JAN 29 2004

GSA Office of Governmentwide Policy

MEMORANDUM FOR RONALD POUSSARD
DIRECTOR
DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM: RODNEY P. LANTIER, DIRECTOR Rodney P. Lantier
REGULATORY AND FEDERAL ASSISTANCE
PUBLICATIONS DIVISION

SUBJECT: FAR Case 2001-018, Applicability of the Cost Principles and Penalties for Unallowable Costs

Attached are comments received on the subject FAR case published at 68 FR 66988; November 28, 2003. The comment closing date was January 27, 2004.

Response Number	Date Received	Comment Date	Commenter
2001-018-1	12/12/2003	12/12/2003	Vernon Edwards
2001-018-2	01/27/2004	01/27/2004	Danielle Brian (POGO)

Attachments

U.S. General Services Administration
1800 F Street, NW
Washington, DC 20405-0002
www.gsa.gov

2001-018-1

vernon.edwards@att.net

12/12/2003 12:00 PM

To: farcase.2001-018@gsa.gov
cc:
Subject: Comments on proposed rule

The following comments pertain to FAR Case 2001-018.

1. The proposed rule should clarify the Government's policy objective in mandating the use of the cost principles when pricing fixed-price contracts and subcontracts and modifications to fixed-price contracts and subcontracts. The phrase "shall be used" in the current FAR and in the proposed § 31.102(a) is vague. What does it mean?

I think that "shall be used" means different things with respect to new fixed-price contracts and subcontracts and to contract and subcontract modifications that add new work, on the one hand, and to the negotiation of equitable adjustments to fixed-price contracts and subcontracts, on the other. I think it means that contracting officers must use the cost principles when developing a prenegotiation objective (FAR § 15.406-1) for new contracts and subcontracts and new work modifications. But I think it means that the allowable amount to which a contractor or the Government is entitled when seeking an equitable adjustment is limited by the cost principles. Is that true? If my thinking is correct, then the FAR ought to be written to make that clear. In any event, the regulation should be clear about the meaning of "shall be used."

2. The proposed rule's mention of cost analysis is potentially confusing and unnecessary, since the criterion for using the cost principles appears to be whether or not cost or pricing data are required.

3. The phrasing of the proposed rule is terribly awkward, due in no small measure to the use of the passive voice.

4. Therefore, I suggest that you revise the proposed § 31.102 to read as follows:

"(a) When an offeror, contractor or subcontractor must submit and certify cost or pricing data, contracting officers and contractors must use the applicable cost principles in part 31 to:

(1) Develop prenegotiation objectives for the pricing of new fixed-price contracts or subcontracts;

(2) Develop prenegotiation objectives for the pricing of modifications to fixed-price contracts and subcontracts that add new work that is outside of the scope of the contract or subcontract; and

(3) Determine the allowable amount of estimated or actual cost increases or decreases that are associated with equitable and other price adjustments to fixed-price contracts and subcontracts that are made pursuant to a contract clause.

(b) The requirement to use part 31 cost principles to develop prenegotition objectives for new contracts and subcontracts and new work modifications, and to determine the allowable amounts of cost increases or decreases associated with price adjustments, does not require that the parties negotiate express agreements about individual elements of cost. The pricing objective is to reach agreement about the fairness and reasonableness of total prices and the total amounts of price adjustments."

I believe that my suggested wording is both consistent with the proposed policy and clearer than the wording in the proposed rule.

2001-018-1

5. Finally, I suggest that you revise proposed § 31.000(a) to read as follows:

"The pricing of contracts, subcontracts, and modifications to contracts and subcontracts, except fixed-price contracts and subcontracts or modifications thereto when the offeror, contractor or subcontractor is not required to submit and certify cost or pricing data; and... "

Vernon J. Edwards
(503) 819-2156

2001-018-2

January 27, 2004

General Services Administration
FAR Secretariat (MVA)
1800 F Street, NW, Room 4035
ATTN: Laurie Duarte
Washington, DC 20405

Via email: farcase.2001-018@gsa.gov
Hard copy to follow

Subject: FAR Case 2001-018

Dear Ms. Duarte:

Thank you for the opportunity to comment on the proposed rule to amend the Federal Acquisition Regulation (FAR) at 48 CFR Parts 15, 31, and 42, "Applicability of the Cost Principles and Penalties for Unallowable Costs," that was published in the Federal Register on November 28, 2003 (68 FR 66988). The Project on Government Oversight (POGO) is a non-partisan, non-profit organization that has, for 23 years, investigated, exposed and worked to remedy abuses of power, mismanagement and subservience to special interests by the federal government. POGO has a keen interest in government contracting matters, especially those relating to the FAR contract cost principles.

The proposed rule would amend the FAR to indicate that the cost principles in FAR Part 31 do not apply to the "pricing" of fixed-price contracts if cost or pricing data are not obtained. That is, when a contractor submits uncertified "information other than cost or pricing data" in support of a cost based fixed-price contract, then the applicable FAR Part 31 cost principles would no longer serve as the basis for developing the government's written prenegotiation objective that is used by the contracting officer to negotiate a fair and reasonable fixed price.

The proposed rule would also amend FAR Part 31.001, "Definitions" to significantly expand the scope of exemptions from the contract cost principles that are available to contractors, particularly with respect to very troublesome "time and materials" (T&M) and "labor hour" (LH) contracts.

Finally, the proposed rule would also increase the dollar threshold for inclusion of the clause relating to "Penalties for Unallowable Costs" to $550,000, thus reducing the number of contracts potentially subject to this provision.

With respect to the application of the FAR Part 31 cost principles by contracting officers when "pricing" fixed-price contracts where cost or pricing data are not obtained, the need for the proposed change was not clearly and fully disclosed. Furthermore, the alternate basis to be used for developing the prenegotiation objective for cost-based negotiated fixed-price contracts, and the expected impact of the proposed change on the

2001-018-2

current process used for negotiating contract prices for cost-based fixed price contracts, was not addressed.

POGO strongly believes that the government's prenegotiation objective for cost based fixed-price contracts should continue to be predicated on the consistent application of applicable FAR Part 31 cost principles. Whether a contractor's submitted cost data is "certified" or "uncertified" should not alter the basis for determining the government's prenegotiation objective, or a determination on whether the negotiated fixed-price is fair and reasonable. The use of "uncertified" cost data only means that the government is willing to assume greater risk in the use of a contractor's submitted cost information when determining "fair and reasonable" prices.

Accordingly, POGO opposes the proposal to no longer require that the government's prenegotiation objective be predicated upon the application of the applicable Part 31 cost principles when uncertified "information other than cost or pricing data" is obtained, analyzed and used to negotiate contract prices for fixed price contracts.

The proposed exemption is applied to the term "cost analysis" without regard to purpose or use that will be made of the cost analysis results. When price analysis alone can establish that a negotiated fixed-price is fair and reasonable, then a cost analysis for purposes of developing the government's prenegotiation objective is not required. FAR 15.404-1(a)(4) provides that "Cost analysis may also be used to evaluate information other than cost or pricing data to determine cost reasonableness or cost realism." As proposed, the exemption would apply to any "cost analysis" that is performed to determine price reasonableness or cost realism.

Current Process:

Currently, when a fixed price contract price is "negotiated" based on contractor submitted cost data, i.e., "certified" cost or pricing data, or "uncertified" information other than cost or pricing data, the ensuing negotiation process is predicated upon the same long standing process. In a cost based negotiation process, the government requests the potential contractor(s) to submit a detailed breakdown of the contractor's proposed fixed price. A responding contractor's breakdown of the proposed fixed price reflects the contractor's estimated costs for each element of proposed cost that the contractor expects to incur and record in its financial records during the proposed contract performance period. The fixed price breakdown also includes the contractor's proposed profit amount. Upon receipt, the government performs a review and evaluation of the contractor's submitted cost estimates (cost analysis) and profit amount.

Traditionally, for such fixed price negotiations, the government's cost analysis is performed in accordance with the FAR Part 31 cost principles applicable to the proposing entity, e.g., FAR Subpart 31.2, "Contracts With Commercial Organizations." Subpart 31.2 establishes how to determine the amount of direct and indirect costs ***allocable*** to a contract, requires that the method used for determining contract costs must be applied in a ***consistent*** manner for all contracts performed by the contractor, and precludes the recognition of certain otherwise allocable costs that are specified in Subpart 31.2 as ***"unallowable"*** contract costs (FAR 31.201-1). Subpart 31.2 also ***mandates the***

2001-018-2

accounting methods to be used for determining and adjusting certain costs, e.g., pension costs and post retirement costs other than pensions. In performing the government's cost analysis, Subpart 31.2 policies, procedures and principles are applied to the contractor's cost-based proposal by the cost analyst and/or the cognizant federal agency auditor.

The resultant "cost analysis" and "profit analysis" is used to prepare the contracting officer's prenegotiation objective, i.e., the government's initial negotiation position. The prenegotiation objective is then used by the contracting officer as the basis for negotiating a "fair and reasonable" contract price with the offeror. While agreement on individual cost elements is not required, the overall negotiated fixed price must still be determined to be fair and reasonable.

Proposed Amendments:

The proposed amendments would no longer require the application of FAR Part 31 when a "cost analysis" is performed and used to develop the government's prenegotiation objective for certain fixed-price contracts. For example, proposed FAR 31.102(a)(1) would provide that the applicable Part 31 cost principles shall be used in the pricing of fixed-price contracts, subcontracts and modifications when cost analysis is performed, except for contracts, subcontracts and modifications issued on a fixed-price basis where cost or pricing data is not obtained.

Thus, if a contractor submitted proposed cost data for a fixed-price contract that is treated as "uncertified" information other than cost or pricing data, then the cost principles in FAR Subpart 31.2, "Contracts With Commercial Organizations," could not be applied to determine allocable contract costs. If so, it appears that a contractor:

- That is otherwise performing contracts subject to Subpart 31.2, would no longer be required to apply its established cost accounting practices in a consistent manner when estimating or accumulating contract costs. There would be no requirement to consistently classify as direct and indirect costs, costs incurred for the same purpose, in like circumstances.

- Could, for any new fixed-price proposal, introduce a new and different set of accounting conventions to estimate proposed contract costs whenever "certified" cost and pricing data are not required.

- Could include, in its proposal the costs, of entertainment, alcoholic beverages and other costs precluded by statute for "covered" contracts.

- Could include the costs currently precluded as unallowable costs by Subpart 31.2, as a matter of policy.

If Subpart 31.2 policies and procedures are not consistently applied to cost-based fixed-price contracts, what are the alternate policies, procedures and principles to be applied when performing a "cost analysis" of the "uncertified" information other than cost or pricing data? What fundamental constructs will the proposing contractor have to comply with? What will guide the cost analyst and/or auditor when performing the "cost

2001-018-2

analysis" of the contractor's uncertified data? It does not appear that any thought has been given to these issues. This would appear to be just another mindless "de-contruction" of the checks and balances applicable to the pricing of federal contracts.

Potential Increased Cost to the Government? Permitting the inclusion of unallowable costs in contractor proposals suggests that the government's resultant prenegotiation objective and consequently, the negotiated contract price, may be higher than the fair and reasonable price that results under the current regulatory process. The profit amount would also be higher to the extent the profit factor is applied to currently unallowable costs. Further, there appears to be no recourse for the government if costs inequitably shift between negotiated contracts and/or duplicate cost recoveries by the contractor occur due to the contractor's use of alternate cost allocation methodologies. Presumably, administrative costs would also increase for both contractors and the government if multiple cost accounting systems were to be permitted. For example, the need for alternate forecasted indirect cost rate agreements would arise, if a contractor elected to propose a new and different sets of forecasted indirect cost rates whenever the use of "uncertified" information other than cost or pricing data is permitted.

Reason Cited For Proposed Change

The preamble states that:

The proposed rule "... would amend the FAR to indicate that the cost principles and procedures of FAR part 31 do not apply to the pricing of fixed-price contracts if cost or pricing data are not obtained. Currently, the cost principles and procedures of FAR part 31 apply whenever cost analysis is performed, regardless of whether cost or pricing data are obtained."

- Comment: Actually, the pricing of fixed price contracts involves the negotiation of a contract price, prior to contract award, but only if the contract is awarded under the FAR Part 15 provisions governing negotiated contracts. Normally, negotiations are based on the government's proposal analysis of the contractor's proposed price (price analysis) or the contractor's proposed costs for each element of proposed cost, and the contractor's proposed profit (cost analysis). **Cost analysis should only occur if price analysis is not sufficient to determine a fair and reasonable contract price.**

The goal of the Councils is to reduce "... government unique regulations when the risk to the Government is low."

- Comment: When negotiating fixed-price contracts based on a prenegotiation objective that was predicated on a "cost analysis" of contractor submitted information other than cost or pricing cost data, POGO believes that the risk to the government is higher, not lower, than if "certified" cost or pricing data had been obtained. Without certified data, there is less assurance that contractor submitted data are current, complete and accurate. Without a certificate of current cost or pricing, there is no recourse to the Government if the data were not current, complete and accurate.

2001-018-2

- Comment: The FAR Councils are engaged in a misleading attempt to distinguish "cost or pricing data" from "information other than cost or pricing data" based solely on the "certification" requirement imposed on the submission of cost or pricing data. While POGO believes that all cost data submitted to the government should be certified, certification of the data is an issue of form, not substance. Cost data is cost data. The FAR contract cost principles should continue to be applied to the pricing of contracts whenever cost data is submitted to support a contract price, regardless of whether the contract type is fixed-price.

T&M and LH Contracts

The proposed rule would also amend FAR Part 31.001, "Definitions" to significantly expand the scope of exemptions from the contract cost principles that are available to contractors, particularly with respect to very troublesome "time and materials" (T&M) and "labor hour" (LH) contracts, which appear to be a rapidly growing form of cost-type "best efforts" contracts. Essentially, the proposed rule would attempt to redefine the so-called "fixed hourly rate" portion of T&M and LH contracts as "fixed-price" contracts. This is disingenuous at best. While POGO could write a book about why T&M/LH contracts are not fixed-price, an excellent discussion is contained in CACI, Inc. - Federal v. General Service Administration, 2002 GSBCA LEXIS 263; 2003-1 B.C.A. (CCH) P32,106 (December 13, 2002). In that decision, the GSBCA wisely stated:

> In essence, the time and materials order falls within the broad genre of cost-reimbursement type contracts. This type of contract places relatively little cost or performance risk on the contractor. n5 In contrast to a fixed-price contract, such a contract requires only that the contractor use its best efforts to provide the goods or services at the stated price. The contractor is entitled to be paid for its costs of performance, up to the contract ceiling, whether it succeeds in fully performing the contract requirements or not. General Dynamics Corp. v. United States, 671 F.2d 474, 480-81 (Ct. Cl. 1982); McDonnell Douglas Corp. v. United States, 37 Fed. Cl. 295, 299 (1997) (further observing that "the focus of a cost-reimbursement contract is contractor input, not output"). If the contractor performs work pursuant to the contract, it is entitled to be reimbursed for labor at the agreed upon rates and for materials purchased at cost. The Board has previously observed that, in certain circumstances, particularly when the appropriate level of Government surveillance is lacking, the time and materials contract format may not be best-suited to the Government's needs. See Midwest Maintenance & Construction Co., GSBCA 6228-REIN, et al., 85-1 BCA P 17,716, at 88,433. n6

- - - - - - - - - - - - - - - - - - -Footnotes- - - - - - - - - - - - - - - - - - -

n5 See FAR 15.404-4(d)(1)(ii)(B) (noting significantly lower degree of cost risk assumed by contractor under cost-reimbursable type contracts compared to risks inherent in fixed price contracts).

2001-018-2

n6 FAR 16.601(b)(1) notes that such contracts "provide no positive profit incentive to the contractor for cost control or labor efficiency." See generally, John Cibinic, Jr. & Ralph C. Nash, Jr., Formation of Government Contracts 1174-75 (3d ed. 1998).

POGO fully concurs in the GSBCA's excellent legal analysis concerning T&M/LH contracts. The FAR Councils attempt to rationalize a portion of a T&M/LH contract as "fixed-price" is shameful capitulation to contractors interests, and an abrogation of the Councils duty to taxpayers. Accordingly, POGO strongly opposes the proposed changes to FAR 31.001 "Definitions."

Lastly, the proposed rule increases the dollar threshold for inclusion of the clause relating to "Penalties for Unallowable Costs" to $550,000 from the current $500,000. This change is authorized by statute. POGO believes that the statute is flawed, but has no objections to the proposed regulatory implementation of the flawed statute. Our larger observation is that the government so infrequently (almost never) imposes penalties against contractors when unallowable costs are billed or claimed.

In summary, POGO urges the FAR Councils to withdraw the proposed rule, with the exception of the ministerial dollar value changes concerning the imposition of penalties for unallowable costs. The proposed change with respect to the use of cost principles when performing cost analysis on "uncertified" cost or pricing data are an elevation of form over substance; and, the proposed "redefinition" of fixed-price contracts to include the fixed hourly portion of a T&M/LH contract flies in the face of law and common sense.

Sincerely,

Danielle Brian
Executive Director
Project On Government Oversight
(202) 347-1122
pogo@pogo.org

GSA

GSA Office of Governmentwide Policy

FEB 3 2004

MEMORANDUM FOR RONALD POUSSARD
DIRECTOR
DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM: RODNEY P. LANTIER, DIRECTOR Rodney P. Lantier
REGULATORY AND FEDERAL ASSISTANCE
PUBLICATIONS DIVISION

SUBJECT: FAR Case 2001-018, Applicability of the Cost Principles and Penalties for Unallowable Costs

Attached is a comment on the subject FAR case published at 68 FR 66988; November 28, 2003. The comment closing date was January 27, 2004.

Response Number	Date Received	Comment Date	Commenter
2001-018-3	01/30/04	01/30/04	GSA/OIG

Attachment

U.S. General Services Administration
1800 F Street, NW
Washington, DC 20405-0002
www.gsa.gov

U.S. GENERAL SERVICES ADMINISTRATION
Office of Inspector General

2001-018-3

January 27, 2004

FAR Secretariat (MVA)
General Services Administration
1800 F Street, NW
Room 4035
Washington, DC 20405
Attn: Laurie Duarte

Re: FAR Case 2001-018 – Proposed Rule Regarding Applicability of the Cost Principles and Penalties for Unallowable Costs

Dear Ms. Duarte:

This letter transmits the comments of the General Services Administration Office of Inspector General (OIG) on the above-captioned proposed FAR rule. The rule would narrow the applicability of FAR 31 cost principles to those fixed-price contracts where cost analysis is performed *and* where cost and pricing data is obtained. Currently, the cost principles apply to such contracts if cost analysis is performed, regardless of whether cost and pricing data is obtained. Notably, the rule would also formulate a new definition for fixed-price contracts and subcontracts. Our comments relate chiefly to the impact such a definition may have on time-and-materials task orders under GSA's Multiple Award Schedule (MAS) contracts; we also note that a clarification may be in order with respect to the rule's impact on the underlying requirement to provide cost and pricing data for pricing purposes.

The proposed rule's coverage provides for a definition of fixed–price contract and subcontract to be included within FAR Part 31. That proposed definition would include "the fixed hourly rate portion of the time-and-materials and labor-hours contracts and subcontracts (subpart 16.6)." Although we understand that this definition applies just to FAR Part 31, we are concerned that this definition will add to the already existing confusion regarding the nature of task orders under MAS contracts (and possibly other indefinite quantity vehicles) because it may suggest that time-and-materials orders with a fixed labor hour component are fixed price in nature for any contracting or FAR purpose.[1] For example, GSA has

[1] Our Office issued an audit report in August 2003 which surveyed COs at federal agencies regarding their use of MAS contracts to purchase services. *Audit of Procurement of Professional Services From the Federal Supply Service's Multiple Award Schedules*, Report Number A020243/F/A/V03009 (July 31, 2003) at FN 10. That survey report asked COs whether the task order they placed was awarded on a firm-fixed price or time-and-materials basis. We received

2001-018-3

mandated that all MAS task orders awarded on a time-and-materials basis include a clause entitled "Payments Under Time-and-Materials and Labor-Hour Contracts." This clause provides contracting officers with an ability to require more substantiation of hours worked under a time-and-materials order. Because such task orders have a fixed labor component, we are concerned that COs may – based on this proposed FAR change – consider such task orders to be fixed price and not invoke the controls attendant this clause or other necessary safeguards to the use of such vehicles.

We would recommend that inclusion of a definition be reconsidered, or that in the alternative a statement be inserted in the definition or in the regulatory preamble to the rule that makes clear that the definition is limited in applicability to applying the cost principles.

We also would note that on first reading of the proposed rule, particularly the preamble language and the proposed coverage at section 31.000, it appeared that the rule was restricting in some way the underlying Truth in Negotiations Act mandate to obtain cost and pricing data in the first place (as to both negotiated contracts and negotiated modifications). We understand that it is not the intent of the rule to do this; we would suggest nevertheless that the FAR Council consider adding a statement in the preamble to the final rule which makes this clear.

Please feel free to call my counsel, Kathleen Tighe, on (20) 501-1932 with any questions regarding these comments.

Sincerely,

Daniel R. Levinson
Inspector General

---

indications that some COs mistakenly believed that MAS task orders could only be fixed-price since MAS labor rates (prenegotiated and loaded with overhead) are fixed price.