
GCA REPORT

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NEW DEVELOPMENTS

Recent Trends in Contracting

Some interesting contract developments have been highlighted in recent meetings between government and industry representatives.

Analysts are offering tips to maximize year-end contracting opportunities. A recent Procurement Conference led many participants to offer suggestions to help contractors prepare for the usual onslaught of fourth quarter government spending that typically takes up at least one third of annual expenditures. Advice includes asking program managers and contracting officers how a given contract has and has not met government needs to understand what requirements have not been met, what contract vehicles exist (e.g. IDIQ contracts) to take on more work and primes should see what vehicles exist for their subcontractors. The objective is to help buyers be able to contact and buy from you quickly. Consider obtaining a GSA federal supply contract if you don't have one or sign up for NASA's Solutions for Enterprise-Wide Procurement or if you are a subcontractor sign up at DOD's Information Analysis Center. Participants alluded to the 2010 Small Business Act that has led to a fourth quarter boom of business so make sure you respond to agencies' requests for information so they will know you for set aside work. Many agency buyers do not receive authority to issue funds until Sep. 15th so that means contractors should be prepared to respond quickly to incremental funding on existing work or new work up to the last day of the fiscal year. Also expect lead times to be very short, as little as two days on GSA FSS schedules. Finally, make sure email addresses are up to date to receive GSA electronic ordering and product lists are up to date on GSA Advantage to make sure your name comes up when agencies are conducting market research. Be aware that simplified acquisition procedures are likely to dominate (see below).

Agencies are increasingly turning to simplified acquisition procedures (SAP) to buy goods and services. SAP is detailed in FAR Part 13 which allow agency officials to expedite the evaluation and selection process for purchases at less than the simplified acquisition threshold which is

currently at \$150,000 for noncommercial items and \$6.5 million (to be increased to \$7 million in the next fiscal year) for commercial items. SAP is favored by government buyers because they lessen the procurement process and costs and by contractors that are provided opportunities to enter new markets.

Competition in federal procurement is at a 10 year high, making things harder for incumbents re completing for contracts according to a July 9 Bloomberg webinar. 69% of obligations in 2014 as opposed to 62% in 2006 were competed where 66% of incumbents lost recompetes compared to 43% in 2012. Reasons cited include urging by agencies to focus more on competition to ensure low pricing and small businesses are taking an increasing share of award dollars especially in multiple award contracts.

Large acquisitions are moving toward LPTA. Two new large acquisitions – the Defense Information Systems Agency Encore III and the Defense Logistics Agency J6 Enterprise Technology Services (JETS) – are using lowest-price technically acceptable evaluation methods. The use of LPTA favors companies with low labor rates where previous contracts did not use LPTA to select companies so more expensive incumbents can be expected to be unseated during these two acquisitions. Review of Encore III bids will first be sorted from lowest to highest costs and then, beginning with the lowest bids, will determine whether the bidder is technically acceptable. The agency will stop reviewing bids once it has found 20 acceptable small businesses and 20 technically acceptable businesses that submitted unrestricted offers (most likely large businesses). Those 40 will win awards which will allow them to bid on task orders during the 10 year contract. For JETS, DLA will use a best value, trade-off evaluation method to make initial selection for the \$6 billion in awards over six years and then have companies compete for task orders where a “large portion” will use an LPTA evaluation approach.

Following two decades of federal buyers increasingly turning to multiple award contracts (MACs) for goods and services some agencies are showing signs of MAC fatigue. Latest contract data is showing a subtle shift favoring definitive over indefinite delivery contracts (IDCs) and a move toward single award contracts over MACs where the implication is that contractors should be prepared to see work

previously performed on MACs to be recomputed as single awards. MAC usage fell in 2014 compared to previous years for IT equipment and professional services. Comments indicate MACs still have certain advantages (e.g. ability to compete task orders over several vendors rather than one, the IDC nature of most MACs allow breakdown of work into task and delivery orders). However, significant budget cuts in Iraq and Afghanistan have reduced use of IDCs and MACs where MACs are seen as being less selective because rather than soliciting bids from all comers they award orders to only a pool of preselected vendors. In addition, other perceived disadvantages are MACs charge a fee and they may force buyers to follow rules or limit the scope of requirements that may not meet agency needs.

Final Rules Are Issued

Several interim FAR rules have been finalized. They include:

1. *Inflation adjustment for acquisition related thresholds will be in effect October 1, 2015.* They include:

- a. The micropurchase base threshold is raised from \$3,000 to \$3,500.
- b. The threshold for using simplified acquisition procedures for commercial items is raised from \$6.5 million to \$7 million.
- c. The threshold for submitting certified cost or pricing data and the equivalent cost accounting standards threshold is raised from \$700,000 to \$750,000.
- d. The threshold for submitting a subcontract plan goes from \$650,000 to \$700,000.
- e. The threshold for reporting first tier subcontractor information including executive compensation is raised from \$25,000 to \$30,000.
- f. The threshold for incorporating FAR 52.203-13, Contractor Code of Business Ethics and Conduct is increased from \$5 million to \$5.5 million.

The threshold adjustments are required every five years (*Fed. Reg. 38293*).

2. *DFARS approval threshold for Time-and-Material and Labor Hour Contracts.* DOD's final rule establishes the level of approval required for a determination and findings (D&F) for T&M and LH contracts or portions of such contracts exceeding \$1 million at the senior contracting official level at the contracting activity. For T&M/LH contracts below \$1 million the D&F must be approved one level above the contracting officer. The D&F must also address why cost-plus-fixed-fee contracts are not appropriate (*Fed. Reg. 29980*).

3. *DFARS legal costs for whistleblower proceedings.* This DOD rule adds to the list of unallowable legal costs those costs that cover whistleblower proceeding commenced by a contractor or subcontractor employee submitting a complaint of reprisal under the applicable whistleblower statute. It will add a new clause DFARS 252.216-7000 (*Fed. Reg. 36719*).

DCMA Fails to Act on Contractors' Estimating System Deficiencies

The DOD IG reports that the Defense Contract Management Agency does not correctly report deficiencies in contractors' cost estimating systems. The DOD Inspector General office selected 18 deficiency reports by DCAA to determine whether DCMA contracting officers followed requirements for reporting deficiencies with contractors' systems of estimating costs according to criteria in DFARS 252.215-7002. Examples of deficiencies found include failing to follow a contractor's own estimating practices, consider relevant past experience, support cost estimates and eliminate duplicative costs. In 12 of the reports, COs didn't issue initial determination letters to contractors within 10 days of receiving DCAA deficiency reports and in nine cases, did not evaluate contractors' responses within 30 days and in all 18 cases did not issue a final determination on contractors' estimating system within 30 days of receiving responses. In five cases, DCMA did not withhold payments to contractors even though significant estimating system deficiencies remained. The IG report recommended refresher training for its COs. Commentators state a new DCMA Director will likely make correction of these deficiencies a priority resulting in more "determinations" of inadequacy including increased withholding of payments until contractors' systems are corrected. Contractors should review their systems for adequacy before they are audited. View the report at dodig.mil/pubs/documents/DODIG-2015-139.pdf.

DOD Proposes Guidance on Commercial Item Pricing

A DOD proposed rule would establish guidance for evaluating contractors' cost or pricing data other than certified cost or pricing data that would define "market-based pricing" and would discard "offered for sale" terminology. The rule would provide that market based pricing is the preferred way to establish a fair price in the absence of adequate competition. It would define market based pricing to refer to cases in which nongovernmental buyers drive the price of a product or service in a commercial market place. The proposed

rule states there is a strong likelihood that pricing is market based when nongovernmental buyers purchase 50 percent or more of the volume of a particular item on the commercial market. Comments on the proposal all state that the new rule eliminates the current “offered for sale” element in the definition of commercial item at FAR 2.101. By tagging price to actual sales it would “all of a sudden read out of the statute the term ‘offered for sale’” which is a key component. For example, a contractor might offer a cloud-based service that no customer has yet purchased where to establish market based pricing the contractor would have to show at least 50 percent sales of that service to nongovernmental buyers which would not be possible. “Offered for sale” is a very common element in services since there are so many variants it is rare to find one to be simple or standardized (*Fed. Reg. August 4*).

DCAA Issues Responses to Two Critical Executive Compensation Cases

The Defense Contract Audit Agency has finally issued their responses to two recent cases that stated their approach to evaluating executive compensation was “fatally flawed.” As we reported in prior issues of the GCA Digest, the JF Taylor and Metron cases severely criticized DCAA executive compensation audits where we have neither seen any changes to their approach in audits subsequent to the cases nor responses to the cases since they were issued. DCAA has finally issued a memo intended to present their position on the cases (actually only the JF Taylor case is addressed). The memo challenges the findings in the JF Taylor case, which we intend to present in detail in the next issue of the DIGEST, and concludes its approach is appropriate (*contact us to obtain a copy of this response*).

Proposed DOL Rule Will Change Who is Exempt from the FLSA

A proposed rule will significantly change the threshold for determining whether an employee is exempt from the Fair Labor Standards Act’s overtime pay rules and hence subject to uncompensated overtime rules imposed by the government. The proposed rule would change who are considered to be “white collar” employees where a new salary test will determine whether the employee is exempt from the FLSA. Currently, there is no duties test to determine who may be exempt but some comments indicate that later revisions to the rule may include some. The current salary test is \$455 per week (\$23,880 per year) where the Department of Labor will increase the minimum salary to roughly \$970 per week (\$50,440 per year). DOL states that 4.6 million employees who are

currently exempt will become immediately nonexempt when the proposed rule takes effect. Also, DOL intends to index the new salary level to keep up with inflation. Written comments will be accepted by DOL until Sept 4, 2015 before the rule becomes effective. It is expected that the rule will have a major administrative impact on all companies who will need to reclassify their workforce, change payroll processes, communicate changes and update policies and procedures. It may also significantly affect the way contractors account for uncompensated overtime (*Fed. Reg. July 6*).

DOD Memo Portends Possible Limitations to IR&D Costs

Undersecretary of Defense for Acquisition, Technology and Logistics Frank Kendall issued a memo which may indicate a tightening of allowable independent research and development costs allocated to government contracts. The memo criticizes the “laissez faire” approach to IR&D spending that has long allowed defense companies to emphasize investments in technologies that provide them a competitive advantage including creation of intellectual property rather than in technologies to improve the military capabilities of the US. The memo recommends DOD prepare new guidelines for allowable IR&D expenses that will include identification and endorsement of an appropriate technical DOD sponsor prior to project initiation as well as a written report when the project is complete or annually if it spans multiple years. In addition, the memo directs DOD offices to develop a proposed regulation that would preclude substantial future IR&D expenses as a means to reduce prices for competitive awards.

CASES/DECISIONS

Malpractice Suit Against DCAA is Dismissed

(Editor’s Note. Though contractors have the right to expect quality audits the following case confirms that contractors must effectively give up hope for DCAA accountability for negligent audits.)

KBR alleged the conclusions in a DCAA audit report that asserted it had billed \$99 million in unallowable private security costs under its LOGCAP III contract were clearly false and that DCAA performed the audit in a negligent manner. The audit report resulted in KBR paying \$42 million in unallowable costs as well as a civil lawsuit by the Dept. of Justice seeking \$103 million in damages. An appeals court ruled the audit report was demonstrably false and negligently prepared and ruled KBR was entitled to recover the \$42 million while DOJ

dropped the civil suit after the DCAA audit report flaws were uncovered. KBR filed a two count complaint to recover \$12.5 million in legal costs related to both the CO's decision to require the \$42 million payment and the DOJ suit. KBR justified its complaint asserting the Federal Tort Claims Act (FTCA), that allows federal employees to be held responsible when acting within the scope of their employment, was violated. The government asserted that it was not liable under the same FTCA because the Act provided an exception from liability when the government employees are acting within their "discretionary function." The Court first ruled that both DCAA and the Contracting Officer performed their functions with "significant discretionary elements" that required considerable use of judgment. Even accepting the allegations about the audit report as true, the Court rejected KBR's assertion that DCAA did not exercise discretionary judgment but rather failed to comply with mandatory audit standards and procedures ruling that as auditors it exercised professional discretion in conducting the audit and hence was shielded from all liability under the FTCA. To further eliminate its accountability, the Court stated DCAA was acting at the behest of the CO when it conducted its audit of KBR ruling it was the CO, not DCAA's audit, that caused the harm to KBR. The Court further found that the CO's interpretation of the contract and decision involved considerable judgment and hence "constitutes a discretionary decision" and hence the CO was also shielded from FTCA liability. Similarly, the Court ruled even though they relied on the DCAA report the DOJ decision to file an action was "all their own." Even assuming, as alleged by KBR that DOJ made a big mistake, their decision to file a claim and what information they decided to rely on was a professional discretionary act. The Court's dismissal of KBR's attempt to recover its legal costs under the FTCA shows the actions of DCAA, the CO and DOJ were discretionary and hence exempt from liability under the FTCA (*Kellogg Brown & Root services Inc. US 2015 WI 1966532*).

Board Addresses Cost Impact Computation of Accounting Changes

(Editor's Note. The following case involves too many important issues to address in the limited space we have here. Therefore, we will briefly summarize the case here and address them in much more detail in the next issue of the GCA DIGEST.)

Raytheon's incurred cost submittals for 2003-2005 reflected several accounting changes it implemented during those years and the case addresses how Raytheon should calculate the cost impact of those changes on its

CAS covered contracts. The government asserted the accounting changes resulted in an additional \$2 million being charged to the government which it sought to recover. Accounting changes often result in increased costs being allocated to some contracts and decreased costs being allocated to others. Prior to FY 2005, the Board stated that cost impact calculations allowed for offsets of increased and decreased costs in computing the impact of the accounting changes. However a FAR 30.606 provision, effective in 2005, prohibited offsets of simultaneous accounting changes where the Board ruled Raytheon could offset increases and decreases in CAS covered contracts in earlier years while in 2005 such offsets were not allowed. The Board did side with Raytheon in its contention that the government sought excessive recoveries from the cost impact calculation stating the government may recover increased costs allocated to flexibly priced contracts resulting from the changes but cannot recover those same costs when they result in decreases to costs allocated to fixed priced contracts. The Board provided an example of this double counting where accounting changes resulted in an additional \$300,000 being allocated to flexible contracts and a corresponding decrease of \$300,000 being allocated to fixed price contracts. The Board rejected DCAA's long time approach that maintained the cost impact should be the sum of increases to flexible type contracts and the decreases to fixed price contracts ruling such an approach represents double counting where the calculation results in a total cost impact of \$600,000 where it is only \$300,000 that is shifted from one type of contract to another (*Raytheon Co. Space & Airborne Sys, ASBCA 57801*).

Protester Fails to Show Bait and Switch

In its proposal for a task order IMG included resumes for 10 key personnel. At the post award conference IMG said that two key personnel would stay but requested approval to replace five key personnel, including the proposed project manager. Invertix protested the award to IMG asserting, in part, that IMG had engaged in improper bait and switch tactics. It cited several cases that proved a material misrepresentation had occurred if an agency requests resumes as part of a proposal where the agency reasonably expects that the resumes identify the personnel who will work on the contract and cited job openings and large number of unavailable key personnel as evidence IMG misrepresented its personnel. In its ruling, the Comp. Gen. ruled that to establish a "bait and switch" a protester must show that the offeror knowingly or negligently misrepresented the resources it planned to use for performance and the agency relied on this information when evaluating the proposal. The

Comp. Gen. ruled in favor of IBG stating the record did not meet these conditions. Relying on a declaration of the President and emails it showed that before submitting its proposal IMG verified the qualifications and security clearance of all 10 personnel and that at the time it submitted its proposal IMG planned on using all 10 people. The President contacted each of the 10 people after the award and learned that five were unavailable. The Comp. Gen. rejected Invertix assertion about its job recruiting efforts and large number of unavailable personnel stating IMG's recruitment of incumbent personnel after award did not prove its proposed personnel was unavailable, concluding it is not unusual for a new contractor to hire incumbent personnel, and that posting job openings is "a matter of practice and precaution" in case key personnel are not available. Moreover, the number of substitutions of key personnel, by itself, does not support a finding of bait and switch if the record does not show the offeror proposed personnel it did not plan on using (*Invertix, Comp. Gen. B-411329*).

ASBCA Rejects Unallowable Bonus Costs as Being Expressly Unallowable Costs

(Editor's Note. Commentators on the following case indicate it puts some breaks on recent tendencies of the government to expand the definition of "expressly unallowable costs" which is the condition to impose penalties on unallowable costs. The case calls for a "narrow" definition of "expressly unallowable" costs.)

Certain bonus and incentive costs were included as elements of fringe benefits and were deemed unallowable. Certain labor costs related to advertising, lobbying and organization activities were ruled to be unallowable in accordance with FAR 31.205-1 (public relations and advertising), 31.205-22 (lobbying and political activity costs) and 31.205-27 (organization costs) where allocated portions of fringe benefits that included the bonus and incentive costs were also deemed unallowable. The government sought over \$2 million of penalties on the allocated portion of bonus and incentive costs included in the fringe benefit allocation asserting these costs were expressly unallowable costs of the three cost principles because they were "associated with" and "in connection with" the expressly unallowable labor costs. *(That assertion would seem to favor the more common treatment of bonuses as elements of overhead and G&A rather than fringe benefits.)* Raytheon disagreed claiming the allocated portion of bonus costs were not expressly unallowable because compensation costs are not specifically named

and stated to be unallowable in the three cost principles. The Board sided with Raytheon stating that though FAR 31.205-1 does state that portions of labor and fringe benefits are unallowable, bonus and incentive costs are not considered to be elements of fringe benefits defined in FAR 31.205-6(p) but are considered to be a different type of compensation where bonuses and incentive pay are addressed in a separate section FAR 31.205-6(m). The Board in its decision affirmed that the definition of an "expressly unallowable" costs under the cost accounting standards and the Federal Acquisition Regulation is narrow, opining that an expressly unallowable costs must be a cost that is specifically named and stated as unallowable by law, regulation or contract (*Raytheon ASBCA 57576*).

Agency Did Not Consider Cost to the Government

DARPA issued a request for proposals for information services where its RFP stated the award would be made on a best-value basis. The source selection committee provided adjectival ratings for several stated factors to be considered (e.g. "outstanding," "marginal", "acceptable"), the agency used these ratings to rank the three offerors without discussing the basis for them and concluded DWK and another offeror with lower proposed costs were "unreasonable and not realistic, representing a high cost risk to the government." Though Agile's \$154.4 million evaluated costs was higher than DWK's \$129.9 million offer the government made the award to Agile stating its proposal had significantly higher technical ratings, substantially higher past performance and the lowest cost risk to the government. DWK in its protest asserted DARPA's best value trade-off determination was not reasonable because the agency did not evaluate the comparative costs to the government nor did the evaluators consider whether any non-cost benefit warranted a \$25 million cost premium. The Comp. Gen. sided with DWK stating that before an agency can select a higher cost proposal over a lower cost one the award must be supported by a rational explanation for why the higher cost proposal is superior and the premium is warranted. The Comp. Gen. concluded DARPA did not conduct a rational best value trade-off analysis noting it accepted adjectival ratings without discussion of the actual proposal features, there was no consideration of relative cost of each proposal and there was no evidence the agency considered either cost to the government or savings from a lower cost proposal (*DKW Communications, Comp Gen B411182*).

NEW/SMALL CONTRACTORS

Common Mistakes Small and New Government Contractors Make

(Editor's Note. In the past we have addressed some of the distinctive accounting differences found in the federal contracting as opposed to the commercial world. For example, government accounting costs are accumulated at the "final cost objective" level (contract, task order, CLIN), significant differences from GAAP can exist, reporting documentation is more extensive, disagreement on costs needs to be negotiated, government may challenge accounting methods and full absorption accounting is the key concept. In addition to these accounting features, we came across an interesting article in the August 11, 2015 issue of Federal Contracts Report by Richard Lieberman that address key contracting difference between commercial and government contracting as well as 9 big mistakes made by small and new government contractors)

Contracting differences between the government and commercial worlds include:

1. Statutory and Regulatory Framework. Whereas the Uniform Commercial Code, which is 50 pages long, and common law dictate how purchases and sales are made, the U.S. Code, FAR and its supplements is far more extensive.

2. Types of Contracts. Commercial contracts are almost always firm-fixed-price (buy 5 units at \$100 a piece you pay \$500) there is cost and time and material contracts in addition to fixed price in government contracting where contractors may recover only "allowable" costs.

3. Written Contracts. Where commercial contracts may be made orally or in writing, government contracts must generally be in writing where it is advised to get everything in writing.

4. Competition Requirements. Commercial contracts may be awarded in any manner it chooses while government contracts generally require award only after "full and open competition."

5. Authority of Agents. In commercial contracts agents act in behalf of their company where their authority to bind the company may be implied from words and conduct. In government contracting there is no implied authority where they receive their authority only in written delegations identified in statutes and regulations.

6. Audits. In the commercial life, the contract is fixed price, performed and generally not audited by the purchasing party where audits are common in the government

7. Socioeconomic requirements. In commercial life, socioeconomic requirements (e.g. small business, minority set-asides) are minimal while in government life they are specific and numerous.

8. Modifications/change orders. Once a commercial contract is formed only a mutual agreement of the parties can be used to modify it. In government contracting, the government may issue a modification and the contractor must make the change even if they do not want to make the changes. In the commercial world a contract may be modified by the parties without any consideration while in government contracting, any modification requires some sort of consideration.

9. Termination for the convenience of the government. In commercial contracting neither party may cancel or terminate a contract without the consent of the other party (unless a breach occurs) while in government contracting the government may always terminate the contract for the convenience of the government.

10. Incorporation by Reference. In commercial contracting incorporation by reference is used sparingly while in government contracting hundreds of important clauses are frequently incorporated in the contract by reference without being printed.

The 9 Worst Mistakes

1. *You failed to read all parts of the solicitation or contract (including printed clauses incorporated by reference).* You need to "read the operating manual" at the beginning – the entire solicitation in order to win the award and then the entire contract once you begin performing. Whereas the Statement of Work is commonly read before preparing an offer, you will miss critical information to prepare the winning offer if you don't read Instruction sections, Condition and Notices to Offerors (Sec. L), Evaluation Factors for Award (Sec. M) and Contract Clauses (Sec. I). Examples of failure to adequately read the solicitation includes (a) failure to offer a one-ton truck (b) failure to limit the proposal to 150 pages (c) bid prices were adjusted for prompt payment discounts (d) failure to provide a test item and (e) offer failed to segregate subcontractor offers.

2. *Failed to ask a written question about an ambiguity in the solicitation before submitting your proposal.* When there are ambiguities in a solicitation, the contractor should

always seek clarification by submitting written questions to the CO (oral have no authority) otherwise you will be responsible for the more expensive method of performing if no questions were asked. Even if the question period is over, you should still email a question since questions about an ambiguity are always allowed up to the due date and time of submission.

3. *Failed to submit a required document on time.* Any proposal, bid, modification or withdrawal must be received at the government's office designated in the RFP at the exact time specified for receipt and "late" will not be considered unless very restrictive conditions are met. Agencies are always very hard-nosed about submission of offers being on time.

4. *You submitted a nonconforming or noncompliant proposal.* The Invitation for Bids (IFB) or Request for Proposal will specify requirements and will be rejected if noncompliant. Common non-complying bids are those which (a) fail to conform to a delivery schedule or delivery location (b) fail to acknowledge a material amendment to the IFB (c) fail to conform to one or more specifications (d) impose conditions that would modify the IFB (e) limit government rights (f) fail to state a specific price or states a qualified price (g) offer a different quantity and (h) fail to meet minimal education or skill requirements or minimum experience levels for the firm.

5. *You failed to flow down necessary clauses to your subcontractors.* The government does not provide a list of required flow down clauses but the American Bar Association occasionally identifies required and recommended FAR and DFARS flow down clauses where we have identified the most recent ones in our GCA DIGEST (use the key word search at our website).

6. *You took advice and direction from officials who were not authorized to provide it.* It is a common mistake to follow direction from a variety of government personnel with multiple titles who "appear" to have authority. In fact, it is only the contracting officer who has actual authority over the contract and can direct changes to it. A contracting officer's representative (COR), a contract officer's technical representative (COTR) or administrative contracting officer (ACO) may have some authority to administer certain parts of the contract but it is only the contracting officer who has authority to award a contract or change a contract that affects contract price, quantity, delivery or other terms of the contract. Contractors are well advised to take direction from only COs where any deviation occurs from the written contract and to confirm any direction from any contract specialist with their CO. For example the

solicitation told bidders to contact contract specialists with any questions where a bidder emailed the specialist asking if a fax copy of the proposal was acceptable. The specialist said yes where even a fax number was provided. However the solicitation explicitly prohibited fax submissions where the faxed proposal was rejected and the court stated the specialist had no authority to change the solicitation.

7. *You failed to deliver on time contract items or when you discovered a delay and requested an extension you failed to give the government consideration.* If you do not deliver on time, you risk having your contract terminated for default which can be costly and prevent you from receiving awards in the future. A CO does not have authority to extend the delivery date in a contract without consideration so it should be provided (e.g. \$.10 off each delivered item, lump sum amount such as \$750 or even a nonmonetary amount that does have some value).

8. *You failed to invoice properly or when your invoices were not promptly paid you did not take decisive action to get paid.* The Prompt Payment clause at FAR 52.232-5, which describes the elements of a proper invoice, requires the government to make payment of a "proper invoice" within 30 days of submission or pay interest penalties on the unpaid invoice. The act requires an agency to return any "defective" invoice within 7 days of receipt with a statement identifying the defect. If the CO disputes the invoice or otherwise does not pay a proper invoice you should follow the Contract Disputes Act (CDA) requirement by (1) writing a letter to the CO stating "we are now in dispute over this invoice. You have refused a lawful invoice. We are converting it into a claim and attaching a certified claim for the entire amount" (2) the company should prepare a short claim with a proper CDA certification (if the amount is over \$100,000) along with the above letter and (3) if the CO denies the claim or the CO makes no ruling within 60 days the company should then make an appeal of non-payment to the ASBCA.

9. *You were a volunteer and did not get paid for your services.* A contractor who elects to perform work without the expectation of payment is a volunteer. A volunteer can be a contractor who performs work not required by a contract without a formal change order or who starts work on a contract before it is signed. Letters of "intent" frequently sent by COs are not an award nor are unsigned contracts or ones not funded. You proceed at your own risk.

Most of these mistakes can be avoided by training your personnel about the unique rules in government contracting and the typical mistakes. Feel free to distribute this article to them.

July - August 2015

GCA REPORT

QUESTIONS & ANSWERS

Q. We have incurred some interest costs related to underpayment of our state income taxes and compensation not paid to certain employees. Since these are characterized as “interest” costs I would think they would be unallowable. What do you think?

A. I think those two instances of interest costs would be allowable. The interest cost principle at FAR 31.205-20 clearly makes “interest on borrowing” unallowable but there are other types of interest costs that are allowable because they are not related to borrowing or raising capital. We are aware of two cases that address the types of costs you mention. In *Lockheed Corp. N Widnall*, the appeals court ruled that interest costs related to non-payment of California income taxes (which are allowable costs in themselves) are not unallowable ruling the cost principle disallows interest on borrowing or raising capital, not interest in general. In *Ingalls Shipbuilding Inc. v. Dalton*, the Court ruled that a 10% “interest” added to an underpayment of compensation costs was allowable where the Court cited the Lockheed case stating nothing in the payment could be regarded as an effort to raise capital or otherwise borrow money.

Q. We have purchased equipment for a three year cost type contract but our normal write-off practices is to use five years. How can we recover the equipment costs for the three years?

A. You will want to charge the equipment costs directly to the contract and you have two options for recovering those costs from the government. Either arrange with your client to reimburse you for the equipment costs

by invoicing directly for the equipment costs or use a three year period for depreciating the equipment. A period less than your normal write off period can be justified by claiming the “useful” or “economic” life of the equipment is three years where such language can be found in CAS 409, Depreciation of capital assets. In order to avoid challenges, your written policy on capitalization and depreciation of capital assets should address this type of circumstance including direct charging.

Q. We have a new bonus incentive program and are worried it will not be accepted by DCAA. Can you provide some general guidance.

A. You are correct to be concerned since contractors’ incentive bonus plans are a hot area for DCAA scrutiny these days where findings in one year may be applied in subsequent years’ incurred cost audits. In general, you need to comply with FAR 31.205-6(f) where auditors are focusing on adequacy of written policies, the basis for award and whether those policies are consistently followed. Adequate documentation for the basis of award has become the most prevalent area of questioned costs where DCAA is questioning bonus costs in both years examined and subsequent years because this documentation is not considered adequate. Common grounds for stating the documentation is inadequate include assertions that (1) an incomplete listing of employees with amounts of award is not identified (2) specific criteria for award such as performance and financial metrics (e.g. percentage of profit or sales) and (3) documentation showing the eligibility of employees for their bonuses. We often evaluate contractors’ bonus systems to help ensure it will be adequate so use our Ask the Experts feature if you have questions.