



Court of Federal Claims to Contractors: You're Totally at Risk in Firm Fixed Contract

By Michael Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

In its decisions filed August 18, 2015, the US Court of Federal Claims denied contractor claims for increased costs arising from the contract with the Defense Logistics Agency (Defense Reutilization Management Services). The contract statement of work involved the disposition of surplus property as troops departed Iraq, Afghanistan, and Kuwait. The contractor submitted two certified claims which sought \$5,900,000 and the contracting officer issued final decisions which allowed \$236,000. As stated in the summary, the Court found:

- the Government's estimated quantities provided to prospective offerors were based on accurate historical data,
- Even though the estimates proved to be low in comparison to actual quantities encountered during contract performance, the Government was not negligent in furnishing the historical data,
- The Contractor assumed a "higher than normal risk" in agreeing to a contract of this type, but that was a choice it voluntarily made, and
- In a firm fixed-price contract like this one, the contractor assumes the risk of controlling its costs unless it can show that the Government's estimates of quantities were negligent in some respect; hence the evidence did not support the contractor's attempt to shift the risk to the Government.

Of some interest, the request for proposal was somewhat unique in terms of including a Statement of Objective from which the offerors were to develop and submit a Performance Work Statement; not exactly the typical wording within a solicitation for which the contract would primarily be firm-fixed-price. With respect to the quantities involved, the solicitation included a price adjustment clause which allowed potential price adjustments if workload exceeded 150% of the history (on a location by location basis); however, the adjustment would be in the form of additional labor using a T&M (time and material) contract modification. In retrospect, all sorts of "red flags" suggesting that a firm-fixed-price contract was a "higher than normal" risk (something of an understatement in the decision).

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In particular, a broadly worded Statement of Objectives (not a well-defined statement of work) along with a price adjustment clause premised upon workload increases (for five consecutive months) which were more than the historical average plus 150%. Similarly, the solicitation and ultimately the contract included a provision which allowed the contractor to keep all proceeds (“free and clear”) from the sale of scrap which was another estimated, but highly unpredictable value.

This contract and the CoFC decision is a painful reminder that firm-fixed-price contracts shift the risk of contract performance (including cost overruns) to the contractor and that it is extremely difficult to obtain any relief from “understated” Government estimates of requirements. Although it was later modified in the actual contract (to reflect only a 50% increase over historical averages), any solicitation which would only consider a price adjustment when workload exceeds 150% of a historical baseline is clearly assigning a huge quantity variability risk to the contractor.

Although it is totally coincidental to the CoFC decision, at about the same time as the CoFC decision was published, there was a press-release by a different contractor announcing that it had won two firm-fixed-priced contracts for base life support to the US Army in Iraq. Per the press release, the contractor will provide all services, equipment, supplies, facilities, tools, materials and supervision necessary to meet the needs of several thousand US coalition forces and contractors. As stated by the awardee, “this is the first time the Army has contracted for a single turnkey solution that includes not just basic life support services, but emergency medical and fire services, bulk food, and fuel and perimeter security as well”. Similar to a statement in the CoFC decision, the recently announced award appears to involve a higher than normal risk, but nonetheless, the awardee was willing to accept the risk and a firm fixed price. All of this begs the question, in contracting with the Government, what is “normal risk”?

Recent GAO Activity

By Michael E. Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

The GAO (Government Accountability Office) issued several decisions or reports of passing interest to Government contractors.

Bid Protest (Unsuccessful)—Government Cost Realism Analysis Doesn't Matter

One of the unsuccessful bidders in a three way contest for task order in Iraq filed a bid protest asserting that the Government agency

- Had flawed in its technical and cost realism analysis,
- Failed to conduct meaningful discussions by advising the protestor that its labor hours appeared to be overstated
- Failed to consider pending litigation as a past performance factor applicable to the successful bidder

In its conclusions, the GAO stated that notwithstanding apparent errors (by the Army/Government agency), the bid protestor failed to demonstrate competitive prejudice; in this case, that the cost realism errors, if corrected, would have changed the results. In particular, that any adjustment would still not have negated the \$111 million difference in cost estimates between the low bidder and the bid protestor (translated, the government errors could not overcome the significant difference between the low bidder and the protestor). Regarding meaningful discussions, the Army stated that nothing in the bid protestor's proposal rendered it ineligible for award; hence, no reason for discussions. Lastly, the GAO found that the Army's determination of responsibility (for all bidders) was appropriate (giving broad latitude to the Government Agency).

Bid Protest (Unsuccessful)---Too Much Contractor Disclosure

An unsuccessful bidder was equally unsuccessful in its bid protest, which asserted that the Army (Government agency) had improperly evaluated its cost as “undeterminable”. The solicitation involved a CPFF (cost plus fixed fee) task order for which the unsuccessful bidder provided full disclosure in

terms of its labor mix. In this case, the bidder's cost estimate included assumptions in terms of the labor sources (across the enterprise); hence, assumptions for the use of affiliates as well as the bidder. However, the bidder also stated that the labor mix and categories are for evaluation purposes only, while performing the CPFF task order, the bidder reserves the right to utilize (other) labor categories (i.e. affiliates) to meet the Government Customer requirements. Based upon the bidder's full disclosure, the Army found that the bidder's estimate contained ambiguities; hence, probable cost was indeterminable (noting in part the significant variance in overhead and G&A across the enterprise).

Without reading the solicitation, we do not know if the solicitation/contract would have prohibited the bidder from proposing one labor mix, but using a different labor mix during contract performance; but at any rate, so much for full disclosure or TMI (too much information). Of some coincidence it apparently doesn't matter that per the GAO, for cost type contracts, an offeror's costs are not dispositive because regardless of the cost proposed, the government is bound to pay the contractor its actual allowable costs. Translated, although an offeror's cost estimates cannot be considered a definitive cost, they can't be ambiguous (as if unambiguous cost estimates provide a definitive value when in reality, the only definitive value is the actual allowable costs only determinable after the fact).

Government Agencies Not Seeking Discounts on FSS Contracts

The GAO did a study of orders using the FSS (Federal Supply Schedules) and found that federal, state and local agencies too often failed to take advantage of discounts. More accurately agencies were not even seeking discounts from schedule prices, even when required. One clarification, there is no requirement that contractors provide discounts, there is only a requirement for government agencies to seek discounts. Further, the GAO concluded that Contracting Officers were not even aware of the requirement to seek discounts, something missing from training and guidance. Of course, the GAO report triggered a few Congressional comments including that "Most Americans know that when buying a car, you should never just accept the sticker price as the final price, and you should always shop around".

Although the GAO is correct in its assertion that agencies should seek discounts, they seem to be oblivious to the fact

that the GSA negotiators maintain that they've already negotiated huge savings (similar to the GSA which maintains that its negotiated airfares are 52% below comparable published airfares as if one can benchmark ever changing airfares to a static government airfare). One other note of caution for contractors who are on the FSS or GSA Schedule, be leery of offering discounts; offered once, they can become the new (lower) sticker price for future government agency orders.

Price Reasonableness and Commercial Items

Noting that the DOD (Department of Defense) usually relies on competition to ensure prices are fair and reasonable, the GAO also noted that DOD Contracting Officers must employ different strategies when dealing with non-competitive contracts. As noted and repeated in FAR and DFARS (Acquisition Regulations), a contracting officer must determine and document that a price is fair and reasonable, a particular challenge for commercial items because there are regulatory limits on the data that maybe requested from contractors.

In its random, but non-generalizable sample of 32 non-competitive commercial contracts over a two year period, the GAO observed that contracting officers only requested cost or pricing information from contractors in 12 cases; six involved cost data (such as cost of labor), six involved price data (such as sales history), and by implication, the contracting officers failed to adequately document price reasonableness for the other 20 commercial contracts. Additionally, the GAO report identified the regulatory limitations on obtaining "certified" cost or pricing data for commercial items, but correctly noted that the contracting officer can request other than certified cost or pricing data (for any procurement which is exempt from "certified" cost or pricing data). One apparent error in the GAO report, although commercial items are exempt from 10 USC 2306a requirements to submit certified cost or pricing data, the GAO incorrectly failed to mention that exclusion from its list of exceptions (page 3 of GAO-15-680).

For anyone unfamiliar with the terminology (other than certified cost or pricing data versus certified cost or pricing data), in application to cost data, the actual cost data can be identical; the only difference is that for commercial items, there would be no certification (FAR 15.403). The implications of the GAO study are that contracting officers should be requesting substantially more cost data for noncompetitive commercial acquisitions, just don't call it certified cost or pricing data. The

unstated objective is to obtain from the seller cost data which will significantly improve the negotiation position (for the Government) because nothing enhances a person's negotiation position more than knowledge of the seller's costs (from which you can then derive the seller's approximate profit if one asks for enough "other than certified cost data").

There is nothing new about the latest or evolving government strategy which is to compel more disclosure of cost data from commercial contractors. This has been evidenced by a number of similar reviews and reports by the DODIG (Inspector General) focused on spare parts pricing (catalog prices, which, per the DODIG, are acceptable only if the commercial sales are 50 percent or more of total sales). Although the regulations may seem to support the ongoing assault on the traditional sanctity of commercial item pricing (rarely supported by anything other than price); the timing is rather peculiar given that the Secretary of Defense continues to visit Silicon Valley, imploring commercial companies to join the fun of being a Government contractor. In addition to Executive Orders which only apply to Government contractors, the continuing Government attempts to obtain more and more commercial item cost data is not exactly a hugely motivating factor in terms of drawing any commercial company into the wonderful world of contracting with the US Government.

US Government Program Cost Estimates Not Exactly Reliable for the New Air Force Bomber

As the US Air Force continues down the path of replacing the aging manned bomber fleet (including B-52s which might have been flying over my parent's house in Wichita, Kansas when I was in grade school the late 1950s), the biggest hurdle will be obtaining Congressional approval and funding. To that end, the Air Force seems to have "shot itself in the foot" with some recent estimates for the cost of the program over a 10 year period. A year ago, the estimate for 2015-2024 was \$33.1 billion and earlier this year it unexpectedly jumped to \$58.2 billion for 2016-2025 (both representing 10 year periods; the latter with a later start date reflecting continued slippage in contract award). After realizing that at least one of the estimates had to be wrong, the Air Force fessed up and has now indicated that the "true" estimate is \$41.7 billion (which should have been the estimate for both 10 year estimates even though one would assume that one year slippage would increase the "true" estimate). Of course, the Air Force had an explanation for the "untrue estimates", human error and

process error (both partially to blame). We don't need to ask what part each "error" played, because it would probably be an incorrect estimate as well (probably add up to more than 100% which would only be detected months later). Perhaps the Air Force needs to develop cost estimating checklists and estimating system criteria, imposed on contractors, but apparently there are no similar controls or cross-checks internal to Air Force program cost estimating. In the end it won't matter because no one will ever be able to determine what the new bomber actually cost (over its life-cycle); hence, we will never know if there ever was a "true" cost estimate.



Training Opportunities

2015 Redstone Government Consulting Sponsored Seminar Schedule

October 15, 2015 – Government Contractor Challenges, Live One-Day Seminar in Ft. Walton Beach, FL.

WEBINAR – Announcement coming soon

October 15, 2015 – Contract Cost Accounting and Pricing Compliance 2015 Webinar Series – Topic: TBD.

WEBINAR – Announcement coming soon

November 19, 2015 – Contract Cost Accounting and Pricing Compliance 2015 Webinar Series – Topic: TBD

WEBINAR – Announcement coming soon

December 17, 2015 – Contract Cost Accounting and Pricing Compliance 2015 Webinar Series – Topic: TBD

WEBINAR – Announcement coming soon

2015 Federal Publications Sponsored Seminar Schedule

October 5-6, 2015 – Accounting Compliance for Government Contractors

Arlington, VA

Instructors:

- Mike Steen
- Scott Butler
- Cyndi Dunn
- Asa Gilliland
- Sheri Buchanan
- Darryl Walker
- Courtney Edmonson
- Cheryl Anderson
- Robert Eldridge

Go to www.fedpubseminars.com and click on the Government Contracts tab.

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Whitepapers Posted to our Website

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About Redstone Government Consulting, Inc.

Our Company's Mission Statement: RGCI enables contractors doing business with the U.S. government to comply with the complex and challenging procurement regulatory provisions and contract requirements by providing superior cost, pricing, accounting, and contracts administration consulting expertise to clients expeditiously, efficiently, and within customer expectations. Our consulting expertise and experience is unparalleled in understanding unique challenges of government contractors, our operating procedures are crafted and monitored to ensure rock-solid compliance, and our company's charter and implementing policies are designed to continuously meet needs of clients while fostering a long-term partnership with each client through pro-active communication with our clients

In achieving government contractor goals, all consulting services are planned and executed utilizing a quality control system to ensure client objectives and goals are fully understood; the right mix of experts with the proper experience are assigned to the requested task; clients are kept abreast of work progress; continuous communication is maintained during the engagement; work is managed and reviewed during the engagement; deliverables are consistent with and tailored to the original agreed-to scope of work, and; follow-up communication to determine the effectiveness of solutions and guidance provided by our experts.

Specialized Training

Redstone Government Consulting, Inc. will develop and provide specialized Government contracts compliance training for client / contractor audiences. Topics on which we can provide training include estimating systems, FAR Part 31 Cost Principles, TINA and defective pricing, cost accounting system requirements, and basics of Cost Accounting Standards, just to name a few. If you have an interest in training, with educational needs specific to your company, please contact Ms. Lori Beth Moses at lmoses@redstonegci.com, or at 256-704-9811.



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