GCA REPORT

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NEW DEVELOPMENTS

Clinton Issues the Contractor Responsibility Rule

In a belated nod to organized labor, the Clinton administration issued a highly controversial rule linking eligibility for federal contract awards to prospective contractors' record of compliance with various labor, tax and other laws. The rule is effective January 19, 2001 and will amend the Federal Acquisition Regulation.

The rule follows two previously proposed rules that would require contracting officers consider compliance with tax, labor and employment, environmental, antitrust and consumer protection laws when evaluating a contractor's responsibility. The adopted rule softens the two proposed rules by providing (1) COs should focus not on isolated violations but on "evidence of repeated, pervasive or significant violations" (2) a hierarchy of violations with greatest significance attached to adjudicated violations of law within the past three years and within this category to felony convictions, then adverse civil judgements brought by the US government and finally adverse determinations made by an administrative judge, board or commission (3) COs must consult legal counsel prior to making an adverse determination and provide contractors prompt notice of any adverse determination so that it can correct or supplement the record or protest under the Contract Disputes Act and (4) a prospective contractor check a box to certify it has or has not been convicted or indicted or had an adverse civil judgement against it and that further information be required only where the box is checked. In addition, FAR Part 31 cost principles will be amended to disallow costs incurred (1) for activities that "assist promote or deter unionization" or (2) in civil or administrative proceedings brought by a government where the contractor violated or failed to comply with a law or regulation.

Understandably, there has been an avalanche of opposition to the new rule from industry, Congress and even several government agencies claiming that attempts to tie eligibility for contract awards to compliance with various laws having nothing to do with procurement results in "blacklisting" or de facto debarment of contractors for reasons having no bearing on their ability to perform. Many groups have asked the new administration to nix the contractor responsibility rule.

DCMC Encourages Use of Roll-Forward Policy

The Defense Contract Management Agency has issued a memorandum encouraging contracting officers to use the "roll forward" technique to close out contracts when the allowability of significant amounts of costs cannot be resolved. The "roll forward" technique occurs when disputed indirect costs are set aside from an overhead claim and then rolled forward to a future year when the allowability of the costs can be determined conclusively.

The type of costs to be rolled over are limited to those that are dependent on a future event while it is inappropriate to defer a cost to a later year merely because it is difficult to resolve the underlying issue. Examples of appropriate roll over costs include legal costs related to a pending fraud action where the costs will not be allowable if the contractor is found guilty, environmental cleanup costs for which the contractor is seeking reimbursement from potentially responsible parties or insurance companies in which case the government will not reimburse the contractor, or when a CO questions certain costs and the contractor challenges the disallowance at an appeals board or federal court. An additional condition for a contractor rolling forward costs are that there is no material increase in costs to the government due to shifts in the number of flexibly priced contracts between when the costs were incurred and the period they are moved forward.

The memorandum also addresses two objections COs may have for using the technique: (1) appropriated funds for the fiscal year the costs were incurred may be cancelled before the disputed costs are resolved – the CO may usually move the costs to a subsequent period or they may invoke 31 USC #1553 that authorizes procuring agencies to pay the resolved costs from any

available appropriation account with the same purpose as the original expired account (2) cost accounting standards prevent reimbursing a cost that were incurred in a different period – CAS recognizes the validity of spreading costs incurred in one period over other years when, for example, restructuring costs and unfunded actuarial pension liabilities are amortized over future periods. The memo is similar to one issued by DCMC in 1997.

DOD Encourages Use of Performance Based Financing Payments

Noting that the Defense Department has been under-utilizing performance-based payments (PBP) – payments made after predetermined goals are met rather than costs being incurred – the Under Secretary of Defense for Acquisition Jacque Gansler released a memorandum setting goals for their use. The memo is in response to a final rule in the FAR Part 32 stating PBPs are the "preferred" method of contract financing that directs COs to use them unless "impracticable."

The memo reminds its readers that DOD has long had authority to use PBPs under sole-source fixed-price contracts while recent amendments to the FAR have removed prohibitions on PBPs for research and development and competitively negotiated acquisitions as well as permitting prime contractors with cost type contracts to use PBP on fixed price subcontracts. Rather than limit their use to "other transactions" that occur now, the memo sets goals of at least 25 percent of all contract financing payments by the end of 2002 for contracts exceeding $2 million and by 2005 PBP should be "the most prevalent form of financing used in fixed-price contracts."

The memo lists several advantages for both government and contractors including (1) focusing on meaningful technical progress (2) enhanced cashflow where PBP can be made for up to 90 percent of the contract or line item value as opposed to a maximum of 75 percent when progress payments are cost-based (3) expanded contractor participation since contractor's accounting systems need no longer be approved before payments can be made (such approval is required for cost-based payments) and (4) lower administrative expenses. The memo is available at "http://www.acq.osd.mil/ar/ar.htm".

DCAA Issues Guidance on Split Dollar Life Insurance

Contractors offer many forms of split dollar life insurance to senior executives and key personnel as inducements to remain in the company where plans call for a sharing between employer and employees of primary payments, cash values and death benefits (hence, "split value" insurance). Typically, the employer pays insurance on the employee's life insurance policy and takes a collateral assignment equal to the premium it pays. The employee still owns the policy and names their beneficiaries and if employment ends or the policy is terminated the employee is required to reimburse the employer for premiums paid. In addition, it is common to have a separate deferred compensation agreement providing the same employee with deferred compensation in the amount of the premium which is generally payable at the time the employee or beneficiaries are required to reimburse the employer.

The guidance reminds auditors that generally accepted accounting principles require contractors to recognize the entire amount of the premium as an increase in assets. Accordingly, the insurance premium does not represent an expense and hence should not be recognized as either a direct or indirect cost on a government contract. However, the cost of the deferred compensation is an allowable costs in the period the contractor pays the premium provided the cost is measured in accordance with CAS 415. CAS 415.40(b) requires the amount assignable to each period be the present value of the future benefits (i.e. premiums paid) which is measured by discounting from the estimated date of payments (frequently the retirement date). The discount rate is the same rate used to calculate cost of money rates.

ABA Group Favors GAAP over CAS Board's PRB Proposal

The American Bar Association has criticized a recent CAS Board proposal to create a new cost accounting standard (CAS 419) for treating post retirement benefit plans. The new proposal permits contractors to use accrual accounting following generally accepted accounting principles to recognize their PRB liabilities providing there is a firm liability to provide promised benefits if certain criteria for recognizing the liability are met. If these criteria are not met, the contractor would be required to use "pay as you go" or cash basis accounting. The ABA group asserts the proposal's criteria for accruing the liability is "virtually impossible" to meet resulting in the government avoiding or reducing contractors' recovery. Instead, the group is advocating that the Financial Accounting Standard's Board's Statement 106, "Employers Accounting for Post-Retirement Benefits Other Than Pensions" provides an adequate means of contract accounting for PRB costs.

ABA Calls For Amending CAS 415 to Account for ESOP

Responding to the Cost Accounting Standards Board's request for public input on accounting for employee stock ownership plans (ESOP), the Public Contract Law section of the American Bar Association called for modifying CAS 415 in order to account for leveraged and non-leveraged ESOP costs on government contracts. While FAR 31.215-6 treats allowability of ESOP contributions and the AICPA Statement of Position 93-6 address financial accounting treatment of ESOP, neither adequately address government contract accounting for ESOPs.

In a leveraged ESOP the employee stock ownership trust borrows funds to purchase shares of the employer's stock which are held in a suspense account. As employer contributions to the trust are used to repay the debt, shares are released from the suspense account and allocated to individual employee accounts. In a non-leveraged ESOP, the employer contributes cash or stock which is used to buy stock and the entire amount of the contribution is allocated to employee accounts by year end. Two issues have led to disputes over accounting for ESOP costs under government contracts where the primary driver of the disputes is whether a portion of the employer's contribution under leveraged ESOPs are disallowed because the trust uses some of the contributions to repay interest.

1. *Pension vs. deferred compensation*. One dispute is whether CAS 412, Pension Costs or CAS 415, Deferred Compensation, governs – under CAS 412 pension cost is measured by the entirety of the contribution even though a portion is used to repay borrowings whereas under current CAS 415, the government can argue the portion of the contribution used by the deferred compensation trust to pay interest should not be included.

2. *Distribution in cash vs. stock*. Under CAS 415-50(e)(1), which applies when the deferred compensation is in the form of stock, the interest payments would be disallowed while under CAS 415-50(d)(6), which applies when payment is in money, the interest portion would be allowed.

The ABA's solution is that the only appropriate measure for a contractor's ESOP costs is the amount of the contractor's irrevocable contribution to the ESOT, whether it is in cash or stock. To exclude any portion of this contribution, such as the deemed interest component, would be contrary to "full costing." If the full contribution is allowed there is no reason to make a distinction between "pension" and "deferred compensation" ESOPs. The group also believes the cost measurement date should be when the contractor makes a contribution rather than the SOP 93-6 requirement to measure the contribution when shares are released from the suspense accounts to individual employees. This avoids the need to have the government's participation depend on fluctuations in stock values.

BRIEFLY…

New Contract-Related Interest Rate Set for First Half of 2001

The Treasury Secretary has set a rate of 6.375% for the period January 1 through June 30, 2001. The new rate is a decrease over the 7.25% applicable in the last six months of 2000. The Secretary of the Treasury semiannually establishes an interest rate that is then applied for several government contract-related purposes. Among other things, the rates apply to (1) what a contractor must pay the government under the "Interest" clause at FAR 52.232-17 and (2) what the government must pay a contractor on either a claim decided in its favor under the Contract Disputes Act or payment delays under the Prompt Payment Act. The rate also applies to cost of money calculations under Cost Accounting Standard 414 and FAR 31.205-10.

DOD Encourages Use of Purchase Card for IDIQ Orders

Director of Defense Procurement Deidre Lee sent a memo throughout DOD encouraging defense agencies to use the governmentwide commercial purchase card for task or delivery orders if authorized in the basic contract, ordering agreement or purchase agreement. FAR 13.301 permits agencies to use the card to place service and supply orders under indefinite-delivery, indefinite-quantity contracts. The card is used to buy from vendors that accept credit cards and is used in the same way as credit cards.

Proposal to Make Signing and Retention Bonuses Allowable

The FAR Council is proposing to amend the Federal Acquisition Regulation to explicitly make allowable signing and retention bonuses offered by contractors to recruit and retain workers with critical skills. The treatment of such bonuses are often inconsistent and the proposal is intended to clarify existing regulations.

Interest Penalty on Cost Type Service Contracts Kicks in Dec 15

All cost-reimbursement contracts for services awarded after Dec 15, 2000 will require federal agencies to pay interest penalties whenever they make an interim payment more than 30 days after receiving a proper invoice from the contractor. Agencies have discretion to apply the rule to service contracts awarded before Dec 15. The rules amends OMB's Prompt Payment Act regulations and is intended to provide prompt payments to attract high quality contractors and lower prices of services.

Industry Challenges FAR Proposal to Require Subcontractor Payment Within 30 Days of Contract Billing

A federal acquisition regulation proposal that would give federal contractors only 30 days to pay subcontractors once they have billed the government for incurred subcontractor costs has generated considerable opposition from industry groups. The proposal follows elimination of the paid cost rule passed last March that required large contractors to pay their subcontractors before including those costs in billing the government. Industry representatives say such inflexible timing would negate the benefits from the paid cost rule abolition because many contractors have processes in place and terms and conditions with suppliers where payment of vendor invoices and contract billing exceed 30 days. Rather than impose inflexible timing industry recommends payment criteria be based on terms and conditions established between contractors and their vendors.

DOD Issues Guidance to Create a "New Environment" for Negotiating IP Contract Terms with Commercial Firms

Acknowledging the shift of technology leadership from the military to the private sector, the Defense Department has produced draft guidelines intended to create a "new environment" for negotiating intellectual property terms and conditions with commercial firms. The purpose is to encourage research collaboration between the commercial sector and DOD. The draft guide discusses the history of IP in government, summarizes the FAR and DFARS IP clauses, identifies current issues dissuading commercial firms from working with the government and seeks to provide detailed solutions to major IP issues facing CO and commercial contractors. The full text is at http://www.contracts.ogc.doc.gov/cld/othernews.html.

DOD Links Profit Margins to Technical Risk

A new rule amending the weighted profit guidelines used by the Defense Department to determine contractor profit objectives of negotiated contracts without competition adds an additional 4 percent to the technical risk range to reward contractors that develop or apply innovative technology. The final rule alters DFARS weighted guidelines in two ways. First, DOD has consolidated the current performance risk factors from three (technical, management and cost control) to two (technical and management/cost control). Second, DOD has added a separate "technology incentive" under performance risk – ranging from 6% to 10% (a minimum of 4% over the standard 2% to 6% range) – for acquisitions contemplating "the introduction of new, significant technological innovation." Innovation occurs when a contract (1) requires the development or application of new technology that fundamentally changes the characteristics of an existing product or system resulting in better performance or reliability or reduced costs and (2) the new products or systems contain significant technical advances over items being replaced. The new rules do not apply to efforts related to studies, analyses or demonstrations where the primary deliverable is a technical report.

CASES/DECISIONS

Government Owes Minimum Quantify Minus Actual Amount Ordered on IDIQ Contract

(Editor's Note. The following addresses how to quantify amounts owed when the government orders less than the stated minimum on an IDIQ contract. It is particularly timely since the government is now instructed to identify "realistic" needs as minimum quantities rather than low-ball amounts.)

The Army awarded Delta an indefinite delivery/indefinite quantity (IDIQ) contract to replace lumber at various facilities which obligated the government to order at least $200,000 worth of supplies or services and required Delta to retain sufficient capability to perform work at $3,000 per day. At the end of the contract the government placed only $86,000 in orders and Delta asked for the difference between the amount ordered and the $200,000. The CO offered $11,216 representing a "price adjustment" for a reasonable profit and reimbursement of G&A costs. Delta appealed.

Citing *Maxim Corp. v. United States*, Delta argued damages under an IDIQ contract were the difference between the minimum quantity and amount ordered. Citing *PHP Health Corp.* where the board stated PHP was not entitled to the dollar value of a minimum number of visits guaranteed and actual visits, the government contended damages are the amount the contract can prove it cost as a result of the failure to order the minimum amount. The Board ruled for Delta saying unlike the PHP case that guaranteed only a minimum number of visits, Delta was guaranteed a minimum dollar amount as long as it maintained the capability to perform $3,000 worth of work per day (which is did). Hence, Delta was entitled to the difference between $200,000 and the $86,000 paid (Delta Const. International Inc., ASBCA, No 52162).

Don't Sign Releases if You Want Additional Funds Later

With the intent to submit a claim, the contractor signed the standard release of all claims against the government reserving the right to submit an unspecified claim on the contract. When the contractor sought relief for $399,000 on a delay claim the CO denied all damages pointing out the company had signed the release which barred all claims. The appeals board denied the claim stating that contractors seeking money from the government on contract claims would be unwise to sign a "blanket" release without reserving specific amounts. The exception made by the contractor was too indefinite and did not satisfy the contractual requirement for claims to be specifically excepted and stated in a precise amount. The Board concluded that though contractors are not obligated to submit certified claims before signing a release if it believes it has incurred unjustified costs it should investigate the facts before signing rather than merely note a vague intent to file a claim (Eagle Asphalt & Oil Inc., IBCA, No 4173-1999).

Government Must Pay Bid Amount Even if Actual Costs are Lower

A contractor bid and won a fixed price contract to dredge shipping channels. The solicitation included a "bidding schedule" that identified several separately-priced line items including "bond costs." The contractor's bid for the bond costs was $275,000 which was intended to include $125,000 for bond premiums and other indirect costs. In its first payment request which included the bond cost item of $275,000, the contractor provided evidence, as required by the contract of paying the premium (about $125,000). The CO rejected $150,000 asserting it owed the contractor only the amount actually paid for the premium.

In its appeal to the Board, the contractor argued it was entitled to the entire lump sum bid for "bond costs" because the fixed price contract obligated the government to pay the entire contract price without regard to actual costs. The Board agreed with the contractor, finding that a fixed-price contract is not subject to adjustment for a contractor's actual cost experience. Otherwise, it would improperly convert one element of a fixed price contract to a "cost reimbursable" item (Bear Stuyvesant, LLC, ASBCA 52889).

Reimbursement of State Income Taxes by a Subchapter S Contractor is Allowable

A Subchapter S contractor, which "passes through" its income to shareholders, reimbursed its sole shareholder for the state taxes he owed and included the reimbursement as an incurred indirect cost on its cost reimbursable contract. The government questioned the cost citing FAR 31.205-41, Taxes asserting when a contractor pays taxes from which it is exempt the contractor will not qualify for reimbursement. The contractor responded that though the contractor is technically "exempt" from paying the state income taxes due to its S corporation status, this is not a tax exemption in the normal sense where an exemption results in a complete absence of the tax payment.

The Court sided with the contractor stating further that the tax liability is not exempt but is transferred to the corporation's shareholders in order to avoid "double taxation." The FAR does not require any specific part of a corporation to pay the state income tax to qualify for the exemption nor does anything in the FAR intend that certain types of organizations be denied reimbursement simply because of their tax election or corporate structure. Because the state income taxes were required to be paid and were paid and because the tax liability was not subject to reduction the state income taxes claimed by the contractor are allowed (Information Systems and Network Corp. V. United States, Fed Cl., No 98-663C).

Contractor Cannot Challenge Award Based on Agency's Past Performance Information Database

(Editor's Note. The following demonstrates the limit of challenging Past Performance information (PPI) and the importance of responding to adverse PPI notification quickly.)

An Army Corp of Engineers solicitation that would award a contract without discussion made past performance one of four technical evaluation factors. Each factor would be assigned a "go/no go" rating and

any "no go" would make the proposal unacceptable. PP ratings would be made by reviewing entries contained in the Corps' Construction Contractor Appraisal Support System (CCASS) database. Knowing the CCASS database contained three unsatisfactory ratings on prior projects, TLT protested the terms of the solicitation arguing it was "arbitrary and capricious" for the agency to rely on the CCASS database without providing offerors an opportunity to respond to the adverse PPI.

The Comp. Gen. denied the protest finding there were sufficient safeguards built into the database ensuring TLT had the opportunity to challenge erroneous information. The safeguards included notifying contractors of any unsatisfactory rating before the report was entered into the database and offering the opportunity to appeal a performance report above the CO level. Here TLT was notified of the performance ratings and given a chance to respond. Moreover, since they were given a chance to respond the Comp. Gen. ruled the agency was not required to provide TLT with further opportunity to discuss the information, citing FAR 15.306 (government negotiated contracts without discussions) that provides the offerors "may" be given opportunities to clarify certain aspects but leaving discretion to the CO who could decide not to communicate further after proposals were submitted (TLT Const., Corp., Comp. Gen. Dec. B-286226).

SMALL/NEW CONTRACTORS

Advance Agreements

From time to time we have alluded to the need to establish advance agreements with the government when it is necessary to change an accounting practice to either increase or decrease allocation of costs to an individual or group of government contracts. Where it used to be relatively infrequent we are now seeing a lot more agreements used by newer contractors who do not have approved government accounting systems but want to establish methods of costing claims or terminations at the beginning of a contract to avoid disputes later. Though our conclusions may differ, our inspiration for writing this article came from an article by Patrick McGeehin of the accounting firm Rubino & McGeehin written in the December 2000 issue of the Government Contract Report.

♦ **Regulation**

FAR 31.109 addresses advance agreements. It states such agreements should be established before costs are incurred to avoid confusion and clarify treatment of costs by a contractor. Advance agreements cannot make an otherwise unallowable cost allowable but is intended to resolve in advance differences of opinions on the allowability or allocability of specific costs. Though not exhaustive the regulation identifies sixteen specific cost topics that are good candidates for advance agreements. In our experience the following are most common: compensation, charges for depreciated assets, precontract costs, royalties and patents, selling and distribution costs, travel and relocation, idle facilities and capacity, severance pay, plant conversion, professional services, indirect costing methodologies, public relations and advertising and training.

♦ **Process**

So not to "muddy the water" advance agreements are usually not put forth before contract award but rather, after contract award but well in advance of either incurring the expense or reporting the cost (e.g. claims, terminations, incurred cost proposals, forward pricing rates for other contracts). A straight forward narrative describing how the cost(s) will be treated addressed to the appropriate ACO is the best approach. Justification for the treatment and allusion to the benefits for the government is advisable. The appropriate ACO is either the contractor's cognizant ACO or if the agreement affects only one contract then the ACO over that contract. Since it is the ACO's decision, I would not advise sending copies to other agencies such as government auditors unless their approval is likely. Though it is not uncommon to have DCAA review the proposal, we are finding it more common for the ACO to by-pass DCAA and in consultation with their price analyst, to make a decision. In its guidance, DCAA instructs its auditors to incorporate all advance agreements in its reviews but if they believe such agreements are "not in the government's interest" to express such an opinion in their audit report.

♦ **Examples**

For fixed price contracts usually awarded on a competitive basis, no cost and pricing data is submitted. Though many veteran contractors may have approved government accounting practices often committed to writing (e.g. disclosure statements, written procedures) more and more contractors do not so when it comes to presenting a claim or termination an advance agreement detailing contract costing treatment of certain costs is

advisable to avoid substantial questioned costs later. The authors suggest several cost categories that contractors will want to consider under such circumstances:

1. *Direct vs. Indirect Charging*. Though veteran government contractors have established criteria for direct and indirect charging, newer contractors and commercial subsidiaries of veteran contractors need to establish how, for example, computer services will be treated.

2. *Home Office G&A Rates and Pools*. Just about every contractor has their own unique ways of accumulating and allocating general and administrative costs (either at the business unit, intermediate home office or corporate level). Mark up, percentage or daily rates may need to be established for claims based on extra work, delays, etc. These rates can be established either before or after contract award and will largely avoid protracted battles about cost allowability and allocability issues later.

3. *Field Office Costs*. Overhead rates, often referred to as general condition costs for construction work and project support costs for non-construction work, are commonly recovered on both a percentage or daily rate concepts. Recent cases (e.g. *Mortenson*) have prescribed methods of calculating these rates – either percentage markup or daily rates, not both can be used – so advanced rates using either method can be established so one method used on a prior contract need not be the presumed method for all government contracts.

4. *Equipment Pricing*. Whereas the contract commonly specifies equipment or supply prices when in operation, costing idle assets can be a highly disputed matter for purposes of quantifying claims. Such disputes can be avoided by proposing rates for extra work or delayed work.

5. *Other Items*. Other items to consider for advance agreements include (a) fringe benefit rates (b) self insurance costs (c) overhead rates for one business unit or segment rather than for the company as a whole and (d) individual company rates when two or more companies are involved in a joint venture.

In addition to pricing items for contracts not subject to cost analysis there are the more traditional contracts requiring cost based data either for forward pricing or incurred cost purposes where advance agreement need to be considered. In our experience, each of the cost items identified above in the Regulation section should be considered for advance agreement. For example, DCAA will generally not recognize costs of idle facilities for longer than one year where such costs may need to be incurred longer or expensive literature used for disseminating information may be questioned as unallowable advertising expenses. The authors present some good candidates for advance agreements:

1. *Rate Structures*. Whereas proposed rates may be based on a business segment, the contractor may plan on performing most of the contract by a specific division or group within the segment having different rates. These differences may need to be specified in the contract or in a subsequent advance agreement. In addition, it may be advisable to establish a separate rate such as a subcontract administrative or material management rate for a contract where no such rates for other contracts exist.

2. *Rental Transactions*. Assets that were charged to government contracts on the basis of depreciation, maintenance, cost of money, etc. would be changed under circumstances where, for example, a sale/leaseback arrangement occurred where the assets would be charged on the basis of a rental agreement. In addition, arrangements where rental costs might be questioned because of perceived related party arrangements or unequal lease provisions (e.g. higher rents at end of lease) are excellent candidates for advance agreements.

3. *Compensation levels*. Though the FAR has established ceilings on executive compensation, DCAA commonly questions compensation levels for other individuals and classes of employees usually based on survey data. An advance agreement providing justification for levels of compensation likely to be disputed later can save a lot of work in this rather nebulous area.

QUESTIONS & ANSWERS

Q. We are a small business and are trying to decide whether to appeal a CO's decision. We do not think the recovery would be worth it after the effort and legal expenses but were reminded the government sometimes pays for the legal expenses. Could you let us know about the rules allowing recovery of these expenses?

A. You are referring to the Equal Access to Justice Act (EAJA) that provides a mechanism for small businesses or individuals to recover attorney and other costs incurred for litigation against the U.S. government. The entity may recover these expenses if the application is *timely*, demonstrates *eligibility*, proves it is a *"prevailing party"* against the government and the government cannot show it was *"substantially justified"* or if *"special circumstances"* make such an award unjust.

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Timeliness. Applications need to be filed within 30 days of a final disposition. If a settlement rather than decision is made, applicants should consult the court on when "final disposition" is considered to have occurred.

Eligibility. A business entity applicant must have a net worth less than $7 million and not more than 500 employees at the time proceedings were begun. An individual is eligible if their net worth does not exceed $2 million when proceedings began.

Prevailing Party. Applicants are considered prevailing parties if they succeed on any significant issue and achieve at least some of the benefit they sought. Thus less than total victory still qualifies an applicant. Also, an applicant is considered a prevailing party if it obtains a settlement in its case though not if it wins purely on a procedural issue (not on the merits).

Substantial Justification. To avoid payment the government must show "substantial justification" in pursuing its case in both fact and law. For example, in *EAJA of Steele Contractors* the Board found the government was substantially justified when the agency recognized the contractor was entitled to a claim and dollars, the agency was attempting to address the amount owed in spite of the contractor not providing adequate accounting data and unilaterally offered to compensate the contractor even though the Board found additional costs the contractor was entitled to. However, the fact there was "reasonable justification" is not enough to deny EAJA compensation.

Special Circumstances. The government may also avoid payment if it can show there were "special circumstances" such as the applicant misused the dispute or appeals process. Mere discourteous behavior has been held not to be sufficient to deny payment.

Amount of Recovery. If it survives all the above tests (which is quite common) the applicant can apply for legal fees and other costs incurred in connection with the dispute (e.g. expert witnesses). Currently, the EAJA award cannot exceed $125 per hour unless the agency determines an increase in the cost of living or special circumstances justify a higher fee. In addition, not all hours billed will automatically be paid – hours claimed may be reduced to an amount the forum deems is reasonable for the dispute.

Q. In neither our fixed price nor cost type contracts did we propose allocations from our corporate home office nor do we account for such costs in our books of account. How do we justify recovery of these costs on our contracts?

A. On your fixed price contracts, you are likely stuck since the costs were not included in your original proposal. Prices of additional work and termination proposals may include these costs in your indirect rates. On your cost type work you may claim these costs in your billings (when you adjust rates to reflect more current expenses) and your incurred cost proposals for settling indirect costs as long as the corporate home office expenses were actually incurred and are allocated to your business unit in an appropriate manner. As for not including them in your financial records, it is commonly recognized that "memorandum entries" may be used for costing government contracts even though the cost may not have been entered into the contractor's books of account. Examples that immediately come to mind are in CAS 403, Home Office costs and CAS 414, Cost of Money.

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