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GRANT THORTON SURVEY ON PROFESSIONAL FIRMS

(Editor's Note. With the cessation of the Wind2 survey we summarized each year we were very happy to find last year Grant Thorton's "12th Annual Government Contractor Industry Survey 2005" that benchmarked primarily similar professional services firms. The 13th Annual GT survey provides a variety of very useful information. Grant Thornton – you know the firm whose advertisement says they have a "passion for accounting" – provides consulting services to government contractors. You can contact the firm at 703-847-7515 to purchase a copy of the survey.)

♦ Company Profile

82% of the "over 100" surveyed firms are privately owned, 9% are publicly traded and 9% are not-for-profit concerns. Size of the survey participants were 19% had sales less than $10M, 12 between $10M-20M, 29% between $20M-50M, 15% between $50M-100M and 29% over $100M. More than 94% of respondents are service companies while 6% sell products. The services companies consisted of engineering (16%), information technology, science and technology (8%), general business services (11%), consulting (18%), research (17%) and other services (6%). The primary customer of the respondents is the federal government where 90% of the revenue comes from the federal government. 60% of their revenue came from the Defense Department, 30% from other federal agencies while 6% came from state and local government and 4% was commercial. 52% of respondents had increased revenue over the prior year, 24% had no significant change while 24% had reductions. 9.9% of total headcount represented indirect labor with the following breakdown of functions: finance and accounting (2.1%), human resources (.8%), IT support (1.0%), contract administration (.8%), legal (.4%), pricing (.4%), procurement (.5%), sales and marketing (1.5%), corporate officers (1.1%), office maintenance (.8%) and security (.5%). The 9.9 percent is a reduction from last year's 13.8% which Grant Thorton ascribes to both an increase in revenue and higher use of consultants which is common during periods of high growth.

♦ Government Contracts

The breakdown of Revenue by Contract Type. 40% revenue from federal contracts come from cost type contracts, 32% are fixed price and 28% are time and material. The percent of cost type contracts has substantially increased each year apparently putting to rest the impression that the government is moving more toward commercial practices where fixed price or T&M contracts predominate.

Fees. Average negotiated fees for cost type contracts averaged 6-7%, T&M contracts had an average of 9-10% while firm fixed contracts had 11-12%. It should be noted that these negotiated profit rates are computed after deducting unallowable costs and before income taxes so actual profit rates are lower than negotiated rates.

Proposal Win Rates. Surveyed companies stated their win rate on non-sole source proposals was 33%. Reasons stated for loosing competitions was a combination of price and technical – 54%, price only – 28% and technical – 8%. Special business units such as joint ventures or limited liability corporations were established by 20% of surveyed respondents where they report a 58% win rate.

Bid and Proposal costs. 72% of respondents reported spending less than $1 million while 13% spent between $1-2 Million.

Claims and Identifying Out-of-Scope Work. Identifying out of scope work, whether it comes from an easy to recognize direct change or a sometime difficult to recognize constructive change, provides an important opportunity to receive additional entitled revenue. 34% of the respondents said their procedures for recognizing out of scope work are vey effective, 40% said somewhat effective and 26% said not effective.

♦ Cost Structure

Profit. Contrary to often public perceptions, government contracting does not generate abnormally high profits. 42% of survey companies had no profit or profit rates between 1-5% while 76% had either no profit or rates between 1-10%. Only 12% had profit rates over 15%. These figures would be diminished after deducting interest and taxes.

Fringe Benefit Rates. Fringe benefit pools consist of payroll taxes, paid time off, health benefits and retirement benefits (some include bonuses while others do not). Fringe benefit rates as a percentage of total labor averaged 37% when bonuses were included and 33.5% when excluded.

Overhead Rates. These costs are considered to be in support of direct staff working directly on contracts and hence are normally allocated as a percentage of direct labor costs. Some companies include fringe benefits associated with direct labor in the direct labor base while others do not – the result when they do is to lower overhead rates. Average overhead rates are as follows: (a) on-site direct labor - 81% (on-site means performed at company sites) compared to 70% last year (b) on site direct labor and fringes – 49%, same as last year (c) off-site direct labor – 46% (off-site is lower because facility related costs are normally borne by the customer at their facilities) compared to 38% last year and (d) off-site direct labor and fringes – 13% compared to 22% last year. When companies used multiple overhead rates logic used for them were location (51%), market (15%), labor function (14%), customer (14%) and products versus services (6%).

G&A Rates. The survey states that general and administrative rates are typically those incurred at the headquarters and include executives, accounting and finance, legal, contract administration, human resources and sales and marketing. (*Editor's Note. In our experience, the elements of costs included in G&A pools vary more than the survey implies. G&A costs may include non-overhead indirect costs incurred at a business segment level which usually includes an allocation of headquarters costs while we also find all the categories of overhead costs identified above as part of the G&A pool when a company decides such categorizations meet their needs.*) G&A costs are most often allocated to contracts on total cost input (direct operating costs, overhead, material, subcontracts) or a value added base that generally includes all the above costs except material and/or subcontracts. Average G&A rates under a total cost input was 12% while those using a value added cost input was 16%.

Material handling and subcontract administration costs. 35% of surveyed companies used a material handling or subcontract administration rate as a burden chargeable on material and subcontract costs. The survey notes that in service industries a handling rate is established in conjunction with use of a value added G&A base to reduce burden applied to pass-through subcontract and material costs. Average material handling rate was 3.5%, subcontract administration rate was 4.5% and combined was 4%.

Special allocations. The FAR and CAS provide authority to negotiate special allocations of indirect costs when an inequitable allocation would result from its normal practices such as when there is an unusual dollar amount of material, subcontracts or equipment that does not commonly occur on its other work. It's often a good idea to adopt a special allocation for a contract that has an unusual cost mix rather than change the indirect rate structure to accommodate the contract. Only 7% used a special allocation.

Service centers. Certain functions that support the company are accumulated in separate pools and then charged to users (e.g. clients, indirect cost pools) on a pre-established allocation method. The most frequently used service centers are facilities (used by 56% of the respondents), information technology (44%) and human resources (32%).

Labor multipliers. Multipliers, a term commonly found in the commercial world, are fully loaded labor multipliers used to price out work and are derived by dividing total burdened labor cost by base labor cost. The average labor multiplier was 2.3 for on-site work and 1.9 for off-site work. Almost all respondents expressed a belief their labor multipliers were competitive with their industry.

Uncompensated overtime. (*Editor's Note. We have analyzed this issue in numerous prior issues of the DIGEST and we suggest using our word search tool at our website to find them. Uncompensated overtime refers to hours worked exceeding the normal 40 hour work week by those salaried employees exempt from the Fair Labor Standards Act.*) 64% of respondents said their employees work uncompensated overtime while 36% said no. 64% of the companies use total time reporting while the other 36% report only 40 hours per week. 64% use a rate (or hours) "compression method" of accounting (e.g. computing an effective hourly rate dividing salary by hours worked) while 36% use a "standard/variance method" that charges an hourly standard rate and then credits an indirect cost pool for the difference between labor costs charged to projects and compensation paid to employees.

♦ Dealing with the Government

The Defense Contract Audit Agency, because of their Defense Department contracts or contracts with other agencies that use the audit agency, audits most of the contractors in the survey. 59% of respondents

described their relationship as good, 31% as excellent while 10% described it as fair or poor. (*Editor's Note. That is certainly a surprise to us but understandable since we are often asked to help contractors only after they have a poor experience with auditors. We would be shocked, however, if the same level of satisfaction applied to other agencies' or local and state auditors.*) When asked if their relationship with DCAA has changed, 81% said it had stayed the same, 10% reported the relationship had deteriorated while 9% said it had improved. The most frequent types of costs questioned by DCAA are executive compensation (27% citing this as an audit issue), consultant costs (9%), legal expenses (10%), bonuses and incentive compensation (8%) and employee morale (6%). Most frequently cited violations of cost accounting standards were CAS 405, Unallowable costs (6% cited this as a compliance issue), CAS 403, Home office expenses (5%) and CAS 410, G&A (3%). The number of companies citing CAS issues was significantly lower than last year indicating a possible turning away from CAS to other areas of audit interest. 91% of surveyed companies reported that DCAA did not question a significant amount of costs while 9% reported either a significant or very significant amount. Of those companies experiencing audit issues, 35% were very satisfied with the resolution of the issues, 55% were somewhat satisfied and 10% were not satisfied.

♦ Workforce Compensation and Fringe Benefits

The shortage of skilled workers has forced most companies to offer a comprehensive package of incentive compensation and fringe benefits as part of a minimum compensation package to attract needed personnel.

A list of different fringe benefits was provided to determine whether they were offered to all employees or only to senior executives. When available, defined contribution and defined benefit retirement plans were offered to all employees almost all of the time. 61% of companies with post retirement health or life insurance offered them to all employees while 39% offered them only to senior executives. 75% of companies with stock options offer them only to senior executives while 25% to all employees. Cash bonuses are paid to all employees at 84% of the companies. Deferred compensation is paid to only senior executives at 88% of the companies.

Medical benefits. In response to questions asking what percent of health benefits are paid by the company the survey results were: 9% reported the company pays for less than half, 5% pays 51-60%. 22% pay 61-70%. 41% pay 81-90% and 11% pay 91-100%.

410(k) benefits. On average the company will match an employee's contribution up to 6% of their compensation and 91% of respondents reported they do not anticipate any changes in the near future.

Wages Increases. Surveyed companies state that the average increase was 3.5 -4.0 %, lower than last year's 4.5%.

Paid time off. 68% of companies polled paid 10 holidays per year, 9% offered 9 and 9% offered 8. None offered more than 12. Though answers were not given this year, last year approximately 49% of responding companies combine vacation, holiday and sick leave into a single personal time leave package while 47% maintain separate leave benefits for each type of leave.

♦ Executive Compensation

(*Editor's Note. Care should be used if our readers consider substituting the following results for a bona fide compensation survey where hundreds of firms are surveyed. However, the results shown below are interesting.)* Surveyed companies provided information on the four highest paid executives in the company and the results are presented by company size measured by revenue for 25th, median and 75th percentiles. The following is a summary of the results.

Highest Position (in thousands)

Revenue	25%	Med.	75%
$1-10 M	160	178	268
$11-20M	250	326	415
$21-50M	290	375	447
$51-100M	383	425	562
>$100M	518	610	829

Second Highest Position

$1-10 M	105	161	172
$11-20M	183	245	331
$21-50M	210	275	359
$51-100M	240	263	315
>$100M	360	429	447

Third Highest Position

$1-10 M	100	148	170
$11-20M	187	204	311
$21-50M	200	215	315
$51-100M	190	260	282
>$100M	308	357	413

Fourth Highest Position

$1-10 M	116	122	154
$11-20M	135	176	233
$21-50M	141	190	296
$51-100M	215	243	295
>$100M	289	327	379

♦ Intellectual Property

Possession of intellectual property can be an important factor in limiting competition for government contracts and revenue from license fees can help partially recoup investments in developing IP. 49% of surveyed companies own IP and of those owning it 92% report it was developed either entirely at private expense or a mix of private and government (IR&D costs are considered private funding even if some are allocated to government contracts). 63% of respondents provide intellectual property with limited or restricted rights, 30% allow the government purpose rights and only 7% allow the government unlimited or unrestricted rights. As for charging license fees, 33% charge them while 67% do not resulting in them not recovering the high costs of obtaining IP.

♦ Charging Subcontractor Hours on T&M contracts

We have frequently reported on new regulations that provide when subcontract labor can be charged at fixed rates provided in the prime contract and when blended or separate rates may be used. 78% of surveyed companies bill the cost of subcontract hours at the fixed rates in the contract while 22% bill on a cost reimbursable basis (i.e. as an ODC). As for subcontractor hours and costs for incidental activities not specified in the labor rates in the prime contract, 58% said they bill such costs on a cost reimbursement basis while 42% said they bill the hours at the fixed labor rate in the prime contract.

CHALLENGING SOME STATE AUDITOR'S QUESTIONED COSTS

(Editor's Note. We are encountering more and more state auditors developing their own audit positions, in spite of the fact that their incurred cost proposals were already audited by either independent CPA firms or DCAA. State agencies (e.g. departments of transportation, environmental protection, housing) that are partially funded by the federal government are increasingly using flexible type contracting vehicles and like their federal counterparts, require submissions of incurred cost proposals. Though their regulations provide for acceptance of audit determined rates when they have been audited either by an independent CPA firm (we frequently provide that service to clients) or DCAA, state auditors are more frequently taking it upon themselves to independently audit some of the proposed costs, often with rather unusual audit positions. The following response is a compressed version of what we prepared for a client to some of these unusual audit findings. The costs that were questioned seem fairly typical of what we have been seeing. I have left out the name of the state agency (called DOT here) and name of the contractor (referred to as Contractor.)

Incentive Compensation Bonus Program

DOT Position

DOT has questioned certain bonus costs, specifically costs associated with Contractor's Incentive Compensation Program (ICP). The reason these costs are questioned is the ICP plan does not apply to all employees which violates DOT and FAR policy.

Contractor Response

We inspected DOT written policy that provides for the allowability of bonus costs but we found no reference to bonus plans that do not include all employees to be unallowable. FAR 31.205-6 states that bonuses paid as part of a contractor's established practices are allowable and it makes no distinction between bonus costs applicable to all employees or certain groups of employees. It is normal industry practice to have a wide variety of bonus plans, some of which apply to all employees while most bonus plans apply to only certain groups of employees because most bonus are oriented to specific company goals where some groups of employees obviously contribute more than others for achieving these goals and hence only selected employees participate in the bonus plan. For example, goals of increasing sales, improving shop floor quality, creating innovative designs and improving management results commonly result in bonus plans oriented to certain categories of employees such as, in our example, sales people, factory employees, engineers and senior management, respectively. These costs are clearly allowable even though this component of the overall bonus program may not apply to all employees.

Uncompensated Overtime

DOT Position

DOT has questioned costs associated with uncompensated overtime on the grounds that Contractor's treatment of such costs is not consistent with DCAA standards of treatment of uncompensated overtime. DOT asserts Contractor (1) must account for all labor hours, both direct and indirect (2) does not adjust the direct labor base for UOT and (3) if total hours are not accounted for then adjustments must be made to indirect and direct labor accounts.

Contractor Response

1. Total time. We disagree that all contractors must record total hours. DCAA does not require it and has, in fact, resisted efforts by other government agencies to impose such a requirement. Its position is that if UOT is not a "significant" element contractors should not be required to record total hours but if it is a significant portion of total hours, then contractors should be encouraged to do so. In the most recent Grant Thorton's "Annual Government Contractor Industry Survey 2006" discussd above it found 64% of government contractor respondents said their exempt employees record total time while 36% said they did not. Notwithstanding there being no requirement to record total time, Contractor's exempt employees do account for total time. All employees, whether they are direct or indirect, do record total time to the cost objectives where work is done.

2. Adjusting direct labor base. DOT is presumably referring to the need for those contractors who compute an effective rate (divide salary by hours worked) to adjust their direct labor base to account for the difference between normal rates (salary divided by standard work period e.g. work week of 40 hours) and effective rates. If the contractor does compute effective rates for costing jobs but uses normal rates times actual hours to compute the direct labor base then we agree that the direct labor base should be adjusted. However, if the contractor uses other acceptable methods prescribed by DCAA then there is no need for an adjustment.

Is computation of an effective rate required? The answer is no. The DCAM Section 6-410.4 lists three acceptable methods of treating uncompensated overtime: (1) calculating an average rate for each pay period based on salary divided by hours worked (2) assign hours on a pro rata basis to all cost objectives during a pay period or (3) allocate costs using an estimated annual rate and credit or debit any variance to an indirect account.

Contractor's method of treating UOT is Method 3 where each direct hour is charged at the normal hourly rate and the direct labor base is the total of all direct labor hours multiplied by the normal rate. Under this method, the direct labor base is not adjusted but rather the overhead pool is adjusted with either a credit or debit for the different amount of hours worked.

Since total time is recorded there is no need to adjust indirect and indirect accounts.

Overtime Premium

DOT Position

DOT states "Overtime premium, (just the premium portion) is completely unallowable in overhead costs, per FAR 22.103 and DOT Overhead Policy."

Contractor Response

We have examined the contract, FAR and DOT overhead policy alluded to as well as DCAA audit guidance in Chapter 6-409.2 and found no prohibition against overtime premium costs charged indirect.

♦ Contract

We examined the contract and there was no allusion to overtime premium costs – it was silent as to the allowability of the costs.

♦ FAR Part 22

FAR Part 22 provides general guidance concerning the government policies, procedures, approval process and use of overtime. It provides guidance to contracting officials on under what circumstances may overtime be allowed for different contracts in the acquisition of products and supplies and leaves it up to the contracting officer to choose an overtime policy for specific contracts. The section does not address the proper accounting treatment of those overtime expenses (e.g. direct or indirect) nor whether these costs are allowable or not in general or after the fact. Rather, it expresses a general policy that "so far as practicable" overtime should not be used unless "lower overall costs to the government will result" or to "meet urgent needs." Under such circumstances, "any approved overtime, extra-pay shifts, and multi-shifts should be scheduled to achieve these objectives."

♦ DOT Overhead Policy

We have closely examined DOT Overhead Policy and failed to identify any specific references to overtime premium costs. Several examples of both allowable and unallowable overhead costs are alluded to but overtime premiums are not. The Overhead Policy states that FAR cost principles and the contractor's policies should cover the allowability of overhead costs which presumably should include overtime premiums.

♦ DCAA Audit Guidance

Chapter 6-409 of the DCAA Contract Audit Manual (DCAM) addresses the evaluation of overtime, extra-pay shifts and multi-shift work. The DCAM alludes to the fact that auditors should be familiar with FAR 22.103, which includes "definitions and conditions under which overtime costs *may* be approved under Government contracts" (Italics added). It recommends that auditors ensure that when overtime work is required that the contractor's policies and procedures are sufficient to ensure the costs are "limited to actual need for the accomplishment of specific work" and that the overtime premiums are "equitably divided between government and commercial operations." It further states that overtime pay is "generally treated as indirect expense" but that it "may be acceptable as a direct charge." In no place does it state that overtime premiums are an unallowable cost and that overtime premiums should not be included as an indirect expense. In fact, the opposite is true. The guidance recognizes that though direct charging of overtime premiums are acceptable, it acknowledges that inclusion of overtime premium pay as an indirect cost is the "general" practice.

Allowability. We believe overtime premium is an allowable cost of government contracts unless there are specific prohibitions included in specific contracts. Unless direct overtime costs are prohibited under a specific contract, overtime is sometimes a necessary cost (e.g. urgency, meeting performance requirements, producing overall lower costs – its often more cost effective to pay exiting employees overtime than to hire and train new employees).

Allocability as indirect costs. We also believe that inclusion of overtime premium costs as an indirect cost is appropriate and best satisfies DCAA's concern that overtime premium costs be equitably allocated to all contracts. Contractor, like most companies, chooses to include such allowable costs in its indirect cost pool rather than charging it to individual contracts. This method is reasonable because it is often difficult if not impossible to allocate overtime premium costs to individual contracts. For example, if an employee works 10 hours in a day on three contracts and in accordance with FSLA is paid two hours at time in a half, how does a company determine which of the three contracts incurred the overtime premium. That is why most companies, including Contractor, charge overtime premium to an indirect labor pool which is allocated across multiple contracts and other final cost objectives.

Marketing Costs

DOT Position

DOT is concerned that some or all of Contractor's marketing labor costs may be unallowable so has questioned all of the costs without stating why.

Contractor Response

With the exception of specific costs discussed below, all costs considered to be sales and marketing costs are allowable if they are reasonable. FAR 31.205-38, Selling costs identifies the types of costs that are considered to be sales and marketing costs – (1) advertising (2) corporate image enhancement (3) bid and proposal costs (4) market planning and (5) direct selling. Some costs in three of these categories – advertising, corporate image enhancement when they are public relations and direct selling when they are "influence" payments- are unallowable while all others are allowable. Contractor and the independent CPA firm identified transactions categorized as advertising or public relations and deleted those costs from the indirect cost pool. All other costs were direct selling expenses which are allowable in accordance with FAR 31.205-38.

REVIEW OF PROCUREMENT AND COSTING ISSUES IN 2007

(Editor's Note. Since the practical meaning of most regulations are what appeals boards, courts and the Comptroller General say they are, we are continuing our practice of summarizing some of the significant decisions last year affecting grounds for successful protests of award decisions, grounds for dollar entitlement for claims and cost issues. This article is based on the January 2007 issue of Briefing Papers written by Miki Shager, Counsel to the Department of Agriculture Board of

Contract Appeals. We have referenced the cases in the event our readers want to study the cases.)

Protests of Award Decisions

♦ Interested Party

To have standing to protest a procurement, a protester must be an interested party – an actual or prospective offeror whose direct economic interest would be affected by the award or failure to obtain the award (*HWA, Inc. v US, 78Fed. Cl 685*). A protester is an interested party where there is a reasonable chance its proposal would be in line for award if the protest is sustained (*Executive Protective Security Svcs. Inc. Comp Gen. Dec. B-299954). We will refer to Comp. Gen. decisions by the name of the company and the case number).* A protester is not an interested party where the record shows that another offeror, not the protester, would be in line for award if it is sustained (*Alutiiq Glbal Solutions, B-299088*). A protester who did not comply with the requirements of the solicitation after extensive discussions is not an interested party (*Metson Marine Svcs., B-299705*). A protester does have standing when the agency's decision to modify the contract deprived it of its ability to compete (*Mgt Solutions & Systems, Inc. v US, 75 Fed. Cl. 820*). A protester had standing when it was rated third but it was not clear the CO knew what it was doing (*Southern Foods, Inc v US, 76 Fed. Cl. 769*). The protester was not an interested party where the cost to perform a contract would be approximately $38 Million and it had $50,000 in savings (*Scott v US, 78 Fe. Cl. 151*). To prevail in a protest the protester must show that it was "prejudiced" where it was established when the protester can show it would have had a substantial chance of receiving the award (*Axiom Resource Mgt. V US, 78 Fed. Cl. 576*) but there was no prejudice when the offeror was not in the competitive range (*Ironclad/EEI V US, 78 Fed. Cl. 351*).

♦ Unbalanced Bids

A bid is unbalanced if it is based on prices significantly less than cost for some work and significantly overstated for other work and there is some reason to doubt the bid will result in the lowest overall cost. An acceptance of a proposal with unbalanced pricing is not, in itself, improper provided the agency has concluded that the pricing does not impose an unacceptable risk and the prices the agency is likely to pay is not unreasonably high (*Legacy Mgt Solutions, B-29998*). Below-cost pricing is not prohibited and the government cannot withhold an award merely because its low offer is or may be below costs or where an offeror, in its business judgment, decides to submit a price that is extremely low (*Central Texas College, B-309947*). An offered price that is 15-20% below other offerors is not too low and did not represent a performance risk (*Olympus Building Svcs. B-296741*). Also, an agency may accept a bid characterized as "unrealistically low" (*Medical Matrix, B-299526*). But, an ambiguous and unrealistically low offer should have been eliminated from the competitive range on the basis the offeror did not understand the competition (*Information Science Corp. v US, 75 Fed. Cl. 406*). Or, an agency's assessment of an offer as unrealistically low where it was assessing risk of offeror's approach was ruled valid (*Zolon Tech, Inc., B-299904*).

♦ Evaluating Negotiated Contract Proposals

The government is free to use a variety of evaluation factors in evaluating proposals. However, the RFP must describe the factors and significant sub-factors to be used to evaluate proposals and their relative importance and agencies must evaluate the proposals according to the criteria established in the solicitation (*ITT Federal Svcs Intl Corp, B-296783*). Agencies must evaluate proposals in accordance with criteria spelled out in the solicitation (*HWA, Inc*) and a protest was sustained where the record showed the agency improperly treated subfactors under the primary technical evaluation criterion as weighted in descending order (*Biorad Labs, Inc. B-297553*). A protest was sustained where the agency applied an evaluation consideration not stated in the RFP (*Information Tech Svcs, B-298840*). In 2007 the GAO sustained several protests where the agency's source selection decision was irrational and/or inconsistent with the administrative record. In deciding these protests the GAO generally considered the record at the time of evaluation and gave little weight to hypothetical arguments presented during the protest hearing. For example, a protest was sustained where the agency unreasonably determined all offerors to be approximately equal but ignored the protestor's lower maintenance costs in violation of solicitation criteria (*Sikorsky Aircraft, B-299145*). But a protest was denied when the agency reasonably determined that technical superiority was worth the additional price *(PWC Logistics Svcs, B-299820*).

Agencies must apply *evaluation criteria equally* to all competitors. A protest was sustained where it was found the solicitation required proposals to be evaluated as more advantageous the greater the extent

to which more recent experience reflected the scope of work whereas the CO instead applied a "threshold of sufficiency" approach to the detriment of the protester (*L-3 Communications Titan Corp, B-299317*).

Agencies must consider *cost or price* in evaluating competing proposals and ruled that a competitive range determination was invalid because price was not properly considered (*Information Sciences Corp.*). The agency unreasonably made a single award of 22 items where second award to protester of 6 items would have saved the government money even with the additional administrative costs (*Para Scientific, B-299046*).

Alleged improper *cost or price realism analyses* decisions received considerable attention in 2007. In one decision the GAO held the agency's price realism evaluation under a fixed-rate solicitation was not unreasonable where it was made as part of an assessment of the risk of the vendor's approach (*Zolon Tech*). A price reasonableness analysis involves prices that are higher than warranted; price analyses whether prices are lower than warranted are not required unless the solicitation calls for it (*Indtai, B-298432*). The agency engaged in improper cost realism analysis under a cost type contract where there were downward adjustments of proposed costs on the basis the costs were unsupported rather than because the agency concluded the actual costs were likely to be lower than proposed (*Magellan Health Svcs, B-298912*). A protest was sustained where the agency's cost realism analysis accepted awardees work allocation in its cost proposal but that allocation was inconsistent with the firm's allocation of work under its technical proposal (*Earl Industries, B-309996*).

FAR 9.104 states that for an offeror to be considered *responsible*, it must, among other things, be able to comply with the required performance schedule, have adequate financial resources, and have the necessary organization, experience, operational controls and technical skills or the ability to obtain them. The burden falls on the contractor to demonstrate its responsibility and in the absence of information clearly indicating responsibility, the CO must make a determination of non-responsibility. The Court rules it will not disturb a non-responsibility determination unless the protester can show the agency had no reasonable basis for its determination – simply put, this is a matter where the CO is vested with broad discretion in exercising its judgment (*United Enterprise & Assoc. v US, 70 Fed. Cl. 1*). In a decision related to the offeror's capability to perform the work, the Court ruled such a decision constituted a non-responsibility determination where the CO was given the benefit of the doubt *(Southern Foods Inc. v US, 76 Fed. Cl. 769*).

There were many cases addressing firms' *organizational conflict of interest (OCI).* The GAO ruled there was an "impaired objectivity" OCI that resulted from the contractor's continuing to receive payment from a firm over which it would have management responsibility (*Greenleaf Construction, B-293105*). The GAO also ruled there was an impaired objectivity OCI where several evaluators were employed by firms that promoted a type of technology that was directly challenged by that offered by the protester. The GAO ruled the agency's reliance on the evaluator's self-certification of the absence of COI did not meet its obligation to ensure no COI existed, especially where the evaluators worked for a firm whose "economic lifeblood" was directly competitive with the other technology (*Celdon Labs, B-298533*). The GAO also ruled there was an OCI in providing a spectrum of engineering support services to a contractor who was involved in the manufacture and marketing of spectrum-dependent products (*Alion Science and Technology, B-297342*).

No OCI existed resulting from the contractor's complete cessation of continued receipt of payments from a firm over which it would have management responsibility (*Greenleaf Construction*). There was no OCI where the company moved the affected work to a separate entity and established a firewall around the entity sufficiently to mitigate the COI (*Business Consulting Assocs., B-299758*). Ruling mere inference or suspicion is not sufficient, the GAO found no biased ground rules where the awardee played no role in drafting a statement of work (*Operational Resource Consultants, B-299131*). The awardee, who was the incumbent, was not so embedded as to have insight into the agency's operations beyond that expected from a normal contractor ruling the incumbent status, without more information to the contrary, typically does not constitute "unequal access to information" which is required to prove a COI (*ARINC Engrg Svcs v US, 77 Fed. Cl. 196*). Or, there was no "unequal access" created by virtue of incumbency and it required no attempt to equalize competition to compensate for it (*Council for Adult & Experimental Learning, B-299798*). Similarly, its role as subcontractor did not provide any competitively useful information to constitute COI (*MASAI Tech,. v US, 79 Fed. Cl 433*).

♦ Past Performance

FAR 15.304 requires that past performance be one evaluation factor that must be considered in all negotiated procurements and the boards and courts are defining how this new factor will be applied. When negotiated awards are to be made with discussions offerors are to be given the opportunity to clarify adverse past performance while negotiated awards that do not provide for discussions *may* be given the opportunity to clarify past performance. An agency is not required to communicate with offerors past performance information where discussions are not held unless there is a clear reason to question the validity of the past performance information.

Several cases confirmed an agency has broad discretion in determining whether a particular contract is *relevant* (*Sumaria Systems, B-299517*). The agency has broad discretion to determine the scope of the past history to be considered provided all proposals are evaluated on the same basis (*Axiom Resource Mgt., B-298870*). The agency is not precluded from considering any relevant information regardless of its source (*Paragon Systems, B-299549*). The agency's past performance evaluation may be based on the perception of inadequate prior performance regardless of whether the protester disputes the agency's interpretation of the underlying facts (*J Womack Enterprises, B-299344*).

It is reasonable to consider relevant only that past performance related to similar tasks performed under government contracts. When the agency considered all four of the protester's past performance references but gave greater weight to the most similar contract to the contract at issue the GAO ruled there was nothing unreasonable done since this contract was an appropriate indicator of likely success (*Metson Marine Svcs, B-299705*). Where the RFP asked for a narrative describing similar contracts for the last five years the GAO sustained the protest where the bulk of awardee's highly credited past performance occurred longer than the last five years (*GlassLock, B-299931*). The GAO ruled it was appropriate to award a "little confidence" past performance rating based on a similar relevant contract despite the fact that its rating on another relevant contract was "very good" (*Sikorsky Aircraft, B-299145*).

It is the *contractor's responsibility* to provide sufficient evidence to establish its past performance history. When the contractor provided references of only limited relevance the agency assigned only half of the available points for past performance the contractor contended the agency should have contacted more references. The GAO found the past performance rating reasonable and the contractor failed to provide adequate information holding there is no requirement that all or a specific number of references be contacted (*Beck's Spray Service, B-299599*). References for contracts with a maximum value of $564,000 did not meet the requirements for past performance information on a contract similar to the solicited $15 Million (*Wizdom System, B-299829*).

An agency properly may *attribute* the experience or past performance of a parent or affiliated company to an offeror where the proposal demonstrates the resources of the parent or affiliate will affect performance of the offeror. Past performance of proposed subcontractors may properly be considered in evaluating past performance of an offeror where the solicitation does not expressly prohibit it (*Indtai Inc.*).

♦ Discussions

FAR 15.306 requires the CO discuss with each offeror being considered for award significant weaknesses, deficiencies or other aspects of its proposal that could be altered or explained to enhance the proposal's potential for award. Discussions should not be confused with *clarifications* which are limited exchanges with offerors to allow correction of minor or clerical errors or to clarify proposal elements (*Government Telecommunications, B-299542*). Communications to correct minor errors in one offeror's proposal constitute clarifications and hence do not require they be held with other offerors (*Dyncorp Intl v US, 76 Fed. Cl. 528*). Exchanges with an agency are clarifications because the protester was not allowed to revise its proposal *(OfficeMax, B-299340)*. There was no merit in the agency's argument that the RFP did not intend to have the agency hold discussions when deciding whether exchanges were discussions or clarifications – exchanges that allow offerors to revise proposals in a material way are discussions, not clarifications (*Computer Sciences Corp. B-298494*).

It has been held there is no requirement that all areas of a proposal be addressed during discussions but only *significant* weaknesses e.g. those that prevent the offeror from having a reasonable chance of receiving the award need be addressed (*PWC Logistics Svcs*,). While an agency must conduct "meaningful discussions" (i.e. discuss areas in a proposal requiring amplification or revision) an agency is not required to "spoon feed" offerors or conduct successive

rounds of discussions until all proposal defects have been corrected (*Metson Marine*). Discussions are not considered inadequate simply because a weakness not addressed during discussions later becomes a determinative factor between two closely ranked proposals (*Planning & Development Collaborative Intl, B-299041*). During discussions the CO is not obligated to identify each and every item that might improve an offeror's proposal (*Blain Intl Group, 79 Fed. Cl. 272*). If an agency holds discussions and identifies a concern based on the revised proposals that should have been raised earlier, the agency must reopen discussions to raise the concerns with all offerors (*Planning & Development*).

Constructive Claims

When contract effort exceeds the original scope of work the contractor is entitled to receive a price adjustment to the contract price. A constructive change occurs when a contractor must perform work beyond contract requirements without a formal "order" to do so under the "Changes" clause. Such a change can include an *informal* order or direction of the government or by the *fault* of the government (*M.A. DeAtley Construction, US, 75 Fed. Cl. 575*). To recover under this theory the contractor must advise the government it considers the contract to have changed. A constructive change was ruled to have occurred where the government kept unused materials belonging to the contractor (*G&R Svc Co. v Dept of Agr., CBCA No 121*) or where a contract permits a manner or method of performance, changing it or forbidding such a manner or method constitutes a constructive change (*Beyley Construction v Dept of Veterans, CBCA No. 5, 07-2*). The Board held the government can be placed on notice of a claim by being made aware of the operative facts and that oral notice may be furnished (*AAB Joint Venture v US, 75 Fed. Cl. 414*). When a defective spec changed the work, a constructive change occurred (*Wu & Assocs., LBCA NO. 204-, 07-2*). The Board further held that the government has the burden to prove prejudice (i.e. harm) from a lack of notice and this burden cannot be met by mere allegation but must be supported by evidence from the record (*SUFI Network Svcs, ASBCA No. 55306*).

Costs

Equitable Adjustments. An equitable adjustment is the difference between the reasonable cost of the work required under the contract and the actual reasonable cost to the contractor of performing the changed work, plus a reasonable amount for overhead and profit. A contractor carries the burden of proving the amount by which a change increased its costs of performing on the contract (*P&C Placement Svcs V SSA, CBCA No. 391*) while the government bears the burden of a downward adjustment in contract price (*Fur-Con Const., ASBCA No. 55197*). Though the preferred method of proving damages is to provide proof of actual costs incurred the courts have acknowledged that other methods are accepted as long as the costs can be shown to be reasonable and it is impracticable to show the costs in any other way. There is no presumption of reasonableness just because the cost was incurred so the contractor has the burden to establish the reasonableness of the cost (*Fur-Con*).

Legal Costs. In deciding whether costs incurred under a sexual harassment suit were allowable, the board found that it was not necessary that the contractor prove that the employee had "very little likelihood of success" for the costs to be allowable stating this standard applies to false claims or fraud cases against the US. Further, settlement costs of the suit were allowable since they were not unallowable fines or penalties under FAR 31.205-15 because payment was made to an individual to remedy an individual harm and was not a "penalty" (*Tecome, ASBCA No. 53884*). Interpreting a Dept of Energy contract and cost principle in the DEAR making defense of any civil or criminal fraud proceeding unallowable, the board held that legal fees incurred in the unsuccessful defense of a qui tam suit under the False Claims Act were unallowable (*Boeing Co., v DOE, CBCA No. 337*).

Contract Administration. For a long time boards and courts have distinguished between unallowable costs of prosecuting claims and allowable costs of contract administration where in a seminal case (*Bill Strong*) the basic guidance is that if the costs are incurred to permit a negotiated resolution of the problems that arose during contract performance they are presumably allowable costs of contract administration while if they are incurred to begin the process of litigation they are unallowable. The Board found that the parties were in a negotiating posture and the exchange of information was ongoing making the consultant's costs allowable contract administration costs though the amount of the bills were reduced due to lack of specificity in the consultant's invoices and apparent lack of oversight by the contractor (*Fru-Con Construction*).

RECENT DECISIONS ON TRAVEL AND RELOCATION

(*Editor's Note. Though only three parts of the Federal Travel Regulations provisions formally apply to government contractors – combined per diem rates, definitions of meals and incidentals and conditions justifying payment of up to 300% of per diem rates – many contractors choose to follow the FTR either because some contracts call for incorporation of it or auditors and contractors consider it to be the basis for determining "reasonableness." This feature is a continuation of our effort to present new changes or decisions likely to affect contractors' travel and relocation expenses.*)

Personal Travel is Not Reimbursable

Shortly before his scheduled travel from Maryland to Alaska to support missile tracking tests, Jacob was unexpectedly detoured to Florida due to a death in the family. To keep the missile testing on schedule he flew from Florida to Alaska rather than returning home and he was only reimbursed the cost for travel from his home in Maryland to Alaska leaving an additional $600 to be paid by Jacob. In both an earlier and an appeal decision the Board ruled the decision to fly to Florida was a personal decision. Since he was not in Florida for official business even though the government benefited from his travel to keep the tests on schedule, the fact he incurred the costs for personal reasons was sufficient for the government not to pay the extra expense (*Robert O. Jacob, CBCA 471-TRAV*).

Your Residence is the One You Commute to Every Day

Allan was transferred from Lorraine, OH to Florida. During his time in Lorraine, he rented an apartment nearby in Sheffield Lake and owned a house in Mentor, about 50 miles from Lorraine. He lived in the house the majority of time but staying in the apartment a couple of times per week. When he transferred to Florida he was denied the $10,300 of costs incurred in the sale of his Mentor house because the agency asserted he did not commute daily from that residence to his duty station. The Board sided with the agency concluding the 2-3 days per night commute from the apartment was enough to establish Allan did not commute from his house in Mentor on a daily basis *(CBCA 691-RELO).*

A similar conclusion resulted when Michael, who worked on a ten-day-on and four-day-off schedule spends his "on" nights near his official duty station in Marquette, MI and his "off" nights at his home in Midland, MI, about 338 miles from Marquette. During the year he had several travel requirements where he went from Midland to Marquette to pick up a government owned car where he drove to his temporary duty (TDY) station, spent the night and reversed the process. The agency only paid for his travel from Marquette to his TDY location stating his Marquette address was his residence, not Midland. The Board ruled against Michael stating an earlier decision by the GAO ruled that "residence", "home" or "place of abode" as used in the Federal Travel Regulation refers to the "residence from which an employee regularly commutes to work each day" (*Michael Bilodeau, CBCA 686-TRAV*).

When Moving Yourself Be Sure What the Regulations Allow

Gene received travel orders to transfer location where the Air Force prescribed a government bill of lading move – commonly called an actual expense move – estimating a cost of $8,270. Gene instead decided to perform a self move where he would use his own trailer, rent a special hitch and use his own vehicle for hauling where he decided it would be prudent to service the vehicle (e.g. thrust alignment, change fluids, balance wheels). When he completed his move and submitted a claim of $823 for the hitch and maintenance costs the AF refused reimbursement asserting it was not authorized to pay these expenses. The Board noted that employees are not required to use moving methods selected by their agency but in choosing to move themselves they should know the government can only reimburse what the "regulations, as interpreted by case law, permit." The Board referred to an earlier, nearly identical case – James R. Adams, B-252629 – where James was unable to find a trailer to rent and purchased a kit and supplies for the move. Like Gene, James move was significantly less expensive than what the government would have had to spend on a actual expense move but nonetheless, his reimbursement was denied because there was "no provision in the FTR" authorizing reimbursement for the truck or trailer used. As for the maintenance part of Gene's bill, the Board acknowledged the servicing of the vehicle would enhance reliability for the move but held those expenses were for "personal preference". It held those services would have been performed at some time or another regardless of the trip so just because he chose to have them done before the trip does not

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translate maintenance of a personal vehicle into a relocation expense" (*Gene Kourtei, CBCA 793-RELO*).

Disability is Beyond Control for Relocation Reimbursement

Clarence, who was a park ranger, was transferred where prior to his move he signed a 12 month service agreement stating that if he failed to remain in the service of the federal government for one year after transfer he would be responsible for repaying his relocation costs unless he was separated for reasons beyond his control. Three months after starting his job he suffered a neck injury during a physical fitness test where he received continuous medical treatment and continued to work where two months later a neurosurgeon recommended corrective surgery. During this time the Interior Department suspended Clarence pending outcome of a complaint filed against him and when he could not determine the reason for the complaint he resigned, citing only his medical condition and upcoming surgery as reasons for leaving. After his surgery the Office of Personnel Management ruled he was disabled. When the government demanded he pay the government for $20,000 of his relocation expenses he appealed stating the separation for medical reasons met the condition for separation for reasons beyond his control while the government claimed the timing of his resignation was "suspicious" and the fact he continued working and the outcome of surgery was uncertain, his separation was not beyond his control. The Board stated the government has the discretion to determine whether a separation is beyond control but there must be a reasonable basis for the determination. The Board ruled that Clarence's medical records and OPM ruling of disability were sufficient evidence he separated. While the investigation, which was dropped after he resigned, may have contributed to his resignation, the only evidence actually available was medical, ruling the Interior Department's attempt to collect the relocation costs was an "abuse of discretion" (*CBCA 616-RELO*).

CONUS Rate is Changed

The Standard CONUS rate is the per diem rate applying to locations that are not identified in the GSA's Per diem Bulletin. The maximum Standard CONUS rates was increased to $109 from $99.

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