA recommends imposition of penalties on three categories of questioned costs citing sections of the FAR that made the questioned costs "expressly unallowable:" (1) Travel Costs - $8,420 (FAR 31.205-46(a)(1) & 31.201-3) (2) Auto Lease Costs - $5,020 (FAR 31.205-46(a)(2) & 31.201-2(d) and VP Bonus - $8,420 (FAR 31.205-6(f))(1).

Contractor Response. We first provided a summary of FAR Part 42.709 provisions and expert commentary where the lessons relevant here are: (1) Penalty provisions apply only to certain contract vehicles like cost reimbursable contracts so the penalty clause must be present where only contracts (not subcontracts) that exceed $650,000 qualify (2) Unallowable costs must be "expressly unallowable" where expressly unallowable costs represent a small subset of unallowable costs and only certain expressly unallowable costs are subject to penalties (3) For an unallowable cost to be expressly unallowable, it must be "unmistakably" unallowable or "obviously" unallowable according to the definition and preambles in CAS 405 where the emphasis on an applicable law, regulation or contract excludes numerous categories of unallowable costs such as a cost determined to be unallowable because it is unreasonable, not allocable or not compliant with CAS or GAAP and (4) if an expressly unallowable cost subject to penalties is less than $10,000 then FAR 42.709-5 provides that a waiver to the penalties will apply.

Even if the costs are deemed to be unallowable they do not meet the criteria for being "expressly unallowable," namely they are "obviously" and "unmistakably" unallowable. As for *travel costs* the first cost principle cited by DCAA does not explicitly state that costs not incurred for business purposes are unallowable while for the second one asserting the costs are unreasonable there is a long history of establishing that assertions of a cost being "unreasonable" are not grounds for concluding the disallowed costs are "expressly unallowable." For penalties on *vehicle costs*, the first cost principle cited does not prohibit charging actual lease costs and in fact, explicitly provides that such costs are allowable while the other citation does not explicitly address vehicle leasing costs but rather provides general guidance that claimed costs should be based on adequate documentation where there is no assertion Contractor did not provide such documentation. As for the cost principle addressing the *VP bonus*, it does not "unmistakably" make the cost unallowable – in fact, the cost principle explicitly provides for the cost to be allowable if there is a clear agreement between the employee and employer which is the case here. Furthermore, many of the government contracts held by Contractor such as its SBIRs do not approximate the $650,000 threshold while most of its other contracts are either fixed price or subcontracts which are not subject to penalty provisions. Finally, the amount of costs being questioned for each of the three questioned costs is less than $10,000 and therefore meets the threshold of qualifying for a waiver per FAR 42.709-5.

DCAA ISSUES NEW GUIDANCE ON PROFESSIONAL AND CONSULTANT SERVICES

(*Editor's Note. The following guidance that addresses the documentation requirements for allowing consultant and professional costs is most welcome. Consultant costs have become one of the top two areas of audit scrutiny. In recent times questioned costs in this area has skyrocketed, where the basis of such findings are often very subjective and quite inconsistent from one auditor to the next. Though audit conclusions are still to be based on "auditor judgment" we find the following audit guidance does provide some reasonable and objective considerations for determining whether such claimed costs are allowable and should lessen the practice of automatically disallowing costs when a document is missing or deemed insufficient.*)

The Defense Contract Audit Agency has issued Dec 19, 2013 new guidance in the form of a Memorandum for Regional Directors entitled "Audit Alert on Professional and Consultant Services Costs (FAR 31.205-33) and Purchased Labor." Though the guidance does often distinguish between consultant and professional service costs and purchased labor costs it does not address the latter so we invite the reader to review our prior articles on purchased labor (conduct a Word Search at our website at govcontractassoc.com). The guidance separately addresses several issues related to these costs and adds a Question and Answer section that covers numerous other highly pertinent issues.

Why is the guidance being issued?

The guidance states there is a need to clarify documentation requirements for consultant and professional services (we will simply refer to these services as "consultant" costs) following "input from field audit offices, internal quality assessments and inquiries from DCMA." We believe the genesis of this new guidance is at least partly a result of complaints from federal contractors about inconsistent and unfair treatment of proposed consulting costs from DCAA and other auditors and increasing appeals of ACO decisions on DCAA determined questioned costs.

What are the documentation requirements of FAR 31.205-33(f)?

FAR 31.205-33(f) contains three documentation requirements that are needed to ensure consulting costs are allowable:

1. Details of all agreements. An agreement explains what the consultant will be doing and what the billing rates are.

2. Invoices or billings. A copy of a bill for actual services rendered including sufficient evidence as to time expended and nature of the services provided to determine what was done in exchange for the payment requested and that the terms of the agreement were met. Whereas we have seen many contractors' claimed consulting costs rejected because the invoice did not provide this information the new guidance states this documentation does not need to be included on the actual

invoice and can be supported by other evidence provided by the contractor.

3. Consultant's work product and related documents. This is an explanation of what the consultant accomplished for the fees paid. This information can be identified on the invoice or can be included in some other evidence such as a drawing or power point presentation.

The claimed costs are unallowable without evidence of an agreement, invoice and what work the consultant actually performed. The guidance stresses that auditors are looking for evidence to satisfy these three areas but they are not to look for "a specific set of documents" where "auditor judgment" will be the determining factor on the type and sufficiency of evidence required. The auditor is to explain to the contractor they are looking for evidence "that a prudent person would already possess" such as an understanding of what they are buying, how much they will be paying and ensuring they get what they paid for.

The contractor may provide evidence created when it incurred the costs as well as evidence from a later period. Though evidence from a later period is acceptable, auditors are told to assess the qualify of the evidence, such evidence prepared after the fact is "less persuasive" and additional corroborative evidence may be needed. Examples of later period evidence may include oral or written documentation from the consultant on what effort was performed.

Special concerns related to work product documentation

The purpose of the work product requirement is for the contractor to be able to show what work the consultant actually performed (as opposed to what was planned). A work product should satisfy this requirement but the guidance states other evidence may also be sufficient. An example of adequate work product even though it is not provided is an attorney's advice to the contractor. Auditors are told not to insist on work product if other evidence provided is sufficient to determine the nature and scope of actual work performed.

When are documentation requirements applied

FAR 31.205-33(a) defines professional and consulting services costs as services rendered by persons who are members of a particular profession or who possess a special skill and who are not officers or employees of the contractor. The guidance states examples of these services are those to enhance "their legal, economic, financial or technical positions." The guidance distinguishes between these types of services and other expenses such as janitorial, clerical and security which the guidance states is "purchased labor." The guidance makes the distinction between these two types of services where if purchased labor is recorded in "Consultant" or "Professional" accounts that nonetheless does not make these costs subject to FAR 31.205-33.

FAR documentation requirements for purchased labor

The guidance states that there are no FAR cost principles covering purchased labor but does allude to the Defense Contract Audit Manual (DCAM) at Section 7-2102. Nonetheless, contractors must have adequate documentation to support the reasonableness of amounts paid (covered by FAR 31.201-3, determining reasonableness), demonstrate the person who provided the services and evidence the effort represented allowable activities (covered by FAR 31.201-2d)

Should FAR 31.205-33(f) always be cited?

The guidance refers to circumstances when there is only partial evidence but that partial evidence indicates the costs are unallowable in accordance with other FAR cost principles. For example, if the partial evidence indicates the consulting costs were for advertising or public relations then the FAR cost principle covering those activities (i.e. FAR 31.205-1) should be cited and not 31.205-33. However, if the auditor cannot gather sufficient documentation to support the evidence requirements of the consulting cost principle but the consulting activity is nonetheless allowable then the costs should be questioned and FAR 31.205-33(f) should be cited.

Other considerations

The guidance rejects the common argument put forth by contractors that the attorney-client privilege protects documentation. It cites the DCAM section 1-504.4g for resolving assertions of attorney-client privilege.

Questions and Answers

The Q&A section of the guidance is quite comprehensive addressing such issues as what are "consultant" versus purchase labor costs, allocation of direct versus indirect costs, what is the meaning of "reasonable" costs, examples of what constitutes adequate evidence for work product, third party testimonials, flat fee consulting arrangements and when are consulting costs considered unallowable public relations.

1. Are temporary accounting services to perform bookkeeping activities considered professional and consulting activities? No. Though accounting is considered to be a profession under the FAR 31.205-33(a) definition, the type and nature of work described are really clerical and hence should not be evaluated by 31.205-33 criteria.

2. Contractor enters into an agreement with an individual to provide program management activities for one of its contracts where the individual works directly with contractor employees to monitor work so is this covered by FAR 31.205-33? No. This individual is equivalent to a contractor employee where he is integrated as part of the operations and hence would be considered as purchased labor not a consultant.

3. The contractor hires a thermal engineer to work on program specific technical activities of a contract and charges these activities as direct consulting costs. Yes. It is appropriate because the service enhances the technical capability of the contractor which is one of the definitions of professional and consulting services in FAR 31.205-33(a). Whether the costs are charged direct or indirect does not affect whether the costs meet the definition found in 33(a), documentation requirements of 33(f) or 33(d) considerations of allowability.

4. Contractor engages an efficiency engineer to evaluate the design of its manufacturing process where the only document for work product is a single agenda item from an executive meeting stating the engineer verbally presented its recommendations (which the agenda says were adopted). Is this sufficient evidence for work product? No but the auditor should seek additional corroborative evidence such as actions taken to improve the manufacturing process tied directly to the consultant's recommendations after taking a physical inspection of the process, interviewing relevant employees and coordinating with DCMA technical specialist or program office technical staff.

5. The contractor provides an agreement and invoice for claimed consultant costs but the contractor does not have evidence of work product but offers to obtain a letter from the consultant describing her activities as well as setting up a meeting with Air Force personnel to confirm the consultant's activities. Should the auditor consider these? Yes. The consultant's testimonial is similar to a third party confirmation where if the Air Force officials corroborate the testimonial an independent confirmation has been achieved.

6. Contractor hires an international marketing consultant to identify business opportunities who is to be paid a flat fee of $12,000 per month. The invoices reference the agreement and detail actual services provided but do not identify hours worked so should the costs be disallowed under FAR 31.205-33 (f)(2)? No, the auditor should not automatically disallow the costs but should first review the invoice in combination with the terms of the agreement and then meet with the contractor to determine whether payment is consistent with the services agreed to and provided. Further tests are needed to determine the nature and scope of the services planned and actually performed to ensure the costs are allowable and finally the auditor is to determine whether the amount paid is reasonable for services performed and sufficient evidence exists to ensure the services were performed.

7. A consultant provided a training course on pricing proposals where the contractor provided a copy of the agreement and the paid invoice as well as a list of attendees but it does not have a copy of the training material so should the auditor question the costs. Not necessarily. The guidance states the agreement, paid invoice and some evidence the training was provided is sufficient to satisfy 31.205-33(f). The auditor "could further" support the training by interviewing names on the attendee list.

8. Contractor claimed costs paid to a public relations firm where it booked the costs as consultant costs and provided extensive evidence in support of the costs paid where if it met all the documentation requirements would the costs be allowable. No because the underlying costs are unallowable in accordance with FAR 31.205-1, public relations and advertising. In evaluating the costs for allowability auditors are told to con-

sider whether the costs are unallowable in accordance with other FAR cost principles such as lobbying and political activities (31.205-22), organization costs (31.205-27), legal and other proceedings (31.205-47) or selling costs (31.205-38).

9. The contractor uses outside writers to augment their in-house staff in preparing technical publications where the outside readers proofread drafts and make recommendations for improvement. These efforts are not covered by 31.205-33 because they do not meet the definition of professional and consulting services because they do not enhance the contractor's "legal, economic, financial or technical position." Rather they are considered to be purchased labor.

CHALLENGING PAST PERFORMANCE EVALUATIONS

(*Editor's Note. We have been reporting for several years now about the increasing importance of past performance evaluations becoming the basis for award decisions and more recently, about developments exhorting agencies to provide more timely, complete and accurate past performance evaluations as well as tips to maximize past performance ratings during contract performance. However, we have not addressed the means available to challenge a past performance evaluation once it has been made which has always been a problem. In fact, new emphasis on timely submittals has resulted in a significant increase in questionable past performance evaluations being submitted and relied upon because in its haste to comply with new requirements to provide timely evaluations assessing officials (AOs) are preparing evaluations without the benefit of hand-on knowledge of contract performance.. In the midst of this proliferation of unfair negative past performance evaluations, contractors need to have practical advice on how to challenge these. This topic was addressed in a new article in the Dec 24, 2013 issue of the Federal Contract Report written by Alan Pamperton, Jade Totman and Kayleigh Scalzo of Covington & Burlington LLP.*)

Background on Recent Developments

Past performance evaluations (PPEs) are usually electronically captured, kept and communicated. The process begins when an AO inputs adjectival ratings – Exceptional, Very Good, Satisfactory, Marginal, Unsatisfactory – and supporting narrative from a Contractor Performance Assessment Report (CPAR) which uploads to a database, the Contractor Performance Assessment Reporting System (CPARS). Data from CPARS and other reports of "adverse actions" such as non-responsibility determinations or terminations for default flow to a separate database, the Past Performance Information Retrieval System (PPIRS). CPARS and PPIRS are not publically available but accessible only by source selection officials to use in making award decisions. But the public can access a separate final database called the Federal Awardee Performance and Integrity Information System (FAPIIS). FAPIIS contains "adverse action" reports from PPIRS, plus other information related to "business integrity" including listings on the System for Award Management, administrative agreements with Suspension and Debarment Officials and records of certain criminal, civil and administrative proceedings.

According to FAR 42.1502 a timely performance evaluation is prepared "at the time the work under contract or order is completed." The government CPARS guidance states it should be completed not later than 120 calendar days after the end of the contract or order evaluation period stressing "it is essential that…information be provided timely and accurately."

So what actions are recommended when untimely, inaccurate or unreasonable evaluations are entered. The authors state there are two main ways to challenge these – agency actions or Contract Dispute Act (CDA) claims.

Agency Level Appeals

The first action is usually an agency level appeal which is in effect a prompt request for the agency to reconsider its evaluation. Under FAR 42.1503(d) a contractor has a minimum of 30 days to submit comments, rebut statements or any additional information to the AO. Any remaining disagreement may be submitted "for review at a level above the contracting officer to a Reviewing Officer (RO)." The authors state no matter the merits of the appeal, the decision still lies with the contracting agency that may be reluctant to change its position. Nonetheless, this agency level appeal does have the advantage of avoiding more adversarial and expensive litigation approaches where the contractor may be successful.

The process of an agency level appeal begins with the contractor responding to an untimely or unreasonable evaluation "immediately, diplomatically and strategically." An immediate appeal within 30 days is needed which

will limit any dissemination of the adverse information. The contractor is advised to state, in writing to the AO, it will dispute the CPAR and that it is preparing comments, rebutting statements and other material where it hopes to resolve the matter informally and with the disclosure of any information that could be construed as adverse to either the contractor or agency. The contractor should request the agency (1) extend the default timeframe for contesting the adverse CPAR from the 30 day window and (2) not make any relevant CPAR information available as source selection information until the dispute is resolved. The extension of time should encompass the full term of the possible dispute including negotiations with the AO and RO as well as an amount of time to assemble the performance record. Additionally, the contractor may ask for a separate level of review apart from and above the RO which may include the agency's procurement officer or legal counsel – a step the FAR neither provides for but does not prohibit.

Next, within the timeframe approved by the agency, the contractor must prepare and submit its comments, rebutting statement and additional information to challenge the CPAR. These comments should include a catalog of substantive and procedural defects of the CPAR where the substantive defects may include incorrect ratings, incorrect definitions used by the agency or incorrect facts. Procedural defects may include an express violation of any agency's acquisition handbook or similar intra-agency rules. In the case of an untimely or overdue CPAR, procedural defects may include violations of FAR provisions or intra-agency guidelines pertaining to timeliness. For example, a contractor may state the CPAR was not completed after contract completion or was completed after the 120 calendar window provided in the CPAR Guidance Manual and DOD policy.

In support of its comments, a contractor can submit documents as attachments. For example, in challenging an adverse fact it may submit documentation from the contract file or favorable comments from contracting officials. Additionally contractors may want to include affidavits or declarations from employees with firsthand knowledge to rebut information. The authors state that timely and effective comments may change a CPAR and eliminate the need for a CDA claim.

Considerations for a CDA Claim

Failing a successful agency level appeal, the next step involves a filing of a CDA claim. Some actions can mitigate the expense and adversarial nature of such a claim. First, to pursue a claim the contractor must submit a CDA claim to the contracting officer for a final decision (as opposed to the appeal to the AO that was part of the agency-level appeal). The CDA claim will probably be a repackaged – perhaps enhanced – version of the agency appeal. It may incorporate new facts and legal issues that arose during the agency appeal. The claim needs to be in writing and seek "as a matter of right," "the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract" as well as a clear and unequivocal statement that gives the contracting officer adequate notice of its basis and asks for relief independent from that available from an agency level appeal (FAR 2.101). The CDA claim should be after the process of negotiation between the agency and contractor is complete. Also, a letter to an agency offering observations relevant to its initial CPAR does not constitute a CDA claim, especially where a final CPAR has not been issued. After the CPAR is issued a CDA claim will present new opportunities for the CO and contractor to reach a final agreement to a revised evaluation without incurring litigation expenses.

Second, once the CO has denied the claim (or has not responded in a reasonable amount of time) the contractor has the option of bringing its claim before an independent decision maker. It needs to first decide on the best forum to litigate. The CDA allows an appeal to an appropriate board of appeals within 90 days of the CO's final decision or one year to the U.S. Court of Federal Claims (COFC). The authors state now the COFC is the best forum because prior cases clearly gave it jurisdiction over challenging adverse performance evaluations while the appeals boards have been less welcoming to such challenges.

Third, contractors need to be realistic about the scope of possible remedies for them. A COFD decision cannot result in the court writing a new CPAR, requiring a different rating or even an injunction. Rather a favorable result is usually a "proper and just" declaratory instruction to correct the CPAR. Some commentators state such declaratory relief is "meaningless" because the declaration cannot require an agency to assign a particular rating, withdraw one or remove one from a particular data base. Consequently, a contractor needs to request a declaratory judgment and remand order with "proper and just" instructions and meaningful corrective actions.

Finally, a contractor needs to consider the types of challenges that are likely to be persuasive to the court or appeals board. So, if timeliness is being challenged, then the contractor must show there is actual prejudice (harm) caused by being untimely such as alleging the CPAR would have been different but for untimeliness. If substantive errors are being alleged then a showing of blatant flaws (e.g. clear cut factual inaccuracies and logically contradictory evaluations) are most effective. For any type of assertion of errors it is best to link the error to a violation of applicable rules, regulations or policy. So for example, in its guidance for A&E contracts being reconciled with construction appraisals in the CPARS a late evaluation may be completed only if the AO for the period being reviewed (1) is available (2) has sufficient knowledge of contractor's performance (3) has documentation for the evaluation and (4) has communicated periodically with the contractor on its performance. So if a contractor can associate a claim for untimely or erroneous evaluation to a violation of one of these four conditions, its case would be more persuasive with the court or appeals board.

CLARIFYING WHAT CONTRACTS ARE CAS COVERED

(*Editor's Note. Many of our non-small business subscribers are not sure whether their contracts are covered by the Cost Accounting Standards. The question is particularly tricky with the proliferation of such contract vehicles as letter contracts, ID/IQs, Basic Order Agreements (BOAs) and options so we undertook some research to clarify this question. We found an article by Karen Manos and Darryl Oyer in the Nov 2009 issues of the CP&A Report that was particularly helpful that addresses the meaning of "award" and "net awards."*)

There are three steps involved in determining applicability of CAS: (1) is the contract or subcontract subject to CAS (it is the contract, not contractor that is CAS covered) (2) is it fully CAS-covered or modified CAS-covered and (3) is a disclosure statement required. The threshold for each of these three steps is based on the dollar value of the CAS-covered "award" or "net awards" received by the contractor or subcontractor (unless otherwise specified, we will use the term contractor to encompass both contractors and subcontractors). Full CAS-coverage applies to contractor business units that receive either a single CAS-covered award of at least $50 million or at least $50 million in net CAS-covered awards during the preceding cost accounting period where one of those awards must be a "trigger" award of at least $7.5 million. Once this threshold is reached, all subsequent negotiated contracts and subcontracts valued at $850,000 or more (this amount is periodically changed) that are based on cost build-up estimates will also be fully CAS-covered. A disclosure statement is required if a business unit receives a single fully-CAS covered award of at least $50 million or if a company, together with its business segments, received net awards of at least $50 million in its most recent cost accounting period. Note that if a company with more than one business segment has fully CAS covered contracts then separate segments may need to complete a CAS Disclosure Statement even if it has no CAS covered contracts or subcontracts. If the fully CAS covered threshold is not met (e.g. no contracts exceeding $50 million or cumulatively the prior year) but a trigger contract of $7.5 million is awarded, then that contract is modified CAS-covered and then all subsequent contracts and subcontracts exceeding $850,000 will also be modified CAS covered.

Meaning of "Awards" and "Net Awards"

The CAS Board regulations do not define "award" but the term is used interchangeably with "CAS-covered contract" which is defined as "any negotiated contract or subcontract in which a CAS clause is required to be included." The CAS Board does define "net awards" as "the total value of negotiated CAS-covered prime contract and subcontract awards, including the potential value of options, received during the reporting period minus cancellations, terminations and other related credit transactions." This definition is similar to definitions in the FAR but the FAR definition does not take into account cancellations, terminations and other related credit transactions and the FAR convention requires use of the maximum quantity and highest final priced alternative to the government.

CAS Coverage of Unique Contract Vehicles

Though a determination of whether "contracts" and "subcontracts" are CAS covered is fairly straight forward, other contract vehicles that are increasingly more common is not so clear in some cases.

• Contract Modifications

The guidance makes clear that the determination of whether a contract is subject to CAS is made at time of award and is not affected by modifications subsequently made regardless of dollar amount. DCAA has taken the position, purportedly based on Working Group Item No. 72, that a modification that adds new work must be treated for CAS purposes as if it were a new contract.

• Options

An option is defined in the FAR as a "unilateral right in a contract by which, for a specified time, the government may elect to purchase additional supplies or services called for by the contract or may elect to extend the terms of the contract." Where the definition of "net awards" include the "potential value of contract options" the authors assert the proper interpretation of CAS Preamble WG No. 76-2 would mean the "probable" level rather than the "maximum" level where the probable amount of a contract with options would only include those options for net award that are probable to be exercised. Nonetheless, the authors warn that government auditors usually take the position that the maximum amount of price options should apply.

• Basic Agreements and BOAs

For Basic Agreements and basic ordering agreements the FAR definitions refer to "future contracts where both the FAR and CAS do not consider contracts and therefore concludes the orders issued under either type of agreement must be considered individually in determining CAS applicability. Because such instruments are not contracts they are not CAS-covered. Only individual CAS-covered orders are contracts. Consequently basic agreements and BOAs do not need to be included when calculating CAS thresholds but only the individual orders under them need to be included.

• Letter Contracts

The FAR defines a letter contract as a "written preliminary contractual instrument that authorizes the contractor to begin immediately manufacturing supplies or performing services." Since CAS applicability is determined based on the value at the time of award, subsequent definitization of letter contracts would not trigger any new standards since definitization is a contract modification rather than a new contract.

• IDIQ Contracts

Though there is general agreement on applying CAS thresholds for many types of contracts there is general disagreements on IDIQ contracts. Whether the CAS threshold applies at the contract award level or individual task order and how is the IDIQ award amount determined is the subject of much disagreement at this time and will require clarification by the CAS Board in the future.

The authors argue the task or delivery order, not the contract level, should determine the net award under IDIG contracts for two reasons.

1. Though an IDIQ is a contract according to FAR Part 16 there are usually multiple contracts awarded where then it becomes nearly impossible to determine the contract value. They argue it is a contract only if the work is completely priced and can be unilaterally ordered by the government. If separately priced task orders are anticipated then those orders are like BOAs where they are recognized only when they are ordered.

2. Since IDIQ contracts provide a minimum and maximum amount where the minimum is required to be ordered and the maximum is often not a "realistic estimate of total quantity" determining the value of the contract is problematic and can produce irrational results that can deter companies from seeking government contracts. For example, if contractors with no CAS covered contracts were to accept a multiple award IDIQ contract with a specified minimum of $10,000 and a specified maximum of $50 million and the higher amount was used to determine CAS coverage then all negotiated contracts or subcontracts exceeding $850,000 the contractor is awarded while performing the IDIQ contract would be subject to full CAS coverage even though it may never receive task orders totaling more than $10,000.

The authors state awarded IDIQ contracts should be carefully analyzed to determine the reasonably anticipated amount the government will order at pre-established prices and that figure should be used for CAS threshold purposes. Possible additional task orders requiring new pricing offers should be treated as separate contracts if and when they materialize. (*Editor's Note. Under most IDIQ contracts we encounter, the question often arises at what level should CAS and Truth in Negotiations Act coverage be triggered where so far most contracting officers are accepting the task order level but this is far from universal.*)

RECENT DEVELOPMENTS ON MOST FAVORED CUSTOMER CLAUSE

(*Editor's Note. Going after various multiple award contract vehicles can provide lucrative results. The Most Favored Customer clause is by far the most important clause affecting multiple contracting vehicles awarded by the government. The fact there is now increased audit scrutiny as well as recent Department of Justice actions has made an understanding of the rules quite essential. In our desire to address new developments affecting the clause we have used an article written by Caitlin Coonan of Arnold and Porter LLC and Peter McDonald in the Feb 14 2012 issue of the Federal Contracts Report as well as our own experience with these types of contracts.)*

The Most Favored Customer (MFC) clause is a common arrangement in many commercial contracts intended to ensure the customer receives the best price the company provides to its other customers. This clause has taken on increased importance in federal solicitations as the award of federal supply contracts has exploded in recent times. The MFC clause has become increasingly subject to government audit scrutiny and litigation for breach of contract in the commercial world exposing government contractors to False Claims Act prosecution and commercial businesses to litigation for breach of contract where significant litigation expenses and loss of business are common. Since its inception in 1949, the General Services Administration's multiple award program (MAS) has enabled government agencies to buy an array of products and services under federal supply contracts. The MAS program has grown to be the largest interagency government contracting program and represents a significant part of the annual government budget. The GSA manages the MAS programs where it provides federal agencies with a simplified process for obtaining primarily commercial supplies and services at prices associated with volume buying.

MAS implementation for the government is governed by FAR Part 8.4, Federal Supply Schedule that authorizes government buyers to place orders directly with GSA MAS contractors and pay for items using commercial purchase cards. MAS program purchases are designed to mirror commercial buying practices that do not require use of FAR based competitive evaluations found in FAR Parts 13, 14 and 15. The GSA's stated goal is to obtain the best price a contractor offers its most favored customer for any particular schedule item.

Pre-Award MAS Negotiations

Before accepting an item for inclusion on GSA MSA, the government requires contractors to list their items at or below the lowest available price to an identified category of customers. The government then compares the price or discounts that a company offers with the price or discount it offers to commercial customers. Thus, before awarded a MAS contract the CO and the Offeror will agree upon (1) the customer (or category of customers) the government will use as the "basis for award" and (2) the government's price or discount relationship to the identified customer or category of customer. The customers that are the "basis for award" need not include all customers or categories of customers a contractor may deal with nor even a majority of its customers where the determination of which customers are included is often a result of negotiation between the government and contractor. The government may attempt to broaden the customer base while the contractor will seek to minimize it asserting certain classes of customers are not comparable to the government customer.

The GSA contract negotiation process requires contractors to disclose their commercial pricing and discounting practices provided to all of its customers. The scope of this disclosure can be vast including every discount ever granted to any customer. This can be quite challenging where there may not be procedures in place to track every commercial transaction let alone unique discounts and terms for every sale. This area provides fertile grounds for noncompliance allegations.

After reviewing the contractors' disclosures and related supporting information, the GSA's discount and schedule pricing are negotiated by the agency contracting officer. Though the stated goal is to obtain a price at least equal to the best price applicable to the contractor's most favored customer, government buyers may seek even further discounts.

Post-Award Considerations

After the lowest price for commercial items have been negotiated, the government may obtain still lower prices through the contract's price reduction clause (PRC). The PRC first requires the CO and contractor to agree upon the "basis of award" for GSA's price or discount relationship to the identified category of customers. Should this discount relationship be disturbed after

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contract award (e.g. the contractor further reduces the price or increases the discount) the PRC mandates price reductions. The price reductions are triggered because contractors are required to report any such discounts within 15 days of their effective date. Basically, contractors are not allowed to lower their prices without informing the GSA. So, for example, when a contractor offers a one time 50% discount to a commercial customer, the contractor must apply the same discount to all subsequent government orders for the same items. Whereas contractors normally do not have expertise about the PRC, government auditors have developed an expertise in this area. But contractors need to realize that application of the PRC is highly dependent on the facts of individual transactions where not every discount will trigger an PRC action nor will price reductions applicable under the PRC be the same as that asserted by auditors.

There are significant perils of not complying with the MFC and PRC where questions of compliance or qui tam actions can result in government claims, prosecution under the False Claims Act (FCA), terminations for cause and suspensions and debarments to name a few. For example, if the government believes a contractor knowingly failed to comply with the PRC or submitted false information it may launch an investigations. If there is sufficient proof the company offered a single discount outside the contract's PRC the government may seek damages under the FCA. The FCA allows the government to recover up to three times the damages incurred plus penalties up to $12,000 per claim. Even suspicions of suspected noncompliance can generate significant costs either for defending against government claims or for settlement costs.

Recent cases show how high the costs of real or perceived noncompliance with MFC can be. The Department of Justice (DOJ) announced a $6.5 million settlement with Fastenal where an investigation alleged Fastenal, a national hardware store distributor, had provided better discounts to its identified nongovernment customer than it had in its GSA MAS customers in violation of the PRC. EMC paid the government $87.5 million to settle allegations that during its negotiations the IT firm would conduct a price comparison to ensure the government would receive the lowest price where the government asserted EMC had no such capabilities to compare prices and hence its assertions during negotiations were false. Similarly, DOJ received a $128 million settlement with NetApp where an employee stated it had knowingly failed to provide the GSA with current, complete and accurate information about its commercial sales and discount practices. These and other highly publicized cases provide incentives for the DOJ to aggressively go after alleged violators of the MFC and PRC.

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