GCA REPORT
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NEW DEVELOPMENTS

DOD Reissues Contractor Business Systems Rule

The Defense Department reissued a proposed rule Dec 3 meant to improve oversight of contractor business systems, incorporating changes to an earlier rule proposed in January 2010 based on comments it has received. The purpose of the rule according to DOD is to provide a "first line of defense" against waste, fraud and abuse by ensuring contractor business systems prevent, when internal controls are weak, increases in the risk of unallowable and unreasonable costs being charged to government contracts. To improve the effectiveness of DCMA and DCAA, DOD is attempting to clarify the definition and administration of contractor business systems by (1) defining business systems as accounting systems, estimating systems, purchasing systems, earned value management systems, material management and accounting systems and property management systems and (2) implementing compliance enforcement mechanisms in the form of a business systems clause that includes payment withholding which allows contracting officers to withhold a percentage of payments when a contractor's business system contains deficiencies.

Following extensive comments, DOD is publishing a revised rule where specific changes over the earlier one includes: (1) the definition of "deficiency" used throughout the rule has been defined to mean a failure to maintain one or more system criteria of an acceptable business system (2) system criteria for each business system has been provided in various parts of the rule (3) cognizant COs, in consultation with the auditor or other specialist, will determine acceptability of the business systems and approve or disapprove of them (4) wording has been added to provide procedures for COs to promptly approve a previously unapproved business system and notify the contractor when the CO determines, in consultation with the auditor, the contractor has substantially corrected the system deficiencies, removing any potential risk of harm to the government (5) wording to provide procedures to promptly distribute copies of determinations to withhold, remove withholds or approve or disapprove a system to all COs at buying commands, auditors and payment offices (6) wording to provide procedures to mitigate risks of accounting and purchasing system deficiencies on specific proposals to evaluate the impact of the deficiencies on proposals and what alternative actions the CO may take and (7) revise the policy to provide procedures the CO must take for withholding payments.

As expected, there has been a flurry of comments by industry representatives on the proposed rule. Though many commentators say the rule is somewhat improved over the prior rule (one says from terrible to bad) all comments we have seen are critical of the proposal. Some common criticisms are (1) the proposal is unnecessary where there are plenty of mechanisms now available for handling system deficiencies including audits and existing reporting requirements (2) there is no correlation between potential damages caused by a deficiency and the amount of money to be withheld (3) there is no "DCAA adapted" definition of a material weakness of a significant deficiency and (4) some risk of internal control flaws have to be accepted where the "risk-avoidance approach" envisioned here ensures the costs will be greater than any benefit. Other criticisms we are beginning to see, including ours, focus on the weaknesses we encounter in auditors' evaluations of contractors' systems which are adding costs and inefficiencies to an already overburdened procurement system and are causing great concern by government contractors we do business with every day. (*We plan on addressing the problems of the proposed rule from the perspective of evaluating DCAA's system audits in a future edition of the GCA DIGEST.*)

Reactions Begin to Surface About New DCAA Restrictions on Proposal Audits

We are beginning to see reactions to DCAA surprise withdrawal of auditing most forward pricing proposals. As reported in the last issue, DOD contracting officers will now limit requests for DCAA audit assistance to fixed-price proposals exceeding $10 Million and cost-type proposals exceeding $100 Million "unless there are exceptional circumstances explained in the request for audit." The thresholds apply to a proposal's total value and do not affect audit assistance between DCAA offices where, for example, an audit of a subcontract

proposal may be lower than the threshold dollar amount. Further, requirements for submitting cost or pricing data (e.g. $700,000) has not changed. Audits below the thresholds will be conducted by the Defense Contract Management Agency.

The Project On Government Oversight advocacy group states since the prior threshold for cost type contracts was $10 million with no threshold for fixed price contracts, the change would result in $92 billion of proposed 2009 DOD dollars not being audited. They state DCMA "is typically less thorough than DCAA" and "does not specialize in examining and verifying cost and pricing data." POGO states it has long feared "contractors and their government allies would block DCAA from exposing contractor rip-offs." Meanwhile other commentators such as Brent Calhoon of Barker Tilly LLP said DCAA's move is good for the agency where lowering the threshold frees up DCAA's limited resources to now be focused on the greatest risk - high dollars.

DCAA Issues New Guidelines

DCAA recently issued several guidelines to its auditors where the most significant are:

♦ **"Rules of Engagement"**

(*Editor's Note. Though the following guidelines are not contrary to those that auditors have been told to follow for a long time, we find them particularly helpful to contractors because we find these guidelines are commonly not followed by auditors, often resulting in unpleasant audit determined surprises.*)

The Defense Contract Audit Agency has published several guidelines to its auditors under the title "Rules of Engagement" that cover proper communications with both contractors and contracting officers. Highlights include:

1. To allay fears that communications with a contractor and COs during an audit may compromise its independence, the guidance clarifies that effective communications with both parties during audits are an essential part of the audit process and is fully compliant with generally accepted auditing standards. Communications with the CO should be made to obtain a complete understanding of their needs and specific concerns and to keep them informed of issues and problems as they arise while communications with contractors are needed to obtain a thorough understanding of the proposal and should continue throughout the audit to understand all pertinent facts and obtaining the contractor's view of audit conclusions and recommendations for inclusion in the audit report.

2. The guidelines stress that entrance and exit conferences should be held and that preliminary audit findings should be discussed with the contractor to ensure that audit conclusions are based on a complete understanding of all relevant facts.

3. For all audits other than those involving forecasted costs subject to negotiations (e.g. price proposals, termination settlement proposals) auditors are told to "provide a copy of the draft report, or at a minimum, the results of audit section of the draft report (including the opinion and any exhibits and notes or statement of conditions and recommendations)" at or before the exit conference.

4. If a contractor revises its submission during the course of an audit to, for example, correct a deficiency or remove questioned costs, the audit report should reflect the results of the original submission and include all questioned costs and deficiencies identified in the original submission. The auditor should consider subsequent modifications to the submittal as contractor's concurrence with DCAA's audit position *(10-PSA-024(R).*

♦ **One Price Proposal Audit Program Replaces Several**

The scope of DCAA audits vary widely where they may audit all proposed costs, limited costs such as direct or indirect rates only or conduct a cost realism audit under conditions of competition to ensure a contractor is not understating its costs to "buy into" a program. Accordingly, DCAA has a variety of audit programs to address these different scopes of audit. Now, it has issued one price proposal audit program that will replace all the others where now the audit program will be tailored for each audit assignment depending on risk assessments and scope of audit *(10-PSP-028(R).*

♦ **DCAA Issues Guidance on Long Term Agree ments (LTAs)**

When evaluating subcontract costs, auditors are told they may identify estimates based on a LTA which is an agreement entered into between a prime contractor and subcontractor to establish pricing for future purchases of specified items. LTAs are considered to be an acceptable pricing method where the guidance notes it is not unusual for such an agreement to exist in advance of a specific request for proposal. Auditors are told they should evaluate the prime contractor's analysis of cost or pricing data at the time the LTA was established while also considering procedures performed by the prime contractor to ensure the LTA prices continue to be fair and reasonable. The guidance also states that the

existence of an LTA negotiated prior to a prime contract award does not relieve the prime contractor from obtaining certified cost or pricing data prior to subcontract award as required by FAR 15.403-3(c). The guidance also states the LTA is fixed so price escalations are considered to be inappropriate *(10-PSP-033(R).*

Final Rule on Excess Pass-Through Costs Issued

The FAR Council Dec 13 finalized an interim rule implementing statutes intended to prevent the government from paying excessive pass-through charges when subcontracting costs exceed 70 percent of the total cost of work to be performed. The rule implements the 2009 defense authorization act amendment to "minimize excessive pass-through charges by contractors to subcontractors or from tiers of subcontractors that add no or negligible value." A new clause requires offerors and contractors to identify the percentage of work that will be subcontracted and when the 70 percent threshold is reached, they are to provide information on indirect costs, profit/fee and value added with regard to the subcontract work to help agencies determine whether there are excess pass through charges on proposed or charged work (*Fed. Reg. 77741*).

New FAR Rules Issued

The FAR Council September 29 passed several final and interim rule changes to the FAR. Of significance to our readers:

1. A final rule change to FAR Part 16 requires the linking of contract award fees and incentive fees to acquisition outcomes in the "areas of cost, schedule and technical performance." The rule also prohibits the practice of "rollover concept" where unearned award fee available to the contractor during one performance evaluation period can be carried over to another evaluation period. In addition, the rule also prevents contractors from receiving a large percentage of the available award fee pool if their performance is deemed less than satisfactory.

2. A final rule establishes procedures for contracting officers to report contractor performance into the Past Performance Information Retrieval System (PPIRS) and the Federal Awardee Performance and Integrity Information System (FAPIIS). Performance information will now include default terminations for cause and defective cost or pricing data. Also the time frame for reporting information in PPIRS is now changed to three from 10 days to be consistent with FAPIIS requirements.

CAS Board Proposes to Eliminate the Overseas Exemption From CAS

The Cost Accounting Standards Board Oct 20 issued a notice of proposed rulemaking to eliminate an exemption from CAS for contracts executed and performed entirely outside the US, its territories and possessions. Two reasons for the change were cited:

1. The statutory basis used to justify the exemption no longer exits because the current statute from which the CAS Board receives its authority does not restrict CAS's applicability to the US like the original statute did.

2. There is no accounting basis for the overseas exemption where the place of contract execution and performance is not relevant to the fundamental principles and methods CAS imposes for accounting for contract costs.

The Board responded to concerns the elimination of the exemption would reduce competition and increase expense saying such concerns are "too speculative to address." It added that many of the cost accounting standards that would now apply are already covered under the cost principles in FAR Part 31.

Senator Tells Agencies to Treat Small Business Set-Asides Programs Equally

The Chair of the Senate Small Business Committee Sen. Mary Landrieu recently urged federal agencies to ensure they are in compliance with a provision of the new Small Business Jobs and Credit Act of 2010 by prohibiting participants in the Historically Underutilized Business Zone program from receiving preferences for contract set asides for small businesses. She stressed that Section 1347 of the Act stresses the congressional intent of the federal small business set-aside programs – e.g. 8(a), HUBZone, service disabled veterans and new women owned small businesses – should be placed "on an equal footing, with no one program receiving priority over another." Sen. Landrieu stated that current statutes allow COs discretion when choosing to award a contract to a small business participating in these programs but there has been misinterpretation of congressional intent in recent decisions by the GAO to give priority to small businesses participating in the HUBZone program.

Talking about HUBZone, in a separate action the FAR Council issued a final rule Dec 13 to require a small business concern be a HUBZone firm at both the time of its initial offer and at the time of contract award. This will eliminate some companies who are not eligible in both cases. Also, the rule amends the FAR to require

HUBZone small businesses to spend at least 50 percent of the cost of personnel on their own employees or on other HUBZone small business concern subcontract employees for general construction or construction by special trade contractors.

One Offer is No Longer Considered to be Adequate Price Competition

One of the exemptions from having to provide cost or pricing data to the government is the expectation that award will be based on price competition. Under this exemption, if sufficient offers are expected then award is presumed to be based on adequate price competition even if it turns out that only one offer is received. That has been changed where now if only one offer is received, either a new competition is called for or the price is to be negotiated where all data, including cost or pricing data, may be used to ensure the resulting price is fair and reasonable.

DCMA and DCAA Intend to Close Out Old Reports

(Editor's Note. The following action is supposedly intended to address the numerous findings issued by DCAA over the years that seem to simply be hanging there.)

The Directors of DCAA and DMCA issued October 29 a memo announcing a joint initiative to "aggressively target contractual opportunities to recover taxpayer dollars" by establishing priorities and closing a large number of open audit findings. The memo states that the first priority will be to resolve outstanding issues where there are questioned costs stemming from incurred cost audits, business system internal controls, defective pricing or termination settlement audits. The initiative will allow each agency to retain their own role of disposing of open DCMA/DCAA audits and states ACOs, with advice provided by DCAA, will be revisiting each issue. ACOs will likely be looking to negotiate settlements of some issues while possibly dismissing others to close them out. Current guidelines to refer differences of opinions between DCMA and DCAA to Inspector General offices for review will not be waived.

SBA Issues Guidance on Women-Owned Small Business Set Asides

The Small Business Administration has published a guide for Women Owned Small Businesses (WOSBs) and Economically Disabled WOSBs (EDWOSBs) for set aside awards. They WOSB and EDWOSB set aside awards will be permitted (1) to specific North American Industry Classification System (NAICS) codes the guidelines indicate are underrepresented (2) the CO determines there is a reasonable expectation of having two or more WOSB or EDWOSBs bidding ("rule of two") (3) the award value does not exceed $5 million for supplies or $3 million for services and (4) the CO determines the bid price to be fair and reasonable. Eligibility for EDWOSB status is a net worth limitation of $750,000 (excluding personal residence, retirement account or equity in the EDWOSB) and no more than $350,000 of income in the last three years.

Proposal to Make TINA Violations Subject to Compound Interest

The FAR Council published a proposed rule to make overpayments to contractors found from Truth in Negotiations Act determined defective pricing actions will be subject to "compound interest" payments rather than the current provision of "simple interest." The proposed rule grows out of a recent case – Gates v Raytheon which held that interest for cost impacts on a cost accounting standards non-compliance should also be based on compound interest. The proposed rule is issued to make CAS and TINA violations consistent (*Fed. Reg. 57719*).

Commentary That DCMA Memo Incorporates DCAA Error on Penalties

(*Editor's Note. The following article includes a concern we have been addressing about inappropriate imposition of penalties on unallowable costs – see our last issue of the GCA DIGEST.*)

A September 24 information memo issued by the Defense Contract Management Agency Director of Contract Policy is receiving critical responses from numerous commentators. The memo notes that DCAA recently issued guidance to its auditors emphasizing that ineligible dependent health benefits costs are to be looked for and questioned in accordance with FAR 31.205-6(m)(1) which expressly requires that fringe benefits be in accordance with contractor's established policy. The controversy is not so much whether the costs are unallowable but rather that the memo incorporates DCAA's assertion that the increased costs resulting from the disallowance should be subject to penalties. The comments we have seen stress that DCAA and now DCMA is taking an "expansive" view of penalties where they are supposed to be imposed only on "expressly unallowable costs" not on costs that fail to meet an "expressed requirement" for allowability.

CASES/DECISIONS

Contractors Not Entitled to Claims for Increased Transportation Costs, Currency Fluctuations and Severe Weather

Under its contract to provide water treatment chemicals to various locations in Iraq that established unit prices for each chemical, Tekkon submitted an economic price adjustment (EPA) claim for additional transportation costs it incurred as well as for losses due to unexpected currency fluctuations. The board stated to establish an EPA increase the EPA clause at FAR 52.216-2 requires a contractor to show (1) it had an established price as defined in the clause in effect on the contract date (2) its established price was increased (3) it asked the CO in writing to increase the established price and (4) it satisfied the criteria for the EPA increase including the effective date and limitations set forth in section (c) of the clause. The Board ruled that unit prices are not "established prices" of Tekkon and there was no evidence of increases in Tekkon's established transportation prices. As for currency fluctuations the Board said that under a fixed price contract the contractor bears the risk of currency fluctuations (*Tekkon Engrg Co., ASBCa No 56831*).

In another case, Edge sought compensation for lost productivity due to time delays caused by "one of the worst winters in the past 20 years." The Court cited FAR 52.249-10 that provides for time extensions but not equitable adjustments for excusable delays, ruling that Edge was entitled only to an excusable time extension not an equitable adjustment (*Edge Constr. V US, Fed. Cl. No 06-635C*)

Solicitation's Experience Requirement is Unduly Restrictive

The Air Force issued an RFP for an 8(a) set aside commercial item contract to provide family advocacy services to 21 bases that included an experience requirement of two years. Total Health, who had one year experience but whose subcontractor met the two year requirement, protested arguing the two year requirement unduly restricts competition, especially among 8(a) firms. It argued that a contractor should be able to meet the requirement with an experienced subcontractor and that its subcontractor's experience should count for meeting the two year test. The GAO said an agency may consider only an offeror's experience and not that of its subcontractors if the agency has a legitimate reason for concluding the successful offeror itself must possess the relevant experience. Here, the Air Force provided no such explanation why a subcontractor's experience could not satisfy the two year requirement and hence ruled the requirement the prime contractor must have the two years of experience unduly restricted competition (*Total Health Resources, Comp. Gen. Dec., B-403209*).

Corrective Action of Resoliciting New Proposal Was Not Rational

JCN protested an award to build an aircraft hanger alleging different treatment in the evaluation of proposals. After filing the protest, the agency allowed JCN and another bidder into the competitive range and invited all to submit revised proposals where the prices of all original offers were divulged. The original awardee, Sheridan, challenged the propriety of the agency's corrective action to resolicit proposals. The Court agreed. There was never an assertion that Sheridan did not submit the best proposal or that the proposals contained errors but rather an assertion of perceived evaluation error was made so resolicitation of new proposals was improper. The Court said a corrective action must target the identified defect where resoliciting new proposals was not a "rational corrective action." Here the only reason to permit resolicitation would be to allow a previously unsuccessful bidder an opportunity to beat the now-disclosed price of the winning proposal where such action would "severely damage the integrity of the procurement process" (*The Sheridan Corp. vs US, Fed. Cl. No 10-547C*).

Agency's Cost or Pricing Data Requirements Are Unreasonable

(*Editor's Note. We often find citations to FAR 15.408, Table 15-2 that a contractor's proposal is inadequate even when such requirements to this FAR section do not apply. The following is a case in point.*)

The Request for Proposals for a contract for program management services under the Dept. of Transportation asked offerors to complete a cost proposal and make records available for audit but did not mention the need to submit cost or pricing data nor be consistent with FAR 15.408, Table 15-2 requirements covering cost or pricing data. Following a successful protest by PMO, the DOT asked DCAA to review PMO's proposal using criteria "within FAR 15.408" and that it "not execute additional coordination with the contractor as is usually conducted to obtain a revised proposal that meets adequacy requirements stipulated in the FAR." DCAA found inadequacies in some of PMO's subcontract costs which DCAA determined had violated FAR 15.408 requirements and in the light of these findings the CO rejected PMO's proposal for being "inadequate as it does

not comply with the documentation requirements of FAR 15.408, Table 15-2"

In its protest, the GAO said the CO improperly limited DCAA's review because FAR 15.408, Table 15-2 applies only to solicitations for which cost or pricing data are required where here the RFP neither referenced nor incorporated the Table. DCAA found its subcontract costs questioned because no price analyses of subcontractor proposals were made but the GAO stated the RFP did not indicate these analyses were necessary. Because the RFP stated that cost or pricing data were not required and because the RFP did not otherwise indicate the data should be presented in any format such as Table 15-2 the agency's evaluation was unreasonable. Further, the GAO found that the prohibition on communications between DCAA and PMO was contrary to FAR 15.404-2(d) requiring communication if deficiencies are found (*P'ship Joint Venture, B-403412*).

Court Rejects "Collective Knowledge" as Basis of Fraud

(*Editor's Note. The following case addresses an interesting point – is it sufficient to assert a company is liable for a fraudulent act based on "corporate knowledge" within the company.*)

In the government's prosecution of a False Claims Act violation against SAIC for allegedly billing the government when there was a conflict of interest, one of the issues raised was that there was sufficient "collective knowledge" within the company to justify the assertion that payment was improper. The Court said it is wrong that a corporation is liable under the FCA for the collective knowledge of all employees and agents within the corporation so long as they obtained their knowledge on behalf of the corporation – this is known as "collective knowledge." The Court rejected this saying someone in the corporation must have the requisite knowledge that forms the basis for wrongdoing and that "such knowledge cannot be established by piecing together scraps of 'innocent' knowledge held by various corporate officials" (*United States v Science Applications Int'l Corp., Cir No. 09-5385*).

NEW/SMALL CONTRACTORS

Performing Audits of Subcontractor Forward Pricing Proposals

(*Editor's Note. The FAR requirement for prime contractors or higher tier subcontractors (for simplicity we will refer to prime contractors with the understanding our comments apply also to higher tier subcontractors) to audit their subcontractors has traditionally been an area of "benign neglect." Rush to audit and award contracts have left the requirement to conduct cost or price analyses of proposed subcontractor costs one of those rules that have not effectively been enforced. However, recent GAO and Inspector General reports highly critical of prime contractors' lack of review of subcontractor proposed costs have generated increased attention in this area. We have been seeing significant increases in DCAA findings that prime contractors' estimating systems are being called into question due to poor review of subcontractor costs, estimating deficiency flash reports have increased and audits of proposals are resulting in reports saying proposed subcontract costs are "unsupported" or "unresolved" resulting in delays and even failure to win awards. It is not a surprise to us that our consulting practice has seen an increase in auditing subcontractor proposals over the last year, especially when there is either a reluctance to send DCAA to subcontractors or timeliness is an important factor. The following article is based on June 3, 2009 DCAA guidance to its auditors to ensure subcontract proposals are reviewed as well as our research on relevant FAR, DFARS and other audit guidelines.*)

Auditors may or may not perform audits of subcontractors' forward pricing proposals prior to completion of the audit of a prime contractor's proposal but now prime contract auditors are told to report proposed subcontract costs as "unsupported" when the prime contractor has not completed a price or cost analysis of the subcontract proposal, regardless of whether DCAA has conducted the subcontract audit (called an assist audit). Several sections of the DCAA Contract Audit Manual have been changed to reflect this audit guidance where in addition a Frequently Asked Questions section is added to the guidance.

It is quite common for significant subcontract forward pricing proposals to be completed and signed by the subcontractor and submitted to the prime contractor in advance of the prime proposal being completed and submitted to the government. To facilitate the negotiation and award process, contracting officers often request a subcontract audit be conducted prior to the prime contract proposal audit being completed. Audits of subcontract pricing proposals may be conducted either by the government or prime contract auditors when the following conditions are met: (1) the subcontract proposal is approved by subcontractor management (2) the prime contractor has submitted a subcontract proposal to the government with an assertion it intends to contract with the subcontractor (3) the subcontract proposal is adequate as set forth in FAR Part 15.4, Contract Pricing and (4) subcontract audit support is required based on DFARS 251.404-3(a).

The DFARS section provides that an audit should be conducted when the CO believes such assistance is needed to ensure reasonableness of the total proposed price. Examples of such conditions where assistance may be appropriate include (1) there is a business relationship between the prime and subcontractor that may not be conducive to independence and objectivity (2) the contractor is a sole source supplier and the subcontract costs represents a substantial part of the contract (3) the prime contractor has been denied access to the subcontractor's records and (4) the contractor has been cited for estimating deficiencies in the area of subcontractor pricing.

Prime Contractor's Responsibilities

FAR 14.404-3(b), subcontractor pricing considerations requires the prime contractor to conduct appropriate cost or price analysis to establish the reasonableness of proposed contract prices and include the results of these analyses in the prime's proposal. The prime contractor is also responsible for ensuring the subcontractor's proposal is adequate to support the prime's price or cost analysis as well as any necessary examination by the CO or DCAA.

New DCAA guidance states the prime contract audit should include audit procedures to (1) determine if the prime contractor completed required cost or pricing analyses of its subcontractors and (2) review the adequacy of the prime's analysis. For those analyses not completed, auditors are to determine the contractor's completion schedule. The audit report is to identify subcontracts for which the prime did not complete required analyses and the proposed subcontract costs are to be reported as "unsupported." The prime contractor auditor is then to assess the need for an assist DCAA audit and request it (if not already done so by the CO). The prime auditor is to incorporate the results of any assist audits in its audit report but if the prime contractor has not completed its own cost or price analysis, the balance of the proposed subcontract costs are to be reported as unsupported.

New guidance also tells auditors that a contractor's estimating systems policies and procedures should include requirements to conduct cost or price analyses and to provide it to the government negotiator prior to negotiation of the prime contract. If, due to time constraints, the prime contractor cannot complete the required analyses prior to submission of the prime proposal the policies should be in place to ensure a plan is implemented to complete analyses prior to the prime contract negotiation. The guidance alludes to DFARS 215.407-5-70, Estimating System, that states continued failure to perform cost analysis is considered to be a significant estimating deficiency where if detected, an estimating system flash report should be issued. In addition, at large contractors, a limited scope internal control review should be established to report the issue as a significant internal control deficiency.

Frequently Asked Questions

1. What constitutes a valid assertion of intent to contract with a subcontractor? No format is suggested only that the prime contractor provide an assertion it intends to contract with the subcontractor which should be signed by the contractor representative that typically approves a contractor's proposal.

2. Does an assist audit by the government relieve the prime contractor from its responsibilities? No. They are required to conduct price or cost analyses of each subcontract proposal and include the results of these analyses in the price proposal or provide a schedule of such analyses prior to negotiations. Failure to do so should result in an estimating flash report regardless of any audit conducted on the subcontract.

3. Should an audit of a subcontract proposal be conducted where the prime contract is firm fixed price and has already been negotiated? No, unless the FFP contract has a special clause providing for recovery of later subcontract price reductions.

4. If the prime contractor is denied access to the subcontractor's cost data, does the prime contractor have to perform any analysis of the subcontractor's proposal? Yes. At a minimum, the prime contractor must perform and documents its (1) efforts to complete FAR 15.404-1 required price analysis of its subcontracts and (2) coordination with the CO to obtain any necessary audit/pricing support from the government. (*Editor's Note. We find that subcontractors will provide their cost data to an independent auditor such as us as long as there is an understanding that the auditor will not provide the cost data to the prime but rather only the results of its audit e.g. questioned costs.*)

5. What's the difference between subcontractor unsupported and unresolved costs as used in the prime proposal? If a DCAA assist audit is requested and the prime has NOT performed a price or cost analysis the subcontract costs should be reported as unsupported. If the prime contractor has performed such an analysis and an assist audit has been requested but findings have not been received, the subcontract costs are reported as unresolved.

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QUESTIONS AND ANSWERS

Q. Our President often works 20 hours a week or more on government contracts but he often just shows 10 hours on his timesheet so we only charge the government for 10 hours to keep the government happy that we are limiting our charges to them. Do you see any problems with this?

A. Yes. You are vulnerable for auditors asserting your timekeeping practices are inaccurate (they may not care if the government benefits). You are also understating your direct labor costs which has the effect of overstating your overhead and G&A rates. If you choose to charge the government less hours than you incur, I would treat these hours as unbilled direct labor so they are identified and still included in your indirect cost bases.

Q. When does it make sense to have two or more fringe benefit rates?

A. In general, when you want to have more precision and/or when it helps for your firm achieve its pricing objectives. Having one company-wide fringe benefit rate provides a simple method of computing fringe benefit costs – you identify all fringe benefit costs (the definition can vary widely by contractors) and divide by company salaries and wages. If you have different categories of employees – full time, full benefits; part time, partial or no benefits; full time, partial or no benefits, etc. – you probably want to compute different rates so you can offer your clients varied rates (and hence prices) for different categories of labor. Also, different categories of full time employees often have significantly different rates (e.g. senior executives vs. wage labor) so you may want to create different rates for them.

Q. Our subcontractors add burden to their costs and we add burden on our subcontractor costs. Our client says this is inappropriate. What do you say?

A. It is totally appropriate. Though there may be contractual prohibitions against both parties adding fee/profit on their costs, I am unaware of any prohibitions against adding true costs, whether they are direct or indirect. The only exception may be if the amount of subcontractor costs exceed 70% of your contract costs and the add-ons do not represent added value (see the final rule discussed above).

Q. How are the current elections likely to affect government contractors?

A, Though the question is outside of our expertise in cost and pricing issues, we did come across an interesting article addressing the question written by Ken Weckstein of the Brown Rudnick Group in the Nov. 16 issue of the Federal Contracts Report. He indicated (1) the lack of any particular power by one group will likely see little "big picture" changes in social programs, immigration, energy or tax reform (2) likely actions on reducing the deficit means the government will be asked to do more with less (3) there will likely be major cuts in government employees through hiring freezes resulting in less training but more use of contractors to fill in the work that still needs to be done (4) a shift from in-sourcing emphasized by the Obama administration to outsourcing of work (5) though deficit reduction will entail spending cuts they will not be implemented any time soon where current work has already been awarded by prior budgets and long term contracts and (6) a pro-defense, anti-terrorist Congress will likely lead to less effects in the defense sector than other sectors.

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