// GCA REPORT
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GCA Report

NEW DEVELOPMENTS

Impact of FY 2015 NDAA on Federal Procurements

President Obama signed into law the National Defense Authorization Act (NDAA) for FY 2015 which includes several procurement related reforms and changes, mostly included in Title VIII, Acquisition Policy, Acquisition Management and Related Matters. The more significant ones of interest to our readers include:

1. *Authority of DARPA to carry out more projects (Section 812).* This broadens DARPA's other transaction authority (OTA) where it was previously limited only to prototypes relevant to weapons or weapons systems.

2. *Extension of limits on DOD contractor services spending (812).* In the NDAA of 2014, a temporary move that DOD may spend for most contract services was limited to the amount requested for such services in the president's FY 2010 budget. The new law extends that temporary limit through 2015. It further requires that each DOD agency continue, during FY 2015, the 10 percent-per-fiscal-year reductions in spending for contracts "for performance of functions closely associated with inherently government functions" and for "staff augmentation contracts." It mandates that any unimplemented amounts of the 10 percent reductions for FYs 2012 and 2013 be implemented in 2015.

3. *Permanent authority for simplified acquisitions for certain large dollar commercial item procurements (815).* Makes permanent the authority to use simplified acquisition procedures (SAP) for purchases of certain commercial supplies and services in excess of SAP up to $6.5 million or $12 million if used in support of contingency operations or responding to nuclear, biological or chemical attack.

4. *Avoiding counterfeit electronic parts (817).* Clarifies that under FY 2012 NDAA suppliers are permitted to "obtain electronic parts from alternative suppliers if such parts are not available from original manufacturers, their authorized dealers or suppliers identified as trusted suppliers." Previously, suppliers were required to obtain electronic parts from only these suppliers "whenever possible."

5. *Test program for comprehensive small business subcontracting plans (821).* Extends for three years until Dec 31, 2017 a "test program" in place for 25 years that allow contractors to develop and report subcontracting plans on a plant, division or comprehensive basis rather than by contract. Beginning in FY 2016, DOD will be prohibited from negotiating comprehensive small business subcontracting plans with contractors who fail to meet their subcontracting plans in the previous year and that failing to make good faith effort to comply with these plans shall be considered when evaluating an offeror's past performance. The NDAA will also require contractors with such comprehensive plans to report fairly detailed subcontracting data to DOD semiannually.

6. *Sole source contracts for WOSBs (825).* The Small Business Act will be amended to, for example, no longer permit COs to rely on women owned small business self certification to demonstrate their status but will now require they to be certified by a federal agency, state government, SBA administrator or national certifying entity approved by SBA. Also, new authority is added that now enables COs to award certain sole source contracts, up to $6.5 million, including options to (a) economically disadvantaged WOSBs or (b) WOSBs in an industry the SBA has determined are "substantially underrepresented." SBA and FAR rules will need to be implemented before these opportunities take effect.

7. *Review of IT procurements (832 abd 833).* OMB will be required to make publicly available a list of each major IT investment (except for national security systems) for all 24 covered agencies which will include information about each investment's cost, schedule, performance and risk and will include both new IT acquisitions and maintenance and operation activities of existing IT. All covered agencies will annually review their IT investments to identify waste, duplication and cost savings where it applies to DOD's business systems IT portfolio (e.g. payroll, finance, logistics and personnel management) and not to national security systems.

8. *Prohibition on contractor reimbursement for certain congressional investigations (857).* This section will make unallowable "costs incurred by a contractor in connection with a congressional investigation or inquiry" into an issue

that is the subject matter of a proceeding resulting in a criminal conviction, finding of civil liability (for fraud or similar misconduct) or imposition of monetary penalty or corrective action order related to suspending or debarring a contractor, rescinding a contract or terminating a contract for default" or "disposition of the proceeding by consent or compromise if such action could have resulted in" any of the above actions.

DCAA Issues Guidance on Late Incurred Cost Submittals with Delinquency List

On February 12, 2015 DCAA issued a Memorandum for Regional Directors notifying auditors of an updated policy on the treatment of overdue incurred cost estimate (ICE) proposals which was accompanied by a "delinquency list" identifying alleged delinquent contractors (*15-PPD-002(R*). The new MRD follows one issued a year earlier that ended the practice of notifying contractors of late ICE submittals while maintaining DCAA actions to educate contractors of their responsibilities and help DCMA develop decrement factors. The new MRD alludes to various FAR provisions identifying ICE submission requirements (e.g. 52.216-7, 42.703-2(c)(1), 42.705(c)(1) and spells out the steps DCAA and DCMA will take this year including either obtaining an adequate ICE proposal or unilaterally establishing contract costs for hundreds of delinquent contractors. The MRD informs contracting officers they may apply a 16.2 percent decrement to total contract costs (both direct and indirect costs) if historical information related to the contract year is not available.

The 16.2 percent decrement factor to be used is supposedly based on "Agency-wide analysis." The MRD states DCAA will close the incurred cost assignments for the listed contractors on June 30, 2015 if the listed contractors have not provided an ICE submission, presumably triggering DCMA's unilateral rate determination. DCAA will not close those assignments where the CO has granted a valid extension or the parties are engaged in communications that would leave the assignment open. If a valid ICE submission is made after the date, DCAA may reopen the assignment at DCMA's request. Both the decrement factor and listing of supposedly "delinquent" contractors, where many stated they do not belong on the list since they have submitted adequate ICE proposals, began generating significant criticism from numerous industry circles. Then mysteriously and without explanation, the MRD has been removed from DCAA's website where as of this writing, we have been unable to obtain an explanation.

CRS Issues Primers on the FAR, Past Performance and Terminations

The Congressional Research Service recently issued basic guidelines on the Federal Acquisition Regulation, evaluation of contractor past performance and termination for the government's convenience. The FAR report provides an overview of FAR's history and promulgation, judicial treatment and permissible deviations. The CRS report on past performance lays out the legal requirements for evaluations, contract challenges and uses as an evaluation factor while the primer on terminations for convenience surveys total and partial terminations, constructive terminations, termination settlements and possibility of government breach of contract when terminating a contract. (The reports are available at www.fas.org/sgp/crs/misc where the FAR is R42826, Past performance is R415562 and Terminations are R43055.)

SBA Expands Mentor-Protégé Program to SDVO, WOSB, HUBZone and Small Business Programs

In February the US Small Business Administration issued a proposed rule making that would expand its current long standing mentor-protégé (M-P) program, currently limited to the SBA 8(a) program, to other small business concern programs such as HUBZone, women owned and service disabled small businesses. The rule change is being highly praised where typical responses are it will significantly expand opportunities to "it's about time." The M-P program allows a business that is other then small (large business) to team up and joint venture with an SBA-recognized small business where the resulting team can pursue small business and set aside opportunities where in return the large business would need to work with and train its protégé in agreed to areas such as financial, accounting, business development and project management.

Under the change, some things have not changed where under the M-P program the small business must locate a qualified mentor and negotiate and enter into an M-P agreement and JV agreement the SBA will need to approve. Even though assertions of affiliation still exist (e.g. over-dependence on large business, family members are in the same or similar line of business, key employees leave large businesses to start a similar small business) simply being part of an M-P cannot be a basis to find affiliation. Also the resulting JV must be "unpopulated" – not include its own employees but use the members' employees to be able to have the SBA verify work and scope of work performed by each JV member and

to make sure the protégé firm self-performs at least 40 percent of the work. Also, current requirements that HUBZone JVs consist of both partners being HUBZone firms will be eliminated where now the mentor need not be a HUBZone small business or be located in HUBZone areas. In addition, the general rule that a mentor may have only one protégé will now allow up to three if the mentor can show (1) it can meet the needs of multiple protégés and (2) the protégés are not competitors (*Fed. Reg. 6618*).

GSA Proposes Rule That May Have Large Impact on FSS Pricing

The General Services Administration has proposed requiring vendors on government-wide procurement contracts and Federal Supply Schedule (FSS) contracts to submit transaction pricing data that will largely displace burdensome reporting requirements of the price reductions clause (PRC) at GSAR 52.238-75. Under the proposed rule, GSA would implement a new pilot program, initially for non-FSS procurement vehicles and then expanded in phases to FSS contracts whereby contractors would no longer be subject to the "tracking customer" provisions of the PRC. The PRC provisions require contractors to monitor the prices it offers to the customer or category of customers that form the basis of award for a specific contract and then provide the government a corresponding price reduction when the contractor offers lower prices for these customers. Notably, the new rule would retain provisions of the PRC that require price reductions based upon changes to commercial catalogs, schedules or price lists that serve as the basis of award. Rather than rely on "tracking customer" requirements the proposed rule would shift the focus to a comparison of prices the government has paid across agencies and vendors for the same or similar goods and services. To obtain this data, contractors will be required to submit monthly reports through an online centralized GSA portal with transactional details of their sales to the government under FSS or other government-wide contract vehicles. Reports will include such details as unit measures, quantum of item sold, price per unit and total price.

The proposal submitted in March is beginning to generate considerable praise from industry groups where proponents of the proposed rule cite several reasons for their support. Tracking the transactional data will be easier than the tracking customer requirements of the PRC where FSS contractors are already tracking federal sales by contract for Industrial Funding Fee reporting purposes. Contractors will no longer have to compare pricing of their government contracts with pricing under commercial contracts where there may be dissimilar terms and conditions and service contractors will no longer be forced to assess whether employees on commercial contracts are performing services that are sufficiently similar to labor categories offered under their government contracts as required under the PRC. However, some critics of the proposed rule are saying though similar, the transactional reports are not the same as the IFF reporting where they will be issued more frequently (monthly rather than quarterly) and contain additional information Second, report per-unit pricing is not always straightforward where line items at the FSS level may account for per-unit pricing, but task orders often bundle goods and services into a single price not easily broken down by unit. Third, an effective cap on pricing goods and services will be in effect which fails to take into consideration contractor-specific terms and conditions such as delivery times (*Fed. Reg. 11619*).

Industry Says a New Bill is Needed to Overturn Non-Manufacturer Rule Decision

Several contractor groups as well as the Small Business Administration are pushing for legislation to undo the effects of a recent court decision broadening the SBA's non-manufacturer rule (NMR) to federal purchases of services as well as products. The NMR implements the Small Business Act's requirement that small business contractors agree to "supply the product of a domestic small business manufacturer or processor, unless a waiver" is granted. Where the SBA traditionally limited the NMR to contracts primarily for goods, the September 2014 decision in *Rotech Healthcare Inc. v US, (BL 26007*) ruled that interpretation was "too narrow" where now NMR applies to purchase of goods under all contracts including service contracts. Typical of industry comments is that when the interpretation is applied to, for example, the construction industry all small business contractors, which provides most services, will have to purchase their materials and supplies through small businesses and any prime contractor would be responsible for their subcontractor's use of small business products. Industry group responses to *Rotech* include "this interpretation is far reaching and extreme" and "nearly impossible to comply with" where the "paperwork burden is staggering." The industry groups as well as the SBA itself is calling for "legislative intervention" to remedy the unintended consequences of the Rotech decision.

DOE Cannot Manage Its Incurred Cost Backlog

Mirroring recent observations by the Inspector General Office of NASA, the IG Office of the Department of

Energy has issued a report stating the department needs to develop a risk-based approach and comprehensive strategy to ensure incurred cost audits are performed despite a backlog of such audits at DCAA. DOE relies on management and operations (M&O) contractors for most aspects of its government owned facilities where in recent years DOE has increased its use of cost reimbursable, non M&O contracts for environmental cleanup and constructions. Most such non-M&O contracts are issued by DOE's Office of Environmental Management (EM) which has over 40 prime contracts worth over $90 billion. Since 1991, DCAA has audited its incurred costs (I/Cs) on DOE contracts and subcontracts but DCAA's backlog has grown in recent years with delays up to eight years. For example, on DOE contract audits of 16 largest EM non-M&O contractors, seven never had an I/C audit, six had not had audits since 2010 and only three had audits since 2012 which IG says exposes DOE to "an unacceptable level of financial risk."

Though DOE offices have used various methods to handle the backlog such as supplementing DCAA work with public accounting firms, expanding current contractors' internal controls functions and considering developing an audit function within EM such efforts have not been well coordinated and in some instances do not comply with audit standards. Problems are exacerbated because DOE has only three year retention of certain records requirements and the Contract Disputes Act's six year statute of limitations potentially restricts recovery of unallowable costs beyond that time frame. The IG report recommends that DOE (a) coordinate with DCAA on a risk-based approach to non-M&O I/C audits to reduce the backlog and (b) develop a comprehensive strategy to supplement DCAA audit coverage to ensure audit of non-M&O I/C costs until the backlog is eliminated (*DOE/IG-0934*).

Review of Recent Executive Orders Affecting Contractors

The President's authority to issue executive orders (EOs) is a hot topic these days where there has been much discussion lately on a series of EOs affecting government contractors, many of which affect labor policy and worker's rights. Here is a brief review of the key government contract-related EOs where readers may examine them in more depth:

1. *Government Transparency/Open Records (2009).* On his first day in office, President Obama issued EOs aimed at expanding public access to government records under the Freedom of Information Act that creates a "presumption in favor of disclosure under FOIA" and directs agencies to publish information about their operations and decisions online and make records available to the public.

2. *Government Contract Workers' Rights (2009).* One week later, Pres. Obama issued three EOs concerning the rights of workers employed by federal contractors: (a) EO 13496 requires contractors and their subcontractors to post workplace notices of employee rights under federal labor laws (b) EO 13495 – "Nondisplacement of Qualified Workers Under Service Contracts" – requires successor contractors to provide a right of first refusal to predecessor employees for jobs they are qualified for and (c) EO 13494 makes unallowable federal contractor costs for activities to persuade employees to exercise or not exercise the right to organize and bargain collectively through representatives of their own choosing.

3. *Project Labor Agreements (2009*). EO 13502 encourages federal agencies to consider requiring use of project labor agreements on a project-by-project basis for large scale federally funded construction projects of at least $25 million.

4. *Controller Unclassified Information (2010*). EO 13556 establishes a program to manage controlled unclassified information uniformly and openly across the Executive Branch.

5. *Human Trafficking (2012*). EO 13627 prohibits federal contractors from engaging in any activities related to human trafficking and requires certain contractors to establish compliance programs to ensure awareness of its anti-trafficking policy.

6. *Improving Critical Infrastructure Cybersecurity (2013*). EO 13636 directs federal agencies to develop voluntary cybersecurity best practices for critical parts of the private sector including government contractors where the order also requires federal agencies to produce unclassified reports of threats to US companies and share them in a timely manner.

7. *Minimum Wage for Contractors (2014*). EO 13658 raises the minimum wage to $10.10 per hours for workers under federal contracts and subcontracts.

8. *Non-Retaliation for Disclosure of Compensation Information (2014).* EO 13665 aims to promote equal pay for women by improving transparency of wages and making gender pay disparities easier to identify by prohibiting federal contractors from retaliating against employees who discuss their pay with each other.

9. *Equal Employment Opportunity (2014*). EO 13672 bans sexual orientation and gender identity discrimination by federal contractors.

10. *Implementing Rehabilitation Act (2014)*. The Act prohibits employment discrimination of disabled employees of federal contractors and subcontractors and establishes a "7% utilization goal" for qualified individuals where employers must apply the goal to their job groups or to their entire workforce if the contractor has 100 or fewer employees. Contractors will not be subject to fines, penalties or other sanctions if they fail to meet the goal but they must conduct an "annual utilization analysis" to identify problem areas and then "develop and execute an action-oriented program designed to correct the problem.".

11. *Fair pay order (2014)*. For contracts worth at least $500,000 contractors must disclose to the best of their knowledge labor and employment law violations of more than a dozen federal wage and hour, discrimination, safety and health, labor and other laws as well as equivalent state laws during the preceding three year period. Agencies will be allowed to deny contracts to those with significant violation records. There is recent criticism from industry groups saying companies are at risk of loosing business over unproven allegations and subjective legal interpretations where there is already in place a robust suspension and debarment process where now contractors will have the burden of proving they have not violated the law in order to compete for contracts.

DOD Issues EVMS Guide

The Defense Department recently released an earned value management system (EVMS) interpretation guide with category guidelines for organization; planning, scheduling and budgeting; accounting considerations; analysis and management reporting; and revisions and data maintenance. EVMS is considered to be a highly useful tool for relevant, mostly large government contractors to obtain program status data to assess cost, schedule and technical performance of programs to allow for timely corrective action. The new guide seeks to provide interpretations of the 32 EVMS guidelines contractors must adhere to. Our consulting practice is seeing a significant increase in EVMS audits conducted by dedicated teams from the Defense Contract Management Agency. Call or email us to send you an electronic copy of the rather large guide.

Army Commits to OASIS Can Mean Billions in Opportunities

The Army, the government's second largest buyer, recently signed a Memorandum of Understanding (MOU) to use the General Services Administration's OASIS and OASIS Small Business multiple award contracts (MACs) for complex professional services procurements. OASIS will provide as much as $60 billion in professional services opportunities during the next decade. The program consists of two large MACs – one unrestricted and the other a small business set aside. Both MACs have identical scopes, with services spanning 28 North American Industry Classification System (NAICS) codes and six exceptions where the top ones are Engineering Services (54133), Research and Development in the Physical, Engineering and Life Sciences, Except Biotechnology (541712) and all Other Professional, Scientific and Technical Services (541990). Work performed on OASIS will include program management, consulting, scientific services, engineering, logistics and financial services. IT is considered ancillary on OASIS where it will be procured only when necessary to complete a solution.

NSF Issues Reports Questioning Costs at Many Universities

Using an audit report conducted by a private CPA firm, the National Science Foundation (NSF) Office of Inspector General has completed its audit of $218 million on 612 NSF awards to Michigan State University from January 2010 through Dec. 2012. The IG questioned $913,210 in senior personal salary and applicable fringe benefits and other indirect costs at MSU stating the questioned costs were due to charges of senior personnel that exceeded two months, typically the limit of such charges on government contracts. MSU disputed the questioned costs asserting the resulting work scope exceeded what was originally expected justifying additional senior personnel costs. A similar IG report was issued questioning close to $1 million of costs at the University of Florida including $867,188 of senior personnel salaries exceeding NSF's two month limit, $48, 453 for travel expenses, $32,822 of unsupported or unallowable allocable expenses, $27,331 of unreasonable equipment charges, $7,880 in student stipend advances, $7,160 in unallowable meals and related services and $1,628 in foreign currency conversion costs. Other NSF IG reports were issued questioning costs at New York University, Cornell, Virginia Tech and UCLA.

CASES/DECISIONS

Contractor Not Entitled to Direct Overhead Costs Using a Per Diem Computation

In its proposal to upgrade utilities, Watts selected the indirect percentage markup method to compute its

overhead. In claiming an equitable price adjustment due to a differing site condition, it computed the overhead it was due by using a per-diem basis, claiming the costs as direct. Though it agreed that additional direct labor charges were justified, the Board sided with the government in disallowing the direct per diem overhead charges. It stated that FAR 31.105(d)(3) allows for either indirect charges using a percentage method or direct charging on a per-diem basis as long as the overhead is charged consistently. Here, Watts impermissively changed its accounting practice on the contract where it was entitled to recover its claimed overhead costs only as an indirect overhead cost using a percentage basis (*Watts Constructors, LLC, ASBCA No. 59602*).

Entitled to Escalated Costs Caused by Government Delay Without an EPA Clause

In its claim for recovery of additional costs due to a government delay, the government rejected the claim asserting ADT was not entitled to escalation of its costs because it did not have an Economic Price Adjustment clause in its contract. The Board sided with ADT saying the cause of the increased costs were from delays caused by the government and citing other cases ruled a contractor can recover damages for cost escalation for government-caused delays where there is no EPA clause in the contract (*ADT Construction Group, ASBCA No. 57322*).

Termination Settlement Entitlement Based on All Work Performed

A contract to manufacture ten aircraft simulators to TriRAD was terminated for convenience after delivery of the first one. The contracting officer denied the termination settlement proposal seeking $2 million arguing that FAR 52.212-4(l) allowed a contractor to recover expenses only for work delivered and accepted. The Board disagreed stating a termination for convenience settlement should fairly compensate the contractor for costs related to terminated work where the principle applies to all work performed, including partially completed items at the time of termination. The Board ruled that TriRAD had completed 56 percent of the contract and hence was awarded about $1 million (*TriRad Tech., Inc., ASBCA 58855).*

Mechanical Evaluation of Government Estimate is Improper

Eight offerors submitted proposals for a cost type contract for base operations to be awarded on a best value basis. The government conducted a non-disclosed cost realism analysis and evaluated all proposals against the government determined full-time equivalent (FTE) staff estimate to determine proposal staffing adequacy. Despite the offerors' varied technical approaches to the contract work, it mechanically applied its FTE estimate concluding Flour's staff estimates on its original proposal was inadequate where Flour revised its proposal adding the number of FTEs the agency identified. The revision resulted in increased costs that made its proposal noncompetitive despite ranking highest in non-cost aspects. The Comp. Gen. sided with Flour on its protest finding the agency improperly evaluated proposals where its evaluation was based on a mechanical application of a government's estimate that did not consider each offeror's unique technical approach (*Fluor Fed. Solutions, Comp. Gen. Dec. B-410486*).

Board Upholds Penalty for Unallowable Legal Patent Costs

(*Editor's Note. One of the more frequent challenges to imposition of penalties on unallowable costs is to assert their inclusion in proposals was "inadvertent." The following case addresses this defense.)*

On its 2007 incurred cost proposal DCAA questioned $82,396 of patent legal costs. It found that two conditions for allowing such costs – either required for a contract or for "general counseling" (e.g. advise in patent laws, regulations, clauses and employee agreements) were not met and hence were expressly unallowable and subject to penalties. The CO agreed where in its final written decision it imposed $91,151 of penalties (including interest). Coherent requested a waiver of the penalty citing FAR 42.709-5(c) that allows for the waiver of the penalty if the unallowable costs were "inadvertently" claimed despite exercise of due care. Coherent insisted it included the legal costs because DCAA had previously approved the costs in prior incurred cost audits and that it had instituted "remedial measures such as written policies and procedures, personnel training and internal controls to identify unallowable costs subject to penalties." The Board said the first prong of proving inadvertent inclusion of the costs was not met because there was no evidence of prior submittal and approval of patent legal costs. It did not address the "remedial measures" since proof of inadvertent inclusion required two prongs where the first was not met. The Board stated "the costs were not inadvertently incorporated into the proposal but were included because Coherent believed them to be allowable" (*Coherent Logix Inc., ASBCA No. 59275*).

Contractor Entitled to Severance Costs

In a NASA firm fixed contract for mail distribution a contract modification was issued incorporating a collective bargaining agreement between GCR and its union that provided for severance pay to employees with six or more months of service. As its contract neared expiration it learned that several of its employees would be hired by the successor contractor so it then requested an equitable adjustment for the employee's severance pay. The agency denied the request arguing that GCR was not entitled to recovery because it had assumed the risk of severance payments when it agreed to a fixed price contract. Citing a similar case, the Board ruled in GCR's favor stating it was entitled to recovery because the wage determinations in the collective bargaining agreement were properly incorporated into the contract. The Board also stated that GCR could not have predicted the severance costs at the time of its initial price proposal that negated the "at risk" argument of the government (*Government Contracting Res. ASBCA No 59162*).

QUESTIONS & ANSWERS

(*Editor's Note. We are not providing our usual New/Small Contractor article this issue in order to keep up with the high volume of questions we have been receiving lately. We will continue with the article next issue and, of course, will continue providing relevant articles in the GCA DIGEST*)

Q. One of our astute subscribers read our recent article in the last issue of the GCA DIGEST where we were challenging a DCAA objection to our client's use of "comp time" – billing the government for all direct labor hours worked but banking all hours in excess of 76 hours per week where employees are free to use the banked hours for vacation, sick or other leave time or simply be paid for the banked time when they wanted to or when they were no longer employed. Our subscriber is asking whether they can adopt a comp time arrangement that would meet its pricing goals of lowering its overhead rate by not providing mandatory vacation, sick leave or other paid time off (thereby lowering its overhead pool) yet charging all time worked and billed as direct labor (thereby, increasing its overhead base).

A. We see no reason why you could not adopt a comp time arrangement. Of course, you want to make sure it will meet your pricing needs over a longer period of time, would not be objected to by employees who are more used to having their earned time off dictated to them by company policy and educating your auditors about the compliance rules.

Q. I am reading an article listing mandatory FAR flow-down clauses titled New Clause Flow-Down Requirements and it listed your contact information for questions. Can you please clarify if the listed clauses are mandatory flow-down to all subcontractors according to the FAR or just what Prime Contractors should flow-down? Specifically for FAR 52.249-2, can you please point out where in the FAR it states that this clause is a mandatory flow-down?

A. The FAR does not address whether most of its clauses are mandatory flowdowns but rather the Committee on Federal Subcontracting section of the Public Law Group of the American Bar Association occasionally puts out guidance addressing what clauses are mandatory, recommended or neither. The "recent" article where we addressed subcontract flow down clauses was in the third quarter 2011 issue of the GCA Digest where we summarized the most recent changes that were made by the ABA in 2005. As far as we know, the ABA has not updated these changes since 2005 where we periodically contact the ABA to see if changes have been made. As for the specific clause you mention, that is a mandatory flow down clause. If you would like to obtain copies of articles we have written that address flow down clauses go to our website and at the key word search prompt input "flow down clauses."

Q. DCAA is questioning costs we incurred in a "consortium" arrangement with a partner in pursuit of commercial opportunities stating they are unallowable costs of a "teaming arrangement, joint venture or similar arrangement." Our attorney thinks this FAR provision is relevant only when those arrangements apply to government contracts, not commercial work. What do you think?

A. You attorney's citation of several cases makes a persuasive argument and I would put it forward. Even if DCAA or the contracting officer eventually disallows the costs, the attorney's argument is sufficient to prevent the imposition of penalties on the claimed costs which are supposed to be imposed only when the questioned costs are "unquestionable." In addition, I would claim the issue is one of allocability not allowability where allocated costs are not considered "expressly unallowable" (e.g. CAS violations are not subject to penalties). .

Q. I am confused about a discussion I am having with our DCAA auditor and contracting manager. The auditor is saying we must withhold fee on our cost type contract where our contracting officer is saying that is not true. What do you say?

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A. The issue has become rather murky these days. The older version of FAR 52.216-8 stated COs "may" allow for fee withhold at no more than 15% of the negotiated fee where there were two possibilities – either take 15% out of all billed invoices at inception or wait until 85% of the fee is paid and then withhold the remaining 15%. Now, "may" has been eliminated but there is still no requirement – it states, for example, a retained amount up to 15% can be used meaning less or none may be acceptable. It still comes down to what is in the contract. The schedule or invoice instructions should explicitly state the amount to be retained. If silent, then there is no requirement. The FAR clause you mention only provides guidelines that can be incorporated in a contract – it is not authoritative over what your specific contracts call for.

Q. We have lots of profit this year. In order to lower our G&A rate to be more competitive, can we build inventory this year to be able to increase our G&A base and hence lower our rate. Or should we submit an adjusting rate for a higher G&A. If we do the latter, we will have to lay off people until we get the government contract we are anticipating.

A. I would consider adjusting your rate, build for inventory and keep people working. You may not have to do so much adjusting where you can still keep labor idle for a reasonable period of time which would tend to increase your rate because it is charged indirect while the inventory buildup will decrease it. Keeping labor idle for a reasonable period of time can usually be justified (e.g. forgo severance related costs, new training costs, finding replacements can adversely affect quality when the new contract is awarded).

Q. My organization has a total cost input G&A base. Every so often, I receive inquiries from project managers about the potential for exceptions to G&A application on "pass-through" costs, where we do not add value to the cost, but merely pass it along to the client. Are there any legitimate exceptions to the total cost input base?

A. Yes there are. You can use a value added base (total costs excluding subcontract and material costs) or a modified total cost base excluding those items that have no support effort. The latter will likely require an agreement with DCAA and your ACO if you intend to include certain types of subcontract or material costs in the base and exclude others.

Q. We have been going through several federal false claims investigations and are considering a settlement to avoid prolonged and costly actions. What are the tax implications of the settlements?

A. Though we are not tax specialists (the compliance work keeps us busy enough) we did come across a relevant article in the Dec 2014 issue of Contract Management written by several attorneys of the firm Lathan & Watkins. The amount that is tax deductible is compensatory damages while the damages called or considered to be punitive are not deductible (C.F.R. 1.162-21). So the way the damages are characterized is key to whether they are deductable. The authors advise making clear during the negotiation process that the settlement offer is intended to "make the government whole" for actual losses or related expenses (e.g. investigation expenses, relator fees, etc.) and to make clear in the settlement agreement the basis for the "compensatory damages" while avoiding language to indicate there are punitive damages (e.g. "penalties").

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