GCA DIGEST

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CAFETERIA OF INDIRECT RATES YOU MAY WANT TO ADOPT

(*Editor's Note. Though we have often discussed in these pages the pros and cons of implementing a particular indirect cost rate we are often asked to provide a range of options for a company to choose from. Helping clients select the best possible indirect rate structure has become an increasing part of our consulting practice. Though the motivation to avoid assertions of improper cost and pricing practices as well as a desire for more accurate accounting is often the motive to consider alternative rates we often find pricing strategies to also be a big motivator where such considerations seem evenly divided between* ***increasing*** *recoveries on new contracts without affecting existing contracts and* ***lowering*** *indirect rate allocations to be more competitive. Though we have addressed this issue in the past we thought we would assemble some of the most common indirect rates to consider. The first part of this article addresses manufacturers but we find the principles discussed are applicable to all firms while the later section addresses all contractors' circumstances such as services and even construction firms. We have used numerous texts to discuss these (especially "Accounting for Government Contracts", edited by Lane Anderson) and our own experiences to see what have been proven useful to our clients.)*

Common Manufacturing Pools and Bases

Generally costs are not recoverable on new contracts unless the indirect cost pools and bases are pre-established. For example, costs of handling material cannot be proposed or recovered unless they are separately identified and established in a material handling pool before the proposal is prepared. Manufacturing firms can be considered labor, material or subcontract or capital intensive and each often calls for using different types of indirect rates.

♦ Labor intensive Firms

Some firms may use a single manufacturing pool while for many more diverse and complex organizations additional cost pools may be appropriate. Separate pools are most commonly established by departments that may include fabrication, assembly, tooling, testing, quality assurance, inspection, machine shop, paint shop and welding. Though we rarely see indirect rates for each department, multiple rates are not unusual depending on their relative significance to others. Though multiple rates could be used, one or two can be decided upon, especially when there is no material differences between rates in multiple departments. On the other hand, more pools than are necessary may be used even when there is little difference when companies, for example, want to track activity under different managers.

When a firm is labor intensive, the allocation base used for most cost pools are direct labor hours or direct labor dollars. Labor dollars have tended to be more favored because it is not affected by inflation – labor costs increase in proportion to the pool - while labor hours will tend to increase rates under inflationary conditions. The drawback to using labor dollars occurs when the labor base includes a wide range of wages and salaries resulting in increased allocation to higher paid labor activities. Generally, if the pool of expenses to be allocated are more closely related to the number of employees then a labor hour base is preferable; if the pool is more related to compensation then a labor dollar base should be used. Some cases (e.g. *Brown Engineering*) have ruled that premiums, bonuses and other pay differentials should be excluded from a direct labor dollar base.

In manufacturing companies where labor is decreasing as a percent of total cost firms may adopt activity based costing applications that have been in vogue for some time now where labor bases give way to other allocation schemes. Common bases are machine set-ups, set-up hours, standard processing times, items inspected, engineering changes, drawings, routing, etc.

♦ Material Intensive Firms

When a firm is material intensive then material related cost pools should be considered. Material related costs might include material handling costs (e.g. unpacking, inspection, moving from and to storage) as well as purchasing and ordering. The government may object to allocating a significant amount of material related cost on a labor base asserting there is little correlation (i.e. casual/beneficial relationship). Using a labor base for material oriented costs may also be inconsistent with a company's goals – for example, for contracts with a relatively heavy material component and lighter labor cost, recovery would be

less. Conversely, contracts containing a relatively high labor component may attract a disproportionately large amount of indirect costs which may or not be desirable. If material is used uniformly on all jobs then a separate pool is unnecessary. Also, if labor costs are insignificant, then a material base may be appropriate for all indirect costs. Multiple material related pools may also be necessary - for example, when both material and customer-furnished material are significant and their proportionate use on contracts differ, then separate pools and bases may be needed.

A variation of a material related pool is a subcontract administration pool. A separate pool may be needed if subcontract related expenses are significant and are not incurred in the same ratio as material costs. We have seen a wide variety of costs included in subcontract handling pools from ordering and administering subcontracts to proportionate shares of engineering, marketing and research and development costs and other services. Generally, direct subcontract costs are the allocation base.

When activity based costing is used, potential allocation bases for material costs may include the size of material, number of items, number of times material is moved within a facility, number of purchase orders, etc. We have seen numerous pools of material related costs divided by a variety of materials where the cost of one category was allocated to contracts based on number of purchase orders while the cost of another category was allocated to contracts on the number of items handled.

For *capital intensive* companies, other allocation pools and bases may be appropriate. Capital intensive manufacturing usually translates into equipment intensive so pools and bases are more oriented to equipment usage. For example, the costs related to a machine shop may constitute a separate pool using a machine hour base. DCAA has come up with guidance for allocating special facility costs where there is a preference, in descending order, for (1) use basis for allocation where predetermined rates are set for a year (2) allocation based on direct charging of specifically identifiable costs and allocating the rest to overhead accounts and (3) allocation to normal overhead cost pools.

♦ Other Manufacturing Rates

Spare Parts. To price spare parts more accurately, you may want to pool costs associated with handling, packaging, shipping, storing spare parts and allocating them on such bases as cost of spare parts or number of items shipped. In selecting a base, you need to consider circumstance – if number of items on an order can vary widely inequities can result if the allocation base is number of shipped items.

Field Service Pools. When field or customer services at off-site locations are significant and especially when such activity for different products or projects are unequal then one or more field service cost pools may be necessary including training of customer personnel, warranty repairs, liaison with operating personnel as well as fully burdened labor costs including allocations of fringe benefits, facilities costs, etc. The allocation base is commonly direct labor dollars or hours.

Process Cost Pools. Sometimes costs are accumulated by the various processes a product goes through before completion rather than on a job or contract basis. Indirect costs not identified with a process must still be allocated to output or equivalent units under the full-absorption concept of government accounting. Though a direct labor base is commonly used, rates can sometimes be quite high especially when the labor component is small. Alternative allocation bases might be machine hours, units of output or product cost.

Service Cost Pools

In addition to actual manufacturing activities, services are often provided within both services and manufacturing firms. For example, an engineering group may provide production and design services. When the costs of these services are included in indirect manufacturing or service overhead pools, they can lead to problems with government auditors and customers who are seeking the lowest possible price. For example, if an indirect manufacturing pool includes both manufacturing and engineering services, a direct labor dollar base could assign a disproportionate amount of indirect costs to engineers due to their higher salaries. The government might object if a government contract receives a high amount of allocations due to an unusually high use of engineering services. Allocating excessive indirect costs to engineering services could result in non-competitive prices for contractors seeking government business. The solution might be to accumulate engineering expenses into a separate pool (or even multiple pools for, say product, design and software engineering) if the resulting rates would be significant.

Or, consider a service firm with multiple offices. If the government furnishes office space, utilities or supplies it would be inequitable for facilities costs to

be included in an indirect cost pool and allocated to contracts for which the government furnishes some or all of these things. Not only would the government object to being overcharged but the contractor would likely not be cost-competitive when trying to win new business. In this case, it is quite common for contractors to keep two types of indirect costs: (1) indirect cost pool(s) at the home location and (2) indirect cost pools at the sites of specific customers. Overhead costs (we will get to G&A costs later) common to all contracts would be accumulated at the first category and costs specific to particular sites at the second category. For example, the home site pool might include rent paid for the home-office space plus fringe benefits for all indirect home office employees while the customer specific site might include no rental costs but all fringe benefits of indirect employees working at that site.

The allocation base for the services we have been discussing is usually direct labor hours or dollars. This is consistent with CAS 418 which prefers use of a labor allocation base when the indirect costs consist of management or supervision activities. Either a labor dollar or hour base is appropriate and if the benefits outweigh the effort, two separate pools – one with a labor dollar and the other a labor hour – may be used. Few other bases are usually appropriate though one variation might include fringe benefit costs of direct employees in the direct labor dollar base. Though the amount of costs allocated to a particular contract would most likely not be significant, it would have the cosmetic appeal of a lower indirect cost rate.

Fringe Benefit Pools

Fringe benefit costs include payroll taxes, pension contributions, medical plans, life insurance, employee welfare, etc. Often fringe benefits are not segregated in a separate pool but simply accumulated with other indirect costs. For example, the fringe benefits for both direct and overhead labor are accumulated in an overhead account and the fringe benefits for G&A labor accumulated in a G&A pool.

Whether it is to appear to lower indirect rates, focus management attention or achieve a higher level of precision, contractors may often decide to use a separate fringe benefit pool. Use of a direct labor dollar base is not uncommon even though it is rarely precise. Unless multiple fringe rates are adopted (which is quite rare) everyone becomes accustomed to some level of imprecision since some benefits vary according to the number of employees (e.g. fixed medical insurance per employee) while other benefits vary according to salary (e.g. pension costs based on employee earnings).

Multiple fringe benefit rates may be desirable when fringe benefit rates vary significantly between groups of employees. Common examples include varying state related taxes (unemployment, workers compensation) or different union agreements between sites. Probably the greatest incentive for more sophisticated treatment of fringe benefits is the increased use of less than full time employees. Full time employees may receive all fringe benefits while other less than full time employees may receive a limited range of benefits – say vacation and taxes but no health benefits or pension and still others (sometimes called "variable" or temporary employees) may receive no fringe benefits except payroll taxes. One solution might include accumulating fringe benefits in layers or tiers where the first pool would consist of only statutory benefits applicable to all employees, the second pool would consist of benefits applicable to the less than full time employees and the third pool to variable employees.

Support Pools

Both manufacturing and service firms have a wide variety of potential support pools. Rather than include support costs in overhead pools and crediting the cost portion of revenue to the pools when they are charged to contracts, contractors can eliminate both the associated costs and revenue of certain support functions from overhead and G&A pools and treat them separately in service centers. Some of the more common support pools include:

Occupancy costs. Occupancy costs include building depreciation, amortization of leasehold improvements, maintenance costs, utilities and other related costs. The occupancy pool is usually an intermediate pool that is allocated to other indirect cost pools rather than directly to final cost objectives. Square footage is the most common allocation base. Though less common, number of employees (when area and type of space used by each employee is similar) or cubic space (when utilities costs are significant and areas with high ceiling use more than those with low ceilings) can be used when the basis is reasonable.

Computer Operations. The costs include computer operations for equipment, supplies and personnel and are commonly associated with (1) business applications such as accounting and payroll or (2) scientific or engineering applications. A large computer operation might justify creating two pools

where accounting functions could be charged to G&A and scientific functions charged to cost objectives that benefit most. Selection of appropriate allocation bases for the second type of costs can be problematic – use of computer time can be difficult because computers process several jobs at once while other traditional usage measures (e.g. central processing time, number of input or output channels, amount of core storage, number of lines printed, number of records handled) need to be carefully selected and monitored and may have less relevance these days.

Other Support Services. Other frequently used indirect cost pools collect a wide variety of service costs. Common examples include: (1) reproduction cost pools consisting of costs of copying machines, machines operators, supplies allocated on copies made (2) graphics, art and photographic departments allocated on items produced (3) communications costs such as telephone, cell phones, etc. allocated on headcount (4) vehicle related expenses allocated on mileage. In addition, special facilities (e.g. wind tunnels, heat treatment, environmental chambers and microelectronic centers) are also common and a usage allocation base such as time spent or number of items processed are usually preferred by auditors over labor bases.

Charge Rates. In the past, the government preferred that all costs in each support center be allocated to benefiting users using a provisional rate that was adjusted at year end for actual costs by charging or crediting the center's costs for over or under allocations. Methods used to accumulate pooled costs and allocation bases have always been a major bone of contention between auditors and contractors so establishing charge rates using commercial prices has gained in popularity. This is generally acceptable as long as contractors can show their costs are similar or above commercial costs.

General and Administrative Pools

G&A costs, sometimes referred to as the remaining costs, are those expenses not identifiable with particular cost objectives but necessary for the overall operation of a business that include the costs of management, legal and accounting, business taxes, selling and marketing and similar costs. In a corporate structure, the firms' G&A expenses may consist of costs at the business unit as well as allocations from the group and corporate level. G&A expenses are allocated based on some measure of the activities of the entire organization. CAS 410 states the preferred bases are the total cost input base, the value added base (excluding material and/or subcontracts) or a single element base (commonly direct labor).

WHAT COSTS CAN BE ADDED WHEN CONTRACTS ARE ADJUSTED FOR WAGE INCREASES

(*Editor's Note. When we report on recent cases in the GCA REPORT we occasionally state we will elaborate on the case later in the DIGEST. This is one of those instances. The following case clarifies what costs and profit can be added to increased wages and fringe benefits when contract price adjustments for such increases are made such as for contracts covered by the Davis Bacon Act (DBA) or the Service Contract Act (SCA*)

Yates had a contract to construct an office building where it awarded a fixed price subcontract to KenMore for electrical work. The prime contract required Yates to pay applicable DBA wages and to include DBA standards in its subcontracts. During a government audit by the GSA they found a revised wage determination for electricians issued by the Labor Department should have been incorporated in a contract mod where as a result the contracting officer was told to modify the contract to incorporate the proper DBA wages retroactively to the time of award in August 2005. Another mod directed Yates and its subcontractor to pay their workers in accordance with revised wage determinations both retroactively and prospectively. Shortly after, Yates submitted a request for equitable adjustment (REA) for approximately $1.4 million to account for the past and future impact of the revised wage determinations. Citing the changes clause at FAR 52.243-4, the REA included costs for its actual higher wage costs for both hourly rates and hours worked plus an allowance for overhead and profit for the entire contract period. Citing the Price Adjustment clause at FAR 52.222-32 (which the CO acknowledged was not actually incorporated in the contract) and FAR 22.404-12 the CO rejected Yates' request for overhead and profit. The CO also refused to compensate Yates for any adjustment based on the actual number of hours the contractor incurred for performing the contract, insisting that any REA should be based only on the number of labor hours included in the contractor's initial bid (adjusted for any change orders). The CO reasoned because it was a fixed price project the contractor would have received payment for only the

labor hours assumed in its bid where the government would not be responsible for paying for those hours had there been no increase in wage rates. Both Yates and KenMore disagreed with the price adjustment offered by GSA and submitted a certified claim.

In its appeal, Yates provided evidence that the increased costs for which it sought recovery represented the baseline difference between the wages paid under the contract as awarded and the increased wage rates it was required to pay following adoption of the revised wage determination. The claimed costs were based on the incremental increase in the wage rate, plus labor burden, overhead and profit because the clause allows for these additions. Yates asserted the retroactive application of the current wage rate was accomplished by a modification under the contract Changes clause and therefore it was entitled to a price adjustment that reflected its actual increased cost of performance for all hours worked plus overhead and profit. The government disagreed saying the contractor's recovery must be limited to costs attributable to increased wage determinations based on the labor hours estimated by the contractor in its bid and that markups such as overhead and profit are not permitted for changes to the DBA minimum wage. The government said that because FAR 52.222-32 precludes recovery of overhead and profit for complying with revised wage determinations the REA should apply only to wage rates only. The government also asserted that the changes clause, which was not included in the contract, should nonetheless be read into contract by operation of law in accordance with the Christian document. (*The Christian doctrine states that if certain clauses are not physically included in a contract they should nonetheless be considered included if they are considered to be operation of law or a mandatory clause.)*

The Board sided with Yates and disagreed with the government. First, with regard to whether the Price Adjustment clause at FAR 52.222-32 should be read into the contract, the Board explained that since the award of the construction phase of the contract was a stand-alone contract award (as opposed to the exercise of an option) any limitations on recovery found in FAR 22.401-12 or the Price Adjustment clause would not apply so it did not need to address the Christian doctrine. The Board noted the clauses cited by the government "clearly apply to the exercise of an option to extend the term of a contract." No such exercise existed here.

Second, because the wage revision was incorporated under the auspice of the Changes clause (as opposed to the Price Adjustment clause) Yates was entitled to recover overhead and profit. Under the Changes clause such recovery is routinely included to "make the contractor whole" and under the FAR Part 31 cost principles the contractor's increased direct wage and fringe benefit costs must bear their pro rata share of indirect costs allocated under generally accepted accounting principles. Here, just as another case held for SCA wage determinations, DBA increased wages incorporated in a mod under the changes clause entitled the contractor to an adjustment for applicable indirect costs and profit.

Finally, the CBCA held that the appropriate basis for any adjustment was the wage increase applicable to the actual number of labor hours, not the proposed number of hours. The Board rejected the government assertion this would lead to a windfall for the contractor. Whether the planned hours were more or less than the actual hours was immaterial – both parties agree that the actual hours were reasonably devoted to the project. "Payment of the incremental costs for all hours worked leaves the contractor's profit or loss unchanged" and leaves the contractor "in the same position it would have been but for the revised wage determination."

So the Board held Yates was entitled to recovered increased costs, including overhead and profit, for the actual hours worked, whether included in the planned hours or not (*W.G. Yates & Sons Constr. Co., CBCA 1495, Dec. 21, 2010*).

DOCUMENTATION REQUIREMENTS FOR PROFESSIONAL SERVICES COSTS

(*Editor's Note. Next to executive compensation, professional services is the most common area of audit scrutiny. In our consulting practice and feedback from subscribers we are coming across a lot of "creative" questioned costs in this area that is mostly focused on "inadequate documentation" so we thought it would be a good time to concentrate on what the FAR and DCAA guidance considers to be adequate documentation of consulting costs. We came across an interesting article in the Government Contracts Consulting report that triggered our interest where we have used that article, several other articles and texts we have seen over the last couple of years, DCAA audit guidance and our experience as sources for this article.*)

For a long time, reviews of documentation for professional services have focused mainly on the sufficiency of the documentation to show that unallowable activity was not performed. Such unallowable activities have traditionally included lobbying, organizational costs, advertising or other circumstances spelled out in 31.205-33(a) such as restrictions of using protected data, improperly influencing the award process or "improper business practices or services outside the scope of agreed to services." So reviews demonstrating documentation requirements are sufficient to show these unallowable activities are not being performed have been transformed to focus on the sufficiency of the documentation itself. If documentation requirements are deemed not to have been met and the corresponding professional services costs are questioned, these days they are considered to be expressly unallowable where additional penalty and interest fees are being sought.

FAR 31.205-33(f) addresses documentation requirements for identifying the nature and purpose of allowable costs incurred for consulting and other professional services expenses. The FAR states that fees for these costs are allowable only when supported by evidence of the nature and scope of services provided. Necessary evidence includes:

1. Consulting arrangement details such as work requirements, compensation and nature of other expenses

2. Invoices and billings that identify in sufficient detail time expended and actual services provided

3. Consultants' work products and related documents such as trip reports.

Some clarification of the practical meaning of these three elements are:

1. Consulting arrangement. The cost principle does not prescribe in-depth requirements of the terms and content of a consulting agreement stating it should be left up to the parties to use good judgment where adequate practices of the commercial marketplace should lead. At a minimum, the consulting arrangement or agreement must have sufficient information describing the agreed-to services and consulting compensation terms. Whereas many consulting agreements are purposely open-ended to allow for a large variety of specific advice we have seen auditors question certain elements of an invoice as not being included in the agreement. Many commentators emphasize the government, usually meaning the auditor, should avoid interjecting its own personal preferences in what they believe the consulting agreement should include and should stick strictly to the requirements in FAR 31.205-33. For example, a consulting agreement for compliance cost and pricing services should allow a contractor the flexibility to seek brief guidance from the consultant when needed. Such an agreement should not attempt to identify every possible consulting service the firm may deliver. Similarly, with legal services, where general legal services will be identified in the agreement and a specific phone conversation on say a patent discussion should not be disallowed because it is not specifically mentioned in the agreement.

2. Time expended shown on invoices for actual services performed. The documentation requirement stating invoices will show time expended does not necessarily mean invoices must display consulting hours actually incurred by each consultant on a daily basis nor does "actual services" mean invoices must show all details of consultants' daily work. Time expended may be number of work days, weeks or other groupings of time and may be identified by groups or categories of professionals. However, labor costs should be segregated from other categories of costs such as travel. The key time identified should allow auditors visibility of actual effort performed and billed so the value and reasonableness of amounts billed for those services can be determined. As for "actual services performed" an invoice may refer to a more detailed outline of a consultant's activities for the billing period using another document (e.g. worklog by task) but such a daily account of all activity performed in a given day is not required by the FAR, especially when daily activities may be diverse.

3. Work Product. Requirements for work product varies. If a defined work product (e.g. incurred cost proposal) is promised in a consulting agreement contractors should ensure these deliverables are provided and meet the specific details described in the agreement. However, many consulting activities do not result in specific work products when on-going help is needed and communications by meetings, emails, telephone conferences, etc. occur but do not result in specific work products. DCAA guidance recognizes these situations and they should accept descriptions contained in consultant invoices that work was performed.

Retainer agreements. Many professionals (including our firm) maintain retainer arrangements where a set amount of hours and dollars are specified in the agreement for the consultant to provide and the contractor to pay. DCAA audit guidance recognizes that retainer agreements may not have detailed work statements nor are such agreements required to provide that level of detail. We are beginning to see DCAA auditors taking the position that all FAR 31.205-33 requirements apply to these retainer agreements where they are questioning invoices that normally do not disclose detail services performed or provide virtually no report of time expended other than a flat amount identified for a month, referencing the original agreement, with no description of services billed.

DCAA Guidance

Much of the problems encountered by contractors when their consulting costs are audited lie in the vagueness of these terms "nature of expense", "work product", "time expended", "actual services provided", etc. Depending on the auditor and the agency they are providing audit services for, the interpretation of these terms can be very strict to very loose. For example, some auditors may expect to see work product for every hour expended while more lenient interpretations may realize that a written report may not be necessary for the type of consulting activities purchased.

DCAA Contract Audit Manual (DCAM) in Chapter 7-2105 provides auditors some guidelines on assessing consulting costs. It recognizes that auditors must be "reasonable" in assessing the adequacy of documentation that meets the FAR criteria. For example, auditors are told they "may not substitute their judgment for the explicit documentation requirement." It further states "although a work product usually satisfies this requirement (work performed) other evidence may suffice." So this section clearly shows that auditors "should not insist on a work product" meaning that if a work product is not provided auditors may rely on other information demonstrating services provided.

DCAA guidance states that after March 1990 the regulations became more specific as to required documentation whereas earlier regulations only generally referenced adequate evidence. They state that after 1990, fees for actual services performed, including retainer agreements, must be supported by the three elements identified above – details of agreements, invoices and work product. The guidance states three criteria should be considered – sufficiency, competence and relevance.

a. Sufficiency. Auditors are to use their judgment to determine what evidence is considered sufficient. Examples of what would be considered to justify sufficiency includes statements of actual work, invoices, work product, trip reports, meeting minutes, collateral memorandums and evidence of company actions in response to consultants' efforts. If there is no work product, then the auditor is told to look for other evidence such as actual work, invoices and or consulting agreements; if work product does exist, an invoice alone may be sufficient.

b. Competence. When considering whether the evidence is competent, the auditor is told to carefully consider whether reasons exist to doubt its validity or completeness and if doubt does exist, he should seek additional evidence. For example, if a statement of work is prepared after the fact then additional evidence should be found or if no work product exists, then some form of third party verification (e.g. a statement from the consultant or contracting officer) should be sought.

c. Relevance. The auditors are told to ensure that either original evidence or corroborating evidence is relevant. For example, if there is no work product and additional evidence is needed, an expired two year old agreement is not relevant to the current year while a statement of actual work from the consultant will be relevant.

DCAA places the burden of providing adequate evidence on the contractor. If the auditor decides the claimed costs need additional support they are to notify the contractor, provide a reasonable time to respond and then to disallow the costs if no evidence is provided. The auditor is told not to attempt to obtain the additional data themselves such as requesting professionals to provide statements of work.

WHAT IS COMPETITION?

(*Editor's Note. We are encountering in different contexts the need to clarify what is and is not competition. For example whether or not a contract is subject to the Truth in Negotiations Act often hinges on whether there was competition in awarding a contract. Or, we have been conducting cost impact analyses to determine which contracts are affected by a CAS non-compliance or an accounting change (the latter often applies even to non-CAS covered contractors) where a competitive award is exempt from such cost impacts. Or finally, increasing scrutiny over contractors' purchasing system is making proper competitive procurements a major area of scrutiny. In making these*

determinations to help us decide what is and is not a competitive award, we needed to research what the FAR and CAS consider competitive awards and we were glad to come across two insightful articles on the issue - the May 2011 issue of Contracts Management by Bryan Fekber who is a purchasing manager of Kratos Defense and Security Solutions and Verne Edwards in the May 2008 Briefing Papers.)

The government's desire for promoting competition is a long held desire where both the FAR and DFARS address the variety of requirements, considerations, methods and exemptions to competition. Once an award is contemplated contracting officers seek to impose competitive requirements on seeking prime and subcontracts where FAR 52.244.5, Competition in Subcontracting is included in all terms and conditions where the contractor must "select subcontractors (including suppliers) on a competitive basis to the maximum extent possible." FAR Part 2 defines full and open competition "as a competition in which all responsible sources are permitted to compete. FAR 15.403 says an adequate price competition exists "if two or more responsible offerors, competing independently, submit priced offers meeting the governments expressed requirements." When the government conducts a CPSR one of the elements reviewed is an assessment of the contractor's "extent of competition" defined as the amount of effort expended to obtain adequate price competition (ranging from 2.3 to 3 responsive bids).

The Competition in Contracting Act of 1984, which is implemented in FAR Part 6, requires cOs to obtain full and open competition when soliciting offers and awarding contracts that are expected to exceed the simplified acquisition threshold. This term "full and open competition" when used for a procurement means that all responsible sources are permitted to submit sealed bids or competitive proposals on the procurement. Full and open competition is achieved through the use of competitive procedures which CICA defines as "the means under which the head of an agency enters into a contract pursuant to full and open competition."

COs need not obtain full and open competition when using simplified acquisition procedures, negotiating a contract mod within the scope of the original contract, exercising a priced option that was evaluated as part of the competition leading to the contract or when placing orders against requirements contracts or definite quantity contracts including a task or delivery order if the contract was awarded after full and open competition.

CICA does not apply to subcontract awards and government contractors are not required to obtain full and open competition when awarding subcontracts. Rather, the clause at FAR 52.244-5 requires contractor to select subcontractors competitively "to the maximum practical extent consistent with the objectives and requirements of the contract." CICA also permits exclusion of certain firms to preserve or enhance competition, to service certain government purposes and to help certain classes of firms such as HUBZone, small businesses concerns, etc. However, after exclusion of certain firms then the CO must obtain full and open competition among those permitted to compete.

In our opinion, one can argue that a subcontract award was a competition if other competitive conditions discussed above apply e.g. seeking three quotes... It would seem pretty clear whether competition existed when it involved two or more companies competing against each other for a contract. Finding potential sources to solicit is done through market research. After this how to you then promote a competitive situation? It usually begins with a request for a competitive quote or proposal. Without specifying you are seeking competitive quotes, the offeror cannot know with certainty that they are in a competitive situation. If you have purchased from them in the past they may assume you are doing so again and not offering a competitive quote. In a RFQ it is necessary that criteria be stipulated against which offerors will be competitively evaluated. Most often award will be based on best price but other factors may be used such as schedule, technical competence, past performance, etc. At a minimum you would need to solicit two, preferably three responsive offers in keeping with the 2.3 to 3 responsive bids criterion. Additional bids may be made to ensure these bids are received, especially when there is reason to believe some sources may not provide a bid.

What is Not Competition?

Catalogue pricing is an ambiguous situation. TINA and CAS explicitly list catalogue pricing as an exemption from these two regulations. However, CICA does not consider comparing published pricing such as catalogs as necessarily competitive since though a degree of competitiveness can be asserted, these prices are closer to standard pricing which may not reflect the most competitive prices in a truly competitive situation. For example it is quite common to offer discounts for a variety of reasons or special pricing to special customers. Rather, competitive

pricing must involve requesting competitive quotes. Though not necessarily competitive such published pricing can be helpful during price analysis where competitive pricing does not exist.

It is a false belief that if quotes are obtained from multiple suppliers in response to a competitive request that a competitive situation always exists. A special case applies when the item being purchased is a brand name, a part number or model number that is tied to one ultimate product. For example, if someone asks you to purchase an HP computer and you go to several stores and request and receive a quote that is not considered a competition but because an HP computer is specified, it is considered to be a sole source purchase. To have competition you would need to request competitive quotes based on attributes common to more than one producer. In the case of the HP computer, you must specify a computer of a certain size and weight, amount of memory and hard drive space, speed of processor, etc. None of the parameters can be unique to one model or brand of computer. With these specifications in hand, the offerors can propose whatever brands they sell that meet the specified criteria in which case you would have a competitive acquisition.

CICA recognizes seven circumstances when it may be impossible or impractical to obtain full and open competition: (1) when there is only one responsible source (2) an unusual or compelling urgency exists (3) it is necessary to award a contract to a particular source to maintain a capability to supply or establish as essential technical capability (4) competition is precluded due to an international agreement or treaty (5) statue requires an agency to buy certain supplies or a brand name is needed for authorized resale (6) disclosure of an agency's need may compromise national security or (7) the head of an agency determines it is in the national interest and notifies Congress in writing.

RECENT DECISIONS ON TRAVEL AND RELOCATION EXPENSES

(*Editor's Note. The following continues our effort to present new changes or decisions likely to affect contractors' travel expenses. Though only three parts of the Federal Travel Regulation explicitly applies to government contract employees – per diem rates, definitions of meals and incidentals and justification for payments up to 300% of per diem rates – many contractors choose to following federal travel regulations or certain contracts call it.)*

A Determination Must be Made Before a Refusal to Pay Travel Benefits is Made

May accepted a new position in St. Louis where he signed a customary 12-month service agreement stipulating that he will reimburse the government his moving expenses if he fails to remain in government service for 12 months. A family emergency prevented his move where he requested a 12 week leave without pay after which he resigned at the urging of his department so the government could recruit another person. The agency sent him a bill of $32,397 for the moving expenses asserting May had breached his service agreement by failing to report for duty. The Board confirmed the service agreement and the statute it was based on did, in fact, provide for reimbursement of relocation expenses if the 12 month period was not met unless the employee is "separated for reasons beyond his control that is acceptable to the agency." The Board noted it had previously ruled that agencies have considerable discretion in deciding whether to collect the debt after looking at the "particular circumstances presented by the claimant." Here, the Board found the agency never made a determination of whether May's separation from service was for a reason beyond his control and acceptable to the agency but rather simply stated the debt was owed because May failed to report for duty. Finding no proof such a determination was made, the Board ruled the bill sent to May was invalid (*Donavan May, CBCA 2188-TRAV*).

Withholding Tax Overpayment May be Recouped in Year 2

(*Editor's Note. Recent changes to the Relocation cost principle provides for the allowability of payment of taxes for the increased income related to reimbursement of travel costs. This provides an insight into proper computation of it.)*

As part of his relocation package, Bittorf received $4,338 to cover income taxes associated with taxable income he gained during his permanent change of duty. The following year Bittorf filed a relocation income tax allowance voucher in accordance with his agency's relocation policy where the agency found it had overpaid the withholding tax. Whereas it had used a 25 percent tax rate in its computation, it found it should have used a 19 percent rate yielding a payment of $3,060, asking Bittorf to repay the overage. The Appeals board agreed citing FTR 302-

17.9 that states an agency may calculate a withholding tax allowance as an estimate whereas in Year 2 the employee submits an RIT claim and if overpayment was made, can claim the overpayment (*George W. Bittorf, CBCA 2053-RELO*).

One Month Rent Waiver Does Not Waive Lodging Reimbursement

Beeman accepted a long term temporary duty assignment to Washington DC where he agreed to receive a reduced per diem rate of 70 percent. On Aug 30 he entered into a 12 month lease where he received the first month's rent free and when he submitted his travel voucher for September his agency denied the lodging portion of the claim asserting his rent for that month was free. The Board sided with Beeman ruling that FTR 301-11.14 prescribed the method of computing lodging reimbursements as calculating a daily rate by dividing the total cost by number of days of occupancy and adding other lodging costs such as utilities and furniture rental which may be reimbursed up to the 70 percent reduced rate for lodging (*Richard Beeman, CBCA 2324-TRAV*).

Inexperienced Travelers May be Reimbursed for Improper Expenses

Ronnett, the wife of a government employee, was given permission to fly to and from Seattle to Chicago to care for her husband who had a heart attack during his travel. After receiving permission to fly where she was told she would be reimbursed for her ticket purchase, she used her travel mileage credits to buy the airline ticket and sought reimbursement of $1,700 for the value of the award miles. Though highly sympathetic to her, the agency came across a Board case that found agencies do not have the right to reimburse employees the "value" of award miles but rather only actual cash paid for the tickets. The Board agreed, stating though no statute or regulation addressed the issue, the Board did rule the value of award miles could not be reimbursed due to problems of control and accountability, difficulty in establishing value and lack of statutory guidance. However, it did find another way to reimburse Ronnett. It cited FTR 301-51.102 that allows for a new employee or invitational or infrequent travelers who are unaware of proper procedures may still be allowed reimbursement for the full cost of transportation. The Board determined that the regulation would apply to Ronnett as an "invitational traveler" who was unaware of the federal procedures where the circumstances "warrants some flexibility" (*Ronnett Megry, CBCA 2240-TRAV*).

Safety Concerns Result in Allowable Reimbursement for Lodging Expenses

On her return flight home to Washington DC at 1:00 AM following an 18 hour day and suffering flight delays Diane decided to stay at a hotel at the airport rather than risk an accident driving home. Her agency refused payment but the Board sided with her. Though the JTR was clear that per diem may not be paid within permanent duty station limits, the Board noted an exception to the no lodging prohibition applies when bad weather poses a safety hazard. The Board ruled because of this precedent it felt the safety hazards following an extended work day involved similar hazards and allowed reimbursement for the hotel (*Diane Balderson, CBCA 42416-TRAV*).

New Employees Not Eligible for Some Relocation Benefits

Rafael was hired by the government in January 2009 where a year later he was still trying to rent or sell his home in Puerto Rico and rent or purchase a home in Maryland where he sought additional time to receive relocation benefits. The Board ruled against Rafael noting he is not eligible for those expenses. Citing the new-hire provisions in sections 5722 and 5723 of the U.S. Code, agencies are authorized to reimburse new hires for travel and transportation, temporary storage and cost of shipping goods but they do not provide new employees with reimbursement for the sale of residences at old locations or the purchase of new ones at the initial duty station. Those benefits, the Board ruled, are provided only to employees who are transferred in the interests of the government (*Rafael Arroyo, CBCA 2228-RELO*).

Oldie but Goodie…

NEW CLAUSE FLOW-DOWN REQUIREMENTS

(*Editor's Note. Most subcontract agreements we examine are outdated, based on models developed as far back as 1984. They are boilerplate agreements that do not reflect recent changes to the Federal Acquisition Regulations – in particular, all FAR mandatory "flow-down" clauses (clauses in prime contracts that must be included in all first tier subcontracts and usually lower tier). The Committee on Federal Subcontracting Section of the Public Contract Law group of the American Bar Association's usually updates their "Guide to Fixed Price*

Supply Subcontract Terms and Conditions" every few years but has not done so since 2005 so we are reissuing this article to reflect those last changes. It is intended to assist both prime contractors and subcontractors draft subcontracts for fixed price supply contracts (though it explicitly applies to "supply contracts" our inquiries to two members of the committee who wrote it said it generally represents good guidance for labor service contracts also). The mandatory list should represent a good education tool - a study of all the FAR clauses is a daunting task but since the mandatory list represents the "key" terms and conditions of doing business with the federal government they are a good area to focus your attention on. We have updated relevant dollar threshold changes since 2005.)

The Committee has identified all mandatory clauses it believes are necessary. The publication identifies the clauses for both government-wide and Department of Defense use, provides full text of them, offers other provisions that parties may want to consider including and subcontracting clauses for commercial items. We will limit this article to listing the new mandatory as well as the new, limited requirements for commercial items. You can receive the publication by calling the ABA Service Center at 1-800-285-2221.

The following provisions are now *mandatory* FAR Clauses:

52.203-6, Restrictions on Subcontractor Sales to the Government (Jul 1995). Applies to orders exceeding $100,000.

52.203-7, Anti-Kickback Procedures (Jul 1995). Applies if order exceeds $100,000.

52.204-2, Security Requirements (Aug 1996). Applies if subcontracts involve access to classified information.

52.211-5, Material Requirements (Aug 2000)

52.211-15, Defense Priority and Allocation Requirements (Sep 1990)

52.214-26, Audit and Records – Sealed Bidding (Oct 1997). This applies to prime contracts awarded by sealed bidding and to subcontracts that are expected to exceed $700,000 and require submission of cost or pricing data.

52.214-27, Price Reduction for Defective Pricing Data – Modifications – Sealed Bidding (Oct 1997). Applies if prime contract was awarded by sealed bidding.

52.214-28, Subcontract Cost or Pricing Data – Modifications – Sealed Bidding (Oct 1997). Applies if prime contract was awarded by sealed bidding and subcontracts exceed the threshold for submitting cost or pricing data ($550,000).

52-215-2, Audit and Records – Negotiation (Jun 1999). Applies if prime contract was awarded through negotiations, exceeds the simplified acquisition threshold of FAR 13 (currently $100,000) and required cost or pricing data.

52.215-10 and 52.215-11, Price Reduction for Defective Cost or Pricing Data (Oct 1997). Applies if the prime contract was awarded through negotiations.

52.215-12, Subcontractor Cost or Pricing Data (Oct 1997). Applies when prime contract over $700,000 was awarded through negotiation where certified cost or pricing data was submitted.

52.215-13, Subcontractor Cost or Pricing Data – Modifications (Oct 1997). Same conditions as 52.215-12.

52.215-14, Integrity of Unit Prices (Oct 1997).

52.215-15, Pension Adjustments and Asset Reversions (Oct 1997). Applies when any purchases will include cost or pricing data or any pre-award or post-award cost determination will be subject to the FAR cost principles.

52.215-18, Reversion or Adjustment of Plans for Post-retirement Benefits (PRB) Other than Pensions (Oct 1997). Same conditions as 52.215.15

52.215-19. Notification of Ownership Changes (Oct 1997)

52.219-8, Utilization of Small Business Concern (May 2004). Applies only if other subcontracting opportunities exist.

52.219-9, Small Business Subcontracting Plan (Jan 2002)

52.222-4, Contract Work Hours and Safety Standards Act (Sep 2000) – Overtime Compensation. Applies if this Order exceeds $100,000.

52.222-20, Walsh-Healey Public Contracts Act (Dec 1996)

52.222-21, Prohibition of Segregated Facilities (Feb 1999).

52.222-26, Equal Opportunity (Apr 2002). Only Subparagraph (b) (1) through (11) is mandatory.

52.222-35, Affirmative Action for Special Disabled and Vietnam Era Veterans (Dec 2001). Applies if order exceeds $10,000.

52.222-36, Affirmative Action for Handicapped Workers (Jun 1998). Applies if order exceeds $2,500.

52.222-37, Employment Reports on Special Disabled Veterans and Veterans of the Vietnam Era (Dec 2001). Applies to orders exceeding $10,000.

52.223-14, Toxic Chemical Release Reporting (Aug 2003). This applies if order is for noncommercial items and exceeds $100,000. Subparagraph (e) (flow down requirement below first tier) is excluded.

52.225-1, Buy American Act – Supplies (Jun 2003). Applies only is seller is supplying an item that is an end product under the buyer's prime contract.

52.225-3, Buy American Act – Free Trade Agreements – Israeli Trade Act (Jun 2004). Same condition as 52.225-1.

52.225-5, Trade Agreements (Jun 2004)

52.225-8, Duty Free Entry (Feb 2000). Applies to duty-free imported supplies in excess of $10,000.

52.225-13, Restrictions on Certain Foreign Purchases (Dec 2003).

52.225-15, Sanctioned European Union country End Products (Feb 2000). Applies only if the seller is supplying an item that is an end product under the prime contract.

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52.227-1, Authorization and Consent (Jul 1995).

52.227-2, Notice and Assistance Regarding Patent and Copyright (Aug 1996). Applies to orders exceeding simplified acquisition threshold.

52-227-9, Refund of Royalties (Apr 1984).

52.227-10, Filing of Patent Application – Classified Subject Matter (Apr 1984). Applies to orders covering classified subject matter.

52.227-14, Rights in Data-General (Jun 1987)

52.229-3, Federal, State and Local Taxes (Apr 2003)

52.233-3, Protest After Award (Aug 1996)

52.252-15, Stop-Work Order (Aug 1989)

52.242-17, Delay of Work (Apr 1984)

52.243-1, Changes-Fixed Price (Aug 1987)

52-244-6, Subcontracts for Commercial Items and Commercial Components.

52.245-2, Government Property (Fixed-Price Contracts) (May 2004)

52.245-18, Special Test Equipment.

52.246-2, Inspection of Supplies-Fixed Price (Aug 1996)

52.246-16, Responsibility for Supplies.

52.248-1, Value Engineering. Applies if order is valued at $100,000 or more while it is discretionary if valued at less than $100,000.

52.249-2, Termination for Convenience (Fixed-Price) (May 2004)

52.249-8, Default (Fixed-Price Supply and Service) (Apr 1984)

The following five clauses are considered mandatory for commercial item subcontracts. The FAR contemplates that parties will use their own commercial agreements as purchase orders.

52.219-8, Utilization of Small Business Concerns (if subcontract offers further subcontracting opportunities).

52.222-26, Equal Opportunity.

52.222-35, Equal Opportunity for Special Disabled Veterans, Veterans of Vietnam Era and Other Eligible Veterans.

52.222-36, Affirmative Action for Workers with Disabilities

52.247-64, Preference for Privately Owned US-Flag Commercial Vessels

The following two clauses, at a minimum, are recommended for review by buyer and seller under a commercial item purchase:

52.212-4, Contract Terms and Conditions – Commercial Items (Oct 2003)

52.212-5, Contract Terms and Conditions Required to Implement Statutes or Executive Orders –

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