GCA DIGEST
(A publication of Government Contract Associates)

Second Quarter 2013 Vol 16, No. 2

Case Study…

CHALLENGING SEVERAL DCAA QUESTIONED COSTS

(*Editor's Note. The following is a real case study of our helping a client respond to several questioned costs asserted by DCAA. We find the following case highly relevant to our subscribers because it identifies common areas of questioned costs by DCAA and shows the effectiveness of certain responses that resulted in DCAA reversing all of its initial positions. Several correspondences, discussions and submittals of data went back and forth where the following is a highly edited version. We are gratified by not only the results but very impressed with DCAA's openness and ability to work through issues with out client which is the way it should be. The name (which we will refer to as "Contractor"), location and dollar values discussed are disguised to keep our client's identity confidential.*)

DCAA submitted a draft audit report of Contractor's incurred cost proposals for fiscal years 2006 and 2007 that included questioned costs for executive compensation, consulting, company car expenses and lodging per diem costs where penalties were sought for certain unallowable costs. Our edited response is below.

Executive Compensation

DCAA's compensation team conducted an executive compensation analysis by benchmarking Contractor's compensation for its CEO/Chairman to an average of two salary surveys, adding a 10 percent range of reasonableness factor and deducting actual compensation from its survey results to compute what it calls unreasonable compensation. We disagree with DCAA's conclusion for the following reasons:

1. A 75% Percentile rather than a 50% percentile should be used. We disagree with DCAA pegging its survey results to a 50 percentile level where we believe Contractor's financial performance and its non-financial characteristics require at least a 75 percentile level. The financial and non-financial reasons are as follows:

a. Financial *performance*. Contractor's 2007 revenue, compared to 2006 revenue, increased more than four fold in that one year. Whereas a small increase in revenue would be considered superior performance during that recessionary period, an increase of over 400% should be considered unquestionably superior. But this was not a one-time event; the revenue from 2005 to 2006 more than doubled. The composite growth rate from 2005 to 2007 was over 100%. Contractor was cited as the third fastest growing company in one of the regional industry periodicals.

b. Non-*financial performance*. Both the recent *J.F. Taylor Inc. (ASBCA Nos. 56105, 56322, Jan. 18,2012*) and *Metron (ASBCA No. 56624, 2012 WL 2282598, June 4, 2012*) cases established that determinations of what percentile to use should consider both financial and non-financial information. The Metron case cited two specific non-financial areas that should be considered - education and security clearance levels of the executives. Dr. Smith, the CEO/Chairman has a PhD in chemistry and both his top secret investigation and active secret clearance clearly put him at the top of his field, justifying a 75 percentile rating for both years.

2. The Watson Wyatt survey does not meet the FAR criteria to benchmark comparable firms where it should be eliminated from the analysis. Though we do not necessarily object to the ERI survey, the Watson Wyatt survey DCAA used does not meet the FAR criteria to compare compensation with such factors as the same industry and same geographic area. Though use of the ERI survey does attempt to benchmark compensation to similar industries such as Research and Development (SIC 8730) the Watson Wyatt survey benchmarks Contractor's compensation to an overly broad "All Non-Manufacturing Supersector and Services Sector." Such a broad survey includes firms that have little to no resemblance to Contractor (e.g. grounds keeping) and it should be eliminated and a more comparable survey, the Radford survey (discussed below), should be substituted.

a. The fact the two surveys are not reasonably similar is demonstrated by the fact that the ERI survey provides a

result that is 38% higher than the Watson Wyatt survey in 2006. If they were comparable, which is required, there would not be such a wide divergence of results. In fact the large difference can only be attributed to the significant differences in firms included in the survey.

b. The Metron case established that it is "inappropriate" to take multiple surveys, assume they are equally valid and compute a simple average from the disparate surveys. The Watson Wyatt survey is clearly inferior to the ERI because of the inappropriate inclusion of highly dissimilar firms and hence should not be treated as if it had equal validity to the ERI survey.

3. The Radford survey should be used exclusively. The Radford survey should not only be substituted for the Watson Wyatt survey but the results should be used to benchmark Contractor's compensation. The Radford survey has generated a great deal of interest lately where the Metron case ruled it and it alone should have been used by DCAA to benchmark Metron's executive compensation. As mentioned above, the case explicitly rejected DCAA's approach of insisting on using multiple surveys where they were treated as if they were equally valid and a simple average was computed. The case established that one survey – the Radford survey – should be used alone since it represented "the best fit" to compare Metron's compensation. Metron and Contractor firms similar so the justification to use the Radford survey for Metron should be applied to Contractor. FYI, we have included a copy of the 2006 Radford survey benchmarking professional services firms.

4. DCAA is incorrectly computing a percentage of time Dr. Smith worked where it then uses that incorrect percentage to "prorate the survey amounts for the CEO." DCAA is assuming that Dr. Smith was employed for 49% of the year and then reduces the survey amounts by 49%. It arrived at the 49% figure by (1) examining Dr. Smith's timesheet (2) adding up all the hours worked plus holiday taken to compute 1,022 hours and then (3) dividing the 1,022 by a standard hour work year of 2,080 hours. The standard work year assumes a 40 hour work week that includes both direct and indirect hours worked and all paid time off such as holiday, vacation, sick leave and miscellaneous time off. Though the 1,022 does include one category of paid time off – holidays – it does not include the other categories such as annual leave and sick leave. If DCAA wants to compute a percentage of time to use to prorate the survey amounts, we believe either the denominator should be reduced to account for the hours of Dr. Smith's work year that should include annual leave and sick leave or the numerator increase to impute a value for paid time off. We believe use of federal employee paid time off would be a reasonable standard to use where annual leave and sick leave is 208-416 hours per year, depending on length of service. We believe the resulting percentage figure used to "prorate the survey amount" should be 55%-63%, again depending on length of service. We would argue the higher rate should apply because of Dr. Smith's long employment history in similar firms. Accordingly, the 49% used to prorate the survey results should be increased to reflect the lower denominator or higher numerator to 63%.

5. In accordance with recent cases, the 10% range of reasonableness should be significantly increased. The J.F. Taylor case ruled that DCAA's approach to evaluating executive compensation was "fatally statistically flawed" where much of the case focused on the "erroneous" use of a default 10% range of reasonableness (ROR) factor. The Board ruled such an approach ignores the data dispersion which results in an "arbitrary, unsupported and unsupportable" 10% ROR. The Appeals Board concluded the use of a default 10% ROR fails to measure the actual dispersion among the data where if used, would be significantly higher. If DCAA uses a ROR factor, it should compute it properly based on the actual dispersion of Contractor's data.

6. Dr. Smith's compensation should be compared to a CEO/Chairman, not just CEO. Dr, Smith is not just an employee whose position is CEO but he is the founder, chairman and CEO of Contractor. In order to fairly benchmark his compensation, his role as founder and chairman should be included in a benchmarked position where the most common position found in surveys is CEO/Chairman. If the surveys used do not benchmark this position then the percentile should be increased accordingly.

Consulting

DCAA questioned all claimed consultant costs for business development (BD) services asserting "Contractor was unable to provide evidence to support the nature and scope of service furnished as required by FAR 31.205-33(f)." The DCAA report quoted this section in its entirety except the section covering retainer agreements where we provided evidence a retainer agreement existed and other documentation such as (1) "details of

all agreements" which included a complete copy of the contract which includes a short statement of work and also specifically identifies type of work that is not permitted under this retainer agreement (2) monthly invoices describing the work effort where each invoice contains a statement that the work conducted is not disallowed (3) a substantiation of the payment for the retainer agreement is provided that included details of work products and descriptions of the work in the invoices and demonstration they meet the descriptions in the retainer agreement asserting this documentation met the requirements of 31.205-33(f). We then added more information showing how Contractor made every effort to meet all the other requirements of the FAR for professional and consulting service costs including:

1. Contractor made extraordinary efforts to ensure compliance by voluntarily excluding any cost that might be considered lobbying where such costs were deleted as unallowable.

2. Showing how using a consultant was the only affordable means to obtain these needed BD services. Contractor provided a history of employee hiring demonstrating though it clearly needed BD support to expand sales but it could not afford a $150,000 per year employee requiring an additional $30K in benefits and $25K in office needs and the only solution had been to hire a consultant on a part-time basis.

3. Showing the services were directly related to government work. Contractor is essentially a 100% government contractor, either as a prime or subcontractor. As such all the benefits of Contractor's work and its consultant's work are for the benefit of its government work. Further, the services discussed here are exclusively directed toward finding and winning government projects.

4. The level of past services justifies the amount of the retainer. We provided a breakdown of the consultant's time (e.g. reviewing business opportunity announcements and communications with staff, opportunities with prime contractors and arranging meetings, preparing and reviewing teaming arrangements). We also demonstrated the $150 hourly rate was well below comparable Washington DC rates when benefits and office needs were factored in.

5. The consultant selected is highly qualified to perform the tasks where we provided a detailed description of his background and accomplishments

Company Car

DCAA questioned all expenses related to the company car for both years asserting Contractor "did not demonstrate the business use of these costs." We disagreed where we provided logs kept in compliance with IRS regulations (Publication 465) which are sufficient to demonstrate the business use of these costs. We provided documentation that showed the car was used exclusively for business in 2006 while for 2007 logs for personal miles as a percentage of total miles was translated into a percentage applied to company car expenses where the personal portion was not claimed.

Lodging - Per Diem

DCAA compared the lodging costs per GSA rates at two business trip locations – Hawaii and San Diego – with actual costs and questioned the differences citing FAR 31.205-46(a), travel costs. We explained the hotels would not provide government lodging rates due to the fact our employees were not government employees and that approval for higher rates was made by our controller. In our response we stated that the extra costs falls under one of the exceptions of "special or unusual situations" where excess costs above the maximum per diem rates are allowable if (a) one of the conditions exist that are identified in subsection C4608 of the JTR exists (b) a written justification for higher amounts are approved by an officer or designee (c) consistency with the organization's policies are maintained and (d) proper documentation exists (e.g. receipts in excess of $75 expenditures). We then provided a narrative of how Hawaii is an unusual situation due to its isolation, rate increases when hotels are near capacity (using internet derived data) and exorbitant costs would be incurred if alternatives were sought like staying on a different island.

Unsupported Lodging

DCAA also questioned $22,000 of lodging costs related to a condo used for housing employee travelers to the company as "unsupported." In our rebuttal we provided supporting records that included a memorandum justifying a year-long lease, lease and utility expenses, copies of checks and a spreadsheet showing summary of expenses, usage of the condo and costs per day of its usage compared to lodging rates. We also cited JTR C4555-G that addresses the utilization of long term rentals.

Penalties

DCAA claims that the consultant and travel costs questioned in its report are subject to the penalties provided in FAR 42.709. We stated we strongly disagreed stating we did not believe they were unallowable and if they were unallowable they should not be subject to penalties. We made the following points:

1. The contracts in effect during FY2006 – fixed price subcontracts where the award was less than $650,000 - made them ineligible for imposition of penalties. FAR 42.709(b) and FAR 42.709-6 remove fixed price contracts without cost incentives, as well as firm-fixed price contracts and contracts under $650,000 from coverage of the prescribed penalties clause, FAR 52.242-3 Penalties for Unallowable Costs. Also implicit in the language of these provisions, and expressly recognized in the DCAA Manual, DCAM 6-609.1f (2), is that "[t]he penalty statutes and implementing regulations do not flow down to subcontracts." So, costs that are allocated to these categories of contracts and to subcontracts – even if unallowable – are **not** subject to penalties.

2. The items identified by DCAA as unallowable are not subject to penalties under FAR 42.709-3(a) because they are not expressly unallowable. The indispensable element of liability under the penalties clause 42.709-3(a) is that the cost be "expressly unallowable under a cost principle in the FAR or an executive agency supplement." Elsewhere at FAR 31.001, the regulations define "expressly unallowable cost" as "a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable."

The courts and appeals boards have consistently ruled that the precondition for a cost to be expressly unallowable is the issue must be clear and "unmistakable" (General Dynamics) or in another General Dynamics case the board ruled "We think the appellant's clam was sufficiently colorable to preclude penalties." *Fiber Materials, Inc., ASBCA No. 53616* the government disallowed certain leased aircraft costs that were in excess of standard airfare but the court ruled they were not expressly unallowable because the ACO had discretion to accept them as long as they were supported. "We think that appellant's claim was sufficiently colorable to preclude penalties." In another General Dynamics case addressing expressly unallowable costs the appeals board ruled costs will not be held to be expressly unallowable "unless the Government shows that it was unreasonable under all the circumstances for a person in the contractor's position to conclude that the costs were allowable." The questioned costs here do not rise to the level of being "unmistakable" or "not colorable."

3. Penalties should be waived because the contractor has implemented appropriate policies that preclude unallowable costs. FAR 42.707-5 provides the CO "shall waive the penalties" when one or all of the following conditions exist: (a) the proposal is withdrawn before the government provides a written notice or holds an entrance conference (b) the amounts of questioned costs are "insignificant," held to be $10,000 or less allocable to contracts (a recent case ruling after our response held the limit was $10K in total, not just the amount allocable to relevant contracts) or (c) the contractor has established policies and procedures in place to preclude unallowable costs being included in regulations *and* the inclusion of such costs was "inadvertent." In addressing the first part of the third condition we alluded to a self-governance program, specific accounting practices for screening unallowables, written policy on unallowable costs, compliance testing to ensure internal controls are effective and there were no prior findings. We argued the second and third conditions applied to Contractor.

Know Your Cost Principles…
MISCELLANEOUS EMPLOYEE COSTS

(Editor's Note. We are continuing our long time practice of focusing on the allowability and allocability of certain costs addressed in the FAR Cost Principles and Cost Accounting Standards. Here we cover a variety of employee costs that frequently arise in questions put forth by our subscribers and clients. The source of our information is Accounting for Government Contracts – Federal Acquisition Regulation edited by Lane Anderson and various writings of Karen Manos of the firm Howrey Simon Arnold & White as well as our own experiences. We have substituted a short overview of these topics rather than a detailed analysis and court decisions so as to provide a useful summary of these topics.)

Contractors incur a variety of expenses to improve working conditions, employer-employee relations, relocation, recruitment, employee morale and employee perfor-

mance. Examples include house publications or newsletters, health clinics, recreation activities, employee counseling services and food and dormitory services.

Employee Morale vs. Entertainment

The government often challenges employee morale expenses as being unallowable entertainment costs. Usually these amounts are immaterial and not worth litigating so as a result contractors normally concede these costs as unallowable even though good cases can be made for their allowability as employee morale expenses. In *Citron & Company (DOE BCA No. 426-6-89*) four categories of expenses totaling $1,000 were challenged: (1) a $100 gift certificate for an employee hosting a company picnic (2) three birthday lunches (3) some luncheon and dinners with key personnel for career counseling and (4) occasional Friday afternoon pizza parties. All the costs were ruled allowable where similar costs were also allowable in *Brown Engineering (ASBCA No. 6830*).

In 1995 the FAR was modified to limit the amount of allowable employee morale costs for employee gifts, entertainment and recreation. Only costs of these types that are allowable are those for employee "wellness/ fitness centers, sports teams and other activities designed to improve employee loyalty, morale or fitness as well as reasonable costs for performance and recognition awards." Unless company picnics, Christmas parties or retirement events can qualify as being designed to improve employee loyalty, morale or fitness they will be questioned by DCAA.

Labor relations costs such as shop stewards, labor management committees, employee publications and related activities undertaken to maintain satisfactory relations between the contractor and employees are allowable.

Recruitment Costs

Several recruitment-related costs such as help-wanted advertising, employment offices, aptitude and educational testing, travel for recruiters or job applicants and employment agency fees are allowable. However some of these costs may be unallowable if (1) employment agency fees exceed commercial rates (2) help wanted advertising ads either fail to identify specific positions to be filled or provide material not relevant for recruitment. Also excessive compensation used to recruit employees from another government contractors are unallowable regardless of the form of payment such as salaries, bonuses, stock options or fringe benefits.

Relocation Costs

Relocation costs are paid when an employee is reassigned or a new employee is recruited. A permanent relocation must be either for an indefinite time or more than 12 months. If an employee is paid for relocation costs and resigns within 12 months, the costs must either be refunded to the government or credited to its relocation account. Costs for mass relocation of personnel such as when a facility is closed and employees transferred to another site are allowable but must be allocated to the contracts or time periods that benefit from the costs.

Generally, allowable costs include travel costs for the employee and their immediate family, transporting household goods, finding a new home that includes house-hunting trips by employees and their spouses. Limitation to these items are house-hunting trips cannot exceed 60 days for the employee and 45 days for either spouses or dependents. Relocation costs should benefit the employee, be in accordance with either an established policy or with a practice that is consistently followed and designed to motivate employees to relocate promptly and economically and they must not exceed actual costs except for a $5,000 provision for miscellaneous costs.

Somewhat different requirements apply for employees hired for a specific contract or long term field projects. First, the employment agreement must specifically limit the duration of the employment to the time spent on the specific contract or project. Second, the agreement must provide for the return of the employee to their original location or at least to a location of equal or less cost. Third, the 12 month refund provisions do not apply.

♦ Other Relocation Costs Provisions

Closing costs incident to the disposition of a residence the employee owns at the time of transfer are allowable within certain limits. Brokerage fees, legal fees, appraisal fees, points and finance charges are allowable. Costs of ownership of a vacant former residence that is sold after the employee purchases or leases a new residence are allowable. Maintenance, utilities, taxes, property insurance, mortgage interest and related items are also allowable. However, the closing and ownership costs cannot exceed 14 percent of the sales price of the property sold.

Other miscellaneous relocation costs normally considered necessary are allowable such as costs of disconnecting and connecting household appliance, automobile registration fees, new drivers license and use fees, cutting and fitting rugs, draperies and curtains, forfeited utility fees and deposits and property insurance for items in transit.

Costs of acquiring a home at a new location are allowable subject to two limitations: (1) the employee must have been a home owner before relocation and (2) the total costs cannot exceed 5 percent of the purchase price of the new home. Mortgage interest differential is allowable limited to the difference in the interest rates between the two residences times the current balance of the old mortgage, which is limited to three years.

Rental differential payments are also allowable. These payments occur when the employee retains ownership of a vacated home and rents at the new location. The rented quarters must be comparable to the vacated quarters and the allowable payment is limited to actual rental costs less the fair market value of the vacated home for up to three years. Also the costs of cancelling an unexpired lease on vacated property are allowable.

♦ Unallowable Relocation Costs

Certain costs are expressly unallowable (e.g. subject to penalties). These include: (1) loss on the sale of a residence (2) mortgage principle payments on the old residence (3) payments for job counseling and placement assistance for spouses and dependents who were not contractor employees at the old location (4) costs incident to furnishing loans to employees or arranging for below-market mortgage loans (5) brokers' fees and commissions (6) litigation costs (7) real and personal property insurance (8) mortgage life insurance or owners title policy insurance when such insurance was not carried on their former residence and (9) property taxes and operating or maintenance costs incident to acquiring a home at the new location. Be aware that tax gross-ups and employment assistance for spouses used to be unallowable but were made allowable in the recent past.

Trade, Business, Technical and Professional Costs

Specific allowable costs under this category include memberships in organizations, subscriptions and meeting and conferences that cover these categories. Meeting and conference costs include meals, transportation, facilities rental and incidental costs when the primary purpose of the meeting is the dissemination of technical information or stimulation of production. Recently, the government is increasingly attempting to ascertain whether such costs are entertainment or is not primarily for business purposes. Careful documentation of the trade, business, technical and professional nature of the events must be made and preparation of written policies addressing the business/trade/technical/professional nature of these meetings are recommended.

Training and Educational Costs

Training and education costs include training materials, texts, tuition, fees, compensation to employees while in training, rental or ownership costs of training facilities and similar costs. The allowability of these costs depends on the type of training provided.

Vocational training costs include costs for such programs below the college level and may include on-the-job training, classroom instruction and apprentice programs designed to increase the vocational effectiveness of employees and is normally allowable. Allowable part-time instruction at the college level is limited to tuition and fees charged by the educational institution, salaries and related costs of instructors paid by the contractor and straight time compensation for attendees for up to 156 classroom hours per year when normal circumstances do not permit class attendance after normal working hours. Specialized training programs designed to enhance the effectiveness of managers or prepare employees to become managers are allowable where such costs may include enrollment fees and employee salaries, subsistence pay and travel costs for up to 16 weeks per employee. However, these training programs are not allowable if they are part of a degree program. Be aware that additional education expenses may be allowed under a negotiated advance agreement but such agreement must provide for a refund of expenses if an employee resigns within 12 months of the completion of such education.

There are certain training costs that are explicitly unallowable. These include grants in any form made to an educational or training institution (they are consider unallowable contributions). Generally educational costs are allowable only for employees, not spouses or dependents. Exceptions are for pay differentials for education of dependents at the primary or secondary school

level if they are working in a foreign country but this applies only if suitable education in the foreign country is "inordinately expensive."

Food and Dormitory Services

Food and dormitory services include costs of operating or furnishing employee cafeterias, dining rooms, canteens, lunch wagons, living accommodations, etc. Income generated by these activities must be credited against the costs. Indirect costs should be allocated to these expenses to establish full costing of them and if reasonable, are allowable. Losses from operating these services are allowable but only if the objective is to operate them on at least a break-even basis. Losses that arise when such services are provided free or at prices precluding the possibility of breaking even are not allowable unless "unusual circumstances" exist (e.g. commercial facilities are not reasonably available, low volume prevents the possibility of breaking even).

REVIEW OF PROCUREMENT AND COSTING ISSUES IN 2012

(Editor's Note. Since the practical meaning of most regulations are what appeals boards, courts and the Comptroller General say they are, we are continuing our practice of summarizing some of the significant decisions during the last year affecting grounds for successful protests of award decisions, what is considered proper evaluations of proposals and selected cost issues. This article is based on the January 2013 issue of Briefing Papers written by Miki Shager, Counsel to the Department of Agriculture Board of Contract Appeals. We have referenced the cases in the event our readers want to study them.)

Protests of Award Decisions

·♦ Interested Party

To have standing to protest a procurement, a protester must be an interested party – an actual or prospective offeror whose direct economic interest would be affected by the award or failure to obtain the award. A protester is an interested party where there is a reasonable possibility its proposal would be in line for award if the protest is sustained. Examples of an interested party included a small disadvantaged veteran owned business when it protests whether a procurement should be set aside for SDVOSB businesses (*Aldevra*), there was not an impermissible organizational conflict of interest (*NikSoft Systems*), challenged the conduct of discussions when there was a reasonable chance it would be in line for award (*Metropolitan Interpreters*), corporate restructuring did not preclude it being an interested party (*ITT Electronic Systems*), it would be permitted to compete for an award if its protest is sustained (*Swank Healthcare*), contractor who is twice selected for award can protest corrective actions taken by the agency (*Navarro Research & Engrg*), incumbent contractor (*Firstline Security*) or an incumbent who is in the competitive range are interested parties (*Omniplex World Svcs*). Examples of protesters ruled not being interested parties include an offeror who did not submit its proposal during the prescribed time (*Digitalis Educational Sltns*), was a disappointed subcontractor (*Intl Genomics Consortium*), an awardee is not considered a disappointed bidder (*Diversified Maintenance*) and contractor without a FSS contract is not interested to challenge FSS task orders (*Three S Consulting*).

The author put forth some general guidelines based on certain cases including: (1) be prepared to demonstrate you are an interested party whose direct economic interest would be affected (*Phoenix Mgt*) (2) there are different timeliness rules that apply for the GAO and Court of Federal Contracts (3) if you are protesting the government's insourcing of work make sure you protest while you are still the incumbent since the courts will rule you do not have standing once your contract expires (*Elmendorf Support Svcs*) (3) ensure your protest includes a detailed statement of the legal and factual bases for the protest that is sufficient for the GAO to conclude the agency violated a regulation or statute (*Complere, Inc.*) (4) if a task or delivery order is being protested make sure it is over $10 million, including all options (*Serco*) (5) make sure to file a protest on a timely basis after learning the basis of the protest (i.e. within 10 days of an agency report (*Data & Analytic Sltns*) (6) agencies must prepare a full and complete documentation of evaluation decisions or otherwise the protest will be sustained (*CH2M Hill*) and (7) if you are successful in your protest make sure you itemize your costs, document your claim carefully, provide detailed evidence in support and present to the agency within 60 days to recover protest costs (*Mayle Real Estate*).

♦ Unbalanced Bids and Below-Cost Pricing

A bid is unbalanced if it is based on prices significantly less than cost for some work and significantly overstated for other work and there is some reason to doubt the bid will result in the lowest overall cost. An acceptance of a proposal with unbalanced pricing is not, in itself, improper provided the agency has concluded that the pricing does not impose an unacceptable risk and the prices the agency are likely to pay are not unreasonably high (*W.B. Construction & Sons*). Even if some offered prices were overstated there was no risk to the government because they had the discretion not to award line items if they were deemed unreasonable (*Inchcape Shipping Svcs*). Prices were based on the RFP's estimated quantities and thus there was no basis to conclude the government would actually pay higher prices (*Triumvirate Environmental*). Low prices are not improper and do not, in themselves, establish risk or create the risk that is part of unbalanced pricing (*Philips Healthcare Informatics*).

Below-cost pricing, which is a common "buy-in" tactic, is not prohibited and the government cannot withhold an award merely because its fixed price low offer is or may be below cost. It is unobjectionable for an offeror to submit a below-cost proposal on a fixed price contract (*Inchcape*). The agency provided no documentation or analysis suggesting a bid 20% below the engineer's estimate and 14% below the competition evidences a mistake (*Virgin Islands Paving*). The GAO ruled below-cost pricing was justified where assertions of low price risk (1) were not explained by the government and the proposal was not inconsistent with the RFP (*Digital Technologies*) (2) comparison of low price with median price showed the median price was unreasonably high (*Lifecycle Construction*) and (3) protester's argument that awardee's low price lacks understanding of contract requirements is little more than a disagreement with agency's exercise of its discretion (*Laboratory Corp*).

♦ Evaluating Negotiated Contract Proposals

The government is free to use a variety of evaluation factors in evaluating proposals where agencies have broad discretion in the selection of evaluation criteria and the GAO will not object if they are reasonably related to the agency's needs (*Trident LLC*). The RFP must identify the factors and significant subfactors that will be used to evaluate the proposal and their relative importance (*National Gov't Svcs*) where if the factors change then a modification must be issued. But an agency is not required to identify the various aspects of each factor it might take into account provided they are reasonably related to the RFP's stated criteria (*Systems Research*).

Agencies must treat all offerors *equally* and evaluate their proposals evenhandedly against the solicitation requirements and evaluation criteria. An agency found there was no unequal treatment where it made a reasonable distinction in viewing data rights (*LASEOD Group*) or one offer was considerably more detailed than another (*Six3 Systems*). Unequal treatment was determined where requirements imposed on the protester differed materially from those stated in the RFP (*HP Enterprise Svcs*) and there was a lack of clarity on the scope of work in the solicitation (*JCN Construction*).

Agencies must evaluate proposals according to the *criteria* established in the solicitation (*360 Training*). Evaluation of key personnel (*ITT Electronic Systms*), evaluation methodology (*The Clay Group*) and selection of vendors (*Glotch*) all differed from terms of the solicitation. Responses that fail to conform to clearly stated requirements cannot form the basis for an award (*J Squared*) and agencies have broad discretion in determining the manner and extent to which they make use of technical and price evaluation results were only tests of rationality and consistency with stated evaluation criteria are relevant (*General Dynamics*). When an RFP states minimum requirements and expresses preferences that exceed the minimum the agency may reasonably discriminate between those that meet the minimum and those that exceed them (*Dellew-Olympic JV*). But the agency improperly used unstated criterion where it assessed weakness for lack of experience with the agency (*Exelis Systms*).

Agencies must consider *cost or price* in evaluating competing proposals (*DNO Inc*). Several protests were sustained when there was no evidence the agency considered protester's lower price where the record showed the selection was based on awardee's higher technical rating (*NikSoft Systms*), not justified to downselect offers without considering price (*Cyberdata*), CO acknowledged there was no direct comparison of evaluated prices between vendors (*Glotech*), CO impermissibly limited his tradeoff analysis to three highest ranked proposals regardless of price without any qualitative assessment of technical differences (*AdvanceMed*). How-

ever, protests were not sustained where under a negotiated best value procurement the agency finds proposals to be essentially technically equal and price becomes the determining factor for award (*Data & Analytic Sltns*), where RFP provides that price and nonprice factors are essentially equal it is acceptable to make an award to a higher rated, higher priced offeror (*STG*), there is no requirement to quantify specific technical advantages corresponding to specific price elements (*General Dynamics*), a single evaluation factor, even a lower weighted one, may properly be used as a key discriminator (*Healthcare Alliance*) and consideration is not meaningful when price is minimized to the extent of becoming only a nominal evaluation factor (*CBY Design Builders*).

To be deemed *responsible*, a prospective contractor must be able to comply with required performance schedule, have adequate financial resources and have necessary organization, experience, operational controls and technical skills where the burden is on the contractor to affirm its responsibility and in its absence the CO is to determine it is non-responsible (FAR 9.104). Normally, the courts cannot disturb a responsibility determination unless the protester can show the agency had no reasonable basis for its determination (*Kilgore*). Examples of determinations that non-responsibility rulings were reasonable included DCAA determines protester's accounting system is inadequate (*Orion Technology*), concerns over the safety of the manufacturing facility (*Kilgore Flares*) and adequacy of offeror's accounting system is properly left to the discretion of the CO (*CAS USA*).

♦ Discussions

FAR 15.306 requires the CO discuss with each offeror being considered for award significant weaknesses, deficiencies or other aspects of its proposal that could be altered or explained to enhance the proposal's potential for award where courts are defining this evolving new area. *Discussions* should not be confused with *clarifications* which are limited exchanges with offerors to allow correction of minor or clerical errors or to clarify proposal elements. Clarification, not discussions, were ruled to exist when supplemental cost information provided to DCAA, not the CO, was not provided with the intent to allow for revisions to the proposal(*Booze Allen Hamilton*), an exchange concerning a clear mistake (*CH2M Hill*) and requests that they clarify or confirm what offeror already committed to (*Pinnacle Sltns*). Also, requesting clarifications does not trigger the requirement to request them from other offerors (*Serco*). However, communications that allowed offeror to make material provisions to its proposal are discussions (*PN&A Inc*). An agency may not hold discussions with one offeror without extending the offer to others in the competitive range (*ERIE Strayer Co*). Discussions are not required when the RFP states award will be based on initial proposals (*Standard Communications*) and the CO discretion on whether to hold discussions is quite broad (*L-3*).

There is no requirement that all areas of a proposal having a competitive impact be addressed during discussions but rather only significant deficiencies or weaknesses be discussed (i.e. those that prevent the offeror from having a reasonable chance of receiving the award (*TriCenturion*). A "concern" represented only a weakness not a significant weakness or deficiency and therefore the CO had discretion whether to conduct discussions (*Weibel Equipment*). While an agency must conduct meaningful discussions i.e. discuss areas in a proposal requiring amplification or revision, an agency is not required to afford an offeror all-encompassing discussions (*Main Building Maintenance*).

When discussions are held they must be *meaningful, equitable and not misleading* where they must identify deficiencies and significant weaknesses in each offeror's proposal that can be reasonably addressed in a manner to enhance the offerors chances of award (*AdvanceMed Corp*). Where the protester was required to submit all resumes but the awardee only representative resumes and thus allowed to lower its proposed price it was found to have been misleading and unequal (*KPMG*). While discussions should be as specific as practicable there is no requirement for them to be all encompassing or extremely specific in describing an agency's concerns but rather they must lead offerors into areas of their proposal that need amplification or correction without being misleading (*QinetiQ North America*). Agencies are not obligated to "spoon feed" offerors as to each and every item that could be revised (*General Dynamics*) and if one awardee receives more extensive discussions that does not mean they were unequal but rather discussions were tailored to the proposals (*General Dynamics Information*). Misleading discussions were held to have occurred when the agency's direction to increase staffing was based on budget concerns not technical ones as the offeror interpreted them (*SeKON Enterprises*) but were not misleading where an offeror misinterprets them

where a reasonably diligent offeror would have at least sought clarification (*CWTSato Travel*).

Costs

Cost Reasonableness. The court found that three quarters of the $41 million billed on an Iraqi contract was unreasonable because it found *KBR*'s negotiations with its subcontractor were not conducted on a reasonable basis. In another case with KBR, the court ruled that $12.5 million of subcontract costs should be disallowed stating *KBR* failed to meet the prudent person rule that is the basis for reasonableness of costs (*Editor's note. We reported in the last issue of the GCA Report that an industry group is challenging this decision asserting, in part, the government is improperly attempting to substitute its judgment for that of the contractor under war time conditions*). In a third *KBR* case, the court ruled that the government may properly review the cost components of a fixed price subcontract. The successor contractor is entitled to recovery of accrued sick leave payments where the plain meaning of "use is to put or bring into action" making any permissible use of sick leave allowable (*Space Gateway Support*).

Legal and Accounting Costs. Interpreting a DOE contract clause that makes costs incurred in defense of any civil or criminal fraud proceedings unallowable, the appeals board ruled he contractor may recover legal fees incurred in the successful defense of a qui tam claim (*Boeing*). However the board found the contractor could not recover any of its legal costs that were common costs holding the finding of liability made recovery of those costs unallowable (*Boeing*) where though a higher case claimed the board had authority to apportion costs based on where the contractor had liability and where it did not, the case ruled here the claims were interrelated and based on the same core facts apportionment would be inappropriate (*Chu vs. Boeing*). Legal costs of defending against a counterclaim for breach of contract and appealing an adverse jury verdict, especially at the government's direction, are allowable where only expressly unallowable legal costs are unallowable (*URS Energy & Construction*).

Contract Administration Costs. The courts have long distinguished between unallowable costs related to prosecuting claims and allowable costs of contract administration where costs related to negotiating a resolution of a problem during contract performance are allowable but if they are incurred to begin the process of litigating a claim they are unallowable. The court this year reaffirmed that costs incurred for the purpose of materially furthering the negotiation process are allowable as contract administration costs even if the negotiations fail (*Tip Top Construction*). Also if the objective reason a contractor incurred attorney fees and costs prior to claim submission was for the purpose of information exchange furthering the negotiation process they are allowable (*SUFI Network Services*). However, internal employee costs of preparing an equitable adjustment were ruled as unallowable while if they were professional or consultant services they would have been allowable (*Versar*). Also costs incurred as the first step in litigation and not for the purpose of furthering negotiations were unallowable (*TMS Environcon*).

Termination Settlement Costs. A termination for convenience is often characterized as converting a fixed price contract to a cost reimbursement contract that entitles the contractor to recover allowable costs incurred in the performance of the terminated work, a reasonable profit on work performed and certain additional costs associated with the termination (*Keystone Plus*). Though contractor did not start work it was nonetheless entitled to startup costs but because there was no bad faith asserted, it was not entitled to anticipatory profit (*NCLN20*). Contractor was not entitled to additional standby costs in the absence of a notice to proceed, profit on subcontractor costs or other costs because it lack sufficient proof (*Singleton Enterprises*).

Executive Compensation. We have reported extensively in both the REPORT and DIGEST on two seminal cases decided in 2012 and even referenced them in our case study above – *JF Taylor* and *Metron*. Rather than attempt a summary here, we refer all our readers to these two important cases that challenge DCAA's approach to evaluating compensation.

Kickbacks. The court held that knowledge of kickbacks paid to two contractor personnel by a subcontractor while performing their obligations under a contract could not be imputed to the contractor where though the employees held management titles they were merely mid-level management employees who lacked the requisite authority for the knowledge and conduct to be imputed to the contractor (*Kellogg Brown & Root*).

RECENT DECISIONS ON TRAVEL

(*Editor's Note. Though only three parts of the Federal Travel Regulation provisions formally apply to government contractors – combined per diem rates, definitions of meals and incidentals and conditions justifying payment of up to 300% of per diem rates – many contractors choose to follow the FTR either because some contracts call for incorporation of it or auditors and contractors consider it to be the basis for determining "reasonableness." This feature is a continuation of our effort to present new changes or decisions likely to affect contractors' travel expenses.*)

The following address such questions as Can an employee on extended temporary duty travel (TDY) status be reimbursed for transportation to any city in lieu of traveling home? When are travel upgrades allowed? Are costs of indirect, as opposed to direct travel, allowable? Is travel to another location when on TDY allowed if costs are lower than going home? Is prepaid lodging allowed when travel is cancelled? Is meal reimbursement allowed when travel is within the permanent duty station? Is car insurance allowed?

When Upgrades Are Acceptable and When Not

Carolyn was relocated by the IRS to Korea and booked a flight from San Francisco to Seoul. She discovered that for the 12 hour flight her seat was located at the rear of the airplane and did not recline. Anticipating the flight to be "unbearable" she requested approval from her supervisor to upgrade to premium economy and paid $149 for the upgrade. The IRS refused to reimburse her stating Carolyn had not provided evidence to justify the upgrade. Generally the FTR 301-10.122 requires federal employees to travel via coach-class accommodations where upgrades are considered a personal preference and hence to be paid by the traveler but each agency nonetheless has he discretion to approve upgrade payments if its policy allows it.

IRS policy states it generally considers upgrades to be a personal expense but if the employee has a medical condition documented by a medical professional requiring additional space the approving official may authorize it. In response to IRS assertions Carolyn failed to provide such documentation, she submitted a March 2008 letter from her doctor stating she had a history of low back pain/disc herniation in the past which is resolved now. Carolyn also submitted her own letter saying she has been able to mitigate her prior pain by frequent stretching and avoiding sitting for long periods. The IRS's medical doctor stated though she may still have a visible abnormality on her spinal MRI most people with them do not experience pain symptoms and hence neither her letter or her doctor's would serve as justification for the upgrade. The Board ruled against Carolyn stating IRS policy required documentation of a medical condition where no such documentation was presented (*Carolyn Working, CBCA-3059-TRAV*).

Re-Routing for Personal Travel Is Limited to Cost of a Direct Flight

Rather than fly direct from Bozeman, MT home to Washington DC Gail obtained permission to leave early, fly to Salt Lake City for a vacation and go to Washington DC from there. The additional flight cost was $1,108 which the board stated was not reimbursable citing FTR 301-10.8 "reimbursement will be limited to the cost of travel by a direct route or on an uninterrupted basis" (*CBCA 2672-TRAV*)

Prepaid Lodging is Reimbursable if Travel is Cancelled

Joe had a training assignment to start on March 20. Due to it being the height of the tourist season Joe could not find hotel accommodations so found lodging at a private residence at $289 per night where the rental agreement allowed for a refund only if requested 30 days in advance. The training session was cancelled on Feb 27 and Joe's request to the landlord for a refund was refused for not meeting the 30 day requirement. He invoiced DOD who refused payment stating the class was cancelled where the dates had not yet occurred. The Board sided with Joe stating the FTR provides that nonrefundable travel expenses may be reimbursed if official travel is cancelled or amended for reasons beyond the control of the traveler. Different regs apply different criteria for payments. For example, under the FTR the traveler needs to seek a refund or otherwise take steps to minimize costs while the Joint Travel Regulations adds a few specifics such as traveler acted prudently in incurring the expenses, had a reasonable expectation the travel would be completed in addition to the FTR steps (*Joe Hannah, CBCA 2948-TRAV*).

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Money Saved Does Not Justify Rental Car Insurance

Xiaoming rented his own car rather than use the agency's travel service which resulted in over $400 in rental car savings. Xiaoming also purchased collision insurance and emergency roadside insurance. The government rejected the insurance costs and the Board sided with it stating JTR Appendix A provides that though cost incurred may be less than the government would have paid going through the travel office claimants can nonetheless be reimbursed for expenses the regulations specifically state are unallowable which is the case here (*Xiaoming Chen, CBCA 2956-TRAV*).

Periodic Travel Home Applies Only to One's "Home"

Valentina was based in San Francisco and was on extended TDY to Washington DC where her orders provided periodic travel to her home or to a less expensive location. She decided to use her return travel authorization to travel to Chicago which Valentina calculated was less than travel to San Francisco. The agency rejected all $820 of travel expenses for the Chicago trip and the board sided with the government. Citing JTR C4578 the board stated a person on TDY who travels to another place for personal reasons and returns to their TDY location "is not authorized transportation expense reimbursement" which is limited only to the per diem related expenses that the TDY location allows. Addressing her travel orders authorizing reimbursement to an alternative location as long as they were less or equal the board stated it is "unfortunate" her supervisor granted her permission where it has been consistently established that reimbursement requests that are not allowed under regulation may not be paid for any reason (*Valentina Caperton, CBCA 2933-TRAV*).

No Meal Reimbursement When Travel is Within PDS

Steven was assigned duties aboard a merchant vessel for four consecutive days where he boarded the vessel at his permanent duty station and travelled 13 miles to perform the work and returned every day. He sought reimbursement for his lunches and snacks while on board which the board ruled were not allowable. Citing FTR 301-11.1, eligibility of per diem or actual expenses are when (1) you perform official travel away from your official station (2) you incur per diem expenses while performing official travel and (3) you are in travel status for more than 12 hours. The board ruled he met only one of three of these criteria, stating Steven was not on TDY because he boarded and departed from his permanent duty station, and was not authorized to incur per diem because such expenses are not authorized when an employee performs temporary duty near – but outside – their PDS and overnight travel is not required (*Steven Gilbert, CBCA 2958-TRAV*).

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