GCA REPORT
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NEW DEVELOPMENTS

OMB Increases Executive Compensation Ceiling

The Office of Management and Budget has set the maximum "benchmark" compensation allowable for contractor executives in fiscal year 2007 at $597,912 for all applicable contracts no matter when awarded. The benchmark will apply to contract costs incurred during a contractor's fiscal year 2007 and should be used on all applicable contracts and subcontracts for FY 2007 and beyond until revised by OMB.

The new cap represents a 9.4 percent increase over the FY 2006 amount of $546,689. Contractors can, of course, pay their executives more than $597,912 but the additional compensation will not be allowable under their federal contracts. DCAA guidance stresses the cap covered compensation includes the total amounts of salary, bonuses, deferred compensation and employer contributions to defined contribution pension plans. The cap covered compensation does not apply to fringe benefits like health benefits and employer contributions to defined benefit plans where if they are reasonable they are allowed irrespective of the cap. The cap covers the five senior managers of a company as well as subsidiary business segments directly reporting to the corporate headquarters. The benchmark compensation amount reflects the median (or 50 percentile) amount of compensation for senior executives of all surveyed corporations for the most recent year data is available.

Since the surveyed companies include the top five highest paid executives of public-traded companies with annual sales over $50 million be aware that lower caps are likely to apply to smaller companies. DCAA's approach in evaluating the "reasonableness" of executive compensation when evaluating smaller firms is to use three or four commercially available compensation surveys, where the surveys used may vary over time. It will usually select total compensation at the median level from each survey for the position being reviewed and compute an average for the median compensation of each position and then will increase the average 10 percent to provide a "reasonableness factor." The difference between the adjusted median compensation and the actual compensation paid by the company being audited is usually questioned as unreasonable compensation. Once this unreasonable compensation amount is put forth, the burden falls on the contractor to demonstrate another (e.g. higher) amount is justified. Our consulting practice has found that successful challenges may include such approaches as producing another bona fide survey, demonstrating the figures put forth by the auditor is not representative of the contractor (e.g. types of businesses surveyed are not representative of ours, company size, competitive market) or justifying use of a higher level than median compensation (e.g. superior company financial performance),

ARWG Submits Its List of Acquisition Reforms in 2007

(*Editor's Note. The following "wish list" of legislative priorities identifies the likely areas industry will be pursuing this year.*)

The Acquisition Reform Working Group, an umbrella group of most industry representatives, has sent its package of legislative recommendations to Capital Hill that it will be working to implement this year. Much of the package addresses commercial acquisitions that call for:

- Enacting a mandate to limit imposing government unique requirements that apply to commercial prime contracting. Those requirements should be limited to the seven statutory clauses that must be flowed down to commercial subcontracts.
- Making permanent the use of special simplified acquisition procedures for procuring certain commercial items valued at up to $5 million (rather than the current simplified acquisition ceiling of $100,000).
- Redefine commercial services by removing the distinctions between commercial supplies and commercial services. Rather, it would define a commercial item as "any item, including any supply or service, other than real property that is of a type customarily used by the general public or by non-governmental entities for purposes other than government purposes." If the service is of a type offered and sold in the commercial marketplace the service should qualify as a commercial item. It should

be noted that ARWG's view is not shared by the recently DOD proposed legislation to provide only those commercial items that are actually "sold in substantial quantities to the general public" would be exempt from requirements to submit certified cost or pricing data.

- Revise the competition requirements for time-and-material contracts and subcontracts to allow justified sole source awards of T&M and labor hour contracts to acquire commercial services.
- Revise the performance period for advisory and assistance services to allow a base five year term with extension of up to an additional five years, similar to the period for multiyear task and delivery order contracts.

Other recommendations include:

- Repeal the Tax Reconciliation Act that requires federal, state and local governments, starting in 2011, to withhold 3 percent of any payment made to contractors for goods and services. ARWG states the act's withhold will adversely affect cash flow and likely limit the number of firms who will enter the government market.
- Establishing uniform payment terms/standards for contract financing that are already established in the Defense Federal Acquisition Regulations.
- Extending the Prompt Payment Act interest payments beyond 12 months.
- Improving efficiency in contract payments by requiring federal agencies to use electronic invoicing systems for contract billing after October 1, 2007.
- Modernizing the Small Disadvantaged Business program by (1) increasing the net worth qualifications to offset costs of inflation and (2) eliminate the requirement that prime contractors count only "third party certified" SDBs in their subcontracting reports to eliminate the need of having to be certified by a third party.

Proposal to Change Definition of "Employee" in HUBZone Act Requirements

The Small Business Administration proposed broadening the definition of employee for purposes of determining whether small businesses may participate in the Historically Underutilized Business Zone (HUBZone) contracting program. Under the program a firm located in an area of economic distress is entitled to certain set asides and also to a 10 percent price evaluation preference for purposes of obtaining government contracts if 35 percent of its employees reside in that HUBZone area. Currently, only employees who are employed full time (or full-time equivalent) can be counted toward the 35 percent figure.

The proposed change would remove from the program's definition of "employee" the requirement the worker be permanent or work on a full time basis. Instead, the HUBZone concern would count "full time, part time and those employed on an 'other basis' as well as leased and temporary employees and employees obtained through temporary agencies, co-employer agreements and union agreements as employees." The SBA said the change would simplify the current definition and would increase employment of HUBZone residents. Counting part time and temp workers as employees would benefit construction and services industries that commonly employ part time and temporary workers. However, to minimize potential distortion of the program (e.g. hiring a few HUBZone residents to work one or two hours a week to qualify for HUBZone status), the proposed rule would count only those employees who work at least 40 hours per month.

New CAS Board Meets

After more than 18 months of inactivity, the Cost Accounting Standards Board met in February with a new slate of members. Office of Federal Procurement Policy Administrator Paul Dennet is the statutory chairman while other members include: April Stephenson, Deputy Director of DCAA; Bruce Timman, director of government accounting policy and compliance at Alliant Techsystems Inc.; Kathleen Turco, CFO of the General Services Administration; and Richard Wall, former partner of Ernst and Young Government Contract Services.

Key tasks and significant pending initiatives include:

- Harmonizing CAS with the Pension Protection Act of 2006. Though compliance with the Act may call for increased pension costs, recent instructions from the Defense Department state contracting officers should not allow such increased costs to be allocated to government contracts which has the effect of leaving contractors "holding the bag" for increased pension contributions required by the Act.
- revising CAS Disclosure Statement requirements
- revising capitalization thresholds and recordkeeping requirements contained in CAS 403, 404 and 409.
- amending CAS 410 provisions that relate to transitioning from a cost of sales or sales base to a total cost input base.
- revising rules regarding computing cost impact calculations when a contractor makes multiple accounting changes on the same date
- determining the appropriateness of clauses applying CAS to contracts with foreign concerns.

- exempting time-and-material and labor-hours contracts for the acquisition of commercial items from CAS
- resolving conflicts between CAS and FAR regarding definition of catastrophic losses.
- finalizing proposed amendments to CAS 412 and 415 concerning recognition of costs of employee stock ownership plans (ESOPs) under government contracts.

Industry Groups Reject Key Panel Recommendations

Even before the recently released recommendations of the Acquisition Advisory Panel were printed, a multi-association group of contractor industry associations have urged the Office of Federal Procurement Policy and Congress to reject three important recommendations of the Panel. They are:

1. Similarly to attempts by DOD to restrict what qualifies as a commercial item (see the ARWG wish list article above), the Panel recommends the definition of stand-alone commercial services be amended to ensure that only those services actually sold in substantial quantities in the commercial marketplace be considered "commercial." The Panel recommends the current definition that includes services "of a type" sold in the commercial marketplace be eliminated. The industry group states if the services are of the same types sold commercially they should qualify as commercial. Moreover, the group argues (1) many commercial service providers, especially small businesses, do not have the infrastructure to deal with government-unique requirements (2) the phrase "of a type" accomplishes Congress's intent to promote reliance on the commercial marketplace and (3) the government tends not to buy exactly what is sold in the commercial marketplace.

2. The Panel's recommendation to lessen use of T&M type contracts by requiring the development of objectives and requirements prior to their use should be rejected. The group argues this would directly contradict current government guidance that "specifically restricts use of T&M contracts to those instances when the requirements cannot be developed sufficiently or whenever there is insufficient time to adequately develop them." Implementing the change to restrict use of such contracts would jeopardize the government's ability to perform critical missions without interruptions.

3. In response to the Panel's call to allow bid protests on task and delivery orders under multiple award contracts when the orders exceed $5 million, the group states such protests would create delays, add to the burdens of a shorthanded supply of contracting officers and ultimately raise the cost to taxpayers.

DCAA Reminds Auditors to Track Directly Associated Unallowable Costs

The Defense Contract Audit Agency issued guidance reminding its auditors to take steps to ensure that when a contractor excludes an allowable cost from its incurred cost proposal that it also excludes all "directly associated costs." Such costs are defined in FAR 31.201-6 as "any cost that is generated solely as a result of incurring another cost and that would not have been incurred had the other cost not been incurred." DCAA told its auditors that to ensure all directly associated costs have been excluded the auditor should, at a minimum: (1) perform a comparative analysis of voluntary deletions to prior years' voluntary deletions to identify significant increases or decreases, obvious omissions or new categories of costs that require follow-up audit effort (2) analyze voluntary deletions to determine whether the contractor has identified and excluded directly associated unallowable costs and (3) review all questioned costs to determine whether the contractor incurred any directly associated costs that should be removed.

The memo gives an example of a directly associated cost as the cost of salaries for contractor employees when performing unallowable lobbying activities. Other common directly associated costs are those portions of employee salaries associated with unallowable entertainment or public relations costs. Keep in mind that both the FAR (31.206-6(e)(1) and DCAA Contract Audit Manual (Chapter 5-1009.1.e) state that "materiality" of directly associated costs should be considered before deciding to screen them. So, for example, if an immaterial amount of an employee's time is associated with an unallowable entertainment event, then that associated cost need not be deleted even though costs of the event should be (07-PAC-002(R).

DCAA Head Testifies on Iraq Contracting

(Editor's Note. The following is interesting because it illuminates some of the highly publicized "questionable" Iraq contract costs recounted in the media.)

The Defense Contract Audit Agency head Bill Reed testified in a House Oversight Committee on "a number of problems" associated with questioned and unsupported costs and reliability of contractors' business systems. In the Committee's widely publicized hearings where committee representatives decried the proliferation of fraud and abuse practices, DCAA

addressed its widely quoted review of $57 billion of contract dollars billed in Iraq, where the agency found that $4.9 billion of costs were questioned and another $5.1 billion was "unsupported." Mr. Reed explained that the $4.9 billion figure represents DCAA-recommended reductions in proposed and billed contract costs where DCAA has taken "routine" contract actions to reduce billed costs for the disputed amounts. He further added that the $5.1 billion in unsupported costs estimates were amounts proposed that needed additional documentation to be accepted and that they were "usually resolved" during the contract price negotiation with the submission of additional supporting information.

Indicating that the challenges of applying sound business practices in Iraq are "daunting" requiring considered flexibility on the part of auditors, Mr. Reed indicated the most common business systems problems identified during its audits involved timekeeping procedures, cash management procedures, management of subcontracts and documentation of costs on proposals where Mr. Reed said that contractors and COs have already or are working to resolve most of these problems. He added many of the problems are not whether or not the costs were incurred but whether or not the costs are allowable in accordance with the contracts.

Two Significant Amendments Included in Minimum Wage Bill

The recently Senate passed minimum wage bill included two relevant amendments of interest to government contractors:

1. A requirement that federal contractors who employ illegal immigrants be debarred for 10 years from receiving future federal government contracts if they currently hold a federal contract and if not, debarment would last seven years. The amendment would prohibit judicial review of any debarment decision. The measure would exempt about 10,000 current employers who are voluntarily participating in a government-provided automated electronic verification system for worker eligibility (called the "basic pilot program").

2. Strengthen requirements that federal agencies report on their purchases of foreign-made goods. Stating the federal government should spend taxpayer money on American made goods whenever possible, the amendment aims to address current loopholes in the Buy America Act that gives agencies broad discretion to waive the requirement that they purchase goods made in the US whenever possible.

New Rule Lets State and Local Government use FSS Contracts for Emergency Purchases

The General Services Administration issued a new rule allowing state and local governments to use the Federal Supply Schedules to make purchases in aid of recovery efforts following a natural disaster or act of terrorism. The interim rule also allows state and local governments to use FSS contracts to purchase products and services in advance of a declared emergency. The rule makes participation in the new program voluntary where businesses with FSS contracts may decide whether or not they will accept orders placed by state and local government buyers and the buyers have full discretion to decide whether or not they want to make purchases (Fed. Reg. 4649).

DOD Again Suspends Small Disadvantages Business Price Adjustment

The Defense Department in a February memo instructed contracting activities to continue to suspend use of price evaluation adjustments for small disadvantaged businesses in its procurements. Per FAR 19.11, agencies must apply a price evaluation adjustment on offers from small disadvantaged businesses (i.e. decrease a SDB proposed price by 10 percent for evaluation purposes when comparing their offer against non-SDB offers). However, in accordance with the 1999 DOD Authorization Act, DOD must suspend the SDB price adjustment if the secretary determines at the beginning of the year that the department achieved its five percent goal for SDB business contracting. Since the goal was met in FY 2006, the price adjustment must be suspended.

CASES/DECISIONS

Lockheed Need Not Provide a Breakdown of Costs in its Claim

(*Editor's Note. In submitting a claim, contractors are often uncertain about the level of detail they need to present. The following decision indicates little to none may be acceptable but keep in mind the contractor should still be prepared to provide detailed backup if and when they are audited.)*

In its claim for an equitable adjustment in price Lockheed presented a lump sum request of $17,763,627. When the government rejected the request partly on the grounds there was no breakdown of the costs, the Appeals Board sided with Lockheed asserting it met

the FAR requirement that a Contract Disputes Act claim state "a sum certain" amount. The Board concluded Lockheed was not required to include a detailed breakdown of costs to meet the sum certain requirement, quoting from *HL Smith v Dalton* where the court said a contractor "may supply adequate notice of the basis and amount of the claim without accounting for each cost component" (*Lockheed Martin Aircraft Center, ASBCA No. 55164*).

Direct Presentation of Invoice to the Government Not Required for All FCA Claims

(*Editor's Note. The following rules demonstrate that not only prime contractors but also subcontractors are normally covered by false claims laws.*)

Two whistleblowers working for a lower tier contractor claimed their employer violated the False Claim Act (FCA) by presenting invoices to their upper tier subcontractors for work that did not meet contract specifications. The district court ruled a false claim had not been presented because the false claim had not been presented to the *government* for payment. The Court of Appeals reversed this finding holding that the plain language of Section 3729(a)(2) and (3) of the FCA states that a false claim is presented when a person knowingly presents a false record which is paid for by the government where, here, all subcontract invoices were eventually presented by the prime contractor for payment to the government. The court held the claim does not have to be presented to the government so long as it can be shown the claim was paid with government funds (*US. Ex rel. Sanders V Allison Engine Co., 471 F.3d 610*).

Court Rules Most Documentation is Adequate to Win Proposal Cost Recovery

(*Editor's Note. Whether it be termination or claim proposals, amounts of time spent by internal employees on the proposal is normally a reimbursable expense. However, it is quite common for auditors and price analysts to reject such costs on the grounds that insufficient documentation (e.g. absence off timesheets) is presented to justify the costs. The following addresses the level of detail needed to document the employees' costs and suggests types of documentation other than timesheets that might be considered.*)

After prevailing in an award protest, Beta sought recovery of its proposal preparation costs. The government rejected the proposed costs asserting Beta failed to adequately document the amount of time spent on the proposal tasks. The Court sided with Beta stating it need not support its claim with "contemporaneous documents akin to a lawyer's billing records" where time for specific tasks must be documented – a billing method developed by the legal profession is not necessarily an "efficient way for other firms to organize their internal operations."

The Court said the General Accounting Office does not require such records and pointed to the fact the GAO has awarded bid preparation costs based on such documentation as a chronology of events indicating the date various tasks were performed, the nature of the tasks and the number of hours spent performing the tasks for each employee position. Here, the Court found adequate Beta's submission of an affidavit from the officer who managed the proposal preparation with an attachment describing the tasks performed by each employee, spreadsheets identifying the hours worked by each employee by task and by month and spreadsheets showing the burdened hourly rates for each employee. The court also noted that Beta's support of its application with certain documentation (e.g. slides from an organization meeting where various proposal preparation tasks were described), agenda from a planning meeting, work schedule for the proposal, several drafts of the proposal) provided, as a whole, a sufficient basis to award the preparation costs (*Beta Analytics Inc. v US, Fed. Cl. No. 04-556*).

Board Vacates Ruling that AM General Violated CAS 418 Homogeneity Requirement

(*Editor's Note. The following reports on a new development in a significant case we have been reporting on over the last year.*)

Am General assembled both commercial Hummers and military HMMWVs in one facility and finished the commercial Hummers in a separate facility after they left the production line. The total costs of both facilities were included in one manufacturing overhead pool where the cost of the additional building used was 11 percent of the pool and the allocation base was number of units produced. An earlier decision by the Appeals Board concluded that a single overhead pool was in noncompliance with CAS 418, Allocation of Direct and Indirect Costs, since it cost more to manufacture the commercial vehicle. The Board ruled the single pool was not "homogeneous" as required by CAS 418 in that all significant activities in the pool did not have "the same or similar beneficial or causal relationship to cost objectives." DCAA estimated a $1,650 per unit cost impact of the noncompliance where the government demanded over $23 million from AM Gen.

In a request for reconsideration of its position, the Board vacated its earlier ruling saying the request raised "numerous issues"that were not raised earlier. Quoting from CAS 418, the judge said whether or not the single pool is homogeneous must depend on three simultaneous factors pertaining to cost allocation: the cost objective, the cost pool and the allocation base. Here, the judge said neither party had provided the board with much help as to what "activities" are in the cost pool, when an activity becomes a "significant activity" and what are the costs of all significant activities in the cost pool. He stated there is no explanation how a causal or beneficial relationship is established between the costs of the significant activities in the pool and the cost objectives – vehicles. In addition no party before the request for reconsideration had previously addressed the issue of materiality which is a crucial test for determining homogeneity. That is, whether the allocation results would be materially different if the costs were separately allocated (*AM General LLC, ASBCA No. 53610*).

Subcontractor Cannot Recover Payment from the Government

In the Army Space Command's (ASC) T&M contract with NRS, Alpine supplied computers to NRS as a subcontractor and invoiced an amount of $28,862 where NRS billed the government for the computers and was paid. During a criminal investigation the government seized NRS's records and NRS ceased performance and the government terminated the contract for default. The subcontractors of NRS, including Alpine, lined up at ASC complaining they had not been paid and the CO explained they were not in "privity of contract" with ASC and suggested they seek legal advice. Alpine submitted a claim for the amount of its invoice alleging there was an implied contract between Alpine and ASC and Alpine was a third-party beneficiary of the prime contract. ASC rejected the claim asserting (1) ASC had already paid NRS for Alpine's invoice (2) there was no contractual relationship between ASC and Alpine and (3) NRS had not sponsored its claim.

The Board ruled against Alpine noting that the prime contractor did not sponsor its claim and that Alpine was not a "contractor" in the meaning of the disputes clause since it was a subcontractor and hence was not "in privity" with ASC. The two exceptions to the privity requirement – when a contractor is acting as a mere purchasing agent for the government and the contract calls for a direct subcontractor appeal – were not met. As for being a third party beneficiary to the ASC/NRS contract where payment billed is for the benefit of Alpine, the Board said only if a clause is included that provided for payment jointly to the prime and subcontractor would the government be liable, which is not the case here. As for Alpine's argument there was an implied contract with ASC establishing privity since it was subject to ASC physical inspection and acceptance the Board disagreed saying such an implied contract would require there be an offer, acceptance and consideration between the two parties which did not exist (*Alpine Computers Inc., ASBCA 54659*).

(*Editor's Note. A commentator on this case stressed that the prime and subcontractor are free to establish their own arrangement so each can be fairly treated and paid when payment is due. For example, a subcontractor could require clauses affording assurance the prime contractor would sponsor its claims and direct appeals. Or, if facing an uncertain prime contractor, a subcontractor could seek an appropriate payment bond where if the prime defaulted or went bankrupt or refused to pay then the bond could assure payment.*)

SMALL/NEW CONTRACTORS

Some Basic Considerations on Preparing Incurred Cost and Forward Pricing Proposals

We saw a question in a periodical that asked how one can be sure all costs are included in indirect pools and bases. Though the response was not particularly practical for our purposes, we have been thinking about this issue frequently in our consulting practice since we have been helping a lot of firms prepare their incurred cost and forward pricing rate proposals. We thought it would be a good idea to both address the question about making sure all costs are included and basic considerations needed when preparing incurred cost and forward pricing proposals.

1. Decide on structure of indirect rates. This is a step that needs to be done at least every couple of years to determine whether you have the right number of indirect rates and the allocation base for each pool is appropriate. We have addressed the appropriate structure (i.e. number of pools and bases) in numerous articles in the past so we will not detail the necessary considerations for this critical step here. Suffice it to say that the structure selected should be consistent with pricing objectives (e.g. maximize cost recovery versus need to offer low, competitive prices), type of business

(e.g. service or manufacturing), nature of direct costs (e.g. proportion of labor to material costs or level of subcontractors and other direct costs), administrative ease and expected resistance by auditors.

2. Remain faithful to the general ledger or trial balance. Ensure all costs incurred during the year are identifiable to ensure all costs are accounted for. Since the first step an auditor takes is to trace the incurred cost proposal amounts to the trial balance or to budget or prior trial balance figures for forward pricing proposals, you might as well make sure your numbers tie back to the relevant figures. Though some costs incurred may not be identified as expenses in the trial balance (e.g. period expenses may have been capitalized for financial or tax purposes) make sure they are separately identified and treated as expenses incurred in the appropriate period. From the trial balance try to determine what costs are direct versus indirect. If these costs are not clearly identifiable (i.e. some direct and indirect costs lumped into one account) you will need to be able to show you can distinguish them. Also, you can generally ignore the numerous debits and credits associated with miscellaneous income and related expense items common in the general ledger. The only exception is revenue associated with an expense item included in a pool such as direct billing income for such items as telephone, reproduction, vehicles, etc. In this case the cost portion of the income needs to be identified and credited to the pool where the associated expense resides - some contractors do not bother with this computation and simply credit the pool for the entire amount of the income received.

3. Reconcile trial balance costs with other accounting records. For example, if there are accurate job cost records where direct costs are identified by cost objective, then those job costs should be reconcilable with the trial balance summary figures and exhibits in the proposal. Also, be sure that the total of direct and indirect costs is reconcilable to financial accounting reports such as cost of sales in a financial statement.

4. Determine what expenses will be assigned to what pools. Some contractors believe that they cannot make changes from one year to the next (for example, assigning certain expenses previously charged to G&A to overhead or a material/subcontract handling fee) but this assumption is generally not accurate. Rather, contractors are required to charge indirect costs to cost objectives in the most appropriate way which may very well entail making changes. Unless it is a new expense not previously incurred, changes are normally considered accounting changes. If the contractor's contracts and subcontracts are covered by the cost accounting standards, a change to an accounting practice needs to be divulged before it is made and the impact of the change on contract costing may need to be demonstrated. However, this is not required if the contracts and subcontracts are not CAS covered. Changes can and are often made with no reporting requirements. When an incurred cost proposal is submitted, significant accounting changes need to be divulged after the fact but when no incurred cost proposals are submitted, accounting changes may go un-communicated because changes need not be divulged when submitting a forward pricing proposal. Sometimes, an auditor may want an explanation (either verbal or in writing) when a change comes to their attention and may even occasionally ask to see evidence of the impact of the change but this latter step is quite rare.

5. Determine what expenses will be assigned to the allocation bases. Though reassigning costs from one pool to another is common, less common is changing the allocation base. Fringe and overhead rates normally will keep the same labor base while most changes will involve the G&A base. Change from a value added base (all costs less material or other relevant ODCs) to a total cost base can occur. More commonly is the adoption of a material or subcontract handling pool where certain costs that were included in the G&A base are transferred to the handling base.

6. Clearly show proper treatment of unallowable costs. For indirect cost pools, be sure to include the cost – make it identifiable – and then clearly show it is deleted. For indirect allocation bases, make sure the base includes unallowable costs.

QUESTIONS & ANSWERS

Q. We purposely bid high with the intension of lowering our bid during the discussion phase. One of the other offerors discussed some items with the government after which it received the award but we were unable to discuss anything including a change in price. When we objected the CO told us we could not change anything in our bid because the communications made were considered "clarifications." Could you explain this to me?

A. We came across an analysis of a case in the October 2005 issue of Procurement Law Advisor that should respond to your question. In the remarks, the author states though we do not often distinguish between terms in our everyday language the FAR distinguishes between "discussions" and "clarifications." In the case, the Defense Department needed beef so it issued a

GCA REPORT
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solicitation for best value, evaluated offers, held discussions and received final proposal revisions (FPRs). Washington's FPR confused the government when it labeled an item "case ready ground beef" rather than what DOD wanted – "coarse ground beef." DOD asked Washington to clear up the confusion and then awarded it the contract. One of the unsuccessful offerors argued in its protest that the government had conducted improper post-FPR discussions with Washington when it tried to clear up the confusion. The GAO disagreed stating all DOD had done was clarify the issue. Citing relevant FAR sections GAO stated it distinguishes clarifications from discussions where "clarifications" are limited exchanges between an agency and offeror to allow the offeror to clarify certain aspects of the proposal or resolve minor or clerical errors while "discussions" occur when an agency points to an offeror's significant weaknesses, deficiencies and other aspects of its proposal that could be altered or explained to materially enhance the proposal's potential for award. When discussions are held with one offeror, it must conduct discussions with all offerors in the competitive range while a clarification allows for communication with only one or less than all offerors. The acid test for deciding whether a discussion occurred is whether it can be said that an offeror was provided the opportunity to revise or modify its proposal. In this case, all that occurred was a clarification.

Q. In our discussions with you, we learned that several costs we treated as unallowable were in fact allowable. Before our discussions we treated the costs as unallowable in our books of account and excluded them from our incurred cost submittal this year. Are we stuck?

A. As for your accounting treatment of the costs, a journal entry changing the assignment of the cost should be made. As for your incurred cost submittal, costs are not considered final until your final rates are settled. If the costs are significant you might want to contact the cognizant audit agency and tell them about the inadvertent deletion of the costs – they may either recommend submitting a revised proposal (your original submission determines whether or not you were late) or will handle it when they conduct the audit. If the cost is insignificant, you can let them know about the inadvertent deletion of the cost when they actually conduct the audit and they will likely adjust the amount by probably offsetting any questioned costs against the deletion or they may increase the "audited" rate to account for the deleted cost.

Q. We do a great deal of research under the Small Business Innovative Research (SBIR) program. We were awarded a phase I and a phase II contract to develop a new item (we purposely disguised the item to keep the questioner confidential) and I am trying to convince a government contracting person that they do not have to competitively bid the procurement of the phase III item because we developed it under the SBIR program. The question is am I correct in this assumption and if so, what FAR clause, etc. can I point to as proof?

A. Yes, you are correct. Though the FAR does not directly address your point, the DOD issued "SBIR Contracting & Payment Desk Reference," Section XII, Phase III B and F does. Section B states "SBIR Phase III awards may be made without further competition" reasoning that the Phase I and II awards satisfied any competition requirements and Phase III effort is normally derived from the earlier effort. Section F states that under the SBIR Program the awardee of the earlier phases, including sole source awards, should be "given preference."

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