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Proposed Amendments to FAR 52.216-7; Allowable Cost and Payment Clause

The Federal Register, Vol. 74, No. 160/Thursday, August 20, 2009 Proposed Rule listed FAR Case 2008-020, Contract Closeout.

The FAR Councils are proposing to amend the Federal Acquisition Regulations to revise procedures for closing out contract files including procedures for clearing final patent reports and quick-closeout procedure, and sets forth a description of an adequate final indirect cost rate proposal and supporting data. Although not stated in the summary, the proposed rule also contains fee withholds to protect the government's interest and to encourage contractors to timely file final indirect cost rate proposal and states that the cognizant auditor would be responsible for determining the adequacy of the final indirect cost rate proposal including those subject to Contracting Officer determination under FAR 42.705-1.

The proposed rule provides for interested parties to submit written comments on or before October 19, 2009 to be considered in the formulation of a final rule. As should be apparent from the discussions herein, it is incumbent on every government contractor to express itself on this matter (either individually or through industry associations).

On the surface of it and especially based on the incomplete and somewhat misleading summary paragraph, this seemingly innocuous FAR amendment would seem to be favorably viewed by government agencies and government contractors given the objective of "streamlining" contract close-out. However, upon closer examination, FAR Case 2008-020 represents the codification of very expansive requirements related to the description of an adequate final indirect cost rate proposal (incurred cost proposal (ICP)) and supporting data because the proposed rule incorporates virtually all of the requirements directly from DCAA's interpretation of an adequate indirect cost rate proposal available at www.dcaa.mil (reference to DCAA Information for Contractors, Chapter 6, Incurred Cost Proposals, the Model Incurred Cost Proposal).

Additionally, the proposed rule shifts long-standing authority from the contracting officer to DCAA (reference to changes to FAR 42.705-1) as it relates to determining adequacy of final indirect rate proposals—specific proposed verbiage (not currently included in this FAR provision) would read, “(ii) The cognizant auditor will make a written determination on the adequacy of the contractor’s proposal for audit”. Also of interest is that FAR 42.705-1 will retain the statement “The required content of the proposal and supporting data will vary depending on such factors as business type, size, and accounting system capabilities” while FAR 52.216-7 will add verbiage which essentially eliminates any opportunity for any variation in proposal content. That FAR 52.216-7 added verbiage would include specific schedules, information and data required for all contractors, regardless of type, size and accounting system. In many cases this would create an enormous burden on many contractors to develop information or adapt information into prescribed formats; administrative actions that are non-value added in accomplishing the FAR objective of achieving a timely settlement of final indirect rates with the least amount of supporting cost data.

The proposed FAR amendment very well could have been drafted by DCAA and is most likely viewed (by DCAA) as mere confirmation of “requirements” given that DCAA has been using the FAR proposed criteria as the basis for rejecting hundreds of ICPs as inadequate (more discussion to follow on the subject of DCAA’s rejection of previous and current ICPs using the proposed FAR as opposed to the existing FAR). In consonance with the possibility that DCAA drafted the wording for FAR Case 2008-020, DCAA’s Director has gone on record of stating that DCAA opinions should be mandatory in reference to “business systems” which would undoubtedly extend to systems which produce final indirect cost rate proposals (ICPs). Without question, the proposed change to FAR 42.705-1, that only the cognizant auditor can make a determination of the adequacy of an ICP, would begin to satisfy DCAA’s quest to the deciding official as opposed to being advisory to a contracting officer.

In terms of the background of the proposed FAR amendment, FAR Case 2008-020 indicates that it dates back to May 2007 when DPAP completed an assessment of public input on systemic issues related to contract closeout; as a result changes were proposed to DFARS and the FAR to improve contract closeout. In fact, the May 2007 assessment did not result in proposed changes, but did result in plans to pursue changes and to further study the closeout process. The reference is Federal Register Vol. 72, No. 98/Thursday May 22, 2007/Proposed Rules wherein the assessment of public input led to i) DPAP plans to pursue revisions to the FAR/DFARS and ii) DPAP opening a DFARS Case on contract closeout to establish a comprehensive PGI section to address contract closeout and to assess whether regulatory clarifications/revisions were needed to address a number of topics including quick closeout, final indirect cost rate proposals, cumulative allowable cost worksheets.

Of passing interest, the May 2007 “proposed rules” noted that DPAP had completed its assessment of public input identified in a public meeting held on September 21, 2005. Simply an observation that it has taken four years to migrate from public comments to a proposed FAR amendment, yet contract closeout is purportedly a priority.

Neither the May 2007 Federal Register nor the August 2009 Federal Register shed any light as to how the FAR Councils (or DPAP in isolation from the FAR councils) prepared and executed the DFARS case to study contract closeout. In terms of the empirical evidence gathered which led to the August 20, 2009 proposed FAR amendment, there is no empirical data and for that matter no data whatsoever which otherwise supports the “contract closeout” need for the final indirect cost rate proposal to be inclusive of Schedules A through O and supplemental schedules which coincidentally mirror those within the DCAA Model Incurred Cost Proposal.

Although the ICP requirements have long been espoused by DCAA as a key component in solving contract closeout issues, there is little empirical evidence supporting

that assertion. There has been success in closing out large numbers of contracts; however, the single factor in achieving such success had little or nothing to do with the expansive “requirements” for extensive cost schedules identified within the DCAA Model Incurred Cost Proposal. In fact, the most noteworthy success was merely the application of common sense in closing out huge numbers of task orders (individually a contract); specifically, the use of audit sampling applied to batch processing of final vouchers as opposed to audits of 100% of the task orders.

In contrast to the assumption that the Model Incurred Cost Proposal has facilitated timely contract closeout, the expansive list of DCAA requirements including supplemental schedules has often delayed the process as DCAA has routinely rejected ICPs for very inconsequential shortcomings including the failure to provide supplemental schedules at the same time as the “required” schedules. As more than one DCAA auditor has expressed it, “supplemental is just a name, we expect them all”.

There are numerous schedules contained in the Model Incurred Cost Proposal (thus the proposed FAR amendment) which have absolutely no connection to contract close-out. It is particularly evident within the supplemental schedules, such as the “annual internal audit plan of scheduled audits to be performed in this year. An audit “to be performed” in a future year has only a tangential connection to an “incurred” (historical) cost audit; moreover the Newport News case established that DCAA does not have access to internal audits.

Further, for those schedules which do facilitate contract closeout, there is no logic nor evidence of any cost benefit which can be attributed to DCAA’s long standing insistence that data, contained and reasonably available within a contractors books and records, be converted to schedules directly incorporated into the incurred cost rate proposal. In fact, DCAA’s long-standing insistence that data be converted into other formats (such as spreadsheets using DCAA’s ICE Model) is in direct defiance of FAR 52.215-2(d)(2) that access to records

“may not be construed to require the contractor or subcontractor to create or maintain any record that the contractor or subcontractor does not maintain in the ordinary course of business or pursuant to a provision of law”. Secondly, the conversion of data from its native form into a different application or format creates an unnecessary opportunity for error in contrast to simply auditing the books and records as they exist as envisioned by FAR 52.215-2.

Upon further review of the proposed rule, it is obvious that no one made any attempt to review the wholesale inclusion of DCAA’s Model Incurred Cost Proposal into the proposed rule. For example the proposed rule has an explicit requirement that the contractor update the cumulative costs claimed and billed within 60 days of rate settlement while also requiring the inclusion of the cumulative costs claimed and billed within the ICP. The real benefit to the cumulative costs claimed and billed (aka Cumulative Allowable Cost Worksheet) is after the indirect rates have been finalized for the year. For the purpose of streamlining contract closeout, even DCAA (the previous Director) recognized the need for a “cumulative costs claimed and billed schedule” but only after rate settlement. In fact, DCAA had a long-standing ground rule that an ICP was acceptable if the contractor agreed to prepare this schedule after the rates were finalized. Apparently the long-standing and common-sense groundrule has been displaced to coincide with DCAA’s vision of a “brave new world” (statement made by the current DCAA Director).

The proposed rule has retained the wording that “the required content of the proposal (ICP) and supporting data will vary depending upon such factors as business type, size, and accounting system...accordingly, each contractor shall submit an adequate proposal to the contracting officer or cognizant agency official.” Such wording is wholly inconsistent within a regulation that also mandates the long list of required and supplemental schedules. As stated, the proposed rule would effectively eliminate any flexibility for contractors to provide only that information necessary to support an ICP, given that the proposed rule will require the same list of schedules and

supplemental schedules from every contractor required to produce an ICP under FAR 52.216-7.

Finally, the Model Incurred Cost Proposal (the required and the supplemental schedules) should be recognized for its primary purpose which has no connection to facilitating contract closeouts. The majority of the schedules were designed to shift resource costs from DCAA to the contractor. Basically, instead of DCAA spending the time to perform an audit step, require the contractor to complete a schedule for the auditor; for example Schedule H-1 which is nothing more than a summary schedule of the government participation rates for the year. That schedule has no relevance to any allowable, allocable or reasonable cost, but does provide the auditor with very basic audit risk information. It has absolutely no connection to contract closeouts. A similar example is the supplemental schedule A which is “comparative analysis of indirect expense pools by detailed account to prior fiscal year and budgetary data”. Again, absolutely no purpose but to facilitate certain audit tests (risk analysis) and having no connection to contract closeouts. In fact, that schedule only serves the purpose of audit risk assessment and its inclusion defies logic given that the fundamental requirement of an ICP is to present the costs for a contractor fiscal year. Costs detailed by account and incurred in a prior year are not allowable, allocable, nor reasonable in a current year ICP. An expression of detailed costs for a prior fiscal year simply doesn’t belong in a current year ICP. This and other “requirements” are nothing more than shifting an audit responsibility to the contractor.

There are numerous other schedules, required and otherwise, which have one purpose only, to facilitate the audit by effectively shifting the resource/cost of audit functions from DCAA to the contractor. In no manner of speaking will any of these schedules directly streamline or otherwise enhance contract closeout unless one makes the assumption that a standardized ICP will result in more efficient and predictable completion of DCAA audits. If DCAA would publish the data, empirical evidence would clearly refute that assumption because DCAA audits are no longer subject to due dates or

budgets. Translated, there is no predicting the completion of incurred cost audits including those DCAA audits of adequate indirect cost rate proposals, prepared today in full conformity with the Model Incurred Cost Proposal. Thus, the proposed rule is fundamentally flawed to the extent its authors apparently believe that a mandatory final indirect cost rate proposal will predictably improve contract closeouts. The fact is that Model Incurred Cost Proposals, operating with the new DCAA and their endless audits (unconstrained by due dates), will have no predictable impact on contract closeouts.

Perhaps the most interesting aspect of the proposed rule is the statement within the Regulatory Flexibility Act that “the changes to FAR Part 4 and Part 42 clarify and streamline closeout procedures”. “The changes to clauses 52.216-8, 52.216-9 and 52.216-10 allow for a reserve to be set aside to protect the government’s interests. Contracting Officer’s may already set aside a reserve under current FAR procedures” (the FAR 52 references are to fee withholds contained in FAR Case 2008-020).

The “clarify and streamline” verbiage suggests that the proposed rule isn’t really changing the FAR, merely clarifying the FAR. If that were the case, why insert a long list of requirements describing an adequate final indirect cost rate proposal when the existing FAR reference to the Model Incurred Cost Proposal already accomplishes this objective? In that context, what’s to be clarified? Further, why restate fee withholds if the option already exists (albeit in an otherwise unspecified FAR procedure).

The regulatory history does not support that the proposed rule is merely a clarification with respect to FAR 42.705-1. In fact, DCAA’s Model Incurred Cost Proposal was incorporated into the FAR as an “example” as opposed to a “requirement”. Moreover, since being incorporated into the FAR as an “example”, DCAA has made wholesale changes to the Model Incurred Cost Proposal and such changes have completely bypassed the FAR rulemaking process.

It is more likely that the FAR councils would prefer that the changes be viewed as clarifications; otherwise the proposed rule could have a devastating effect on existing (and past) ICPs which have been deemed inadequate by DCAA based upon the Model Incurred Cost Proposal which was apparently not a requirement within the current FAR. Similarly, contractor billing systems have been deemed inadequate because of inadequate ICPs (measured against the Model Incurred Cost Proposal) and direct billing has been rescinded based upon the same audit criteria. In other words, hundreds of audit actions have been premised upon the existing Model Incurred Cost Proposal requirement (FAR 42.705-1(b)(1)) and it is entirely possible that the proposed rule will have unintended consequences with respect to any DCAA action which was premised upon the Model Incurred Cost Proposal. FAR Case 2008-020, a proposed rule, appears to have established that DCAA was enforcing a non-existent regulatory requirement.

In summary, it is important that all contractors understand the significance of FAR Case 2008-020 which goes far beyond “streamlining” the contract closeout process. And as FAR Case 2008-020 states, interested parties should submit written comments on or before October 19, 2009.

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2009 Beason & Nalley Sponsored Seminar Schedule

Cost and Price Analysis in Government Contracting

Date: September 10, 2009

Location: Beason & Nalley, Inc.
Huntsville, AL

Time: 8:15 am – 4:45 pm

Understanding Government Audits and How to Resolve Audit Issues

Date: September 17, 2009

Location: Sheraton
11810 Sunrise Valley
Reston, VA

Time: 8:15 am – 4:45 pm

FAR Part 31 Cost Principles Basics Class and Advanced Workshop

Date: November 17-18, 2009

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December 2-3 – Las Vegas, NV

Government Contract Accounting Systems Compliance

September 22-23 – Huntsville, AL

October 6-7 – Washington DC

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Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk

September 15-16 – Washington DC



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