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Oldie but goodie…

GRANT THORTON SURVEY ON PROFESSIONAL FIRMS

(Editor's Note. For the last several years we have been happy to summarize the results of the Grant Thorton Annual Government Contractor Industry Survey. The survey benchmarks important financial and contracting data for firms that offer primarily professional services to the US Government market. Unfortunately, Grant Thorton has informed us that they will not be publishing the survey this year due to a shortage of respondents. Since many of our subscribers have been asking us where the survey is we decided there was sufficient interest to offer last year's survey results with a little modification rather than simply omitting it. Since there are not significant changes from year to year, we believe the results shown here are similar to those that would be reflected in a 2013 survey.

♦ Company Profile

53% of the surveyed companies are classified as large and 47% as small where 18% had sales less than $10M, 10% between $10M-20M, 17% between $20M-50M, 13% between $50M-100M and 42% over $100M. The vast majority of surveyed companies sell professional services – consulting, IT, research, engineering, general business services, science and technology, training and education, other services - while less than 5% sell products. 84% said their primary customer is the federal government. 47% of their revenue came from the Defense Department, 37% from other federal agencies, 7% came from state and local government and 9% was commercial. The survey shows government business trends are lower where 36% of respondents had increased revenue over the prior year (50% in 2011), 26% had no significant change while 38% had reductions (compared to 29% in 2011). Indications are that 2013 and 2014 will see even more reductions.

♦ Indirect Headcount Breakdown

12.5% of total headcount is represented by management and support functions. There is an overall downward trend over the last several years which is attributed to more outsourcing of support services such as HR, legal, internal audit, contract compliance as well as some larger contracts allow for direct billing of normal indirect support costs. The breakdown of certain functions are finance and accounting (2.9%), contract and procurement administration (1.7%), sales and marketing (2.1%) and other indirect (5.8%). Though not reported this year, facilities costs as a percentage of revenue in 2011 last year was reported by 80% of respondents as less than 5%, 14% reported 6-10% and 6% said it was greater than 10%.

Government Contracts

Breakdown of Revenue by Contract Type. 40% of revenue from federal contracts came from cost type contracts compared to 45% in 2011, 20% are fixed price (equal to 2011) and 40% are time and material (compared to 35% in 2011) indicating a decrease in cost type and a corresponding increase in T&M.

Fees. Though fees were not tracked this year, the results for 2011, which is pretty consistent from year to year, were average negotiated fees for cost type contracts was 6-7%, T&M contracts had an average of 8-9% while firm fixed contracts had 9-10%. It should be noted that these negotiated profit rates are computed after deducting unallowable costs and before income taxes so actual profit rates are lower than negotiated rates.

Proposal Win Rates. Surveyed companies stated their win rate on non-sole source proposals was 30% and 50% when they were the incumbent. Win rates when either a special business unit or joint ventures were created was 50%, higher than 43% in 2011.

Bid and Proposal costs as a Percent of Revenue. 14% reported less than 1%, 41% 1-2% while 44% reported greater amounts.

Claims and Terminations. Identifying out of scope work, whether it comes from an easy to recognize direct change or sometimes difficult to recognize construc-

tive changes, provides an important opportunity to receive additional entitled revenue. 30% of the respondents said their procedures for recognizing out of scope work are very effective, 52% said somewhat effective and 18% said not effective. 85% of respondents said the government requests out-of-scope work either occasionally or frequently without issuing contract mods. 23% of respondents who have performed out-of-scope work indicate they have filed either requests for price adjustments and/or claims indicating the majority of firms are performing out-of-scope work without compensation. The authors assert this high level partially explains the lower profit levels discussed below. As for terminations for convenience the survey found that 32% of all respondents had a contract terminated for convenience in recent times where 40% submitted a settlement proposal while 60% did not. As for partial terminations, where an increase in contract price is usually justified due to allocating fixed or semi-fixed costs over a smaller base, 32% of those experiencing a partial termination actually negotiated a price adjustment on continuing work (up from 17% the prior year) while 68% did not.

Contractor Business Systems. The survey notes recent changes to contractors either fully or modified CAS covered are now subject to audits of six business systems (cost accounting, EVMS, estimating, purchasing, material management and accounting and property management) where future surveys will focus on results of these audits. For now, the survey found that 33% of respondents had already undergone at least one of these audits and that 29% said they had made improvements to their business systems in order to comply with these new rules.

Financial and Cost Statistics

Profit. Contrary to common public perceptions, government contracting does not generate abnormally high profits where the survey defines it as profit before interest and taxes as a percent of revenue. Profit rates appear to be plunging compared with prior years where 56% of survey companies had profit rates between 1-5%, 31% between 6-10%, 5% between 11-15% and 4% above 15%. 4% of respondents reported no profit. These figures would be even lower after deducting interest and taxes. Compared to 2011, there has been a substantial decrease in profit where this year 60% of surveyed companies either did not make a profit, experienced a loss or posted a 1-5% profit rate compared to 37% last year.

Fringe Benefit Rates. Fringe benefit pools consist of payroll taxes, paid time off, health benefits and retirement benefits (some include bonuses while others do not). Fringe benefit rates as a percentage of total labor averaged 36.4% when bonuses were included and 34% when excluded which is an increase from last year.

Medical Expenses. Despite widespread concerns about health care costs increases, most contractors have apparently not made any changes to health coverage. In response to questions asking what percent of health benefits are paid by the company the survey results were: 5% reported the company pays for less than half, 12% pays 51-60%, 20% pay 61-70%. 36% pay 71-80%, 9% pay 81-90% and 18% pay 91-100%. With respect to health costs as a percentage of labor costs, 6% of respondents incurred health costs less than 4% of labor costs, 5% between 4.1-5%, 11% between 5.1-6%, 13% between 6.1-7%, 9 between 7.1-8%, 5% between 8.1-9%, 12% between 9.1-10% and 39% over 10% of labor costs.

Overhead Rates. These costs are considered to be in support of direct staff working directly on contracts and hence are normally allocated as a percentage of direct labor costs. Some companies include fringe benefits associated with direct labor in the direct labor base while others do not – the result when they do is to lower overhead rates. Average overhead rates are as follows: (a) on-site direct labor (on-site means performed at company sites) - 84% compared to 80% in 2011 (b) on site direct labor and fringes – 43% compared to 48% in 2011 (c) off-site direct labor – 38% as opposed to 48% in 2011 (off-site is lower because facility related costs are normally borne by the customer at their facilities) (d) off-site direct labor and fringes – 21% compared to 23% in 2011. When companies used multiple overhead rates logic used for them were location (52%), labor function (13%), customer (28%) and products versus services (7%).

G&A Rates. The survey states that general and administrative rates are typically those incurred at the headquarters and include executives, accounting and finance, legal, contract administration, human resources and sales and marketing as well as IR&D and bid and proposal costs. G&A costs are most often allocated to contracts on total cost input (direct operating costs, overhead, material, subcontracts) or a value added base that generally includes all the above costs except material and/or subcontracts. Average G&A rates under a total cost in-

put base was 12% (13.5% in 2011) while those using a value added cost input was 15% (15.4% in 2011).

Material handling and subcontract administration costs. 24% of surveyed companies used a material handling and or subcontract administration rate as a burden chargeable on direct material and subcontract costs (higher than 2011's 22% and 19% the previous year). The survey notes that in service industries a handling rate is established in conjunction with use of a value added G&A base to reduce burden applied to pass-through subcontract and material costs. Average material handling rate was 3.0 and subcontract handling rate of 3.4% (2.7 and 2.5% in 2011).

Labor multipliers. Multipliers, a term commonly found in the commercial world, are fully loaded labor multipliers used to price out work and are derived by dividing total burdened labor cost by base labor cost. The average labor multiplier was 2.2 for on-site work and 1.9 for off-site work. Almost all respondents expressed a belief their labor multipliers were competitive with their industry. It should be pointed out that the labor multipliers are overall averages where many companies commonly use different multipliers for different markets.

Uncompensated overtime. (*Editor's Note. Uncompensated overtime refers to hours worked exceeding the normal 40 hour work week by those salaried employees exempt from the Fair Labor Standards Act.*) 60% of respondents said their employees work uncompensated overtime (UOT) while 40% said no. 80% of the companies working UOT use total time reporting while the other 20% report only 40 hours per week. 78% use a rate compression method of accounting (e.g. computing an effective hourly rate dividing salary by hours worked) while 22% use a "standard/variance method" that charges an hourly standard rate and then credits an indirect cost pool for the difference between labor costs charged to projects.

Charging Subcontractor hours on T&M contracts. We have frequently reported on new regulations that provide that subcontract labor can be charged at fixed rates provided in the prime contract as opposed to the older way of simply billing subcontractor costs plus applicable prime indirect rates. 80% of surveyed companies bill the cost of subcontract hours at the fixed rates in the contract or subcontract while 20% bill on a cost reimbursable basis (i.e. as an ODC). This change has led to a different audit focus from merely auditing hours charged to ensuring labor skills being billed meet contract requirements where 77% of respondents state their procedures for properly assigning employees to labor categories are effective while 23% state they are either somewhat effective or not at all.

Dealing with the Government

The Defense Contract Audit Agency, because of their Defense Department contracts or contracts with other agencies that use the audit agency, audits most of the contractors in the survey. Regarding the respondents' opinions of DCAA audits, 47% say auditors' opinions are substantiated with appropriate references and 53% are arbitrary and not substantiated while 40% of auditors are open-minded and receptive to contractor rebuttals and 60% say auditors are inflexible and are rarely receptive. Contracting officers receive higher ratings where 60% of their opinions are considered substantiated with references and 56% are considered open-minded and receptive. When asked if their relationship with DCAA has changed, 71% said it had stayed the same, 19% reported the relationship had worsened (compared to 2% in 2011) while 10% said it had improved. In an effort to measure the quality of relationships with ACOs and DCAA, the survey found 18% of respondents resolve issues efficiently where the remaining 82% say the government was inefficient where 56% say they believe DCAA is the primary cause for delays of resolving issues while 26% believe it is the ACO. The most frequent types of costs questioned by DCAA are executive compensation (23%), consultant costs (7%), incentive compensation (17%), labor charging (11%), indirect cost allocations (12%), legal expenses (9%) and employee morale (5%). Most frequently cited violations of cost accounting standards were CAS 401, consistency (2%, compared to 16% last year), CAS 403, home office expenses (3%) and CAS 405, Unallowable costs (9%, compared to 4% last year). Costs questioned as a percent of revenue were less than 1% of revenue (61%), 1% of revenue (11%), 2% of revenue (6%), 3% of revenue (3%), 4% of revenue (0%) and 5% or more of revenue (19% compared with 4% last year). Of those companies experiencing audit issues, 18% were very satisfied with the resolution of the issues, 61% were somewhat satisfied and 21% were not satisfied.

Executive Compensation

(*Editor's Note. Care should be used if our readers consider substituting the following results for a bona fide compensation survey where sometimes hundreds of firms are surveyed. How-*

ever, the results shown below are interesting. If you want to escalate the results below for 2013, applying a 3% escalation factor would be a conservative approach.) Surveyed companies provided information on the four highest paid executives in the company and the results are presented by company size measured by revenue for 25th, median and 75th percentiles. The following is a summary of the results.

Highest Position (in thousands)

Revenue	25%	Med.	75%
$0-10 M	250	320	447
$11-50M	260	349	500
$51-150M	275	407	585
>$150M	300	410	708

Second Highest Position

$0-10 M	170	262	432
$11-50M	225	294	444
$51-150M	250	339	479
$>$150M	280	372	646

Third Highest Position

$0-10 M	160	242	300
$11-50M	180	269	379
$51-150M	225	279	450
>$150M	260	357	565

Fourth Highest Position

$0-10 M	144	189	267
$11-50M	157	228	310
$51-150M	208	241	344
>$150M	218	322	395

Companies whose executive compensation was challenged by DCAA and provided rebuttals and/or additional information state 30% of their positions were sustained, 30% stated a reasonable compromise was achieved and 40% stated either DCAA's position was sustained by the ACO or an unreasonable compromise was put forth.

Knowing Your Cost Principles…
PRECONTRACT COSTS

(*Editor's Note. The following represents our continuing presentation of important FAR Cost Principles and Cost Accounting Standards. This is particularly timely since some recent cases addressing precontract costs are challenging long held rulings that these costs are clearly allowable. Our source for this article is an article written by Karen Manos in the November 2013 issue of the Cost and Pricing Report.*)

The cost principle covering precontract costs at FAR 31.205-32 constitutes two sentences and has not changed since it was first published in the Armed Services Procurement Regulation in 1959. However, several cases and expert commentary do provide some important clarifications. The cost principle states "costs incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award where the incurrence of such costs is necessary to comply with the proposed contract delivery schedule. Those costs are allowable to the extent that they would have been allowable if incurred after the date of the contract (See 31.109)."

Overview

As a general rule, government contractors may recover only those costs incurred after award of a contract. However, FAR 31.205-32 makes an exception for costs incurred in anticipation of a specific contract provided the costs satisfy the circumstances prescribed by the cost principle. In referencing FAR 31.109 the cost principle suggests, but does not require, the parties enter into an advance agreement to avoid disputes over the allowability of the precontract costs. But many agency FAR supplements do require an advance agreement in order for the precontract costs to be allowable.

Case Law Interpretations

For a simple two sentence rule, the provision has generated a surprising amount of litigation. Some of the cases involve a termination for convenience of a fixed price contract under which the fixed price presumably includes all the contractor's anticipated costs of performance regardless of when performance occurs. If the contract was not terminated the contractor would presumably be entitled to be paid the full amount of the fixed price. However, the government has argued the costs are not allowable because they were not incurred in the performance of the work terminated. In other circumstances when the contract was cost type the government has argued the contractor was improperly trying to recover as a direct charge to the contract what should have been an indirect cost including IR&D, bid and proposal and selling costs.

To recover precontract costs the contractor must establish three elements: (1) the costs were incurred directly pursuant to the negotiation of the contract and in anticipation of award (2) the costs were necessary to comply with the proposed delivery schedule and (3) the costs would have been allowable if they were incurred after award (*Penberthy Electromelt Int'l Inc. v US, 11 Cl. Ct. 307*). Though the cost principle does not expressly state the precontract costs that do not meet these conditions are not allowable, it has been interpreted as making such costs unallowable by implication (*Codex Corp., ASBCA No. 17983).*

Lets clarify the meaning of these three elements.

1. "Directly pursuant to the negotiation and in anticipation of the contract award."

The two phrases "directly pursuant to the negotiation" and "in anticipation of contract award" are generally read in tandem rather than as two separate elements. The FAR Council has interpreted the two phases as meaning as a result of the solicitation and award process.

It is not necessary for the government to agree to pay for the precontract costs for them to be allowable. In fact, the precontract costs need not even have been discussed during the negotiation (*AT&T DOT, BCA No. 2007, 89-3*). For example in one case precontract costs were allowed even though it was a sealed bid contract.

Precontract costs have been held to be allowable even when the government told the contractor not to incur them. During negotiations of a sole source cost type contract Radiant was told not to incur costs for providing liners for Navy aircraft where shortly after award it gave notice under the Limitation of Cost clause it was about to exceed authorized funds due largely to precontract costs it had incurred. The CO denied the request for precontract costs stating (a) because the hardware was not due until six months after contract award there was no reason to start work before the award and (b) precontract costs are allowed only if the CO authorizes them in writing. The Appeals Board rejected both arguments saying it had satisfied each of the requisite conditions for allowability. With respect to the government assertion it should be precluded from recovering precontract costs because the government told it not to incur the costs it was "without contract significance" because Radiant was fully aware it was taking a risk in incurring the expenses where if it was not awarded the contract it would not be entitled to recovery of the costs it incurred since it had no advance agreement. The Board also rejected the government's assertion that there was no advanced written approval by the CO stating FAR 31.109 makes it clear though advanced agreements are desirable they are not mandatory (*Radiant Techs, ASBCA No.38324*).

However, if a contractor who has incurred precontract costs and subsequently is awarded a fixed price contract without ensuring the precontract costs are part of the price or without reserving the right to make a claim for them the contractor will be precluded from later trying to recover them (*Mid States Mgt L td, ENG BCA No. 5203*).

The author strongly warns that two recent cases do confuse the results of these earlier cases holding that precontract costs are not allowable unless the government has agreed to pay for them. In one case, ILSS spent a lot of money before contract award on numerous items that were rejected and excluded from the statement of work. Though it would have been non-objectionable to disallow the costs because they were not needed for the contract the Board went a step forward ruling that for the preaward costs to be recoverable the government must agree not only to the scope of work but it must also agree to reimburse the costs (*Integrated Logistics Support Sys. Int'l vs. US, 47 Fed. Cl. 248*). In its ruling on this case the Court cited many of the cases we discussed above asserting they confirm the proposition that the government must provide its prior approval for expenditures for them to be allowable where in fact the cited cases support exactly the opposite proposition.

In another recent case, the government refused to reimburse the contractor for consulting services and other expenses that were incurred prior to an engagement to prepare a financial plan where the Court stated "generally, except in special circumstances not shown here, those costs incurred prior to the actual execution of a contract are not recoverable" where it cited the Codex case that had actually ruled the opposite. The author states that "regrettably" other cases are starting to cite Integrated Logistics' incorrect conclusion that in the absence of an advanced agreement precontract costs are not allowable.

2. "Necessary to comply with the proposed contract delivery schedule."

This second element is the one most likely to make otherwise allowable costs unallowable because they

were incurred before the effective date of the contract. Seaworthy performed tasks under an ID/IQ contract where some of the tasks were incomplete by the end of the contract. Since the agency wanted a continuity of service Seaworth continued performing the tasks during the brief period between the time the first contract ended and the second follow on one was awarded. The Appeals Board held the costs incurred before the second contract was awarded were unallowable because the contractor did not establish they were necessary to meet delivery schedules but it allowed costs after the second contract was awarded even though no task orders were issued reasoning that nothing states the contractor shall not be reimbursed costs on a task order after the second contract was awarded but prior to issuance of a task order as long as the work was within the scope of that task order once it was issued (*Seaworthy Systems Inc., ASBCA No 41202)*

In a dispute about the allowability of legal costs for a pre-award and post-award protest of an unsuccessful offeror, the Board ruled that the pre-award costs were not allowable because the protester did not present any evidence to indicate the costs were incurred "in order to meet the delivery schedule" (*Jana Inc., ASBCA No 32447*

In another case, the government rejected Radant's claim for precontract costs on the grounds that at the time the delayed contract was awarded the government schedule for the flight test had slipped and hence it was unnecessary to incur the flight tests to meet the schedule. The Board sided with Radiant ruling it is not necessary for the contractor to prove that the incurrence of the costs was actually necessary to meet the delivery schedule but rather what is required is for the contractor to reasonably believe it was necessary where here, Radiant did believe the test was required (*Radiant Techs., ASBCA No. 38324*)

3. Advance Agreement and meaning of "at risk."

As many of the cases have observed, the contractor that begins work before a contract is awarded undertakes a significant risk in doing so since if the award is not made it cannot recover the costs. The advance agreement contemplated in FAR 31.109 does not obviate this risk.

A contracting officer generally has no authority to obligate the government outside of a contract under the FAR and is prohibited under the Anti-Deficiency Act to obligate the government in advance of or in excess of appropriated amounts. The risk that is mitigated by an advanced agreement only applies *if* a contract is awarded where if a contract is not awarded the advance agreement does not provide a way for the contractor to recover its precontract costs.

RECENT TRAVEL AND RELOCATION COST DEVELOPMENTS

(*Editor's Note. About once a year we recount some of the more important developments affecting reimbursement of travel and relocation costs. Most of the issues arise in board decisions or Q&A forums that address reimbursement of these costs for government employees but we consider these decisions very relevant for government contractors. 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 article is a continuation of our effort to present new changes or decisions likely to affect contractors' travel and relocation expenses.*)

When in Doubt Choose the Cheapest Lot

Todd drove to the airport and parked in the daily parking lot for a rate of $20. The agency reimbursed him only $11 per day which was the price for the economy lot. Todd told the Board (1) the higher daily rate was still cheaper than a round trip taxi fare (2) he chose the daily lot due to having undergone previous arthroscopic knee surgery and (3) he was consistently reimbursed for the higher rate for eight years. The Board ruled against Todd taking each argument separately. First, though the FTR does provide for reimbursement of airport parking up to the cost of taxi fare (301-10.308) the FTR 301-2.3 nonetheless establishes that travelers must exercise the same care for incurring expenses that a "prudent person" would exercise during his personal activities. Second, as for the knee surgery argument, though the FTR does provide for additional reimbursement to accommodate an employee with a special need, FTR 301-13.2 clarifies that in these cases a special need

must be either "clearly visible and discernible" or "substantiated in writing by a competent medical authority" where Todd's history of knee surgery did not meet either criteria. Third, as for prior payment, the Board stated "past error that may have been made in interpreting the FTR is not justification for continuing to make a similar mistake" (*CBCA 3593-TRAV*).

Compelling Circumstances Justify Payment of Higher Actual Expenses

(*Editor's Note. Employees are often told to find lodging at the government's maximum rate even if it means they suffer inconvenience. The following sheds light on at what point does the situation move beyond "inconvenient."*)

Becker was to fly from Oahu to the Big Island in Hawaii to support a site survey for construction of a training facility where four days before going he called hotels near the worksite where the lowest rate was $230 per night, over the $180 maximum rate. Though agency requirements stated he needed to obtain higher level approval his supervisors nonetheless said they did not anticipate any problems. When he submitted his request for reimbursement of actual expenses it was rejected, citing agency policies that stated actual expenses would be reimbursed only under "the most compelling of cases." In his appeal, Becker stated he had a compelling case for the higher rate showing documentation that the site survey was critical to meet the project schedule and he was unable to find a lower rate hotel room within a 90 minute drive where his long work days of 10-13 hours would make it even more important to stay close to work. The Board found the government's position to be "clearly erroneous" where though it found support for the agency's policy, the supervisors clearly saw that travel on quick notice to a remote location, to work long hours performing a function critical to remaining on schedule and no lower rates were available were appreciated by his supervisors who concluded spending a little extra money for the hotel was worthwhile (*CBCA 3435 TRAV*).

Cost Increases Due to Mistakes Within Employee's Control are Not Reimbursable

Riddle went to the airport to catch his plane to Australia when he realized he did not have his passport and would need to go home to get it where he would miss his flight. He made a reservation for the next day but because there was a delay in him obtaining the go ahead from his supervisor he had to go to the counter to buy the ticket for $5,075. The government reimbursed him for is original flight at $2,069 where in his appeal the Board ruled against Riddle citing the requirement that personnel must exercise the same care in incurring business expenses as a prudent person would exercise if travelling on personal business. It stated Riddle's additional charges were incurred because he forgot his passport where if he hadn't he would have made his original flight and as such he did not act as a prudent traveler would (*CBCA 3235-TRAV*).

Government Can't Require Unreasonably Long Work Day

Craig was authorized to travel from Kansas City to San Francisco to attend a business meeting which ended at 4:30 on July 25. Craig took personal leave afterward and stayed in San Francisco until July 29th. The government rejected his claim for hotel reimbursement for the night of July 25 asserting he could have caught a flight at 6:50 PM, arriving in Kansas at 12:50 and arriving home at 2:00 AM. The Board rejected this position stating it is simply not reasonable to require an employee traveling on official business to return home at 2:00 AM. It cited cases that established travel the day after conclusion of agency business is appropriate to avoid late-night travel (*JTR C4485* and *GSBCA 13684*) or when safety considerations preclude late night travel. The Board added that Craig's "personal travel on July 26 does not affect his right to be reimbursed for lodging while still on government business" (*CBCA 3211-TRAV*).

Internet Charges Not Reimbursable Without Prior Authorization

John relocated from a more expensive hotel where internet service was included to a less expensive hotel that charged $12.95 per night for the service. The Navy rejected the $12.95 charge explaining the charge was not authorized and was not necessary to conduct business where John asserted he saved the government money by switching to a cheaper hotel. The Board sided with the Navy stating Appendix G of the JTR provides that internet charges for government business is reimbursable when approved but since John did not obtain authorization the charges were not reimbursable (*CBCA 3032-TRAV*).

Questions & Answers

Q. Since the General Services Administration has eliminated the conference lodging rate how can a traveler recover lodging rates that exceed the per diem lodging rate?

A. Previously, if a conference lodging facility exceeded the local per diem rate the traveler could receive up to 25 percent more of the locality lodging per diem rate without further justification. Now, under FTR Amendment 2013-01, if the conference lodging rate exceeds the applicable lodging per diem rate "travelers should construct a cost comparison, including all travel-related costs of the available options. If the cost comparison shows that obtaining lodging at the conference facility results in the lowest total travel costs, the agency may authorize actual expense reimbursement" in accordance with FTR Section 301.71-105(o).

Q. I see the term "constructive cost" when referring to how much of my travel costs I may be reimbursed for but I do not know what it means.

A. A constructive cost is a calculation showing what the allowable travel cost would have been if the employee travelled according to the recommended guidelines for official travel (e.g. airfare, transportation to and from home, etc.). When scheduling travel to accommodate personal preferences rather than the most advantageous arrangement for the government, travelers will be reimbursed for the amount of constructive cost or the actual cost, whichever is less.

NEW CASES ADDRESSING ALLOWABLE CONTRACT ADMINISTRATION COSTS AND UNALLOWABLE CLAIMS COSTS

(*Editor's Note. Whether it be challenging adverse audit findings or attempting to receive precious added funds for claimed out of scope work under this budget cutting environment we are at any one time involved with several clients in preparing and negotiating requests for equitable adjustments (REAs) and preparing work on claims and appeals. Proper categorization of these costs as either contract administration costs (allowable) or costs related to pursuing a claim (unallowable) will determine whether those costs are allowable and also when the interest clock for claimed costs begins. The distinction between costs for contract administration versus claims continues to be far from clear and a matter of controversy where evolving cases provide the practical meaning of how to treat these costs. There has been a long list of cases that address this issue where recently, at least four cases have addressed this distinction. We are relying on an article by Professor Ralph Nash in the June 2013 issue of the Nash & Cibinic Report.*)

The seminal Bill Strong case (*Bill Strong Enterprises Inc. v Shannon 49 F 3d 1541*) established the guidelines on distinguishing between administration versus claim costs where subsequent cases have addressed when costs are considered to be incurred for administrative or claim purposes. Four recent cases continue to fill in the blanks.

Tip Top Construction

In Tip Top Construction Inc. the Federal Circuit Court provides some guidance. In that case the agency issued a change order and the parties negotiated with the CO for several months over the amount of the request for equitable adjustment (REA) that was due the contractor. When they could not agree the contractor, Tip Top, appealed to the Postal Service Board of Contract Appeals which ruled in favor of the contractor on some issues but denied costs of a consultant and lawyer who participated in the negotiations. The Board ruled that negotiations between Tip Top and the Post Office after October 15, 2009 related solely to the recovery of Tip Top costs expended by the consultant and lawyer to convince the CO to accept its estimated costs and to maximize recovery where it had nothing to do with either performance of the changed work or contract administration. In effect this ruling held that negotiating equitable adjustments is not part of the negotiation process. The Court rejected this approach.

The Court ruled the Board erred in concluding the consultant and lawyer costs were not contract administration costs. The Court alluded to several important dates such as Oct 19, 2009 when Tip Top submitted a proposal for additional costs associated with the change, a Jan 2010 letter from the CO saying a price will be negotiated later, through March 2010 where the consultant handled the negotiations for Tip Top after which the President continued negotiations, April 2010 the CO advised Tip Top of its receipt of guidance within the Postal Service of the consultant's costs, June 18, 2010 submission of a claim by Tip Top to the CO and a June 23, 2010 final decision. The Court said the parties con-

tinued to negotiate the price of the changed work where only on June 18, 2010 did the negotiations finally end. The Court stated negotiations related to the price of the change does not remove those discussions from the realm of negotiation and contract administration – "consideration of price is a legitimate part of the change order process." This last sentence makes crystal clear that negotiating the price of a REA, no matter how difficult, is part of the contract administration process.

SUFI Network Services

This decision addresses the issue of whether the contractor, SUFI, is entitled to recover attorney fees related to protracted negotiation and litigation where the Bill Strong test is applied. The first issue the Court had to decide was whether the attorney's fees were unallowable in accordance with FAR 31.205-33(b) which states such costs are allowable when reasonable in amount and not contingent on the recovery of costs from the government. Since SUFI was a small business who had no revenue stream SUFI could not afford expensive legal fees and the attorney took the engagement on a contingent basis. The Court acknowledged the fees in this case were contingent fees but the REA submitted to the CO was for hours worked during contract administration where the FAR provision does not bar such fees. The Court alluded to a case that allowed award of reasonable fees despite a contingency fee arrangement and ruled though the FAR provision may prevent attorney fees as a percentage of recovery against the government it does not prevent payment of fees based on hourly rates.

The Court elaborated on the Bill Strong test of distinguishing between allowable administration costs and unallowable claim prosecution costs stating if costs are incurred for the genuine purpose of materially furthering the negotiation process and the fees are reasonable and allocable then they are allowable even if negotiation fails and a subsequent claim is filed. However, if the underlying purpose of incurring the costs are to promote prosecution then they are unallowable. The Court added there is no "bright line test" that renders costs allowable just because they were incurred before a Board appeal. The government must receive "some benefit" from the incurrence of the cost for them to be allowable where such "benefit" might include an increase in "the likelihood of settlement without litigation." The Court concluded that attorney fees and expenses incurred as a preparation for a REA are themselves "presumptively compensable" where (1) the contractor incurred the costs due to (a) a formal or informal change to the contract (b) government defect or delay or (c) a government breach (2) the contractor incurred the cost in furtherance of information exchange or negotiation with the government whether or not it ultimately succeeded and (3) where applicable, the contractor incurred the costs before actually filing its Board appeal.

The Court ruled that SUFI easily satisfied this test for presumptive compensation where it engaged in regular negotiations and exchanges of information. It also subjected its monetary claim to a DCAA audit where its counsel responded to DCAA inquiries on numerous occasions.

Northrup Grumman

In this case, the board seems to have reached an opposite conclusion from SUFI where the facts worked against the contractor. First Northrup submitted an REA prepared by an unnamed law firm and, second, neither the law firm's invoice nor the REA itself contained sufficient information to induce the CO to enter into negotiations. The Board rejected the claim holding the REA was not prepared to further contract administration but looked like part of the litigation process. It pointed to the fact the REA was not prepared until after contract performance and close similarity of the REA to the claim indicates the efforts recorded were for the purposes of documenting the claim it intended to submit. It stated "Costs incurred before the filing of a CDA claim are not automatically allowable and any presumption must yield to a consideration of the particular facts and circumstances involved."

States Roofing

The following case addresses the importance of properly accounting for the costs, demonstrating the need to carefully document the costs and properly treat the costs (e.g. credit the indirect cost pool they may initially be charged to, why the direct treatment is justified). The contractor had entered into protracted negotiations with the CO attempting to arrive at a settlement for a series of changes and ultimately filed a claim. The Board rejected the government's argument that the costs of preparing the REA and negotiations were costs of prosecuting a claim because "they were already in dispute." Though it sided with the contractor on as-

serting the costs were contract administration, the Board nonetheless rejected all of its claimed costs for legal and accounting assistance because they were not well supported in the contractor's records and were charged to general and administrative expense rather than as a direct cost of the contract. The contractor put forth an argument that the treatment of these costs were in error where the Board rejected the argument stating it is the contractor's practice to charge legal and accounting fees to G&A expense pool and the treatment of such claimed costs as direct costs are inconsistent with its accounting practices. The contractor acknowledged that fees requested needed to be transferred from its G&A expense pool to the contract as direct costs but since it failed to do so the Board agreed with DCAA that the contractor was seeking double recovery. Here the critical issue is the contractor's non-reversal of the charge where both Professor Nash and us would assert it is perfectly proper to charge proposal costs for new work to G&A and charge proposal costs for changed work as a direct cost of that contract. In addition the Board stated it had problems with the level of accounting detail for the costs of company personnel that were involved in preparing the REA which should serve as a warning to contractors to closely account for such costs if they wish to recover them.

LESSONS ON RECOVERING BID AND PROPOSAL COSTS ON A PROTEST

(*Editor's Notes. Protests of awards are increasing where protesters usually attempt to recover their bid and proposal costs on the protested contract, whether or not they were successful in the protest. We find the following article in the March 18 issue of the Federal Contracts Report useful in describing strategies that may be successful in recovering these costs.*)

Some recent court decisions are providing insight in how to recover bid and proposal costs when a contractor is pursuing a protest. Though there are no hard and fast rules, protesters should make every effort to justify recovery of these costs.

The ability to recover bid and proposal costs is a long established principle. FAR 31.205-18(a) defines them as costs incurred in preparing, submitting and supporting bids and proposals on potential government contracts while 18(c) states such costs are allowable on contracts to the extent they are allocable and reasonable.

Unlike several cases that allowed such costs, *Innovation Development (Innovation Dev. Enters of Am vs. US, BL 13402, Fed. Ct. No 11-217*) highlighted specific categories of bid and proposal costs that are not recoverable The court rejected claims for costs on the grounds that a proposal was not submitted where it delineated three categories of non-recoverable costs: (1) training (2) networking and marketing and (3) precontract logistics such as certification of a product. The costs of visiting contacts at an Air force base and attempting to contact officials were found to be related to general small business management activities and training classes, though integral to bid submittals were found to be outside the ordinary meaning of proposal preparation.

Commentators on this case have said the contractor would have increased the likelihood of receiving bid and preparation costs by documenting its efforts to pursue a particular procurement opportunity and showing that its efforts related to the pursuit of that procurement. If the protester in *Innovation* had documented its costs more thoroughly and showed a stronger connection between them and the procurement at issue the results would have probably been different. For example, the trips to the Air Force base should have been documented to show they were incurred to win the award. Or if the training could be shown to involve helping presenters during orals do a better job they probably would have been allowed. Other commentators have stressed that "marketing" efforts to ferret out what the customer really wants offerors to propose can be shown to be bid and proposal costs. One example cited was that if the government induced a contractor to expend resources chasing an opportunity that even if the contract turned out to be a sole source award to someone else and a proposal was not submitted it still could be construed as bid and proposal costs.

In *Reema (Reema Consulting Svcs V US, BL 306522 Fed. Cl No. 12-402C*), though the court ruled against the contractor, it established three conditions for the costs to be recoverable: (1) agency committed a prejudicial error in conducting a procurement (2) the error caused the protester to incur bid preparation and proposal costs unnecessarily and (3) the costs are allocable and reasonable, meaning they were incurred specifically for the contract in question.

In *Alabama Aircraft (Ala. Aircraft Birmingham vs. US, Fed. Cl. No 08-11-217*) showed recovery of bid and proposal costs depend on adequate documentation. The court earlier granted it $1 million and enjoined the award to Boeing but the higher court rescinded both the award and injunction against Boeing. But it did show the possibilities for recovery of bid and proposal costs. The Court ruled it could recover costs where it showed it had stopped being a subcontractor for Boeing and submitted its own proposal that included $300,000 in labor costs and $174,000 of "internal expenses" (e.g. travel related to the proposal). Whereas these costs may have fallen under the category of precontract costs and hence unallowable in accordance with Innovation discussed above, Alabama provision of hundreds of repair receipts and declarations sufficed to support its claim. Though it was awarded $700,000 of consultant costs to help prepare the proposal by the lower court the court denied these claims asserting they were for a proposal writing workshop and not incurred specifically for the contract at issue. If they could have shown the workshop and training costs were for the direct purpose of performing a specific contract they would have been recoverable.

The authors put forth four conditions to help support the allowability of the specific bid and proposal costs: (1) the agency committed a prejudicial error (2) the error caused the protester to waste money preparing and submitting a proposal (3) this money was spent specifically to bid on the contract in question and (4) the costs were reasonable and well documented. .

SOME BASIC RULES FOR GETTING BUSINESS WITH THE GOVERNMENT

(*Editor's Note. We frequently receive inquiries from small to mid-sized companies on how to obtain business with the government. Since we specialize in cost, pricing and contract rules we usually either indicate that sales and marketing is not our area of expertise or sometimes we will provide some general information. In the midst of looming budget cuts we have recounted some of the proliferation of articles addressing advice on how to take advantage of government business which has been popular with our readers so we continue the practice. We recently came across an article that provides some good practical advice on starting up with the government so thought it would be useful to not only new contractors but also veteran contractors who need novel approaches for finding new business in this era of budget cuts. The article was written by Olessia Smoyrova-Taylor of OST Global Solutions in the July 9, 2013 issue of Federal Contracts Report.)*

The author reminds us of the increasing "Byzantine rules" that govern government awards but also reminds us of the enormous amount of dollars out there for companies willing to bite the bullet.

Start Small as a Sub

Olessia suggests the best way to enter the government market and gain great experience is to become a subcontractor. Having well qualified employees and being able to sell yourself is often sufficient to become a sub. However, not all primes are the same and pains should be taken to find the right ones. The prime has to be willing to take on inexperienced firms and be sympathetic to their needs. (Of course veteran contractors can be highly desirable for those primes who do not want to work with inexperienced firms or who may not have adequate accounting practices in place.) They should be willing to treat you well, show you the ropes, pay quickly for completed work and possibly underwrite your loans. Olessia offers other advice for working with primes: (1) resist simply being a W-2 employee for the prime where the objective should be to gain credit for the firm and (2) confirm that your firm will get past performance credit since past performance has become the key criteria for winning contracts with the government. The goal need not be to become a prime contractor – many subcontractors do very well in that role where the jump from business-to-business relationships to business-to-government relationships can be quite daunting. For example, some firms do great focusing exclusively on the work where as primes they do not have the necessary skills for proposal writing.

Try State and Local Contracts

Who you know is usually more important for obtaining state and local contracts than federal work which is subject to strict arms-length bargaining. If you have the right relationships, state and local contracts can be much easier to land. Word-of-mouth and professional relationships usually count for more. Knowing what the state and local government want can heavily contribute to writing a proposal that clearly shows you are the best candidate. Another advantage of going after state and

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local business is that contracting officials are much less concerned about protests which means they will often be more open to having meaningful discussions with potential bidders than you will find from federal COs.

Think Small, Multiple Awards

Start with smaller contracts awarded under simplified acquisition procedures (currently $250K with some exceptions up to $5 million) in your area of particular competence and then grow into bigger opportunities later. Once you have one of these contracts under your belt you would have demonstrated your ability to get prime contracts. Consider getting on a GSA schedule or even becoming a subcontractor on a multiple award schedule. In such situations, primes are not so picky and will have much less hesitation in bring on an even inexperienced firm where then you can drive some task work.

Other Options

Look at FedBiz opportunities where past performance ratings are not needed. This "fully managed online marketplace" allows buyers to specify what they want and then choose from seller's documented pricing options. Sellers pay nothing while buyers pay a small fee.

Go after "lowest price technically acceptable" (LPTA) awards. They have become increasingly popular where past performance is based on a "pass/fail" basis. This means that any past performance you have must be good but if you don't have experience you can still win with a "pass" grade. Be aware that there are recent industry and even legislative moves to lessen LPTA awards.

Consider forming a joint venture. You can form a JV with a firm you know well and be able to share their past performance rating as your own. Remember the joint venture is a separate company and like forming any partnership, you will need legal advice.

Find the Right Customer

There is no substitute for finding the right customer. Olessia cautions against the tendency to create a long laundry list of possible services and products you may be able to offer and then go find multiple NAICS codes that match up to all of them. Though it could work for large companies, if you are a small business it will make you look excessively diversified where you are a jack of all trades but a master of none. She recommends listing no more than three or four core areas of expertise where it can be fine to list multiple NAICS codes.

If you do decide to go for being a prime contractor make sure the size of the work matches your experience and past performance ratings.

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