GCA REPORT
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NEW DEVELOPMENTS

DOD Recommendations for Streamlining CAS

(Editor's Note. Since many of the affected cost accounting standards discussed below are applicable to both CAS covered and non-CAS covered contractors these changes should be significant to all contractors who must justify costs.)

In response to the Cost Accounting Standards Board's request for input to streamline CAS in order to encourage commercial contractors to enter the government marketplace, the Department of Defense through its procurement office of cost, pricing and finance has put forth its list of high priority recommendations it intends to push for implementation. They include:

1. *Identifying unallowable costs.* CAS 405 should clearly permit the use of sampling in lieu of specific identification to demonstrate it is properly screening unallowable costs. The sampling plan would need approval from DOD representatives (e.g. DCAA).

2. *Capitalizing tangible assets.* Revise CAS 404 to permit minimum capitalization thresholds reflected in contractors' books of accounts.

3. *Depreciation.* Replace CAS 409 to allow contractors to use the depreciation practices represented in its financial statements provided they are the same as the practices used for commercial segments.

4. *Pension costs.* Study the feasibility of amending CAS 412 to permit accrual of costs without funding when the six requirements of CAS 415 are met – most notably a future payment is required which the contractor cannot unilaterally avoid.

5. *Accounting changes due to external restructuring.* Contract price and cost adjustments should not be required when a contractor takes actions that include changes to cost accounting practices (e.g. pool combinations, pool spinouts and functional transfers) when costs on CAS-covered contracts are not increased.

6. *Disclosure statements.* Limit disclosure requirements to only home offices and segments subject to full CAS coverage and eliminate items from the disclosure statement that do not relate to cost accounting practices.

DCAA Softens Its Stand on Auditing Subcontractor Costs

DCAA has issued a "clarification" to its earlier guidance on citing contractors for estimating system deficiencies for failing to obtain and audit cost or pricing data from subcontractors. The earlier guidance, reported in our September-October issue, reminds auditors that a contractor is required to obtain cost or pricing data and conduct a cost analysis of "prospective sources" for procurements exceeding $500,000 prior to negotiations (unless otherwise exempted such as a commercial item). When the subcontract either exceeds $10 million or represents more than 10% of the prime contract and still meets the $500,000 threshold, auditors are instructed to issue estimating system deficiencies if the cost and pricing data is not obtained and analyzed.

The new guidance states that under "exceptional circumstances" it is not always possible to obtain and analyze subcontractor cost and pricing data prior to negotiation of the prime contract. Criteria for "exceptional circumstances" are the contractor has made a good faith effort to comply with FAR requirements but circumstances beyond its control (e.g. government imposed time constraints) prevented completion of steps related to cost and pricing data. The guidance states for these exceptions to apply the contractor should show it has policies and procedures in place that provides for the contractor to (1) timely identify such circumstances and (2) submit requests to the ACO to be excused from obtaining and analyzing the data. Such requests need to include an explanation why it cannot be submitted in a timely manner and offer a proposed alternative method such as applying a decrement factor to a proposed subcontract based upon the historical differences between initial proposed subcontractor amounts and the amount negotiated.

Recovery Auditing is Advancing

In response to recent GAO reports highlighting the fact that overpayment to contractors has increased, the government is taking steps to curtail such practices. The FAR Council already proposed last August the FAR and DFARS be amended to require contractors promptly notify the government of overpayment. In addition, a bill passed by the House and another introduced September 12 by the Senate will require the heads of executive agencies to conduct recovery audits and activities each year if their payments exceed $500 million. Recovery auditing is the practice of reviewing accounting and procurement records to find overpayments to vendors from duplicate payments, pricing errors, failure to provide discounts, rebates or other applicable allowances. The recovery audits may be conducted by current agency CFOs or inspector general offices or an agency head may conduct public-private cost comparisons to determine whether outside firms will conduct the audit. Already, the Commerce Business Daily recently announced a Defense Commissary Agency solicitation for recovery audit services for researching accounts payable resale and non-resale items where the contractor will be compensated by receiving a set percentage of amounts actually collected.

Congress Attempts to Delay FASB Elimination of "Pooling of Interest" Method

Congress has proposed legislation intended to stop the Financial Accounting Standards Board (FASB) from eliminating the "pooling of interests" method of accounting for business mergers and acquisitions. FASB is seeking to eliminate the pooling method, which simply adds together the book values of the combining companies, saying the method hides the true cost of the combination. The proposed legislation, endorsed by many influential legislators of both parties, is proposed because many companies, particularly high technology companies, would be harmed if they are required to write off the premium over book value paid for the companies they buy. The proposed legislation call for "further study" before issuing the rule. The Chairman of FASB, Edmund Jenkins, spoke out against the proposed legislation stating it would have "serious and negative impact upon consumers of financial information" and interferes with the independence of FASB. It does appear as if the decision will be postponed until 2001 rather than the earlier late 2000 schedule.

DOE Allows Contractors to Recover Defense Costs of Whistleblower Retaliation Claims

The Department of Energy has amended its Acquisition Regulation DEAR 931.205-47(h) to provide its contracting officers the flexibility to allow costs associated with defending against employee whistleblower retaliation claims on contracts and subcontracts exceeding $5 million. Effective November 17, DOE COs are to determine the allowability of defense, settlement and award costs related to whistleblower retaliation claims on a case-by-case basis. The intention is not to allow costs resulting from unlawful conduct but to allow costs resulting from prudent business judgement.

The original proposed rule sought to allow settlement costs while excluding costs where an adverse determination against a contractor was made but commentators successfully argued that this would give DOE contractors the financial incentive to settle all employee retaliation claims no matter how meritless and encourage frivolous claims. A latter proposed rule tried to include all labor cases but this was rejected and limited to the whistleblower cases only. Responding to some commentators' concern that the flexibility would result in inconsistent rulings by different COs the proposal includes a stipulation that all COs report their final cost allowability determinations along with their rationale to DOE and additional guidance can be put forth if inconsistencies result.

Actions Increasing Opportunities for Minority and HUBZone Firms

President Clinton signed an Oct 6 Executive Order No. 13,170 aimed at increasing federal government contracting opportunities for minority small businesses. The order calls for agencies to establish separate goals for contracting with 8(a) firms, small disadvantaged businesses (SDBs) and minority business enterprises (MBEs). The goals are in addition to the current government-wide goals of contracting with 23 percent small businesses and at least 5 percent of total prime and subcontract dollars going to SDBs. To achieve these goals, agencies are to enforce commitments from prime contractors to use SDBs as subcontractors, require each agency to submit implementation plans within 90 days, submit annual reports on efforts to achieve goals and "aggressively" seek participation of 8(a), SDB and MBE firms in all information technology contracts and GSA schedules. Many say the executive order was issued to allay fears that efforts to bundle previously separate contracts would hurt minority small businesses.

The SBA rules to help expand HUBZone program opportunities and ease eligibility rules. The HUBZone program was created to provide expanded contracting opportunities to small businesses (regardless of race or sex) that locate in or hire 35 percent or more of their employees from economically distressed and rural areas. The proposed rule has added three more federal agencies (Commerce, Justice and State) to the original 10 agencies that use the HUBZone program. In order to accommodate contractors who work at various job sites the rule includes a revised definition of "principle office" to mean the location where the greatest number of the concern's employees perform their work but excluding those employees who perform work at job site locations to fulfill specific contract obligations. Further, the new rule eliminates the existing requirement that a qualified HUBZone concern may have only affiliates who are also qualified HUBZone, 8(a) or women owned concerns because of complaints of otherwise qualified companies whose affiliates did not meet the conditions. Finally, non-manufacturer HUBZone firms no longer need to demonstrate they provide products manufactured by qualified HUBZone small businesses and for contracts below $25,000 can use products of any business.

CAS Board Proposes New Coverage of Post Retirement Benefits

The Cost Accounting Standards Board Oct 5 proposed a new standard – CAS 419 – directly addressing the costs of post-retirement benefits (PRB) under government contracts. The proposal is in the form of an advanced notice of proposed rulemaking which followed a 1996 staff discussion paper and a 1999 request for comments on adopting the current SFAS 106 guidance on PRB cost.

The CAS Board decided coverage was necessary because PRB costs, mostly in the form of health and insurance costs for retirees, are significantly increasing and unlike pension costs, are largely unfunded. Earlier discussion envisioned amending relevant sections of CAS (e.g. pension costs of 412 and 413, insurance costs of 416, deferred compensation of 415) but it was decided such action would be "extremely cumbersome" and would "muddy" the existing standards so it was decided to issue a separate standard that would maintain consistency with the others. Earlier considerations also thought it would be sufficient to apply Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefit Costs other than Pensions" to government standards but it was decided that though SFAS 106 could be used as a "baseline" it was either inadequate or inappropriate for government contract costing. Also, earlier debate centered around funding where government representatives thought actual funding was necessary but industry objections resulted in recognizing the cost on an accrual basis when a valid liability to pay was sufficient to charge government contracts. The proposed standard is presented in six subsections and we will detail them in the next issue of the GCA DIGEST.

CAS Board Addresses ESOPs

In what is the first of a four-step process to change cost accounting rules, the Cost Accounting Standards Board issued for public comment a Staff Discussion Paper on employee stock ownership plans (ESOP). ESOPs, which have become more prevalent in recent years, are individual stock bonus plans that facilitate employee investment in the stock of an employer that can be structured as a form of pension plan offering benefits for life or as a non-pension plan intended to provide deferred compensation. Employer contributions of cash, stock or other marketable securities are made to an Employee Stock Ownership Trust (ESOT) that holds or invests employee securities for the benefit of employees.

Though FAR 31.205-6 "Compensation" treats ESOPs as allowable and SOP 93-6 provides guidance on measurement and disclosure for *financial reporting* purposes, CAS does not specifically address how these costs should be allocated to *government contracts*. Depending how they are structured contractors have invoked either CAS 412 "Pensions" or CAS 415 "Deferred Compensation" to support their measurement and allocation practices. The staff paper asks (1) whether SOP 93-6 provides sufficient guidance for treating ESOPs and if not, should CAS 412 or 415 be amended to provide adequate coverage (2) should the form of ESOP benefit payments (e.g. money, other than money) make a difference in measuring cost allocable to government contracts (3) should the fair value of shares released by an ESOP to employee individual accounts be set when title to the shares is transferred to the ESOP or when the shares are committed to be released to employee accounts and (4) for contract costing purposes, should a distinction be made between the measurement of the "cost to the company" or measurement of compensation "received by the employee"?

Though the issue of whether the government should reimburse interest costs attributable to ESOPs (when the ESOT borrows money to acquire employer stock) has been a hot top in recent years the interest issue is

not one of cost allocation under the CAS but a cost allowability issue addressed by procurement regulations.

BRIEFLY…

DOD Fiscal Year 2001 Authorization Bill Passed

The House and Senate conferees reached agreement on the fiscal year 2001 National Defense Authorization Bill. Provisions related to contracting, cost and pricing include: (1) when *contract bundling* (i.e. combining two or more prior contracts into one) is contemplated comprehensive studies are required analyzing their effect on small businesses, socially disadvantaged or women-owned businesses (2) it will allow procurement notices to be published electronically if they are "accessible" – in a form that allows convenient and universal user access through the single government-wide point of entry (3) women-owned businesses will become eligible to join mentor-protégé programs and (4) make performance-based contracting (i.e. basing payments on agreed-to milestones) a priority by requiring contracts or task orders for acquiring services to be in the following order of preference: (a) a performance-based contract that contains fixed prices (b) other performance based contracts or task orders (c) a contract or task order that is not performance based. An earlier amendment that would have made the CAS Board independent from the Office of Federal Procurement Policy was not included.

FAC 97-20 – Final Rule on TINA Threshold

Effective October 11, a final Federal Acquisition Regulation rule was passed to revise the Truth in Negotiations Act (TINA) threshold from $500,000 to $550,000. The purpose of TINA is to provide assurances the government receives current, accurate and complete cost information on contracts requiring it. It requires contractors to provide cost or pricing data when the contract exceeds a certain threshold and if the data is defective allows for a price adjustment to the contract. The final rule amends FAR 15.403-4, Requiring Cost or Pricing Data.

House Panel Wants Debtors to Pay Back Taxes Before Receiving a Contract

The House Government Reform Committee approved legislation that would require individuals and businesses to pay past-due federal taxes and loans to be eligible for new federal contracts or loans. Citing statistics that over 2 million businesses owe nearly $50 billion in back taxes, the panel states many delinquent government contractors are receiving government contracts. The bill is expected to go to the House floor in 2001.

OMB Releases More Fair Act Lists

Pursuant to the Federal Activities Reform Act requiring agencies to list all positions that may be potentially available for outsourcing to the private sector, 26 agencies listed almost 200,000 jobs. That number should pale after the Department of Defense lists its jobs. Though the Office of Management and Budget has directed each agency to list the jobs on their own individual website this has not yet occurred and all the jobs can be found at http://www.whitehouse.gov/OMB/procurement/fairindex.html.

CASES/DECISIONS

Cannot Retroactively Apply Compensation Caps

The contractor was awarded a cost plus fixed fee contract in 1996 that contained the standard clause (FAR 52.216-7) stating the contractor was entitled to be reimbursed for its allowable costs set forth by the FAR cost principles "in effect on the date of the contract". FAR did not impose a cap on executive compensation in 1966 but Congress subsequently passed the 1998 DOD Authorization Act that imposed a cap on the amount of executive compensation allowable on flexibly priced contracts in effect on the date of passage as well as future contracts.

When the government disallowed costs exceeding the cap, the contractor challenged it contending the cap breached the terms of its contract. The contractor made two arguments: (1) the Authorization Act was not a "public and general" act that allows the Sovereign Act to release government from its contractual obligations but was an act specifically designed to reduce costs to the government in its contract capacity and (2) the allowable cost and payment clause contained an "unmistakable" promise on the part of government not to pass regulations that would prevent reimbursement of costs made allowable on the date of the contract. Applying reasoning from other cases (*US vs. Winstar Corp* and *Yankee Atomic Electric Co.*) the court agreed the Authorization Act was not a "public and general" act and therefore the government could not invoke the sovereign acts defense but instead, was no more entitled to favorable treatment in contract interpretation than a private party. Since the law of contracts and not

sovereignty prevailed, the regulations in effect had no cap on allowable executive compensation and the regulation seeking to impose a cap retroactively constituted a breach of that contract (General Dynamics. V. United States, Fed. Cl. No.-99-45C).

Agency Reasonably Evaluated Subsidiary's Proposals by Assessing Corporate Parent's Resources

(Editor's Note. The following demonstrates the advantages of having a "heavy-weight" parent and how to use their capabilities when proposing.)

In its proposal for providing mailing supplies to the Post Office, Ensemble, a subsidiary of Hallmark Cards, made numerous references to its parents capabilities to bolster its proposal. For example, under the "level of service" evaluation factor Ensemble touted Hallmark's "retail support center" providing a sales force, order processing system and quality assurance and under the "capability" evaluation factor Ensemble referenced Hallmark's warehouse management, information technology and accounting systems. In visits to Hallmark facilities the source selection team were told of the services "we" provide. When Ensemble was awarded the contract T&S protested alleging it was arbitrary and capricious to assess Ensemble's proposal by focusing on Hallmark when Hallmark did not "guarantee" its support. The Court sided with Ensemble stating it was proper to consider Hallmark's resources when the solicitation did not prohibit subsidiaries from relying on their parent corporation.

(Editor's Note. In other cases, we have seen that a parent's past performance may be considered when they plan to participate in the project and the solicitation does not prohibit it (Fluor Daniels, Inc., Comp Gen B-262051) but if not involved in the project it is improper for the agency to consider the parent's experience (Universal Bldg. Maint. Inc., Comp Gen Dec B-282456). Similarly, the experience of a subcontractor may also be considered when not prohibited or limited by a solicitation.)

Union Wages Trump SCA Wages

AKAL Security was covered by a collective bargaining agreement with Local 80 of the United Government Security Officers union that required it to pay security officers $16.65 per hour. When AKAL won a security contract it contacted the Department of Labor's Wage and Hour Division to issue a wage determination rate for the new year and the DOL, not knowing of the union agreement set a $17.57 per hour rate. When it discovered the union agreement DOL notified AKAL the wage determination was not applicable and AKAL immediately lowered the wages paid to $16.65.

Local 80 appealed to DOL's Administrative Review Board to receive the higher amount for its members asserting the area wage determination governed the procurement even when it was higher than a collective bargaining agreement (CBA). The Review Board rejected Local 80's argument stating the SCA sets forth two wage determination mechanisms. First, where a CBA covers a group of service employees, the SCA wage rate for any successor contract is based on the wages paid under the CBA. Second, if there is no CBA, the wage rate is based on the "prevailing rates for such employees in the locality" commonly known as the area's wage determination. Since the CBA covered AKAL's employees, the correct wage determination was $16.65 (United Govt. Sec. Officers of Am., Local 80, DOL ARB 00-030, 2000 WL 1273986).

Cost Realism Analysis Should Consider All Information Available at Time of Evaluation

(Editor's Note. The following case demonstrates the need to justify proposed indirect rates that are lower than historical ones under a cost type contract.)

Deloitte Touche proposed a lower G&A rate than its historical actual rate for a cost type contract for services supporting family planning programs overseas. During its cost realism analysis, where rates can be adjusted based upon what the analysis concludes, the agency nonetheless accepted the lower rates believing that the increased revenue from the contract would lower the actual rates to those proposed and subsequently awarded the contract to Deloitte. TGI protested asserting that using the higher historical rates would have resulted in an upward adjustment of $14 million to Deloitte's offer which would have given it a lower bid price and hence the award. The Comp. Gen agreed with TGI and ordered the agency to conduct a better cost realism analysis since Deloitte did not demonstrate how its lower rates would be achieved.

In its subsequent audit, DCAA concluded that Deloitte's proposed rates were understated by $4.5 million for the first two years due to the delays in realizing contract revenue but the proposed rates were realistic after that period. The agency did not adjust the Deloitte proposal for the $4.5 million asserting a cost realism analysis should only include information available at the time proposals were submitted – since the revenue shortfall and DCAA's audit conclusions were not known at the time of the initial proposal that information should not

be considered. In addition, the agency modified the contract it gave Deloitte by capping its indirect costs at the proposed rates. FGI challenged the second cost realism analysis asserting the $4.5 million understatement should be used to upwardly adjust the proposal. The Comp. Gen. sided with FGI stating a cost realism analysis should reflect the Government's best estimate of likely costs and hence should consider all information reasonably available at the time proposals are *evaluated* not just at the time the proposals were *submitted*. As for the subsequent cap on rates, it represented a material change in Deloitte's proposal and could not be considered by the agency without first conducting discussions with all the other offerors (The Futures Group Intl., Comp. Gen. Dec. B-281274.2).

It is Improper to Discuss the Same Weaknesses on One But Not All Offers

During evaluation of a second round of proposals, the source selection board discussed previously identified weaknesses of the revised proposal with one party but did not discuss the same recurring weaknesses with another. The unsuccessful bidder protested and the Court sided with the protestor stating they were prejudiced because unlike the awardee were not given a second chance to resolve its previously-identified weaknesses and hence improve its chances for award. The Court concluded FAR 15.306(d) was violated which prohibits agencies from favoring one offeror over another (Dynacs Engrg. Co. vs U.S., 2000 WL 1584169 (Fed. CI).

Combining FSS and Non-FSS Items Require Consideration of Non-FSS Vendor

The Army solicited quotations for a fire alarm system from several Federal Supply Schedule (FSS) vendors as well as two vendors that did not have FSS contracts. T-L-C, one of the non-FSS vendors, offered the lowest price but the Army made the award to a higher priced FSS vendor because only its system was included in the FSS in spite of the fact other critical items were not part of its FSS contract. The Army offered to eliminate those items from the contract and bid them out separately but T-L-C argued it would not be satisfied.

The GAO sided with T-L-C stating that when an agency does decide to purchase from the FSS it may limit its consideration to the lowest cost FSS vendor. It cannot select a vendor when an award to a FSS-vendor includes items not on the schedule that exceed the micro-purchase threshold (currently $2,500). The GAO also agreed that it was not sufficient to remove the non-FSS items from the order since evaluating non-FSS vendors expanded the acquisition to those vendors (T-L-C Systems, Comp. Gen. No. B-285687).

NEW/SMALL CONTRACTORS

Evaluations of Estimating Systems

Audit scrutiny over contractors' estimating practices have substantially increased for several reasons. DCAA wants to ensure contractors' controls over estimating are sound so it can conduct less transaction testing during its proposal audits, increased government urgings to cite contractors for "estimating deficiencies" when certain events do or do not occur (e.g. failure to review subcontractor proposals, using inappropriate estimating techniques) and fewer audit requests in many DCAA branch offices result in assigning surplus auditors to lower priority audits such as estimating system surveys. The emphasis on citing estimating deficiencies has resulted in expanding these surveys from traditionally large contractors to smaller ones who may represent a "high audit risk".

Consequently, increased audit scrutiny on estimating systems require greater contractor attention. A determination of inadequacy can and does lead to rejection of proposals, suspension of progress payments and inability to win awards. A knowledge of what is an adequate estimating system, what are considered significant weaknesses and what steps auditors are likely to take can avert adverse audit opinions. In our consulting practice, for example, we were able to help a client avert assertions of estimating deficiencies during a period they were to bid on major government work by demonstrating it had sound internal controls over estimating. In this article we will summarize the major regulation covering estimating systems and in the next article we will focus on what auditors will look for.

DFARS Regulation

DFARS 215.811-70 provides an unusually high amount of detail on requirements of estimating systems including who is covered, identifying the characteristics of an adequate estimating system, procedures for review, indicators of deficiencies, notification steps to be taken when deficiencies are found and what options the CO has for awarding a contract to a contractor having estimating problems. In addition the clause at DFARS 252.215-7002 provides the contracting authority to the government.

♦ **Who is Covered**

DOD policy is that all contractors should have estimating systems that are (1) adequate (2) consistently produce well supported proposals that can be relied on to negotiate fair and reasonable prices and (3) are consistent with and integrated with applicable management and financial control systems. Suspected problems meeting these standards are often cited as justification to review non-major contractors' estimating system. In addition large businesses are subject to more elaborate requirements if it received either (1) $50 million or more in contracts or prime contracts in the preceding fiscal year for which certified cost or pricing data was submitted or (2) had prime or subcontracts totaling $10 million (but less than $50 million) requiring cost or pricing data and the government decides it is in its best interest (e.g. significant estimating problems are believed to exist or the contractor's sales are primarily to the government).

♦ **Characteristics of an Adequate Estimating System**

Generally an adequate system should provide for appropriate source data, utilize sound estimating techniques, show good judgement, maintain a consistent approach and adhere to established policies and procedures. Examples of adequacy include:

1. Clear responsibility for preparing, reviewing and approving cost estimates
2. Provides a written description of the organization and duties of personnel
3. Assures personnel have adequate training, experience and guidance
4. Identifies the source of data, estimating methods used and rationale for developing cost estimates
5. Appropriate supervision is applied
6. Consistent application of estimating techniques
7. Timely detection and correction of errors
8. Protects against cost duplication and omissions
9. Provides for use of historical experience including historical vendor pricing information when appropriate
10. Uses appropriate analytical methods
11. Integrates information from other management systems
12. Requires management review to ensure a company's estimating policies, procedures and practices comply with this regulation
13. Provides for internal review of accuracy of projections by, for example, comparing actuals with estimates
14. Possesses procedures to update cost estimates in a timely manner during the negotiation process (e.g. defective pricing scrubs)
15. Addresses responsibility for analyzing the reasonableness of subcontract prices.

♦ **Indicators of Potential Deficiencies**

The following are examples of incidents that may lead to assertions of estimating deficiencies which are usually identified during audits of forward pricing proposals.

1. Failure to ensure that historical experience is available to be used by cost estimators
2. Continuing failure to analyze material costs or perform reviews of subcontractor prices
3. Consistent absence of analytical support for significant proposed cost amounts
4. Excessive reliance on individual personal judgements where historical experience or commonly utilized standards are available
5. Recurring defective pricing findings within the same cost elements
6. Failure to integrate relevant parts of other management systems (e.g. production control, cost accounting) with estimating so reliable estimating is impaired
7. Failure to provide established policies, procedures and practices to persons responsible for preparing and supporting estimates.

♦ **Disposition of Audit Findings**

Once the audit (which we will discuss in the next article) is complete and the contractor responds to audit findings the contracting officer will make a determination on the estimating system. The contractor has 45 days to correct the deficiencies or to submit a plan of action to eliminate them. If this is not done, the ACO will disapprove all or selected portions of the contractor's estimating system. The auditors and/or ACO will monitor the corrective actions and if the deficiencies are corrected the estimating system disapproval will be withdrawn.

Meanwhile, if the disapproval is not withdrawn (it can sometimes take a long time) the CO is authorized to take several steps short of rejecting the proposal including (1) allowing additional time to make corrections to submit a corrected proposal (2) use a different type of contract (e.g. FPIF instead of a FFP) (3) employing additional cost analysis techniques to determine reasonableness (4) segregating the cost

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elements affected by the estimating deficiency and making them cost reimbursable line items (5) reducing the profit or fee objective or (6) including a contract reopener clause providing for an adjustment after award. These measures can also apply to subcontractors who may have estimating systems that are suspect.

QUESTIONS & ANSWERS

Q. We were told by a DCAA auditor we had to submit our incurred cost proposal using their so-called ICE (Incurred Cost Estimate) schedules. Though we have tried we could not get a copy of this schedule so how can we meet their requirements? What is it and how can we obtain this schedule?

A. The version of the ICE manual we have used (January 1999) is a series of electronically linked spreadsheets that represent all potential schedules DCAA asks contractors to provide. First, we are unaware of any requirement to use these schedules. Instead, we recommend obtaining the latest version of "Information for Contractors" that include all the required schedules with examples and are easily obtained by calling your local DCAA branch office. Usually, not all schedules are needed so you can go through each schedule and select the ones that are relevant to your organization.

Secondly, in preparing many incurred cost proposals for our clients, we have attempted to use the ICE Manual schedules and have found them unwieldy and difficult to use. Since data used for preparing the proposals come from different sources (e.g. trial balances, job cost reports, billing reports, payroll), unless each perfectly reconciles to the other, linking schedules requiring different data usually causes problems. Its far better to create your own schedules where you can select the schedules you want to complete, determine where the information comes from, enter it on spreadsheets, reconcile one to the other and make adjustments if the differences are significant. In spite of DCAA's preference to have contractors use the ICE, most offices to date either do not have them or have not instructed auditors in their use. If you can't find them and want them, email us and we will email you a copy of ours.

Q. We have a cost type contract and found an excellent subcontractor to provide an essential service. They proposed a total contract price, have never had a government contract and we do not believe they could defend a price based on cost or pricing data. We thought the only justification for their approach would be to classify their proposed services as a commercial item. Consequently we decided to "stretch" the definition of a commercial item (as defined in FAR 12) and claim exemption from submitting cost data. Can we have some problems?

A. The obvious short answer is it depends on how much you "stretched" the definition. We have been reading a series of articles on definitions of commercial items written by Professors Nash and Cibinic in "The Nash & Cibinic Report." They strongly advocate that agencies adopt a more flexible definition and indicate that recent decisions favor COs "stretching" the definition when it will give the government access to buying from companies that would not otherwise compete for work so that the government can obtain better prices. We don't see why this loosening of the definition cannot be applied to subcontracts. Of course, I would recommend having some basis for defending the offered price as reasonable in case your stretch does not cut it.

Subscription: $125 for one year, $225 for two years.