CHAPTER 1

CONTRACT ADMINISTRATION DUTIES

BEGINNING AT THE BEGINNING

Ernest N. Deavors has contract administration duties on a new contract. Although he has purchased and administered fixed-price contracts for his agency over the past two years, this is his first cost-reimbursement contract.

Ernest's agency does not divide its contracting responsibilities according to preaward and postaward tasks, using instead a "cradle-to-grave" approach. However, Ernest is receiving this contract right after award due to the retirement of the contract specialist who purchased these contract services. Additionally, due to an illness of the contracting officer managed the award, contracting officer responsibilities have been reassigned to Bea Ware.

The new contract is for auditing services from a professional accounting firm, Tally-Up, Inc., and is to be used selectively by agency contracting offices to investigate accounting and accounting-related issues on its contracts and subcontracts. The contract can only be used when the Inspector General's Office and the Defense Contract Audit Agency cannot fulfill an auditing requirement within the time needed.

Separately, Ernest and Bea reviewed the contract itself for several hours. Additionally, Ernest looked through the file documentation. Then they got together for a quick conference.

"From the paperwork in the file, it looks like Anna Lize has been nominated for COR responsibilities, but there hasn't been any letter of designation issued," Ernest observed.

"Oh, I've worked with Anna before—she's well qualified to monitor these services,"

Bea said with obvious relief.

"This is going to be a highly visible contract, Ernest," Bea said quietly. "I know you haven't had much experience with cost-reimbursement contracts, but don't let that bother you. Just be sure to work closely with me and ask questions whenever you don't understand. Being organized and using good business sense are the keys to success."

"Well, I admit I'm anxious," Ernest said. Then, shifting in his chair, he let out a nervous laugh.

"This dropped in our laps this morning," he said. "I just vaguely remember some of the things I've read about cost-reimbursement contracts and, frankly, I'm undecided as to what might be the most productive thing to do first."

continued . . .

Bea appreciated his honesty. "Treat it just like any other contract," she told him. "First, take the time you need and continue to read this contract thoroughly, including the contract clauses incorporated by reference. Then, we'll decide who else we'll need to administer this contract effectively and define their roles. After that, we'll get all these Government players together and make sure everyone understands the game plan. Only then will we be ready to meet with the contractor."

Ernest was particularly glad to have a thoroughly experienced contracting officer for this one.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Determine what contract administration duties must be performed for a particular contract and which duties are appropriately assigned to various contract administration team members.

Individual:

1.1 Identify the contract administration roles that need to be filled for a contract.

1.2 Determine which contract administration functions will be delegated and to whom.

CONTRACT ADMINISTRATION DUTIES

Advanced Contract Administration

Advanced Contract Administration builds on your skills and experience in administering routine Government contracts to help you develop competency, particularly in cost-reimbursement contracts. This course covers most contract administration responsibilities from the time a contract is awarded until it is completed or terminated. Depending on your prior assignments, you may find that some of this content is familiar to you. However, this course will add new details, concepts and insights to the understanding you already have. Read every chapter closely and carefully. What you learn will help you perform your duties better and will help you as you take on new and more difficult responsibilities.

Federal Agencies Differ

Federal agencies differ in how their contract administration activities are organized and, in some instances, performed. Agency-specific acquisition regulations issued as supplements to the FAR may expand on or help you implement the basic principles and practices described in this course. These agency-specific policies may affect the way certain contract administration issues are approached and resolved. They also may govern the way the contract administration role is filled in terms of which offices are responsible for what actions, and the titles typically held by those who participate in administering contracts. Your role in administering contacts therefore will depend in part on your particular agency and, sometimes, the specific office in which you work. Nevertheless, all contract assignments face similar problems, and involve the same goals and objectives. These are what you will learn in this course.

1.1 CONTRACT ADMINISTRATION ROLES

Except for relatively small and simple contracts, a number of individuals may be involved in administering a Government contract. Together, these individuals comprise the ***contract administration team.*** Understanding the roles these various individuals have in overseeing contract performance is important to ensure that no responsibilities are overlooked, that no one exceeds their authority, and that the team can work smoothly together.

Contracting Officer

FAR 2.101

The ultimate responsibility for administering contracts rests with the contracting officer (CO). Contracting officers are the only officials authorized to enter into, administer, and terminate contracts. In most agencies, a single contracting officer will be responsible for all of these duties. In some agencies, however, contracting officer duties are divided by category among contracting officers who specialize in specific duties as follows:

- **Procuring Contracting Officer (PCOs)**—Some agencies have PCOs, officials who enter into the original contract and who retain responsibility for all actions that other Government officials may take, including those actions the PCO may delegate to other contracting officers.
- **Administrative Contracting Officer (ACOs)**—An official specializing in performing postaward contractual actions. Some agencies have set up separate offices called Contract Administration Offices (CAOs) to handle postaward functions as prescribed by that agency. ACOs would be assigned to the CAO.
- **Terminating Contracting Officer (TCOs)**—An official authorized to perform those postaward actions involving the termination of contracts as dictated by agency policy.

Agencies differ in whether they use the PCO, ACO, or TCO designations, and how they assign responsibility among them. When agencies do have specialization of contracting officer duties, the PCO is specifically responsible for basic contract administration decisions, including whether or not to:

- Retain the contract and perform all applicable contract administration functions
- Retain the contract and perform the administrative functions with the assistance of other Government personnel
- Assign the contract to a Contract Administration Office (CAO)
- Assign the contract to a CAO with specific limitations and/or specific additions in responsibility.

For this reason, references to the CO generally mean the PCO, although the title also applies to ACOs and TCOs within their limits of authority.

When COs Keep Administrative Functions

FAR 42.203

Even when duties are divided, the CO usually retains contract authority and the responsibility to perform all administrative functions related to it when:

- Monitoring performance at or near the contractor's facility is not necessary
- Agency-specific regulations require that the CO retain administration, typically citing
  - Contracts below a specific dollar threshold, or
  - Specific types of contracts.

COs also may officially retain administration while requesting administrative support from another organization. However, if the requested support covers a substantial proportion of normal contract administration functions, official retention of contract administration by the CO must be approved at one level above the CO.

FAR 30.601

When cost accounting standards (CAS) apply to retained contracts, CAS administration must be assigned to cognizant CAOs.

FAR 4.201(d)

CAO Responsibilities

FAR 42.202(e)

When a CO assigns a contract to a CAO, the CAO generally is responsible for:

- Performing 67 baseline functions
- Serving as the focal point for inquiries
- Advising the CO on all pertinent matters
- Requesting additional support, if required
- Reassigning contract administration, if required.

Typical Functions

FAR 42.302(a)

The 67 contract administration functions listed in the FAR represent the baseline functions of a contract administration office. Some examples of these functions are:

- Conduct postaward orientations
- Perform production support, surveillance, and status reporting
- Ensure contractor's timely submission of required reports
- Consent to subcontracts
- Issue administrative changes
- Determine contractor's compliance with cost accounting standards and disclosure statements.

CO Retention of Specific Functions

COs may retain any of the 67 baseline functions while assigning most others to a CAO when:

- The CO determines that its office can better handle the performance of that function
- The retention of that function is approved by an official one level above the CO
- Specific-agency regulations or an interagency cross-servicing agreement requires it.

COs should consult CAOs prior to making decisions on discretionary retention of a specific function.

Additional CAO Functions

FAR 42.302(b)

In addition to the 67 baseline functions, a CO may also assign additional functions to the CAO, including administering:

- Supplemental agreements incorporating contractor proposals submitted under a clause addressing contract changes
- Prices and priced exhibits for unpriced orders under basic ordering agreements (BAOs)
- Supplemental agreements providing for the deobligation of unspent dollar balances considered excess to known contract requirements
- Changes to interim billing rates
- Adjustments to contract prices resulting from the exercise of an economic price adjustments clause
- Supplemental agreements incorporating contractor proposals resulting from the issuance of amended shipping instructions
- Changes under contracts for ship construction, conversion, or repair
- Reduced quantities on firm-fixed-price contracts based on inconsequential delivery shortages
- A change in place of inspection at origin for contractors that are nonmanufacturers.

Unless specifically assigned by the CO, these functions *cannot* be performed by the CAO.

Keep in mind that these are a menu of potential functions that can be assigned to a CAO, but rarely would all of them be assigned. In fact, some of the functions may not even apply to a particular contract. For example, monitoring industrial labor relations would not apply to a

contract for commercial products. Similarly, there would be no need to maintain surveillance of flight operations on a contract that does not involve aircraft.

There are also functions that are dependent, to some extent, on the events that occur during contract performance. For example, your CAO may have the responsibility of negotiating supplemental agreements changing contract delivery schedules. However, if no change in contract delivery schedules is required during contract performance, you will not have to perform this function.

Termination of Delegation

An ACO or CO can recall a delegated function at any time when:

- There has been a change in circumstances, and
- The recall has been approved by an official one level higher than the ACO or CO.

In addition to specialized contracting officers, delegations of contract administration functions can be made to other Government personnel, resulting in the formation of a contract administration team.

The Team Concept

The contracting officer always heads up the contract administration team. The definition of contracting officer contained at FAR 2.101 "...includes certain authorized representatives of the contracting officer acting within the limits of their authority as delegated by the contracting officer."

FAR does not specify any official names for such authorized representatives, nor does it specifically state how these authorized representatives obtain their authority. As a result, these issues are addressed by agency FAR supplements, are not standard, and generally reflect organizational practicality.

In practice, the only contracting officer's representative that is *always* officially designated is the contracting officer's technical representative (COTR). Some agencies use the term "contracting officer's representative (COR)" instead of COTR. Most agencies use one term or the other to identify that individual who is specifically given the chief role in monitoring aspects of the contract that relate to the statement of work or specification. A few reserve the COTR designator for these representatives, while using the COR label for individuals who have other contract administration duties.

This course uses the terms "COTR" and "COR" interchangeably to parallel the practice within the majority of Government agencies. COR/COTRs generally perform their contract administration duties as secondary responsibilities to their primary job in a functional area not related to contract administration.

Follow your own agency's practice. The most common place for listing this practice is in your agency's FAR 1.6 or 42.2 supplementation.

Team Members

Although they may not be specifically designated, other Government officials who may perform various contract administration tasks include:

- Contract administrators/contract specialists
- Project inspectors
- Quality assurance specialists
- Property control administrators
- Legal counsel
- Patent counsel
- Auditors
- Cost and price analysts
- Engineers
- Scientists.

Team Roles

The roles and authorities of these team players depend on the size of the Government organization and the size of the contract. For instance, an engineer may be the representative of the requiring activity for a purchase order for testing services and may not only have written the technical specifications, but also may perform COR/COTR functions, project inspector functions, and property control administration functions.

1.2 DELEGATION OF FUNCTIONS

Typical functions of key contract administration personnel are generally as follows.

Contracting Officer

Contracting Officer Responsibilities. The contracting officer is responsible for the business relationship that exists between the Government and the contractor including:

- Interpreting and implementing diverse contract terms and conditions
- Analyzing costs
- Auditing the contractor's books and records
- Issuing changes and negotiating modifications to the contract
- Organizing and coordinating the efforts of all the functional specialists who comprise the contract administration team.

Being an effective contracting officer involves more than the application of expertise to specific problems. A successful contracting officer must also have leadership qualities to ensure that the Government's representatives work well together as a team and do not exceed their delegated authority.

Contract Administrator

Contract Administrator Responsibilities. A contract administrator may be a contacting officer or someone authorized by the CO to perform selected contract administration functions. Depending on how the contracting office is organized, the designated contracting officer may delegate various contract administration duties to less senior staff. Typically, these duties include the routine monitoring of contract performance, processing communication from the contractor, scheduling inspections, tracking compliance with various contract clauses, and so forth.

Contract specialists who are assigned contract administration responsibilities may not have the limits of their authority on a particular contract spelled out explicitly. They should seek clarification whenever in doubt, however, so they know what responsibilities rest with them and what actions they are prohibited from taking.

COR/COTR

Responsibilities of a COR/COTR. The COR/COTR is usually an official with expertise in the area of the contract effort who possesses the necessary background to monitor technical aspects of contract performance. Typical primary responsibilities of the COR/COTR include:

- Monitoring performance
- Evaluating work as it progresses
- Inspecting and accepting completed work for the Government.

Exhibit 1-1 provides more specific COR/COTR duties related to individual contract performance that *may* be assigned.

QAS Personnel

Quality Assurance Responsibilities. Quality Assurance Specialists (QAS) and other technical personnel can report to either the contract administrator, contracting officer, or COR/COTR, depending on how contract administration for each project will proceed, or depending on how your agency has set up these reporting procedures among its organizations. At any rate, their responsibilities are usually restricted to monitoring and inspection duties, such as:

- Monitoring the contractor's efforts to measure progress
- Reviewing the contractor's progress reports

COR/COTR Delegations

1. Administration
   a. Act as the Government technical representative for contract administration.
   b. Supervise all technical and clerical personnel assigned to assist the COR/COTR in his or her duties.
   c. Assists the contracting officer conducting the postaward orientation conference.
   d. Represent the Government in conferences with the contractor and prepare a memorandum for the record of pertinent facts.
   e. Confer with representatives of the requesting office and other user groups on performance matters.
   f. Maintain a filing system.
   g. Prepare a project diary.
   h. Keep a current set of drawings and specifications by noting all changes or deviations.
   i. Monitor contractor costs to prevent overruns and to assure that inappropriate charges are not made to cost-reimbursement contracts.

2. Labor
   a. Ensure that equal opportunity in employment posters are prominently displayed at the job site.
   b. Report violations of labor standards provisions to the contracting officer.
   c. Monitor time and timekeeping records of contractor employees for abuse or mischarges.

3. Inspection and Acceptance
   a. Inspect all work to ensure full compliance with contract requirements.
   b. Promptly reject, orally and in writing, all work that does not comply with contract requirements.
   c. Advise the contracting officer if the contractor fails to remove, correct, or replace rejected work promptly.
   d. Provide technical guidance on fixed-price contracts or technical direction on cost-reimbursement contracts, advising the contractor of formal appeal rights when there is disagreement.
   e. Prepare and maintain a running list of items at variance with contract requirements, advising both the contractor and the contracting officer of corrective action or the need for it.
   f. Maintain a master copy of the official list of defects and omissions.
   g. Ensure that all defects and omissions are corrected or completed.

Exhibit 1-1 (page 1 of 2)

COR/COTR Delegations

4. Changes
   a. Administer contract changes previously authorized by the CO.
   b. Ensure that the contractor provides formal proposals for contemplated changes.

5. Payments
   a. Review and approve the contractor's invoices, determining the Government agreement or nonagreement with the contractor's percentage of physical completion for progress reports and cost vouchers.
   b. Determine allocability and validity of costs under cost-reimbursement contracts.

6. Schedule
   a. Review and forward to the contracting officer the contractor's schedule or project management chart with a recommendation for acceptance or rejection.
   b. Require the contractor to submit, if specified in the contract, a progress chart or report showing the actual progress at the end of each accounting or payment period.
   c. Advise the contracting officer of any delay factors (strikes, weather, etc.) and record their impact.

7. Submissions
   a. Determine (from the contract) and list the number and types of submittals required from the contractor.
   b. Monitor the contractor's timely and complete submission of required samples, shop drawings, reports, and so forth.
   c. Monitor the Government's timely and complete response to the contractor's submission of samples, shop drawings, reports, and so forth.
   d. Maintain a record of submittals on a current basis.
   e. Approve or reject submittals as provided in the contract documents.

8. Safety
   a. Enforce all safety and health requirements.

Exhibit 1-1 (page 2 of 2)

- Inspecting all work performed by the contractor for contract compliance
- Advising the COR/COTR or contracting officer of any unusual problems—such as schedule slippage, requests for changes, or nonconformance with technical specifications or quality control requirements—which actually or potentially affect contract compliance
- Performing on-site checks to ensure that the contractor and any subcontractors are complying with labor standards and practices
- Maintaining a list of subcontractors on the project
- Maintaining a daily diary
- Submitting reports to the contracting officer or COR/COTR.

Other Personnel

Roles of Other Government Personnel. Depending on the complexity of the contract, other Government personnel may also become involved in contract administration. They include:

- Program or requiring activity personnel
- Administrative support personnel
- Legal counsel
- Cost and price analysts
- Auditors.

These individuals provide their input as requested by the contracting officer.

While other Government personnel can be assigned many of the surveillance and acceptance duties, there are some functions that must not be delegated to them. These are listed in Exhibit 1-2.

Actions CORs/COTRs and Other Technical Personnel Must Not Perform

- Award, agree to, or execute a contract or contract modification
- Obligate, in any way, the payment of money by the Government
- Make a final decision on any matter that would be subject to appeal under the Disputes clause of the contract
- Redelegate any of their assigned duties unless specifically authorized to do so
- Cause the contractor to incur costs not specifically covered by the contract with the contractor's expectation that such costs will be reimbursed by the Government
- Tell or instruct the contractor to stop work
- Terminate the contract

Exhibit 1-2

Oversight of the Team

Responsibility for contract management does not end when duties are assigned to contract administration team members. Many difficulties can arise during the course of contract performance that the contract administrator must be alert to:

- A team member leaves his or her present position
- A team member fails to accomplish assigned duties properly or on time
- A team member oversteps his or her authority
- A change in the contract occurs that affects team member duties.

Particularly for large, complex contracts that depend on a sizable contract administration team, careful monitoring is needed to make sure the team is working smoothly and that no tasks fall between the cracks. The contract administrator can help forestall problems by communicating regularly with team members, providing them with guidance when appropriate, and keeping vigilant for signs that not all is well.

APPENDIX 1-A: CONTRACT TYPES

	Firm-Fixed-Price (FFP)	Fixed-Price Econ. Price Adjustment (FPEPA)	Fixed-Price Award Fee (FPAF)	FP Prospective Redetermination (FPPRD)	Fixed-Price Incentive (FPI)
Principal Risk To Be Mitigated	None. Costs of performance can be estimated with a high degree of confidence. Thus, the contractor assumes the risk.	Market prices for required labor and/or materials are likely to be highly unstable over the life of contract.	Acceptance criteria are inherently judgmental, with a corresponding risk that the end user will not be fully satisfied.	Costs of performance can be estimated with confidence only for the first year of performance.	Labor or material requirements for the work are moderately uncertain. So, the Government assumes part of the risk.
Used When:	• The requirement is well-defined. • Contractors are experienced in meeting it. • Market conditions are stable. • Financial risks are otherwise insignificant.	The market prices at risk are severable and significant. The risk stems from industrywide contingencies beyond the contractor's control. The dollars at risk outweigh the administrative burdens of an FPEPA.	Judgmental standards can be fairly applied by an Award Fee panel. The potential fee is large enough to both: • Provide a meaningful incentive • Justify the administrative burdens of FPAF.	The Government needs a firm commitment from the contractor to deliver the supplies or services during subsequent years. The dollars at risk outweigh the administrative burdens of an FPPRD.	A ceiling price can be established that covers the most probable risks inherent in the nature of the work. The proposed profit sharing formula would motivate the contractor to control costs and meet other objectives.
Elements	A firm-fixed price for each line item or one or more groupings of line items.	A ceiling on upward adjustment, and a formula for adjusting price up or down based on: • Established prices • Actual costs of the labor or materials • Labor or material indices.	• A firm fixed price. • Standards for evaluating performance. • Procedures for calculating a "fee" based on performance against the standards.	• Fixed price for the first period. • Proposed subsequent periods (at least 12 months apart). • Timetable for pricing the next period(s).	• A ceiling price. • Target cost. • Target profit. • Delivery, quality, and/or other performance targets (optional); • A profit-sharing formula.
The Contractor Is Obliged To:	Provide an acceptable deliverable at the time, place, and price specified in the contract.	Provide an acceptable deliverable at the time and place specified in the contract at the adjusted price.	Perform at the time, place, and the price fixed in the contract.	Provide acceptable deliverables at the time and place specified in the contract at the price established for each period.	Provide an acceptable deliverable at the time and place specified in the contract at or below the ceiling price.
Contractor's Incentive	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Generally realizes an additional dollar of profit for every dollar that costs are reduced; earns an additional fee for better performance.	For the period of performance, realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes a higher profit by completing the work below the target cost.
A Typical Application	Commercial supplies and services.	Multi-year contracts for commercial supplies during high inflation periods.	Large-scale installation support services.	Multi-year production of spare parts for a major system.	Production of a major system based on a prototype.
Contract Administration Concerns	Monitoring quality should increase with indications that contractor (1) is behind schedule or (2) has exceeded its contract budget.	Economic adjustments must be made only using indices and methods specified in contract terms.	Award fee panel members should be higher-level agency managers.	Contractor must have an adequate accounting system that supports the pricing periods. Prompt redeterminations.	Contractor must have adequate accounting systems. Targets must be supported by the cost data.
Variants	Firm-fixed price level of effort			Retroactive redetermination	Firm or successive targets

APPENDIX 1-A *(continued)*

Cost Plus Fixed Fee (CPFF)	Cost Plus Incentive Fee (CPiF)	Cost Plus Award Fee (CPAF)	Cost or Cost Sharing (C/CS)	Time & Materials (T&M)	Indefinite Delivery (ID)
Labor hours, labor mix, and/or material requirements (among other things) necessary to perform are highly uncertain and speculative. Hence, the Government assumes the risks inherent in the contract; benefiting if the actual cost is lower than the expected cost; losing if the work cannot be completed within the expected cost of performance.					Varies from contract to contract.
Relating fee to performance (e.g., to actual costs) would be unworkable or of marginal utility.	An objective relationship can be established between the fee and such measures of performance as actual costs, delivery dates, performance benchmarks, and the like.	Objective incentive targets are not feasible for critical aspects of performance. Judgmental standards can be fairly applied. Potential fee would provide a meaningful incentive.	• The contractor expects substantial compensating benefits for absorbing part of the costs and/or forgoing fee, or • The vendor is a nonprofit entity.	Costs are too low to justify an audit of the contractor's indirect expenses.	Delivery requirements are uncertain. • Definite quantity (if quantity is known, but delivery is not) • Indefinite quantity (if known minimum quantity) • Requirements (if quantity totals can be estimated)
• Target cost. • A fixed fee.	• Target cost. • Performance targets (optional). • A minimum, maximum, and target fee. • A formula for adjusting fee based on actual costs and/ or performance.	• Target cost. • Standards for performance evaluation. • A base and maximum fees. • Fee adjusted based on performance quality.	• Target cost. • If CS, an agreement on the Government's share of the cost. • No fee.	• A ceiling price. • A per-hour labor rate that also covers overhead and profit. • Provisions for reimbursing direct material costs.	• "Per unit" price. • Performance period. • Ordering activities and delivery points. • Maximum or minimum limit (if any) on each order. • Extent of obligation on quantity.
Make a good faith effort to meet the Government's needs within the estimated cost in the Schedule.				Make a good-faith effort to meet the Government's needs within the "ceiling price."	Provide acceptable deliverables at the time and place specified in each order at the per-unit price, within any established ordering limits.
Realizes a higher rate of return (i.e., fee divided by total cost) as total cost decreases.	Realizes a higher fee by completing the work at a lower cost and/or by meeting other targets.	Realizes a higher fee by meeting judgmental performance standards.	If CS, shares in the cost of providing a deliverable of mutual benefit.	If "blended" rates are used, can increase profit by using more lower-cost labor.	Generally realizes an additional dollar of profit for every dollar that costs are reduced.
Research study.	Research and development of the prototype for a major system.	Large-scale research study.	Joint research with educational institutions.	Emergency repairs to heating plants and electrical transformers.	Long-term contracts for commercial supplies and support services.
The contractor must have an adequate accounting system. The Government must monitor performance to ensure use of efficient methods and cost controls. Must be negotiated.				The Government must exercise appropriate surveillance to ensure efficient performance.	Orders placed must be within the scope of the basic ID contract. With requirements contract, must buy covered deliverables only from contractor.
Completion or term				Labor hour	Task order contract

CHAPTER 2

CONTRACT ADMINISTRATION PLANNING

ON YOUR MARK, GET READY

Bea Ware and Ernest N. Deavors read every word of their new auditing services contract. Bea was pleased with their plan of action, but realized that they had to be flexible in assimilating new ideas from the other Government personnel who also would have a role in contract administration.

Johnnie I. Dotter, the agency lawyer who had reviewed the contract, left a phone message that he had some concerns he wished to raise. Bea had no opportunity to call him back before she convened the Government planning meeting, but Johnnie was among the attendees.

"Hopefully, you have all reviewed this contract thoroughly and have thought about the specific tasks we wrote down for each of you," Bea said. "First of all, does anyone disagree or not understand what is expected of them?"

Anna Lize, a management analyst with the agency's Inspector General and the now officially-designated contracting officer's representative, cleared her throat. "Well, I understand that I'm to provide documentation for you to issue task orders under this contract, but will you just take my word for it that in-house capabilities are unavailable for a particular project task, or will you need a statement to that effect from the Inspector General? And will I also need written evidence from the Defense Contract Audit Agency that they can't help with our auditing requirement within the time we need it completed?"

"No, we don't need anything in writing from any other agency," Bea told her. "Just give us a memo for the record with the names and numbers of your DCAA contacts. Your signed memo as to the IG's current auditing capacity suits our purposes."

"I don't see any problems, then," Anna said. She was greatly relieved. Having to get the Inspector General's signature probably would not have caused a big delay, but trying to get paperwork out of another agency would have taken forever.

"Who is going to make sure that there is no conflict of interest with each project?" Johnnie I. Dotter wanted to know.

"What do you mean, Johnnie?" Ernest asked the attorney.

continued . . .

"Well, we don't know yet what contractors or subcontractors we might ask Tally-Up to audit," Johnnie explained. "So organizational conflicts of interest couldn't be addressed prior to contract award. Consequently, they must be addressed as part of contract administration. For example, they can't audit a contractor if they already have an established business relationship with that contractor."

Bea's brow was furrowed. "All of us involved in contract administration have to be aware of those kinds of conflicts of interests, but we probably won't be in a position to know if such a conflict really exists in any particular case. Perhaps we can come up with a statement for the contractor's signature as part of the process for accepting the task order under the contract. Can you help us with that, Johnnie?" she asked.

"Of course, I can and will," the lawyer said with a satisfied smile. "That's an excellent way of handling it!"

Other matters were discussed and then Bea brought the meeting to a close, promising the attendees to advise them of when a meeting with Tally-Up would be held.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Develop a contract administration plan and instruct personnel on their roles.

Individual:

2.1	Read the contract to identify critical clauses and requirements.
2.2	Identify the contract's criticality designation.
2.3	Identify, from acquisition history, previous issues and problems with the same contractor or contracts for similar requirements.
2.4	Meet with requiring activity to discuss performance monitoring.
2.5	Determine the extent of monitoring that will be needed.
2.6	Determine which contract administration functions will be delegated to others.
2.7	Document a contract administration plan.
2.8	Provide notice and instructions on the roles, responsibilities, and limits of authority of technical representatives and other support personnel.
2.9	Plan a postaward orientation if one is needed.

INTRODUCTION TO CONTRACT ADMINISTRATION PLANNING

Definition of Contract Administration Planning

Contract administration planning includes all of the activities involved in setting up systems and procedures to ensure compliance with the contract's terms and conditions during contract performance.

The key to effective contract management is a flexible contract administration plan that permits updates over the contract's duration as problems arise or conditions change. This chapter tells you how to draw up such a plan.

Steps in Performance

The steps in planning for contract administration are charted on the next page. Following the flowchart, each step is discussed in turn.

STEPS IN CONTRACT ADMINSTRATION PLANNING

1 Identify critical clauses and requirements.

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2-5 Determine extent of monitoring needed.

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6 Determine which contract administration functions will be delegated.

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7 Document a contract administration plan.

↓

8 Provide notice and instructions to technical representatives and contractor.

↓

9 Plan a postaward orientation.

CONTRACT ADMINISTRATION PLANNING

2.1 IDENTIFY CRITICAL CLAUSES AND REQUIREMENTS

Every contract requires some planning to ensure successful completion. Planning can be as simple as identifying a milestone date for checking on a delivery or as detailed as monitoring and reporting on a contractor's performance daily. The amount of planning you need to do is based on the amount of administration required to effectively manage a specific contract.

The first task in the contract administration process is for you, the contract administrator, to review the contract file to identify critical contract clauses and requirements. Concentrate your review on areas that usually have the most relevance for contract administration activities, but **read the whole contract.**

Language derives its meaning largely from the context in which it appears. So you must read all parts of the contract, not as isolated statements, but as integral pieces of the whole unified document.

Do not neglect to review documents incorporated by reference. For example, documents incorporated into contracts by reference often include:

- Specifications and standards referenced in the statement of work
- The contractor's own proposal.

Perform this contract file review even if you awarded this contract. If you look at the file strictly from a contract administration point of view, it will give you a fresh perspective for contract administration planning. Exhibit 2-1 lists some of what you should look for as you read the contract.

Areas for Detailed Review

A thorough review of the contract file will turn up any clauses that are critical to contract performance and any other requirements that may have an impact on your planning decisions.

Contract File Checklist

Exhibit 2-2 provides an example of items found on a contract file checklist. Use of a checklist can simplify the review of any contract file.

Write in the "comment" column references to items that have particular or unusual importance to your contract administration plan. For example, you might note a paragraph number in the preaward survey that casts doubt on the contractor's plant capacity, warranting an increased level of monitoring for your contract administration team.

Areas in the Contract File To Study in Detail

FAR 42.2	The delegation of contract administration functions
FAR 42.1105	Criticality designator
FAR 4.4	Security requirements
FAR 42.11	Production surveillance requirements
FAR 42.2	Supporting contract administration requirements
	Other contract requirements, including: • Specifications • Data requirements • First article testing • Government-furnished property • Inspection and acceptance • Section H clauses • Contractor's proposal • Delivery schedule (or period of performance)

Exhibit 2-1

Scan Preaward Data

It is important that you carefully scan preaward file documentation. This is particularly crucial when another person performed the purchasing function. For instance, if you had not attended a prebid or preproposal meeting, you might find some information in the minutes of that meeting that addresses an interpretation of a special contract clause. If you do not read the minutes, you might interpret this clause differently. In fairness to the contractor, you must be consistent with prebid or preproposal information provided to all offerors.

After completing the contract file review, you should have identified all critical areas that bear on performance and monitoring. With this knowledge, you can determine:

- How critical the requirement is to the Government;
- How much of your time and effort is needed to ensure success.

Areas in the Contract File To Study in Detail

	Item	Yes	No	Comment
1.	Purchase request, acquisition planning information, and other presolicitation documents.	☐	☐	_____
2.	Justifications and approvals, determinations and findings, and associated documents.	☐	☐	_____
3.	Evidence of availability of funds.	☐	☐	_____
4.	A copy of the solicitation.	☐	☐	_____
5.	Security requirements/required clearances.	☐	☐	_____
6.	Contractor's contingent fee representation and other certifications and representations.	☐	☐	_____
7.	Preaward survey reports or references relied upon.	☐	☐	_____
8.	Contracting officer's determination of the contractor's responsibility.	☐	☐	_____
9.	Statement of facts justifying waiver of SBA requests to suspend award per FAR 19.505(f).	☐	☐	_____
10.	Packaging and transportation data.	☐	☐	_____
11.	Price analysis and, if appropriate, cost analysis.	☐	☐	_____
12.	Audit reports or reasons for waiver.	☐	☐	_____
13.	Record of negotiation.	☐	☐	_____
14.	Deviation authority from regulatory, statutory, or other restrictive requirements.	☐	☐	_____
15.	Notice of award.	☐	☐	_____
16.	The original of the signed contract, all contract modifications, and supporting documents.	☐	☐	_____
17.	Documentation on bid, performance, payment, or other bonds, and notices to sureties.	☐	☐	_____

Exhibit 2-2

2.2 DETERMINE CRITICALITY

The Government simply does not have enough resources to evaluate a contractor's every action on each contract it awards. Prioritizing every contract based on how critical the contract is to the Government is one indicator of proper allocation of contract administration resources.

FAR 42.1104

Criticality designators are shown on the contract cover sheet (SF 26 or SF 33). Together with other factors, they indicate where among several contracts to concentrate surveillance efforts. These designators become particularly important when contract administration resources are spread thin. The criteria for assigning criticality designators are summarized in Exhibit 2-3.

Criticality Designators
FAR 42.1105

Criticality Designator	Criterion
A	Critical contracts, including DX-rated contracts, contracts containing an unusual or compelling urgency, and contracts for major systems
B	Contracts (other than those designated "A") for items needed to maintain a Government or contractor production or repair line, to preclude out-of-stock conditions, or to meet new needs for nonstock items
C	All contracts other than those designated "A" or "B"

Exhibit 2-3

DX and DO Ratings

FAR 12.3

Although the A-B-C designators the contracting officer assigns have significance within your office, a certain class of "A" designated contracts, those designated "DX" prior to award, also have a potential impact for work in process within the contractor's plant.

Persons who have special authorization under the Defense Production Act can apply either a DX or a DO rating to a contract that supports the national defense. The ratings are assigned prior to issuance of the solicitation and will appear on the contract.

"DX" rated contracts become first priority in the "pecking order" within a contractor's plant in the event of material shortages, strikes, and similar problems that impact the normal processing of production orders within the plant. This "pecking order" includes any commercial work in process as well as other Government contract requirements within the plant that are not rated DX.

The other rating is "DO". When a contractor is behind in its production scheduling, it is legally bound to give second priority to DO rated Government contracts after the DX rated orders.

Legal Significance

It is important to realize that a contractor is legally bound to expedite these two classifications of Government contracts.

Even if you do not administer contracts that support the national defense, be aware that contractors may not be able to expedite delivery for your order if they have received rated orders from other agencies. The DX or DO orders have priority.

2.3 IDENTIFY PREVIOUS ISSUES AND PROBLEMS

You also need to consider the amount of time and effort needed for contract monitoring. This time and effort varies depending on such factors as:

- **Type of contract**. Consider typical problems associated with this contract type. Investigate whether previous contracts used the same contract type. (See Appendix 1-A on contract types.)
- **Past experience with this type requirement**. Investigate any problems on previous, similar purchases and consider ways to prevent them from recurring on the current contract.
- **Past experience with this contractor**. Consider the contractor's delivery record. Investigate whether the contractor typically meets quality expectations.
- **Type of specification**. Consider whether requirements are described in terms of design, function, performance, or a combination of these and whether previous purchases used similar specifications. If the description changed, the monitoring method also may need to change.
- **Type of requirement**. Service contracts have unique considerations. Commercial supply items require little monitoring, whereas a design-to-spec supply item requires diligent monitoring.
- **Warranty terms**. Read contract warranty terms and compare them to any offered by the contractor to commercial customers. Expect terms that are different from the commercial terms to be less familiar to contractor personnel and, therefore, potentially troublesome to administer. Investigate any previous problems with reliability beyond the warranty period.

- **Urgency**. Consider what would happen if delivery was delayed and whether delays are typical for this type of requirement or this contractor. Consider whether this contractor has a good record for expediting delivery if needed.

Information to Review

Focus your review on:

- Patterns of performance
- Previous remedies and the contractor's reactions to them
- Key personnel for the contract who are identified with either good or poor performance data.

Past Performance

FAR 4.801(c)(3)

Identify indicators of a contractor's past performance by reviewing:

- Files covering contractors' performance history, and
- The contract file itself.

What to Look For

Review the file on contractor performance history. One important source of information on potential problem areas is the general contractor performance file that your office maintains. The data included in this file is considered confidential and is not available to non-Government personnel. Contractor data should include the following information:

- Contracts awarded
- Items purchased
- Contract dollar amount
- Key personnel involved with the contract
- Delivery/performance results.

It represents an experience history of the contractor's performance over a period of time on individual contracts.

If your office has had previous experience with this contractor, past problems would be documented within this file. These areas require special attention on a current contract. Generally, when a contractor has demonstrated an inadequacy on a past contract, it will have a tendency toward similar deficiencies in future work.

Deficiencies in a contractor's performance include:

- Missed delivery dates
- Labor problems
- Shortfalls in technical capabilities
- Financial difficulties
- Reporting requirements (progress reports, submission of subcontracting reports, etc.).

Past Remedies

You should find any remedies that were used and the contractor's reactions to them documented within this file.

Other Indicators

Review other available indicators of past performance. Normally, records of past performance within your office will be sufficient for your planning effort. However, if your office has no previous experience with this contractor, you may want to look for other indicators of past performance. The contract file itself is the best place to look for other indicators. Responsibility information in the contract file may contain information from:

- Other Government offices, and
- Contractor's commercial clients.

This information may indicate some problem areas, even though they may not have been of sufficient magnitude to warrant a nonresponsibility determination.

It is important to keep information provided by both Government and non-Government sources strictly confidential. The contractor should never be given access to these records or told of their contents. You would use any indicators found within them for your own surveillance planning only.

2.4 MEET WITH REQUIRING ACTIVITY TO DISCUSS PERFORMANCE MONITORING

Another important technique used in developing your contract administration plan is to meet with the requiring activity. This discussion should include:

- Sharing of acquisition history concerning the contractor and the supplies and services required
- Identifying and ranking the requiring activity's priorities regarding the contract.

Focus on User's Priorities

It is important to focus your discussion for monitoring the contract on the priorities of the requisitioner. Do not spend too much time on contract requirements that the end user is not overly concerned about and ignore his or her vital concerns. However, you must make the requisitioner aware of any terms and conditions in the contract that may influence contract performance.

The ultimate goal of any contract, Government or commercial, is to satisfy the needs of the end user. So fashion your contract administration plan, as much as possible and practical, to meet those priorities.

Meeting Objectives

In sophisticated or complex requirements, the use of meetings with requiring activity personnel is beneficial to ensure that:

- The Government is working as a team
- Priorities or potential problem areas are understood by all
- Contract progress is measured by foresight, not hindsight.

2.5 DETERMINE THE EXTENT OF MONITORING NEEDED

A good contract is a tool that the Government uses to acquire goods and services, and contract administration is an attempt to manage this tool effectively. A vital part of this management process is the monitoring of contractor performance. There are two steps involved in determining how much monitoring is necessary. They are to:

FAR 42.1104A

1. Assess factors that indicate the appropriate level.
2. Select the best method for that level.

Assess Risk Factors

FAR 42.1104(a)

Assess factors that indicate the appropriate monitoring level. Many factors are involved in determining how much monitoring is necessary. They are listed in Exhibit 2-4.

Factors in Determining the Monitoring Level

- Level of the contractor's own inspection system
- Criticality of the requirement
- Contract requirements for reporting progress and performance
- Contract performance schedule
- Contractor's production or performance plan
- Contractor's history of contract performance
- Contractor's experience with the contract supplies or services
- Contractor's financial capability
- Contractor's risks involved in performance, including contract type

Exhibit 2-4

Contractor's Inspection System

Standard Government clauses specify the type of inspection system that the Government requires the contractor to maintain for the performance of the contract. For example:

FAR 46.202-1

- FAR 52.246-1, *Contractor Inspection Requirements,* relies on the contractor's own internal inspection procedures.

FAR 46.202-2

- FAR 52.246-2, *Inspection of Supplies—Fixed Price,* requires a contractor to establish and maintain an inspection system not otherwise defined except that it must be acceptable to the Government. This standard clause can be the only inspection clause in a contract, or it can be the foundation on which other Government inspection specifications are based. It contains the Government's basic rights of inspection.

FAR 46.202-3

- FAR 52.246-11, *Higher-Level Quality Requirements (Government Specification),* requires a contractor to comply with specific Government inspection or quality control systems, or a quality "program."

You must first determine what type of inspection system is in the contract before you can decide how much you want to rely on it.

Contractor Reporting

You will note that the third factor listed in Exhibit 2-4 is reporting data on progress and performance. It is important to emphasize that the Government has no right to require the contractor to submit data for monitoring purposes when the contract does not give the Government such a right. Any data that you want must be specifically authorized within the specification or by a contract clause.

Contract Risk

FAR 16.103

The risks of performance, the last factor listed in Exhibit 2-4, determines, in part, your level of monitoring and administrative effort. Because both the Government and the contractor promise to do something or keep from doing something, both are potentially "at risk" if one or the other, for whatever reason, fails to live up to the terms of the contract.

The Government stands to lose the benefit of the product or service at the price it agreed to pay if, for example, performance as outlined in the contract's terms is physically impossible or if the contractor does not have the capability to complete the work.

The contractor potentially stands to lose as well. The contractor may lose money if, for example, its performance costs exceed the fixed price it agreed to or if it is assessed damages for its failure to perform. It may also lose good standing if it fails to live up to the contract terms.

Contract Type As a Risk Factor

A ***contract*** is basically an instrument that allocates and defines risk between the contractor and the Government. Its terms and conditions spell out each party's obligations to the other, as well as each party's rights if the other should fail to carry out its obligations. It is essential, therefore, that you understand how the terms and conditions—those that are standard and those that are unique to a specific contract—affect the contractor's risk. When you have identified what the risks are, you can understand what the contractor might do to cover those risks, and what you might have to do in the way of monitoring to ensure that the Government's interests are protected.

For instance, if stiff liquidated damages for late delivery are to be assessed in a production contract and you know progress is lagging in the last month of the contract, a stepped up level of inspection is probably warranted to ensure that the contractor will not cut corners on quality procedures to make the delivery.

Standard terms and conditions that relate to price are what determines the contract type. Contract types are usually characterized as either fixed-price or cost-reimbursement. The degree of risk associated with the two basic contract types can be depicted as follows:

Contract Type	Highest Risk	Lowest Risk
Fixed-Price	Contractor	Government
Cost-Reimbursement	Government	Contractor

Contract Type Variations

FAR Part 16

Within these two basic categories are various adjustments in standard contract clauses designed to recognize cost/price risks that recur in Government contracting situations. These adjustments shield the contractor from certain financial contingencies or offer a financial incentive to achieve a particular goal in contract performance. Many of these contract type variations are described in Appendix 1-A. In addition to variants within the two main contract types, there are several categories of contract types that belong in neither of them, including Time-and-Materials and Indefinite Delivery contracts. These contract types also are summarized in Appendix 1-A.

FAR 16.102(c)

Note that certain types of contracts are prohibited in Government contracting. Two major procurement laws prohibit contracts that include cost-plus-percentage-of-cost pricing arrangements.

Contracting type is an important consideration in deciding the level of monitoring that will be needed. Generally, cost-reimbursement contracts represent greater risks to the Government than fixed-price contracts and therefore are likely to require more intensive monitoring.

Other Ways of Risk Allocation

Risk is also allocated through contract terms and conditions that are not associated with a particular contract type, but may be used with a variety of them in appropriate circumstances.

Exhibit 2-5 lists some standard contract terms that minimize different kinds of risk to one or both of the contracting parties.

Select Monitoring Method(s)

Select the most appropriate monitoring method(s). The type of monitoring effort that is appropriate depends on the complexity and scope of the contract, as well as the contract's specific requirements for submission of progress reports, schedules, and other reports.

Contract Terms that Adjust Risk		
Clause	**Purpose (in part)**	**Minimizes risks:**
Changes—Cost-Reimbursement (FAR 52.243-2)	Provides for immediate implementation of contract changes, if necessary, with after-the-fact adjustments to contract terms and price.	To the Government for delays that could result while needed contract changes are negotiated.
Economic Price Adjustment— Labor and Materials (FAR 52.216-4)	Allows adjustments in the contract price if rates of pay for labor or the unit prices for materials shown in the schedule either increase or decrease.	To the contractor for unexpectedly high rates of inflation or deflation in the market prices of labor or supplies that are critical to contract performance.
Performance Bond (FAR 52.228-2)	Requires the contractor to guarantee repayment (e.g., through a surety) of excess costs of reprocuring an item or service if it defaults.	To the Government for business failure when dealing with industries that have unusually high failure rates.
Progress Payments (FAR 52.232-16)	Allows the Government to provide the contractor with interim financing based on an estimated amount of completed work.	To both Government and contractor for impossibility of performance, if private sector financing is not likely to be available in the required amount or at a reasonable rate of interest.
Warranty of Supplies of a Noncomplex Nature (FAR 52.246-17)	Requires contractor to repair/replace defective items during a stated period after acceptance (or provide other consideration).	To the Government for unsatisfactory performance during the useful life of the item.

Exhibit 2-5

Numerous techniques and procedures for determining, in a timely manner, whether satisfactory delivery or contract completion will take place include:

- Appropriate inspection systems
- Cost monitoring systems (except fixed-price)
- Schedule tracking systems.

Key Factors

Make your choices among monitoring methods based on two considerations:

1. How much confidence you have in the contractor's quality assurance and reporting systems, and
2. How much confidence you have that contract problems will receive necessary management attention.

Typical Monitoring Examples

Progress on production work is easier to measure than progress on a research or development contract. For production work, a Government inspector can visit the plant to see if widgets are, in fact, coming off the assembly line as scheduled and examine them for contract compliance.

In the developmental phase of an R&D acquisition, many of the unknowns inherent in the research phase are gone. Monitoring becomes easier. Although the work is not yet repetitive and detailed specifications are still lacking, the experience gained on earlier contracts provides some standard for comparison. Nevertheless, the work still depends on the contractor's ability to cope with obstacles not encountered before.

Contractors may attempt to solve performance problems on cost-reimbursement, labor-hour, and time-and-materials contracts with overtime and multishift work. Unless authorized by the contract and approved in advance, the Government will not reimburse the contractor for any extra costs that result. Close monitoring of hours charged under these types of contracts is very important. There is no concern with cost control for fixed-price contracts because the Government does not pay for the increased costs, only the fixed-price for the contract. These issues are discussed further in Chapter 8.

FAR 42.1104(b)

Generally, interim monitoring of standard commercial and commercial-like products and services are not administratively cost effective. You need only monitor timely delivery or performance and inspect the delivered items or work performed. You may rely on the contractor's inspection system, production control, or data management system for these types of products or services.

Goals of Monitoring

You should select a monitoring method most likely to bring to your attention:

- **Actual or potential default situations**. You must act promptly and carefully in these situations to take action to initiate immediate improvements while preserving the Government's right to future remedies available under the contract.
- **The need for Government action.** For example, the unsuitability of Government-furnished equipment would require immediate Government action. Other situations may not be as obvious. Government action may supplement, but not supplant, the contractor's own efforts to solve performance problems for which the contractor is at fault or at least shares blame for the problem.

2.6 DELEGATE CONTRACT ADMINISTRATION FUNCTIONS

FAR 2.101

After determining how the contract would be monitored most effectively, the next decision is to determine who should participate in its administration. Agency policy often provides direction. In any case, some officials are authorized to take official action for the Government on contracting matters while others are limited to an advisory or supporting role. Remember that it is the CO who is ultimately responsible for protecting the Government's interest in a contract and for ensuring that all Government obligations are met.

Participation on the contract administration team will depend, in part, on what kinds of assistance are required and on the backgrounds and experience of likely team members. Various specialists may be needed to cope with technical and other complexities. Also, additional specialists may have to be called upon later if their help is needed to resolve problems that arise during contract performance.

In some cases, functions or tasks will be allocated to offices within your agency rather than to specific individuals. Where this is done, it is important to identify the appropriate contact person in that office.

FAR 42.101

Interagency cross-servicing arrangements also are encouraged, where practical, to provide contract administration assistance when work is being performed at multiple sites, for example, or when the contractor is performing contracts for several agencies at one time.

2.7 DEVELOP A CONTRACT ADMINISTRATION PLAN

Although the FAR does not require the CO to prepare a formal contract administration plan, the CO is responsible for ensuring that the parties have complied with all terms and conditions of the contract. At a minimum, contracting officers track receipt of the deliverables (or performance of the service), acceptance, and payment under the contract. This even is true, for example, when contracting for standard commercial items.

Need for a Formal Plan

A formal contract administration plan is essential when the contract involves large dollar amounts or complex technical requirements that typically place many duties and responsibilities on both contracting parties. Ideally, you had an opportunity to prepare a tentative contract administration plan during the solicitation stage of the procurement. Immediately after contract award, you must either finalize that plan or, if you have no tentative plan, prepare a full plan. This plan should provide for:

- An appropriate level of surveillance or monitoring of contractor performance
- Timely and proper performance of the Government's responsibilities.

Key Elements of the Plan

All members of the Government contracting team may identify and plan for key contract administration decisions even before a solicitation is issued. Some implementation of these key decisions may be necessary in the solicitation. For example, any decision to monitor through a contractor reporting procedure would need an implementing procedure in the contract itself. Key elements of a contract administration plan are identified in Exhibit 2-6.

Key Elements of the Contract Administration Plan

- A listing of contract administration terms and conditions related to administration
- Contract milestones
- Contractor reporting procedures
- Quality assurance guidelines (from requiring activity)
- Inspection and acceptance process (from requiring activity)
- Names, roles, authorities, and limitations of authority for contract administration team members or officers
- Milestones for reports from contract administration team members

Exhibit 2-6

Need for Flexibility

Although you finalize the contract administration plan soon after contract award, it needs to be a flexible working document if it is to fulfill its purpose of providing:

- A baseline for project management and scheduling
- A simple way of tracking the extent of contract completion, and
- An aid for postaward orientation.

As the contract progresses, you may find it necessary to shift responsibilities or add tasks that could not have been anticipated at the time of award. Therefore, over the life of the contract, you will need to update your plan to reflect all developments.

Planning Steps

There are several steps to follow in devising a workable contract administration plan:

1. Identify contract terms and conditions related to administration.
2. Identify contractor reporting procedures.
3. Ensure your plan provides for the inspection and acceptance process and conforms to quality assurance requirements.
4. Identify contract administration team members and define their roles.
5. Develop key milestones.
6. Document your decisions.

Contract Requirements

Identify contract terms and conditions. Make an outline of all major tasks and responsibilities contained in all sections of the contract. The outline will be most helpful if you sequence the tasks in rough chronological order.

Be sure to list only the major tasks. If you decide to hold a postaward orientation conference, for instance, you would want to list that as a major task, but would not list the subtask of preparing an official record of the conference. Your goal is to identify what must be done, when it must take place, who must do it, and how and where it is to be accomplished.

Make sure that someone on the Government team has the responsibility to ensure that Government-furnished products and services are:

- Delivered in a timely fashion, and
- If property, suitable for its intended use.

Exhibit 2-7 summarizes some common areas to consider. Note, however, that you may wish to expand the checklist—particularly in the quality assurance area — tailoring it to unique contract requirements.

Contract Milestones

Identify contract milestones. The contract will specify many of the key dates you must be alert to, but not necessarily all of them. Every major task, however, whether a contractor deliverable or a Government responsibility, should have an action date assigned to it. Maintaining the contract performance schedule is an important requirement and you should devise a way to become aware of schedule deviations.

Not all significant milestones necessarily will be spelled out in the contract. For example, the contract may call for delivery of a test report by a certain date. Also, you have been informed by the technical experts on your team that the test takes at least two months. You may want to include the *beginning* of testing as a key event to obtain assurance that the report can be submitted on time.

Various methods are available to help you identify particularly critical events whether they are specified in the contract or not:

- **Bar Charts** allow you to track percent completion for each major contract task and compare what has been done against the expected duration of that task. You also can use that information to plot cumulative accomplishment against what was targeted to provide a broad gauge of whether work is ahead of or behind schedule.
- **Critical Path Method (CPM)** also assesses progress by task against targeted dates, but shows the interrelationship of tasks as well. This method is useful when certain tasks cannot begin until others have been completed; production cannot begin until the component parts arrive on-site, for example. CPM helps identify those tasks which, unless completed on time, will result in later delays in major deliverables.
- **Program Evaluation Review Technique (PERT)** is similar to CPM but uses statistical information on task duration to evaluate whether the effort is falling behind to a significant extent. In part, PERT allows for some variability away from the projected schedule when determining whether delays encountered can be made up at some later time.
- **Other scheduling methods** for setting up monitoring points and tracking progress along a schedule are available. These include several “project management” software packages and similar tools that can help specify key events, those that are critical to the timely completion of the contract.

Common Elements of a Contract Administration Checklist

After you have reviewed your contract and identified major tasks for your checklist, run through this list of common contract administration functions to see if there are others you wish to include.

Applies	Does Not Apply	
_____	_____	Designate COR/COTR
_____	_____	Notify the contractor of the COR/COTR designation and roles of other Government representatives
_____	_____	Hold a postaward orientation
_____	_____	Furnish Equal Employment Opportunity poster
_____	_____	Ensure contractor submits insurance and bond certifications to the CO
_____	_____	Provide Government-furnished property
_____	_____	Monitor contractor material submittals
_____	_____	Verify subcontracting plan submission
_____	_____	Verify first article submission
_____	_____	Obtain OSHA standards certification
_____	_____	Give first article approval
_____	_____	Obtain quarterly reports of prime contractor subcontracts with small and minority-owned businesses
_____	_____	Monitor contractor-conducted testing procedures
_____	_____	Monitor Government-conducted testing procedures
_____	_____	Review and approve contractor technical reports
_____	_____	Review/approve reports required for interim payment
_____	_____	Establish acceptance procedures and conduct acceptance
_____	_____	Obtain instruction/maintenance manuals on newly-acquired equipment
_____	_____	Arrange for/participate in contract audit
_____	_____	Notify contractor of decision on exercising options
_____	_____	Obtain warranty

Exhibit 2-7

A good contract administration plan not only will specify due dates for deliverables, but also will indicate opportunities well in advance of the due dates that you have to gauge progress and forecast any probable delays.

Note that the scheduling technique you use should be one that is appropriate to the type of contract. Most project management software, for instance, focuses on fixed delivery dates and adjusts for delays by adding resources to tasks that are behind schedule. This is appropriate for fixed-price contracts but can be expensive for cost-reimbursement contracts.

Reporting Procedures

Identify contract reporting procedures. Some agencies use a special form as a contract attachment in Section J of the contract to identify contract deliverables including reports. Others insist that all contract deliverables, including reports and technical data submissions, be given distinct contract line items in the contract schedule. If your agency does one or both, identification of these reports will be much simpler. Otherwise, you must compile your own list.

Note procedures and due dates that are pertinent to the reports. Include these in your contract administration plan to ensure that these are complete, on time, and otherwise comply with contract terms.

Quality Assurance

Determine quality assurance methods. There are three general categories of quality assurance methods that may be cited as a requirement in the contract:

FAR 46.202

- **Government reliance on inspection by the contractor** generally is used for small purchases or the acquisition of standard commercial items. This approach is used when there is little likelihood of a significant loss in case of defects, when there is an expectation that defective work will be replaced or corrected by the contractor, and when the cost of inspection might outweigh the benefits.
- **Standard inspection requirements** are those that require the contractor to have an acceptable inspection system, give the Government the right to inspect and test work in process, and require the contractor to make records of inspections available to the Government.
- **Higher-level quality requirements** are used for complex and critical work, or when the technical nature of the work requires an examination of work operations and attention to how the work is organized, planned, and so forth. For such contracts, the Government usually will specify the inspection or quality control system to be used.

Regardless of the method specified in the contract, your contract administration plan must indicate how quality assurance will be monitored. This often will depend on the nature of the work and what opportunities there are to examine quality. Deficiencies in the way soil samples are gathered, for instance, are not likely to be evident from reports giving the results of tests completed on those samples.

Inspection and Acceptance

Ensure your plan provides for the inspection and acceptance process. The requisitioner will have had some input on the inspection and acceptance process by identifying unique requirements that affect it. These unique requirements will be in the contract's terms and conditions. For example, a unique inspection requirement might be a performance test. This is not covered by most agency's standard inspection and acceptance procedures. So your contract administration plan would include a checklist of required test parameters as well when and where the test would be performed and by whom. Examples of some common areas that should be addressed are:

- The standard in the contract that establishes an acceptable product or service. Examples are:
  - — A requirement that a piece of equipment must run for 100 hours at a specific level of operating efficiency establishes that operating efficiency level as the standard.
  - — Statement of work language that food on cafeteria lines must be "set up no more than 30 minutes before opening" establishes 30 minutes as a performance standard.
  - — A requirement that a contractor respond to on-call repair service "within 6 hours from receipt of a telephone call from an authorized Government representative" establishes six hours as a performance standard.
- Allowable variations from the standard authorized within the specifications or other contract terms, such as those for:
  - — Calibration requirements which contain a range within which calibration is acceptable.
  - — Many service contracts recognize human error as a fact of life for some kinds of service and state an "acceptable quality level" of, for example, 5%, meaning that if a contractor only meets the performance standard 95% of the time, it will still provide "acceptable" service.

- A required or otherwise reasonable method to document test results using, for example:
  - — An outside testing laboratory, or
  - — A standard agency form or format.

FAR 52.209-3(b)

FAR 52.209-4(b)

- Deviations that would indicate "conditional" approval rather than rejection for things such as tests on a first article of production that should not cite easily correctable defects as a reason for rejection.

Another unique requirement may be a quality standard for key personnel. You must include monitoring key personnel in the contract administration plan if:

- The contract requires contractor personnel to have specific qualifications—for example, a CPA for an accountant. If a departing employee's qualifications were reviewed as an award factor, you need to review the qualifications of the new employee.
- Substitutions in key personnel are requested for those previously approved. In these cases, you must ensure that:
  - — Only approved key personnel are used for contract performance, and
  - — Requests for key personnel substitutions are submitted and approved in a timely way.

Usually, the contract provides for contractor notification in the above circumstances. When there is no requirement for contractor notification, your plan must require observance of personnel on site or when making entries for daily reports.

While invoices may require back-up information, including names of personnel being billed on a time-and-materials contract, a contractor employee can be on site for many weeks before an invoice showing his or her services is presented for payment. Therefore, invoice scrutiny and verification alone are not sufficient for proper monitoring of contractor personnel changes when such tracking is important to contract requirements.

Identify Contract Administration Team Members

Identify contract administration team members and define their roles. The roles and authorities of team members depend on the size of the Government organization and the size of the contract.

FAR 2.101

In previous steps, you identified all necessary tasks for administering the contract. Now identify who, or what office, will have official responsibility for those tasks. Make sure that each task is clearly defined and any overlapping of functions will not result in confusion over

responsibilities. In addition to specific tasks associated with the contract, identify who has been delegated overall responsibility for normal contract administration functions. Each member of the team should receive a copy of the list of participants and their roles and responsibilities. This will help avoid any member duplicating the effort of others.

Being an effective contract administrator involves more than being an expert troubleshooter for specific contract problems. A successful contract administrator must also have leadership qualities to ensure that the Government's representatives work well together as a team.

Milestones for Member Reports

Schedule contract administration reporting milestones. Assign a time frame for the completion of each task delegated to a contract administration team member, from contract award to contract closeout. Identify which reporting tasks are crucial to the success of the contract. This is especially important when related tasks are assigned to different team members for accomplishment or monitoring.

Document the Plan

Document your contract administration plan. Use formal written plans for high visibility, high dollar, or complex multi-task contracts. Some agencies require written plans for certain requirements and specify a format for these plans. If your agency does not require a specific format, you can use the format in Exhibit 2-8 as a model for your plan. Even when written formal plans would not be cost effective for a specific requirement, the first five planning steps should be completed informally.

2.8 PROVIDE NOTICE AND INSTRUCTIONS

Formal notice is required to delegate contract administration duties and to inform the contractor of the roles and limits of authority of designated contract administration team members.

Review COR/COTR Qualifications

Review qualifications of COR/COTRs prior to issuing notices. Make sure any individuals proposed as COR/COTR have the training, qualifications, and experience commensurate with the authority the contracting officer is delegating. Otherwise, request a qualified substitute unless immediate training is available to qualify the proposed individual for the COR/COTR appointment. An example of a situation to avoid is having an organization nominate an administrative coordinator on a highly technical service contract. The technical advisor to the proposed administrative coordinator is probably the better choice as your COR/COTR.

Sample Contract Administration Plan

Contract Number: XXXX-X-XXXX

Plan Date: Update #2, 2/20/93

Contractor: Fremiet Service Company

Key Contractor Contact: Franklin Fremiet (phone: (123) 870-XXXX)

Brief Description of Work: Accounting services for temporary operations at Building XYZ on Anywhere Government Installation

Contract Type: Cost-plus-fixed-fee contract

Contract Amount: $30,000 (est.), with two 1-month options at $10,000 each.

Government-Furnished Supplies/Services: Computer training—see milestone calendar, item #7.

Performance Period: 3/1/93 through 5/28/93

Milestone Calendar for Specific Government Action:

Event	Milestone Date	Government Person Responsible	Coordination Necessary	When Milestone Met
1. Write COR/COTR designation letter	1/8/93	M. Juan, Contracting Officer	R. Hamilton, Supervisor of COR/COTR	1/7/93
2. Contractor's submission of quality control plan (in technical proposal)	1/29/93	M. Juan, Contracting Officer	T. Smith, Evaluation Panel Chairperson	1/29/93
3. Analyze quality control plan	2/3/93	S. Holmes, COR/COTR	T. Smith, Evaluation Panel Chairperson	2/3/93
4. Tentative award date	2/19/93	M. Juan, Contracting Officer	Required approvals	2/18/93
5. Hold Government team meeting	2/20/93	M. Juan, Contracting Officer	Government team members	2/19/93

Exhibit 2-8 (page 1 of 3)

Sample Contract Administration Plan

Milestone Calendar for Specific Government Action: *(continued)*

Event	Milestone Date	Government Person Responsible	Coordination Necessary	When Milestone Met
6. Hold postaward orientation meeting	3/1/93	M. Juan, Contracting Officer	Franklin Fremiet/ Government team members	
7. Provide training services on Government-unique computer software	3/2/93	R. Wong, Computer Specialist	Franklin Fremiet	
8. Evaluate contractor performance as to desirability of excercising option to extend service period	4/16/93	S. Holmes, COR/COTR	On-site Inspectors	
9. Notify contracting officer of need to exercise option for additional service periods	4/23/93	S. Holmes, COR/COTR	Fund Expenditure Approval	
10. Notify contractor of intent to exercise option, if appropriate	4/30/93	M. Juan, Contracting Officer	N/A	
11. Option exercised, if appropriate	5/7/93	M. Juan, Contracting Officer	N/A	
12. Hold on-site audit	4 business days after receipt of final invoice	S. Holmes, COR/COTR	Auditing Department Head; On-site Inspectors	
13. Document contractor performance evaluation and forward monitoring records to contracting office	6/21/93	S. Holmes, COR/COTR	On-site Inspectors	
14. Close out contract file	7/23/93	M. Juan, Contracting Officer	Program Office Chief	

Exhibit 2-8 (page 2 of 3)

Sample Contract Administration Plan

Contract Monitoring Schedule:

Because the known performance period is relatively short, the Government will rely on a final contract audit for cost verification, with sampling techniques and standard checklists used for periodic on-site visits. Service outputs are summarized as follows:

Output Item	*When Available*	*Monitoring Method and Responsibility*
1. Transaction/Remittance Report	15th (ea. mo.)	Reviewed monthly—S. Holmes
2. Accounting Records	Ongoing	Site visit verification—S. Holmes
3. Remittance Collections	30th (ea. mo.)	Monthly and final audit—S. Holmes

Procedure for Implementing Changes:

The COR/COTR will provide the contracting officer with a standard format entitled "Request for Contract Change." Elements of this form will include:

1. Date
2. Reason for change request
3. Contract paragraphs the change affects with recommended revised language
4. Cost elements the change affects
5. Total estimated cost impact of the change

The form will be accompanied by a funded purchase request if additional contract funds are needed.

The contracting officer will attempt to finalize negotiations within 5 business days from receipt of the change request, with the technical assistance of the COR/COTR.

Invoice Processing:

The COR/COTR will verify invoices within 5 business days after receipt with assistance of on-site inspectors.

Exhibit 2-8 (page 3 of 3)

Letters of Designation

Letters of designation are required. The essential elements of a COR/COTR delegation or appointment letter are outlined in Exhibit 2-9. Only the contracting officer can sign designation letters to the COR/COTR, QAS, or other contract administration team member.

Essential Elements of a Letter of Designation

- Address the individual by name and position title.
- Specify the contract number that applies to the delegation.
- Specify the authorities being delegated.
- Specify the tasks being delegated.
- Emphasize limitations of the delegation.
- Specify if the designee may redelegate any authority or task.
- Specify any recordkeeping requirements and the disposition of those records.
- Include a requirement that the individual certify that he or she has read and will abide by your agency's procurement integrity and conflict of interest requirements.

Exhibit 2-9

Need for Specific Instruction

When the designee is to act for the contracting officer on more than one contract, write a separate designation letter for each contract. Do this because limitations, authorities, and tasks will vary, depending on the contract terms.

When instructions and responsibilities of individuals in the contract administration process are contained in regulations, office procedures, and job descriptions of contract administration team members, you may not need to prepare any designation letter. This usually is the case for contract specialists working in a Contract Administration Office.

COR/COTRs are from a wide variety of organizations whose main function is usually not to act in a contract administration supporting role. Therefore, guidelines and other instructional documentation within their organizations normally do not cover contract administration support activities.

Project inspectors may also be in organizations where contract administration duties are secondary to their normal responsibilities. When this is the case, these instructions for preparing COR/COTR notices apply to project inspector designations as well. More typically, however, contract administration inspection duties are the main job functions of a project inspector.

Exhibit 2-10 provides a sample COR/COTR appointment letter.

COR/COTR Designation Letter

TO: Tom Jones, Project Engineer

FROM: Jane Justice, Contracting Officer

SUBJECT: Contracting Officer's Representative (COR) Designation, Contract No. ARN 91-7028

I am hereby designating you as contracting officer's representative (COR) on Contract No. ARN 91-7028 awarded to the ABC Corporation, Our Town, WI, for the production of a new concept in Super Duper Widgets.

In this capacity you have the specific responsibilities detailed below, but perhaps the most important aspect of this authority is its limitations. Under no circumstances are you to make changes that would affect the cost or duration of the contract. You will have the following responsibilities which you may not redelegate to any other individual:

1. To furnish the contractor directly with technical assistance and guidance in all aspects of the contract. To expedite this high-priority project, you may formalize your guidance to the contractor in a written change order provided the order does not affect price or contract duration and contains both a signed contractor acknowledgment and a statement, as follows:

   In accepting this change order, the contractor agrees that the price and all other terms and conditions of the contract remain unchanged.

2. To provide me with a copy of all change orders issued under paragraph 1 above within 48 hours of issuance.

3. To provide me with written notification of any dispute that cannot be resolved between you and the contractor regarding contract performance.

4. To keep accurate records of all interim and final contract testing procedures outlined in Section 2B of the statement of work, and send a report within 5 working days to the contractor and to me.

Exhibit 2-10 (page 1 of 2)

COR/COTR Designation Letter

5. To keep a daily log of all contract-related activities while you are on site at the contractor's plant.
6. To verify invoices and, upon receipt, promptly certify them for prompt payment. After verification, send me a copy of the certified invoice and send the original to Finance.
7. To turn over all records pertaining to this contract to the successor COR if this COR designation is terminated for any reason before completion of the contract, and to notify me that you have taken such action.

Please note that you may not redelegate any of the contractual authority listed above, except for clerical tasks associated with that authority.

I am providing you with two copies of this letter of designation. Please sign one copy in the space provided below to indicate your acceptance, and return that copy to me. In addition, please sign the following certification to indicate that you have read and will abide by the Code of Ethical Conduct (copy attached).

ACCEPTED: _____
Contracting Officer's Representative

DATE: _____

I have read the Integrity Awareness Act for Government Employees and will abide by its requirements in conducting all my responsibilities as contracting officer's representative.

CERTIFIED: _____
Contracting Officer's Representative

DATE: _____

Attachment: Agency's Code of Ethical Conduct

Exhibit 2-10 (page 2 of 2)

Provide Notice to the Contractor

Notify the contractor, in writing, of the names of individuals designated as CORs/COTRs. Include in this notification what authority the COR/COTR has in relation to this particular contract. Provide a similar written notice outlining the roles of any other Government employees having a direct contract administration role. This is especially necessary when the contract itself has not identified these officials.

Such a notice must include some key information. These essential elements are listed as Exhibit 2-11.

Essential Elements of a Contractor's Notice of a Contracting Officer's Delegation

1. Specify the name and position title of the COR, COTR, etc.
2. Cite the contract number for which authority has been delegated
3. Specify the extent of the delegation, and
4. Emphasize the limitations of the authority delegated.

Exhibit 2-11

Exhibit 2-12 provides a sample COR notification letter to the contractor.

Changing CORs/COTRs

You may need to set up a system to make sure you are aware of when changes or terminations are needed because of personnel reassignments, long term travel, extended leave, or other circumstances that affect your COR/COTR.

A system will be particularly important when you have no routine contact with the COR/COTR. So you might, for example, make it a point to call each COR/COTR each Friday. If you have too many to call, you may arrange to have the COR/COTR's supervisor provide you with information on changes in that person's status.

Whatever the method, make sure that you are aware of any situation having a potential impact on the performance of contract administration duties that have been delegated to others.

Notification Letter to the Contractor

TO: Alvin Johnson, Chief Project Officer
The ABC Corporation
123 Main Street
Our Town, WI XXXXX-XXXX

FROM: Jane Justice, Contracting Officer

SUBJECT: Contracting Officer's Representative (COR) Designation,
Contract No. DSN079-2241

This officially notifies you that Tom Jones, Project Engineer, This Agency, will be my on-site representative for this contract.

Perhaps the most important aspect of his authority is its limitations. Under no circumstances can he make changes that would affect cost or duration of the contract. Please contact me directly at (XXX) 123-4567 when you anticipate changes that would affect the price or overall time of performance.

Mr. Jones is authorized to act in my behalf in:

1. Furnishing technical assistance and guidance to you in all aspects of the contract and formalizing this guidance in a written change order, as long as the change does not affect the price or duration of the contract.
2. Verifying and certifying all invoices. You should submit invoices directly to Mr. Jones.

I am providing you with two copies of this notice and request that you acknowledge one copy in the space provided below and return it. Thank you for your cooperation.

ACKNOWLEDGED: _____
Contractor

DATE: _____

Exhibit 2-12

Terminate or change appointment letters in writing. When possible, issue the termination letter before the termination and specify the date on which the termination will become effective. Send the contractor either a copy of the termination letter or a separate letter advising of the termination or change.

2.9 PLAN A POSTAWARD ORIENTATION

Plan a postaward orientation if one is needed. This often is the first major step in administering a new contract. You want to make sure that all contract requirements are clear to the contractor and that the contractor has an opportunity to ask questions and clarify misunderstandings that otherwise might affect contract performance.

A postaward orientation is advisable for almost every complex, long duration contract. This will be your best opportunity to explain any performance requirements, scheduling details, compliance issues, or contract clauses that may be unfamiliar to the contractor or are potential problems based on your review of the contract and the contractor's history. While postaward orientations for many simple contracts can be completed by telephone or correspondence, the orientation for a complicated contract is best done through a face-to-face conference.

Define the Government's Position

Based on your reading of the contract, your understanding of problems that arose on similar contracts, and inputs from the contract administration team members and the requiring activity if not represented on the team, identify any issues that may be the source of concern. For each issue, prepare the Government's position, your understanding of the requirement, and your plan for establishing whether the requirement has been met.

In addition to technical details, any of the following may be issues you will want to cover in the postaward orientation:

- Special contract clauses
- Critical milestones
- Contractor's quality control procedures
- Contractor's reporting requirements
- Billing and payment procedures
- Roles of the Government's contract administration team members, and
- Roles of the contractor's technical and contract personnel.

Prepare the Agenda

A postaward agenda is important to the success of a postaward orientation. You want an agenda that can be shared with the contractor, who may want to add a topic or two, and with other members of the contract administration team who will participate in the conference. All Government representatives attending should have a clear understanding of their roles in the conference and the Government's position on issues.

In addition to allocating time for introducing key Government and contractor staff, your agenda should provide time to cover each significant issue and a period to allow the contractor to raise additional points or ask questions. Also, do not neglect to clarify how the contractor can communicate with you and the COR/COTR. Try to keep the number of issues to be covered to a minimum. It may be better to schedule additional meetings than attempt to cover too much at one sitting.

APPENDIX 1-A: CONTRACT TYPES

	Firm-Fixed-Price (FFP)	Fixed-Price Econ. Price Adjustment (FPEPA)	Fixed-Price Award Fee (FPAF)	FP Prospective Redetermination (FPPRD)	Fixed-Price Incentive (FPI)
Principal Risk To Be Mitigated	None. Costs of performance can be estimated with a high degree of confidence. Thus, the contractor assumes the risk.	Market prices for required labor and/or materials are likely to be highly unstable over the life of contract.	Acceptance criteria are inherently judgmental, with a corresponding risk that the end user will not be fully satisfied.	Costs of performance can be estimated with confidence only for the first year of performance.	Labor or material requirements for the work are moderately uncertain. So, the Government assumes part of the risk.
Used When:	• The requirement is well-defined. • Contractors are experienced in meeting it. • Market conditions are stable. • Financial risks are otherwise insignificant.	The market prices at risk are severable and significant. The risk stems from industrywide contingencies beyond the contractor's control. The dollars at risk outweigh the administrative burdens of an FPEPA.	Judgmental standards can be fairly applied by an Award Fee panel. The potential fee is large enough to both: • Provide a meaningful incentive • Justify the administrative burdens of FPAF.	The Government needs a firm commitment from the contractor to deliver the supplies or services during subsequent years. The dollars at risk outweigh the administrative burdens of an FPPRD.	A ceiling price can be established that covers the most probable risks inherent in the nature of the work. The proposed profit sharing formula would motivate the contractor to control costs and meet other objectives.
Elements	A firm-fixed price for each line item or one or more groupings of line items.	A ceiling on upward adjustment, and a formula for adjusting price up or down based on: • Established prices • Actual costs of the labor or materials • Labor or material indices.	• A firm fixed price. • Standards for evaluating performance. • Procedures for calculating a "fee" based on performance against the standards.	• Fixed price for the first period. • Proposed subsequent periods (at least 12 months apart). • Timetable for pricing the next period(s).	• A ceiling price. • Target cost. • Target profit. • Delivery, quality, and/or other performance targets (optional); • A profit-sharing formula.
The Contractor Is Obliged To:	Provide an acceptable deliverable at the time, place, and price specified in the contract.	Provide an acceptable deliverable at the time and place specified in the contract at the adjusted price.	Perform at the time, place, and the price fixed in the contract.	Provide acceptable deliverables at the time and place specified in the contract at the price established for each period.	Provide an acceptable deliverable at the time and place specified in the contract at or below the ceiling price.
Contractor's Incentive	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Generally realizes an additional dollar of profit for every dollar that costs are reduced; earns an additional fee for better performance.	For the period of performance, realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes a higher profit by completing the work below the target cost.
A Typical Application	Commercial supplies and services.	Multi-year contracts for commercial supplies during high inflation periods.	Large-scale installation support services.	Multi-year production of spare parts for a major system.	Production of a major system based on a prototype.
Contract Administration Concerns	Monitoring quality should increase with indications that contractor (1) is behind schedule or (2) has exceeded its contract budget.	Economic adjustments must be made only using indices and methods specified in contract terms.	Award fee panel members should be higher-level agency managers.	Contractor must have an adequate accounting system that supports the pricing periods. Prompt redeterminations.	Contractor must have adequate accounting systems. Targets must be supported by the cost data.
Variants	Firm-fixed price level of effort			Retroactive redetermination	Firm or successive targets

APPENDIX 1-A *(continued)*

Cost Plus Fixed Fee (CPFF)	Cost Plus Incentive Fee (CPiF)	Cost Plus Award Fee (CPAF)	Cost or Cost Sharing (C/CS)	Time & Materials (T&M)	Indefinite Delivery (ID)
Labor hours, labor mix, and/or material requirements (among other things) necessary to perform are highly uncertain and speculative. Hence, the Government assumes the risks inherent in the contract; benefiting if the actual cost is lower than the expected cost; losing if the work cannot be completed within the expected cost of performance.					Varies from contract to contract.
Relating fee to performance (e.g., to actual costs) would be unworkable or of marginal utility.	An objective relationship can be established between the fee and such measures of performance as actual costs, delivery dates, performance benchmarks, and the like.	Objective incentive targets are not feasible for critical aspects of performance. Judgmental standards can be fairly applied. Potential fee would provide a meaningful incentive.	• The contractor expects substantial compensating benefits for absorbing part of the costs and/or forgoing fee, or • The vendor is a nonprofit entity.	Costs are too low to justify an audit of the contractor's indirect expenses.	Delivery requirements are uncertain. • Definite quantity (if quantity is known, but delivery is not) • Indefinite quantity (if known minimum quantity) • Requirements (if quantity totals can be estimated)
• Target cost. • A fixed fee.	• Target cost. • Performance targets (optional). • A minimum, maximum, and target fee. • A formula for adjusting fee based on actual costs and/ or performance.	• Target cost. • Standards for performance evaluation. • A base and maximum fees. • Fee adjusted based on performance quality.	• Target cost. • If CS, an agreement on the Government's share of the cost. • No fee.	• A ceiling price. • A per-hour labor rate that also covers overhead and profit. • Provisions for reimbursing direct material costs.	• "Per unit" price. • Performance period. • Ordering activities and delivery points. • Maximum or minimum limit (if any) on each order. • Extent of obligation on quantity.
Make a good faith effort to meet the Government's needs within the estimated cost in the Schedule.				Make a good-faith effort to meet the Government's needs within the "ceiling price."	Provide acceptable deliverables at the time and place specified in each order at the per-unit price, within any established ordering limits.
Realizes a higher rate of return (i.e., fee divided by total cost) as total cost decreases.	Realizes a higher fee by completing the work at a lower cost and/or by meeting other targets.	Realizes a higher fee by meeting judgmental performance standards.	If CS, shares in the cost of providing a deliverable of mutual benefit.	If "blended" rates are used, can increase profit by using more lower-cost labor.	Generally realizes an additional dollar of profit for every dollar that costs are reduced.
Research study.	Research and development of the prototype for a major system.	Large-scale research study.	Joint research with educational institutions.	Emergency repairs to heating plants and electrical transformers.	Long-term contracts for commercial supplies and support services.
The contractor must have an adequate accounting system. The Government must monitor performance to ensure use of efficient methods and cost controls. Must be negotiated.				The Government must exercise appropriate surveillance to ensure efficient performance.	Orders placed must be within the scope of the basic ID contract. With requirements contract, must buy covered deliverables only from contractor.
Completion or term				Labor hour	Task order contract

NOTES

CHAPTER 3

CONSENT TO SUBCONTRACTS

INTERACTING CLAUSES

Bea Ware, the seasoned pro with lots of gray hair to prove it, and Ernest N. Deavors, the very young up-and-comer who seemed to have no end of questions, were having an early morning conference while waiting for the coffee to brew.

Ernest had administered many task order contracts before. His agency—like many others—used that contract type extensively. But none of those Ernest previously administered were cost-reimbursement. Several issues troubled him.

"How come these auditing services don't have fixed rates?" Ernest asked Bea.

"This is the first time we've contracted for this type of service, Ernest," noted Bea. "The idea is to use contractor personnel with some real expertise in the issues involved. So the agency decided it would be against its best interests to be tied to a blended rate for an accountant. We'll be buying the services of experts for the particular issues we wanted investigated. Tally-Up has a very impressive roster of expert resources."

"Hmmm," Ernest mused. "It will be interesting to see if there isn't some sort of pattern in the rates we end up paying."

Bea nodded. "If we can establish a series of rates based on the type of issues we actually audit, then the next time we contract for those services, we could try to fix those rates in the contract—to reduce the agency's risk in performance and cut down on our own administrative time."

"Another thing I'm not catching on to is this Consent to Subcontracts clause," Ernest confided. "When the Tally-Up reps mentioned at the orientation conference that they would be subcontracting out any issues that are not accounting-related to a firm that deals in the analysis of nonaccounting business aspects of Government contracting, you told them that they would not have to give us a notice. Why? Shouldn't we have specified that if it looked like we would go over the dollar threshold in the clause, they would have to provide a notice?"

"Tally-Up has had their purchasing system reviewed and approved by our Inspector General's auditors and if you read the FAR 52.244-2 subcontracting clause in this contract carefully, you'll see that this system approval exempts them from having to give us notice," Bea responded, and then chuckled.

continued . . .

"There's no need to think about the dollar threshold because we will be controlling the type of work," she continued. "Therefore, we'll be controlling the volume of subcontracting and we don't even know for sure what type of work we'll have them do—except for the first project which is strictly accounting work."

"What would you have told them if they had no purchasing system approval?" Ernest wanted to know.

Bea bit her bottom lip and thought a moment. "I probably would tell them that I wanted to review the issue more thoroughly and get back to them. You see, the way this agency writes task order contracts its by changing the standard FAR clauses for indefinite delivery contracts, but instead of specifying "delivery orders," we substitute "task orders" and make other changes appropriate for services rather than finish products. Then, we add any other clauses usually used for the type of business pricing arrangement—in this case, standard cost-reimbursement clauses."

"Unfortunately, the two sets of clauses have not had a long history of being used together and occasionally procedural issues arise," Bea pointed out. "When that happens, the best thing to do is get the contracting policy people and the lawyers to agree with what you want to do or get some recommendations for alternate actions—so they won't be second-guessing you later!"

"Good advice!" Ernest thought as he made his way back to his desk.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Consent (or decline to consent) to the placement of proposed subcontracts.

Individual:

3.1 Determine if the contract contains a consent to subcontract clause.

3.2 Determine which potential subcontracts would require an advance notice and confirm the contractor's understanding.

3.3 When advance notices are received, determine if they are adequate and decide if consent is required.

3.4 Determine whether the FAR allows consent.

3.5 Determine whether to withhold consent or identify any requirements upon which consent must be conditioned, such as Equal Employment Opportunity (EEO) clearance from the Department of Labor, when required.

3.6 Negotiate changes or corrections in the contractor's subcontracting procedures or the contract itself, when appropriate, obtaining the contracting officer's approval in writing for those changes if they conflict with previously-approved plans.

3.7 Consent, decline to consent, or make appropriate recommendations in that regard to the contracting officer and, after obtaining the contracting officer's decision, document it and transmit it in writing to the contractor.

3.8 Monitor contract performance to ensure that subcontracts are not awarded without consent.

INTRODUCTION TO CONSENT TO SUBCONTRACTS

Definition

Consent to subcontracts refers to the contracting officer's written consent for the prime contractor to enter into specific subcontracts. The contracting officer provides consent or declines to consent based on an advance notice provided by the prime contractor to the Government.

Policy on When Consent Requirements are Required

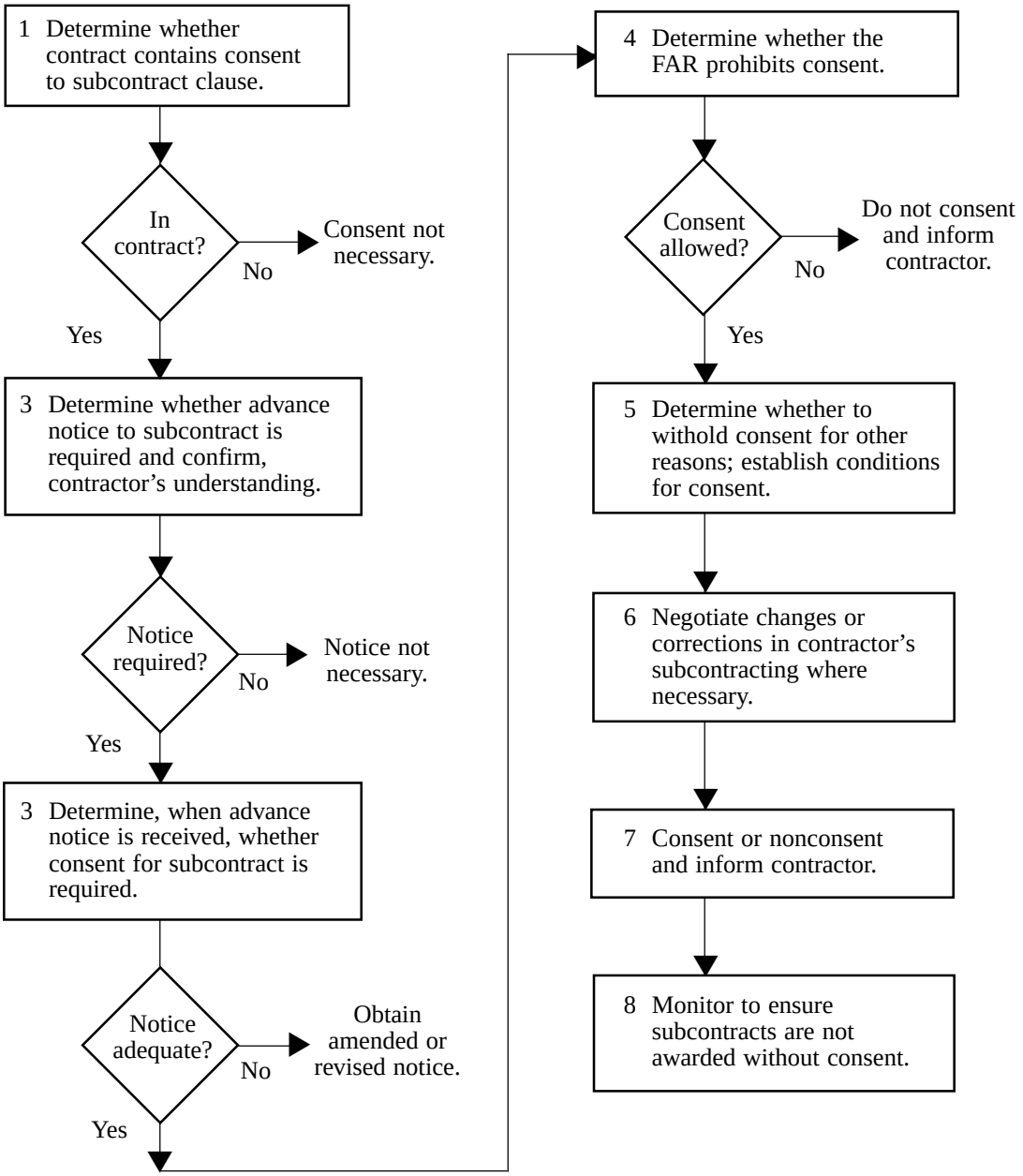
Consent to subcontracts may be required when the subcontract work is complex, the dollar value is substantial, or the Government's interest is not adequately protected by competition and by the type of prime contract or subcontract.

Consent requirements for most subcontracts do not apply when the contractor's purchasing system has been reviewed and approved through the procedures outlined in FAR Subpart 44.3.

Steps in Performance

The steps in providing Government consent to subcontracts are charted on the next page. Following the flowchart, each step is discussed in turn.

STEPS IN CONSENTING TO SUBCONTRACTS



CONSENT TO SUBCONTRACTS

3.1 DETERMINE IF THE CONTRACT CONTAINS A CONSENT TO SUBCONTRACT CLAUSE

Subcontracting issues often arise soon after a contract is awarded. During your review of contract requirements for preparing a contract administration plan, you should:

- Determine if the contract contains a clause that requires the contractor to notify the Government in advance of awarding a subcontract, and
- Gives the Government the right to consent or not consent to that subcontract.

This advance notice and the right of consent or the withholding of consent apply regardless of the purchasing mechanism used by the prime contractor. This reflects the fact that in commercial contracting, purchase orders may be used in place of formal subcontracts unless a specific company policy limits their use.

Specific Subcontracting Clauses

Not all clauses that address subcontracts require that a contractor ask for the Government's consent prior to subcontracting with a supplier. Five standard FAR clauses do require this consent. Exhibit 3-1 outlines the major requirement of each of these five clauses. Additionally, unique contract terms may address consent requirements. You must review the entire contract to fully understand what is required.

Importance of Competition

FAR 52.244-5

Competition has long been recognized as the key to obtaining reasonable prices and terms in both Government and commercial contracts. This recognition was confirmed by law with the passage of the *Competition in Contraction Act* in 1984. The clause at FAR 52.244-5, *Competition in Subcontracting,* implements this law and protects the Government's interest by requiring competitive subcontracting practices to the maximum extent possible. However, requiring competitive subcontracting practices is not always sufficient to protect the Government's interest.

Summary of Standard FAR Consent to Subcontract		
Standard FAR Subcontracting Clause		**Major Requirement Addressed**
FAR 52.244-1	*Subcontracts (Fixed-Price Contracts)*	Notice/consent required for specific subcontracts detailed in the clause
FAR 52.244-2	*Subcontracts (Cost-Reimbursement and Letter Contracts)*	Notice/consent required for specific subcontracts detailed in the clause
FAR 52.244-3	*Subcontracts (Time-and-Materials and Labor-Hour Contracts)*	Notice/consent required for most subcontracts
FAR 52.244-4	*Subcontractors and Outside Associates and Consultants*	Notice/consent required for all subcontracts (but preaward consent is obtained; postaward notice and consent only involves substitutions)
FAR 52.209-6	*Protecting the Government's Interest When Subcontracting with Contractors Debarred, Suspended, or Proposed for Debarment*	Notice/consent required for first-tier contractors identified by the Federal Government as being ineligible to receive Federal contracts

Exhibit 3-1

Why Consent is Required

FAR 44.102

To Minimize Financial Risk

There can be several reasons why a subcontract consent clause was included in the contract.

Generally, the FAR requires the preaward inclusion of a consent to subcontract clause in a prime contract when the Government's financial interest in subcontractor selection is not protected by:

- The contract type, or
- Competitive practices of the prime contractor.

The Government wants to keep a close eye on subcontracts that are not fixed-price, particularly when the prime contract is also not fixed-price, because the Government assumes the greater risk for nonperformance in such cases. Review Chapter 2 and its Appendix for details on risk assumption and how it relates to the contract type.

To Focus on Critical Subcontracts

FAR 44.201-1(b)

FAR 44.205

However, consent may also be required when a subcontract is recognized in the preaward phase of the procurement as being particularly critical to overall contract performance, even though the Government's interests are generally protected by the contract type and/or competitive practices. These critical subcontracts are specified in the prime contractor's Government contract as requiring the Government's consent, while other subcontracts that the prime contractor may let for contract performance will not be subject to consent restrictions. The prime Government contract may even specify other special surveillance requirements for these critical subcontracts, such as Government approval of the subcontractor's quality control program, and so forth.

To Ensure Quality

The Government may also want to ensure that it obtains the quality of product or service that it anticipated at contract award by requiring consent to any substitutions in subcontracts it authorized during contract negotiations.

In summary, the purpose of consent is to ensure that the Government's overall risks in pricing, timeliness, and quality in subcontract performance are minimized.

Limitations on Consent Process

Obviously the Government does not want to over manage its contracts. It wants to avoid spending its own administrative time to excess—that is, beyond any potential benefit that could be expected from the amount of time spent.

It stands to reason, then, that the Government does not want its employees to review information that might apply to a subcontract, but does not have a significant impact on Government interests when deciding whether to consent to a subcontract. An example of such unrelated information is "flow-down" clauses—clauses that are required for inclusion in the subcontract by the terms of numerous individual clauses that are likely to be incorporated in the prime contract.

The Government's interest is protected with flow-down clauses by the operation of a legal concept known as the "Christian Doctrine" (named from a court case involving G.L. Christian & Associates). The Christian Doctrine has been held to apply to subcontracts as well as prime contracts. This legal rule applies to clauses:

- Required by Government regulation, *and*
- Involving issues that implement fundamental procurement policy.

The Christian Doctrine provides that such a clause has the full force and effect of law *even if it is not included in a contract that requires it.* In other words, the clause is legally binding on the contracting parties even if it is not specifically listed as a clause in the contract or subcontract.

Clearly, the Government is not at risk if a required clause is omitted from a subcontract by a prime contractor.

Of course, the contractor still has an obligation to its subcontractor to advise it of all subcontracting terms and conditions, but this is a matter between the prime and its sub. Taxpayer dollars are not well spent in monitoring this administrative detail.

FAR 44.201-2

Therefore, the FAR's summary of contracting officer responsibilities does not include a review of the entire subcontract, and specific requirements regarding advance notice submissions only ask for enough information to ensure that the Government's interest is protected in most contracting situations.

3.2 DETERMINE WHICH SUBCONTRACTS REQUIRE AN ADVANCE NOTICE AND CONFIRM CONTRACTOR'S UNDERSTANDING

Not all subcontracts require advance notice or Government consent under the terms of the standard FAR subcontracting clauses in Exhibit 3-1.

You must review any FAR clauses and unique contract terms to make sure that both you and the prime contractor understand what is required for each subcontract it contemplates.

Privity of Contract

However, you need not be concerned with the subcontractor's understanding because Government subcontractors do not have "privity" of contract. ***Privity of contract*** refers to the legal relationship and responsibilities between parties to the same contract. The subcontractor has no privity in the prime Government contract. Therefore, the Government has no legal responsibilities to the subcontractor, but the subcontractor and prime contractor have legal responsibilities to each other.

Variations in Notice Requirements

There are major notice requirement differences that depend on the contract type of both the prime contract and the subcontract, the magnitude of the intended subcontract, whether the prime contractor has an approved purchasing system, the purpose of the subcontract, and so forth. A summary of these considerations are outlined in Exhibit 3-2. A postaward orientation, if one is held, is a good occasion for clarifying notice and consent issues.

Contractor Purchasing System Review (CPSRs)

FAR 44.3

Note that some FAR clauses generally exempt subcontracts from advance notice requirements if the prime contractor has a Government-approved purchasing system. This approval process is called a Contractor Purchasing System Review (CPSR). These reviews examine a contractor's adherence to Government competition requirements and general good business practices. CPSRs are usually:

- Required for every contractor whose negotiated sales to the Government are expected to exceed $10 million during a 12-month period
- Repeated every three years.

When Notice and Consent to Subcontract Are Required

The following clauses and contract types in prime contracts...	Require advance notice/consent for the following subcontracts...	Exceptions are...
FAR 52.244-1 in Firm-Fixed-Price or Fixed-Price with Economic Price Adjustment Contracts	Subcontracts resulting from unpriced modifications that: • Are over $100,000 • Total $100,000 when combined with other subcontracts issued to the same subcontractor	Any subcontract specifically excepted due to preaward approval No advance notice or consent is required if purchasing system has been approved
FAR 52.244-1 in Fixed-Price Incentive or Fixed-Price Redeter-mination Contracts	All subcontracts that: • Are over $100,000 • Total $100,000 when combined with other subcontracts issued to the same subcontractor	Any subcontract specifically excepted due to preaward approval No advance notice or consent is required if purchasing system has been approved

Exhibit 3-2 (page 1 of 2)

When Notice and Consent to Subcontract Are Required		
The following clauses and contract types in prime contracts...	**Require advance notice/consent for the following subcontracts...**	**Exceptions are...**
FAR 52.244-2 in Cost-Reimbursement or Letter Contracts	All Cost-Reimbursement, Time-and-Materials, or Labor-Hour subcontracts All subcontracts for experimental, developmental or research work Other subcontracts under DOD, Coast Guard, and NASA prime contracts that are: • Over $100,000 or • 5% of prime Other subcontracts written under civilian agency prime contracts that are: • Over $25,000 or • 5% of prime Other subcontracts over $10,000 for special test equipment and facilities items—except when issued under facilities contracts	Any subcontract specified for special surveillance even though it does not fall within the general clause requirements No advance notice or consent is required if purchasing system has been approved except those subcontracts: • Specified for special surveillance which require both the notice and consent • For major systems, subsystems, or their components which require only the advance notice
FAR 52.244-3 in Time-and-Materials or Labor-Hour Contracts	Any subcontract except those for material or commercial items	No exceptions
FAR 52.244-4 in Fixed-Price Architect-Engineer Contracts	Any substitution of a subcontract for one that was authorized during contract negotiations; any additional subcontracting is prohibited.	No exceptions
FAR 52.209-6 in all contracts	Any first-tier subcontract with a firm listed on *Parties Excluded from Procurement Programs*	No exceptions

Exhibit 3-2 (page 2 of 2)

FAR 44.201-2

Also note that even though the contractor has an approved purchasing system, and therefore consent by the contracting officer is not required, the contractor must still provide an advance notice of its intent if FAR 52.244-2, *Subcontracts (Cost-Reimbursement and Letter Contracts)*, would otherwise require it. This inconsistency results from a requirement in Government law *[10 U.S.C. 2306(e) and 41 U.S.C. 254(b)]*.

3.3 REVIEW ADVANCE NOTICE AND DECIDE IF CONSENT IS REQUIRED

When subcontracting clauses require an advance notice from the contractor before it contracts with a particular subcontractor, the Government review process involves several steps.

Determine If Content is Adequate

Standard FAR subcontracting clauses not only require an advance notice, but also outline content requirements for some of those advance notices. Exhibit 3-3 lists circumstances when specific content is required under standard FAR clauses.

Content Requirements

Exhibit 3-4 lists, in the form of a checklist, these content requirements as outlined in the FAR Part 44 series of consent to subcontract clauses. Note that this checklist is not all inclusive. You must consider the peculiarities of each subcontract and the specific clause that establishes the advance notice requirement. Content requirements under FAR 52.209-6, *Protecting the Government's Interest When Subcontracting with Contractors Debarred, Suspended, or Proposed for Debarment*, merely ask for:

- The name of the first-tier subcontractor
- Reasons for the firms's ineligibility
- Explanation of need to subcontract with the firm
- Prime's plan to protect the Government's interest.

The required content for most advance notices emphasize the importance of full and open competition for subcontracts, and the steps the prime contractor takes to secure a subcontract at a fair price. Sole source subcontracts are permitted, but only when adequately justified.

Subcontracting Circumstances that Require Specific Content for an Advance Notice to Subcontract		
If the standard FAR clause in the contract is...	**And a proposed subcontract...**	**Then...**
FAR 52.244-1, *Subcontracts (Fixed-Price Contracts)*	Will require an advance notice under the terms of the clause	Specific content requirements of the FAR clause are mandatory
FAR 52.244-2, *Subcontracts (Cost-Reimbursement and Letter Contracts)*	Will require an advance notice under the terms of the clause ***and***: • Is a cost-reimbursement, time-and-materials, or labor-hour subcontract estimated over $10,000 with fee • Is any other type subcontract and — Is over $100,000 — Totals $100,000 when combined with the total of other subcontracts issued to the same subcontractor	
FAR 52.209-6, *Protecting the Government's Interest When Subcontracting With Contractors Debarred, Suspended or Proposed for Debarment*	Will require an advance notice under the terms of the clause	

Exhibit 3-3

Sample Checklist Containing Minimum Requirements for Assessing the Adequacy of an Advance Notice to Subcontract

A "No" answer to ***any*** question on this list indicates that you do not have all the required content information, as described in paragraph (c), FAR 52.244-1, Subcontracts (Fixed-Price Contracts) (APR 1991) and paragraph (b)(2) of FAR 52.244-2 Subcontracts (Cost-Reimbursement and Letter Contracts)(JUL 1985).

CAUTION: An advance notice may be required, but specific content requirements may not apply. Refer to Exhibit 3-3 for clarification. When specific content is not a contractual requirement, review checklist items and consider whether they are a practical prerequisite for consent in each specific case. Then add only specific additional information required by unique contract clauses or that you need, as a matter of practicality, to make an informed consent decision.

	YES	NO	N/A
1. Does the notice describe the supplies or services to be subcontracted?			
2. Does the notice identify the contract type of the proposed subcontract?			
3. Does the notice identify the proposed subcontractor, with an explanation of why and how it was selected, including the competition obtained? (Note: The notice must provide sound reasons for lack of competition for consent to be justified)			
4. Does the notice identify the proposed subcontract price, accompanied by the prime contractor's cost/price analysis?			
5. If required by the contract[1], does the notice contain the subcontractor's current, complete, and accurate cost or pricing data?			
6. If required by the contract[1], does the notice include a Certificate of Current Cost and Pricing Data?			
7. If required by the contract[2], does the notice include the subcontractor's Disclosure Statement or Certificate relating to Cost Accounting Standards?			

[1] The prime contract must contain FAR 52.215-24, *Subcontractor Cost and Pricing Data*, and the proposed subcontract must exceed $100,000 for civilian prime contracts or $500,000 for DoD, NASA and Coast Guard prime contracts.

[2] Regarding the Disclosure Statement, see note 1. Regarding cost accounting standards (CAS), there are numerous variables, but only a few constants: There must be a CAS clause in the prime contract and CAS never applies to a small business.

Exhibit 3-4 (page 1 of 2)

Sample Checklist Containing Minimum Requirements for Assessing the Adequacy of an Advance Notice to Subcontract

	YES	NO	N/A
8. Does the notice include a memorandum of negotiation between the prime and proposed subcontractor?			
9. Does this memorandum of negotiation reflect:			
• The principal elements of the subcontract price negotiations?			
• The most significant considerations controlling the establishment of initial or revised prices?			
• The reason why cost or pricing data were or were not required?			
• The extent, if any, to which the prime contractor did not rely on the subcontractor's cost or pricing data in determining the price objective and in negotiating the final price?			
• The extent, if any, to which it was recognized in the negotiation that the subcontractor's cost or pricing data were not accurate, complete, or current?			
• The resulting action, if any, taken by the prime contractor and subcontractor as a result of the defective pricing?			
• The effect of any such defective data on the total price negotiated?			
• The reasons for any significant difference between the prime contractor's price objective and the price negotiated?			
• If incentives were used in the subcontract, a complete explanation of the incentive fee or profit plan?			

Exhibit 3-4 (page 2 of 2)

Obtain Revisions or Additions

If you do not receive all the information that is required, if the information is unclear, or if the peculiarities of a specific situation otherwise require additional information to make an informed decision, obtain that information promptly.

Request an amendment to an advance notice when the original notice has only minor errors or inconsistencies. Otherwise, request a total revision.

Identify When Consent is Not Required

FAR 52.244-2

Remember that in a few, limited circumstances the contractor is required to provide an advance notice to the Government, but consent itself is not required. These circumstances are outlined in the "Exceptions" column of Exhibit 3-2 for FAR 52.244-2, *Subcontracts (Cost-Reimbursement and Letter Contracts)*, as the last exception listed.

If an advance notice is received, but consent by the Government is not required, acknowledge receipt of the advance notice to the contractor and place the notice in the contract file.

3.4 DETERMINE WHETHER THE FAR ALLOWS CONSENT

FAR 9.405-2

FAR 44.203

After you determine that the advance notice is adequate, examine it for any FAR prohibitions requiring the contracting officer to withhold consent for this subcontract. These prohibitions are contained in a checklist format in Exhibit 3-5.

FAR Prohibitions Against Subcontracting

If you have checked a "YES" to **any** item on the following list, the FAR prohibits consent to the subcontract. The contracting officer ***must*** withhold consent for this subcontract. If your check marks appear in the "NO" or "N/A" columns, other discretionary factors are to be considered by the contracting officer before he or she makes a determination on whether to consent to the subcontract. Also see FAR 44.202-2 and Exhibit 3-7.

	YES	NO	N/A
1. If this subcontract is for experimental, developmental or research work performed under a cost-plus-fixed-fee, does the fee exceed 15 percent of the subcontract's cost?			
2. If this subcontract is for architect-engineering services for public works or utilities, does the estimated cost and fee for production and delivery of designs, plans, drawings, and specifications exceed 6 percent of the estimated cost of construction?			
3. If this subcontract is for cost-plus-fixed-fee subcontracts other than above, does the fee exceed 10 percent of the subcontract's estimated cost?			

Exhibit 3-5 (page 1 of 2)

FAR Prohibitions Against Subcontracting

	YES	NO	N/A
4. If this subcontract is for cost-plus-incentive-fee or cost-plus-award-fee subcontracts and a deviation has ***not*** been obtained, does the fee exceed 15 percent for experimental, developmental or research work or 10 percent of estimated subcontract costs for other requirements?			
5. Are payments under this subcontract made on a cost-plus-percentage-of-cost basis?			
6. Does this subcontract obligate the contracting officer to deal directly with the subcontractor?			
7. Does this subcontract make the results of arbitration, judicial determination, or voluntary settlement between the prime and subcontractor binding on the Government as well?[1]			
8. Does this subcontract, in consonance with other subcontracts under this prime contract, show a repetitive or unduly protected use of cost-reimbursement, time-and-materials or labor-hour contracts?			
9. Is this proposed subcontractor on the List of Parties Excluded From Procurement Programs?[2]			
10. If this subcontract requires an EEO clearance (see Exhibit 3-6) has it been refused clearance by the appropriate regional Office of Federal Compliance Programs?			
11. If this proposed subcontract contains a requirement for jewel bearings and related items, is there a clause that requires these items be obtained from the William Langer absent from this contract?			

[1] You are not to answer "yes" to this question merely because the subcontract contains a clause giving the sub the right of indirect appeal to an agency Board of Contract Appeals, as long as this clause does not attempt to oblige the contracting officer or the appeals board to decide questions that do not arise between the Government and the prime contractor or that are not a matter for dispute under the Disputes clause, FAR 52.233-1.

[2] The contracting officer has some leeway to consent to a subcontract award to a firm on this list. See FAR 9.405-2 and FAR 52.209-6.

Exhibit 3-5 (page 2 of 2)

EEO Clearance Requirement

FAR 52.222-28

One piece of information contained within your advance notice, either required specifically or as a matter of practicality, is the proposed contract price. This, along with other notice content requirements, determines if an Equal Employment Opportunity (EEO) clearance is required for the subcontract. Refer to the decision chart in Exhibit 3-6.

Determining When EEO Subcontract Clearances Are Required

If	And	Then
The prime contract contains FAR 522.222-28, *Equal Opportunity Preaward Clearance of Subcontracts*	The proposed subcontract is: 1. For a first-tier subcontract and 2. Equal to or exceeds $1 million	EEO clearance is required

Exhibit 3-6

FAR 22.805

Request the EEO clearance from the appropriate regional office of the Department of Labor's Office of Federal Contract Compliance Programs. The contracting officer may not consent to this subcontract and the prime contractor cannot award it until this clearance is obtained.

3.5 DETERMINE WHETHER TO WITHHOLD CONSENT FOR OTHER REASONS AND ESTABLISH CONDITIONS FOR CONSENT

After examining the contractor's advance notice to subcontract and discarding all FAR consent prohibitions as nonapplicable, you are now ready to consider whether consent would otherwise be appropriate and to make your recommendation to the contracting officer.

Discretionary Factors

FAR 44.202-2

You have to research the appropriateness of providing consent. Base your research on the considerations listed in FAR 44.202-2, *Considerations,* that are summarized in Exhibit 3-7.

Discretionary Factors in Consenting to Subcontract

The contracting officer takes the following discretionary factors into account in deciding whether to consent or withhold consent on a subcontract:

1. This subcontract's effect on the total amount of subcontracting when the clause at FAR 52.219-14, *Limitations on Subcontracting*, is included in the prime contract.
2. The necessity for subcontracting
3. The consistency of this subcontract with the prime contractor's make-or-buy program
4. The availability of special test equipment or facilities from Government sources that would otherwise be procured under the subcontract
5. The technical justification for the selection of specific supplies, equipment, or services
6. The prime contract's requirements regarding labor surplus area or small business subcontracting including, if applicable, its approved subcontracting plans, as discussed in FAR Subparts 19.7 and 20.3
7. The adequacy of price competition or justification for its absence
8. The contractor's assessment and disposition of alternate proposals from subcontractors, if offered
9. The basis for selecting the particular subcontractor and determining its responsibility
10. The adequacy of contractor's cost or price analysis
11. Whether the contractor obtained accurate, complete, and current cost or pricing data, including any required certifications
12. The type of subcontract, given the risks involved and current policies on the use of that type of contract
13. The adequacy of consideration to the Government for any proposed subcontract involving the use of Government-furnished facilities
14. The adequacy and reasonableness with which the contractor has translated prime contract technical requirements into subcontract requirements
15. Compliance with applicable cost accounting standards for awarding the subcontract as discussed in Appendix B to the FAR

Exhibit 3-7

Prior Commitments You should examine previous commitments the prime made that affect subcontracting. Several items in Exhibit 3-7 refer to formal plans or limitations the contractor may have acknowledged in its offer or during negotiations.

Subcontracting Limitations

FAR 52.219-14

Refer to item #1 in Exhibit 3-7. The clause at FAR 52.219-14, *Limitations on Subcontracting,* is required only for prime contracts that were awarded as a small business set-aside or are Section 8(a) procurements. For nonconstruction contracts, the clause requires that the level of subcontracting not exceed 50% of the amount of the prime contract.

Make-or-Buy Programs

FAR Subpart 15.7

Refer to item #3 in Exhibit 3-7. The term "make-or-buy program" is that part of a contractor's written plan for a contract that identifies:

- Major items to be produced or work efforts to be performed at the prime's own plant, and
- Those items to be subcontracted.

Although there are some exceptions, prospective prime contractors are generally required to submit make-or-buy programs for negotiated acquisitions with an estimated value of $5 million or more.

When the Government obtains a make-or-buy program, it is required to give primary consideration to the effect of the proposed program on price, quality, delivery, and performance, including the technical and financial risk involved. Therefore, the approval of a make-or-buy program involved careful consideration in the preaward phase of the acquisition and constitutes an endorsement of the way the prime contractor intended to manage contract performance. Any divergence from that program warrants an inquiry. Exhibit 3-8 summarizes why.

Reasons to Examine Variations from Make-or-Buy Programs

1. When the make-or-buy program has been incorporated into the contract, it is an enforceable contract requirement.
2. When FAR 52.215-21, *Changes or Additions to Make-or-Buy Program,* is in the contract, the Government may be entitled to an equitable reduction in contract price.
3. If the program was an evaluation factor for award, allowing changes that would be less beneficial to the Government may prejudice the rights of others who provided offers.
4. If the program was not incorporated into the contract, you may be obligated to review and agree to the program in the postaward phase of the acquisition.

Exhibit 3-8

There may be justifiable reasons for adjustments in a make-or-buy program, such as in response to changed conditions. However, it may also signal the initiation of an approach that is less favorable to Government interests.

FAR 52.215-21

When you agree to a contractor's divergence from a make-or-buy plan that was incorporated into the contract and became a contract requirement, you must seek the contracting officer's written approval, not necessarily a formal modification.

Subcontracting Plans

FAR Subparts 19.7 and 20.3

Refer to item #6 in Exhibit 3-7. Small business subcontracting plans and labor surplus area subcontracting programs are both usually required in contracts that:

- May exceed $500,000, or
- Otherwise offer substantial subcontracting potential.

Your review of an advance notice must consider any inconsistencies with these plans. The reasons for your close observation of subcontract inconsistencies with these programs are summarized in Exhibit 3-9.

Reasons to Examine Variations from Socioeconomic Subcontracting Plans

1. When FAR 52.219-16, *Liquidated Damages—Small Business Subcontracting Plan*, is included in the contract, the Government may be entitled to monetary damages for the prime contractor's divergence from its small business subcontracting plan.
2. Examining inconsistencies fulfills other responsibilities you have in monitoring these programs [see FAR 19.706(a) and FAR 20.303].
3. If subcontracting plans were an evaluation factor for award, condoning changes that would be less beneficial to Government objectives may prejudice the rights of others who provided offers.

Exhibit 3-9

Obtaining Assistance for Evaluation

If needed, obtain assistance for your evaluation from Government support personnel. Support personnel who may provide valuable assistance in deciding the appropriateness of factors listed in Exhibit 3-7 include:

- Auditors
- Pricing specialists
- Technical experts.

Use their expertise especially when you have indications for concern, but do not have enough information to base a reliable judgement. Sometimes your use of these experts is a decision based on tradeoffs—time versus the potential risk that these indications represent. Often you will need to assemble additional information from the contractor to make a decision on whether the proposed subcontract represents an unacceptable risk to the Government.

Results of Delay

After you complete your evaluation, provide your recommendations promptly to the contracting officer.

A delay in acting on this notice may constitute, depending on the terms of the contract:

- An excusable delay for additional time or compensation, or
- Consent to the subcontract because no refusal to consent was provided.

3.6 NEGOTIATE SUBCONTRACTING CHANGES

After you have all the information that is needed, you can come to some preliminary conclusions.

You must distinguish between legitimate concerns and micro-management. Bring up legitimate major issues only.

Address Major Concerns

For instance, if you discover that the subcontractor is on the List of Parties Excluded From Procurement Programs, you would have a legitimate major issue.

You would also be legitimately concerned if there is no evidence of competition that would have the effect of assuring a good price. An example is noting in the price analysis information for a subcontract under a cost-reimbursement contract that the prime contractor's price

analysis is based on its own estimate of subcontracted costs because competitive practices yielded "no bids" except for the proposed subcontractor. You could do a number of things with this information, depending on the circumstances:

- If you have a technical expert in this area, you could ask his or her opinion of the prime's price analysis and then question the prime on any concerns that this technical expert relayed to you.
- You could also question the appropriateness of other competitive sources, if you know of any.

In any event, do not bring up issues based solely on suspicion and not based on firm facts that you have available. The prime is likely to view this as harassment, obstructing its authority to manage contract performance. Your monitoring efforts must not thwart that authority because the Government has no privity of contract in the subcontract.

Including Flow-Down Clauses

As mentioned earlier in this chapter, the Government is concerned about the time spent in administrative review in general. Standard advance notice requirements represent what the Government considers major issues in most contracting situations. Standard FAR clauses only mandate a relatively few specific terms and conditions to "flow down" to Government subcontractors. You assume that a prime contractor is complying with these requirements, absent evidence to the contrary.

When you do have evidence to the contrary, question the prime contractor about the evidence you have and point out that it has a legal and moral obligation to its subcontractors to include all flow-down clauses in its written subcontracts. It would be very administratively burdensome to determine what all those clauses are for a particular contract. However, you can recommend to the contracting officer that consent be conditioned upon the inclusion of all required flow-down clauses without specifying which ones apply.

In actuality, what often happens, particularly on major acquisitions, is that prime contractors insist on passing on Congressional and regulatory restrictions to their subcontractors, even when they are not required to do so—very often simply because they do not know which ones apply and do not want to take the time to figure it out. Many industry analysts have recognized this as the main reason for a reduced participation by lower-tier subcontractors in Government business. These smaller firms are not equipped or inclined to handle this paperwork burden or to keep current on the details of the Government procurement process to protect their interests.

Encourage Competition

Concentrate your negotiation efforts on the extent of competition in subcontracting. There is little data on the extent of competition in subcontracting Government-wide. Further, there is a general consensus that a comprehensive subcontract data collection system would not be cost effective and is not necessary. However, there is also a consensus of opinion in the Government contracting community that competition at the subcontractor level can and should be increased. The Office of Federal Procurement Policy recommends that agencies develop procedures to reach this goal in specific areas. Exhibit 3-10 summarizes these recommendations.

Ways to Increase Subcontractor Competition

1. Plan for subcontract competition early in the acquisition process
2. Emphasize the importance and benefits of competition in subcontracts
3. Increase emphasis on Contractor Purchasing System Reviews
4. Direct prime contractors to seek second sourcing on ***key*** noncompetitive subcontract components in ***major*** contracts where a potential for ***high payback*** exists
5. Use award fee provisions, where appropriate, to motivate prime contractors to increase competition at the subcontract level

Exhibit 3-10

Consent to a subcontract can be withheld only for the second and fourth reasons listed in Exhibit 3-10. However, it is also useful to keep the other methods in mind when you are asked to participate in early acquisition planning. Using these methods reduces the risks to both the Government and the prime contractor, your major concern in contract administration.

Multiyear Subcontracts

FAR 17.104-2

If the prime contract is a multiyear contract, you could encourage the use of multiyear subcontracts. Multiyear subcontracts may be particularly desirable under a multiyear prime contract awarded without full and open competition to increase competition at the subcontract level. However, remember that the choice is entirely the prime contractor's. Prime contractors should generally use fixed-price multiyear subcontracts only when the conditions listed in Exhibit 3-11 apply.

Accept Compromise, If Appropriate

Negotiate subcontracting changes when you have reliable evidence to back up the reasons for these changes, but realize that there is generally room for compromise. Different managers seek solutions to the same problems in different ways. However, remember that the burden of demonstrating that an intended subcontract is not contrary to the Government interests rests with the contractor. You are not obligated to suggest ways the prime can overcome any legitimate concerns you have.

Prerequisites for the Use of Multiyear Fixed-Price Subcontracts

1. The subcontract item or service is of stable design and specification
2. The quantity required is reasonably firm and continuing
3. Effective competition may be enhanced
4. Multiyear subcontracts can reasonably be expected to result in reduced prices

Exhibit 3-11

3.7 DOCUMENT THE DECISION

Document your recommendation and the contracting officer's ultimate decision to consent or to withhold consent in several ways.

File Documentation

As in other aspects of contract administration, provide backup for your recommendations in the contract file to prevent second-guessing at a later date. Problems subsequently may arise that could cast doubt on the wisdom of contract administration decisions that you made or recommended.

Use the checklists provided in Exhibits 3-4 and 3-5 as one means of documenting the decision process.

Contractor Notification

FAR 44.202-2(c)

Notify the prime contractor of the contracting officer's decision. There are only a few regulatory rules in regard to this documentation:

- It must be prompt
- It must be in writing
- It can include a requirement for changes or corrections.

There is no guideline that would prevent the inclusion of suggestions for the prime's consideration.

For example, it might be appropriate to include suggestions for enhancing competition, perhaps with the help of your agency's Competition Advocate's Office.

The contracting officer must be careful, however, not to withhold consent, particularly on fixed-price contracts, based on generalized concerns for competition. To do so would amount to usurping the prime's management prerogatives with respect to its subcontracts, and not only could cause contract delays, but also make the Government liable for any monetary or time increases that result.

Notification to the contractor of the Government's decision regarding consent usually is in the form of a letter. However, some agencies issue a modification to the contract when consent is granted.

Notification to Government Personnel

You also must notify any Government personnel who may be affected. Depending on the nature of the subcontract, it may be appropriate to issue new or revised instructions or letters of delegation to support contract administration. You may want quality assurance specialists to examine production at the subcontractor's plant, for example, or you may have to implement procedures regarding the subcontractor's use of Government property.

3.8 MONITOR CONTRACT TO ENSURE SUBCONTRACTS AWARDED ONLY WITH CONSENT

Ensuring compliance with consent requirements would not usually be of key concern. When the Government schedules a CPSR, general compliance to contract clauses requiring Government consent to subcontract can be spot checked, but you would not initiate an audit for that purpose.

However, there is one instance when close and timely monitoring of subcontract consent clauses is appropriate—when you have, in fact, refused to consent to a subcontract and an unusual lengthy period of time elapses without any feedback from the prime contractor. In this case, informal inquiries usually reveals the cause and indicates if further action is necessary. There may be legitimate reasons for the lack of feedback. The prime may have decided to perform the work originally earmarked for subcontracting itself, for instance. On the other hand, the prime may just be ignoring the subcontract consent requirements.

In general, therefore, be alert to informal indications of an intent to subcontract without formal follow-up in the form of an advance notice as a part of your overall monitoring effort, but do not spend an excessive amount of time in investigating whether such intentions exist.

CHAPTER 4

ASSIGNMENT OF CLAIMS

A STITCH IN TIME

Ernest N. Deavors was trying to cut through a variety of paperwork that had accumulated in his "IN" basket.

He winced when he came to the next one on the pile, from Troubles, Inc.

The Troubles, Inc. contract was relatively small—just $125,000, but it had caused him no end of headaches. Contract performance had been mediocre and, because they were providing a highly visible service—grounds maintenance, Ernest and the COR were always having to explain the status of action taken or not taken to top agency managers when those managers who often become irate about a slippery sidewalk or weed-choked flower bed.

Now, Troubles, Inc. wanted to assign payments under the contract to a financial institution.

Ernest figured that the company probably was having financial problems, but the contract he was administering was almost complete—only three more months to go—so he figured it wasn't worth getting excited about. He would give the COR a heads up though. A company in financial trouble tends to cut corners in their work.

Ernest had never assigned a contract payment before, but Bea Ware told him that it was not a big deal—just a bit of an administrative hassle. She had jotted down a set of conditions from Exhibit 4-1 in the Text/Reference for her advance contracting course. They generally permit the Government to process a payment assignment. Ernest checked through them. No obstacles there.

However, Troubles, Inc. managers hadn't the first notion of how to go about processing the paperwork. They provided no paperwork from the financial institution and their request concerning the assignment was inadequate.

"Typical for their haphazard management style," he thought.

Bea had given him a format for the company to follow if it wanted the Government to implement a payment assignment. She copied it from Exhibit 4-3 in her textbook. Ernest had a meeting scheduled with the Troubles, Inc. project manager and grounds foreman that afternoon and would provide the format to them at that meeting.

He couldn't do anything else until they got their act together.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Review and approve or disapprove a request for assignment of contract payments.

Individual:

4.1 Determine if the assignment is permitted by the contract's terms.

4.2 Determine whether the request, Notice of Assignment, and the instrument of assignment are proper.

4.3 Determine if an assignment has already been made.

4.4 Identify any provisions of the assignment that are not consistent with the contract's terms.

4.5 Execute receipt of the Notice of Assignment and return copies to the assignee.

4.6 Approve release of an existing assignment.

INTRODUCTION TO ASSIGNMENT OF CLAIMS

Definition of a Claim Assignment

An ***assignment of claims*** is the transfer of a contractor's right to payment under a specific Government contract to a bank, trust company or other financing institutions, as security for a loan or in consideration of money owed to the financing institution.

Policy on Assigning Payments

FAR 32.803

When aggregate remaining payments on a Government contract amount to $1,000 or more, the Government generally allows the contractor to assign its financial interests to financial institutions. The financial institution then becomes the "assignee."

The Government recognizes that such assignment will make it easier for the contractor to obtain a loan. Because that loan may be crucial in allowing the contractor to complete its obligations under the terms of the Government contract, the Government allows the assignment on the basis that it is generally in its own interests to do so.

Under an indefinite quantity or requirements contract, the Government will generally allow the assignment of future payments with respect to individual orders of $1,000 or more.

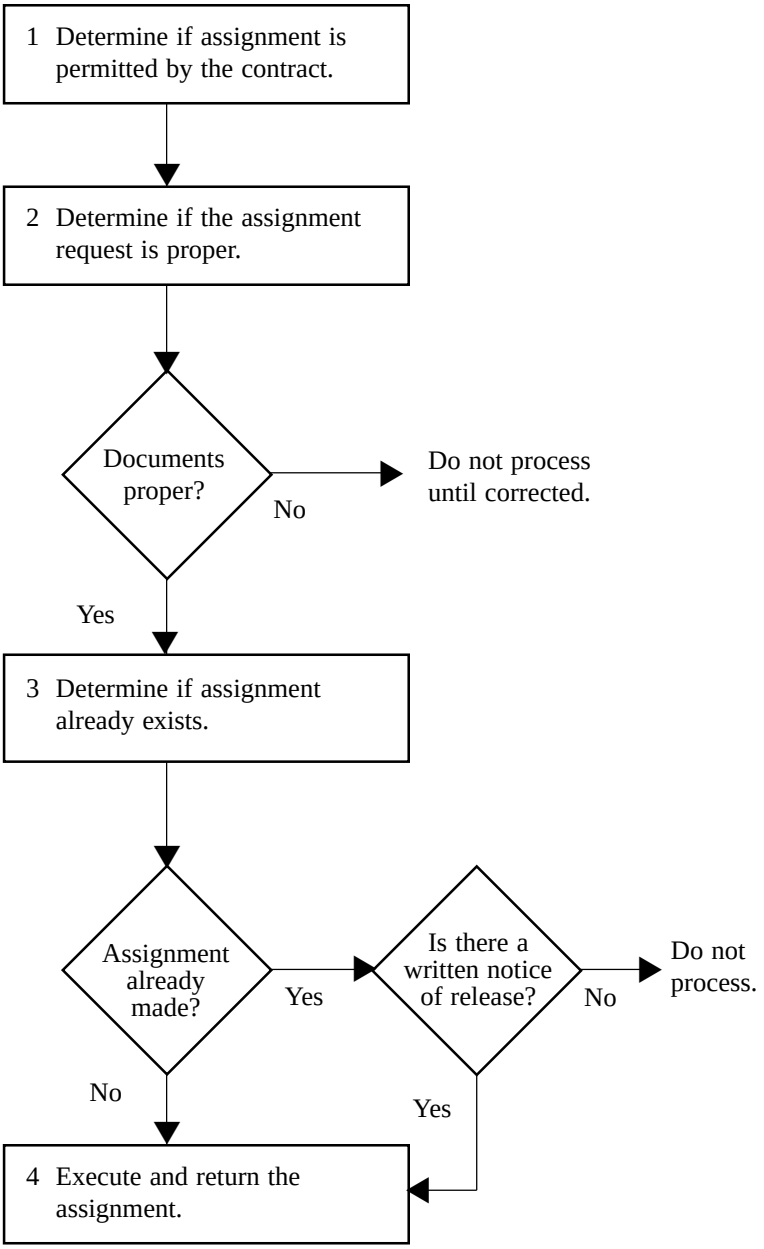
FAR 32.806(b)

However, individual contracts may prohibit the assignment of claims when the Government determines that individual contract circumstances make potential assignments contrary to its best interests.

Steps in Performance

The steps in assigning payments on a Government contract are charted on the next page. Following the flowchart, each step is discussed in turn.

STEPS IN ASSIGNING PAYMENTS



ASSIGNMENT OF CLAIMS

Purpose of an Assignment of Claims

An assignment of claims generally is used by a contractor to secure a loan that may be needed to perform the contract. For example, the contractor may need to purchase machinery. Contractors also may need to borrow funds to pay workers and other operating expenses that must be paid before the Government even can be invoiced. The assignment serves as collateral for the loan.

Contractors may request the assignment of claims at any time during the course of a contract, but only one assignment under a contract can be in force at any one time. An assignment of claims has no impact on the amount to be paid to the contractor.

An assignment of claims can be initiated by a contractor or by a Federal court. This chapter concentrates only on those assignments that are initiated by a contractor. When a Federal court orders an assignment, your agency does not have the discretion to act against the court's direction. You would use the court order to lift any contractual prohibition on payment assignments.

4.1 DETERMINE IF ASSIGNMENT IS PERMITTED BY THE CONTRACT

Before processing any requests for assigning payment, determine whether the contract addresses this issue. Either of two clauses may apply:

- FAR 52.232-23, *Assignment of Claims*
- FAR 52.232-24, *Prohibition of Assignment of Claims.*

You may process a request even if the contract is silent on the issue, but only when:

1. The contractor provides appropriate consideration for modifying the contract to include the right to assign claims, and
2. There is no reason to prohibit an assignment of claims.

4.2 DETERMINE IF THE REQUEST IS PROPER

A ***Notice of Assignment,*** the request to transfer payments from the contractor to an assignee, must come from the assignee, not the contractor. The assignee must include a "true" copy of the **Assignment Instrument** along with the notice. A "true" copy is either a certified duplicate or a photostat.

Exhibit 4-1 provides a summary of conditions required to permit an assignment of claims.

Conditions Permitting a Payment Assignment

1. The assignment is made to either a:
   - Recognized financial institution,
   - Trustee, or
   - Agent.
2. The assignment is made to only one assignee under any one contract, although that assignee may receive payments on behalf of multiple parties.
3. The assignment covers only the remaining unpaid amounts due under the contract or, in the case of indefinite delivery contracts, amounts due under an order.
4. Remaining unpaid amounts exceed $1,000.
5. Disclosure of any classified information must be authorized by the Contracting Officer.
6. The assignment is not inconsistent with any other terms and conditions of the contract.

Exhibit 4-1

The assignment instrument accompanying the notice must be properly executed based on the business structure of the contractor. Refer to Exhibit 4-2 to see what is appropriate for various organizational structures.

Requirements for the Assignment Instrument	
If the Contractor is Organized As a...	**Then the Assignment Must....**
Corporation	• Be executed by an authorized representative; AND • Be attested by the secretary or assistant secretary of the corporation; AND • Be impressed with the corporate seal; OR • Be accompanied by a certified copy of resolution of the corporation's board of directors authorizing the signing representative to execute the assignment.
Partnership	• May be signed by one partner **IF** it is accompanied by a certification that the signer is a general partner of the partnership; OR • Contain the signatures of all partners.
Single Proprietorship	• Be signed by the owner, AND • Be notarized.

Exhibit 4-2

Notification The assignee transmits the assignment by written notice. The Government must acknowledge receipt after examining the notice. The Notice of Assignment should contain language similar to the sample format in Exhibit 4-3.

Notice of Assignment Format

To: Contracting Officer
Disbursement Officer
Surety Official

This has reference to Contract No. _____ dated _____, entered into between _____ [*contractor's name and address*] and _____ [*Government agency, name of office, and address*], for _____ [*describe nature of the contract*].

Moneys due or to become due under the contract described above have been assigned to the undersigned under the provisions of the Assignment of Claims Act of 1940, as amended, 31 U.S.C. 3727, 41 U.S.C. 15.

A true copy of the instrument of assignment executed by the Contractor on _____ [*date*], is attached to the original notice.

Payments due or to become due under this contract should be made to the undersigned assignee.

Please return to the undersigned the three enclosed copies of this notice with appropriate notations showing the date and hour of receipt, and signed by the person acknowledging receipt on behalf of the addressee.

Very truly yours,
[*name of assignee*]

By _____ [*signature of signing officer*]

Title _____ [*title of assignee*]

[*address of assignee*]

ACKNOWLEDGEMENT

Receipt is acknowledged of the above notice and of a copy of the instrument of assignment. They were received at _____ (a.m.) (p.m.) on _____, 19___.

[*signature*]

[*title*]

On behalf of

[*name of addressee of this notice*]

Exhibit 4-3

The assignee must submit an original and three copies of the written notice together with a true copy of the assignment to each of the following:

1. Contracting officer/agency head.
2. Surety of any bond.
3. Disbursing officer designated to make payment.

Assignee's Protection

FAR 32.804(a)

The Act authorizing assignment of claims also prohibits the Government from recovering any payments already made to the assignee as a way of collecting contractor liabilities. This applies to claims by the Government to satisfy amounts due from the contractor because of reasons such as reductions in contract amounts, fines, penalties, or taxes. The assignee is protected whether the amount due to the Government results from the contract under which assignment was made or another contract.

No Setoff Provision

FAR 32.804(d)(e)

FAR 52.232-23

However, the Government usually retains the right to withhold future payments to an assignee because of a contractor liability, including an unrelated liability that existed prior to the notice of assignment. Because of the possible impact of withholding payments on critical contracts, the Government may waive this right by inserting Alternate I to the Assignment of Claims clause, stating that payment will not be reduced or withheld to satisfy contractor liabilities. This "no setoff" provision can be used only by designated agencies and only in time of war or national emergency.

4.3 DETERMINE IF ASSIGNMENT ALREADY EXISTS

Once an assignment of claims has been made, the financial institution, trustee, or agent may further assign (or reassign) its rights to another qualified assignee. Reassignment is permitted under the Assignment of Claims clause.

Verification Requirements

However, before processing any request to change the assignee, you must verify that the:

1. Contract permits reassignment;
2. Conditions of the reassignment are satisfactory; and
3. Documents executing the reassignment are proper.

Submission Requirements for Reassignment

The documentation to support a reassignment require the ***new assignee*** to submit:

1. A written notice from the existing assignee releasing the contractor from the assignment and restoring its right to payment under the contract; and
2. A copy of the release instrument itself; and
3. A written notice that the rights to payment under the contract have been further assigned or reassigned, but ***only if*** the contract allows further assignment or reassignment; and
4. A copy of the actual document that further assigns or reassigns the right to payment under the contract, if appropriate.

The new assignee must provide these documents to the same officials as the original assignment:

- The contracting officer, and
- The surety on any bond issued for the contract, and
- The disbursing officer designated in the contract to make payment.

4.4 EXECUTE AND RETURN THE ASSIGNMENT

The assignment of claims is considered approved when the Government acknowledges receipt. It is very important the assignment not be acknowledged unless it is determined to be:

- Complete; and
- Properly executed.

After completing your review of the request, dispose of the request by returning three copies of the notification and:

- Indicating acceptance by signing the acknowledgement block, or
- Providing the requestor with the reason acknowledgement was not made:

  – Improper or incomplete documentation

  – Assignment not permissible.

Some agencies acknowledge and accept a request for assignment of claims by issuing a contract modification.

4.5 APPROVE A RELEASE OF AN ASSIGNMENT

Sometimes the loan will be paid full and the assignee will release the contractor from the assignment prior to the completion of all payments to the contractor due under the contract. This is called a ***Release of Assignment.*** However, the contractor can only reestablish its right to receive contract payment by filing:

- A written notice of release, and
- A true copy of the release of assignment.

Separate sets of this documentation must be filed with the:

- Contracting officer, and
- Surety, if there is one, and
- Payment office.

In case of a faulty request for release of an assignment, advise the contractor of any problems with the documentation and of the corrective steps it must take to successfully reestablish its right to payment.

Upon receipt of all appropriate documentation for a release of assignment, ensure that the payment office will make future payments directly to the contractor.

NOTES

CHAPTER 5

MONITORING STATUTORY COMPLIANCE

EYES AND EARS AND NOSEY TOO

Anna Lize, the COR for the auditing services cost-reimbursement contract, seemed disturbed when she telephoned.

"Ernie," she said, "this contract doesn't include the Service Contract Act clause—I guess because all of these people are either considered professional or administrative personnel and are exempt—but, aren't we supposed to give the contractor other posters?"

"Yes, we are," Ernest agreed. "This contract requires two of them—an equal opportunity poster and a poster on the contractor's obligations in regard to handicapped individuals and a handicapped individual's rights."

"Was I supposed to do this?" asked Anna.

"No, we normally give them out at the orientation conference when we have one," Ernest responded. We were out of them when we held the Tally-Up conference, but just got some in from the Department of Labor. They're required because the Equal Opportunity clause and the Affirmative Action for Handicapped Workers clause are in the contract."

"Will you be seeing the Tally Up project manager soon?" he asked her. "If so," he added, "I can send these over in the interoffice mail. Otherwise, I'll mail the posters directly to Tally Up."

"I'll see him the end of the week," she responded. "They're to start on the first project at the Down-Hill Industries plant. I'm meeting with them just to make sure they have everything they need and to observe how they interact with the contractor being audited. It's to be very much like a standard commercial accounting audit—the backbone of their business—so I certainly don't anticipate any problems. But it is their first job under this contract so I want to be sure it gets off to a good start."

"Excellent," Ernest said. "I'll send these posters to you then."

"Okay," Anna said and then added, "You know some of these statutory requirements seem a little silly for a company doing work at somebody else's installation—the Drug Free Workplace requirements, for example. Tally-Up won't have any control over the workplace environment at Down-Hill Industries."

continued . . .

"That's true," Ernest said. "But Tally-Up still has responsibility for controlling its employees even though they are physically located at someone else's office. Read the clause. The focus is more on the employee than an environment that might foster drug abuse—although a conducive environment is obviously a concern too."

"Hmmm. I see," Anna mused. "I guess I'll stick to the technical end of it. I'm not too well-versed on these legal clauses."

"Hey, Anna, you're the contracting officer's eyes and ears at the work site," Ernest responded. He had heard that "eyes and ears" terminology at a training session once and thought it summed it all up. "So, if you can give us a heads up when you think you've detected any violations of a statutory nature as well as technical violations, you'll be doing the Government a real service," Ernest continued.

"Me and my big mouth," thought Anna. "As if I didn't have enough to do."

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Monitor compliance with contract clauses that result from statutes governing socioeconomic and other nontechnical aspects of Government contracts, performing any actions required of the contracting officer, and informing the contractor of any violations.

Individual: PART A—In regard to statutory and regulatory requirements:

5A.1 Identify contract clauses involving statutory or regulatory compliance.

5A.2 Monitor compliance and respond to notices involving labor law.

5A.3 Monitor compliance and respond to notices involving Privacy Act and Drug-Free Workplace issues.

5A.4 Monitor compliance and respond to notices involving hazardous, non-domestic, or recovered materials, and environmental issues.

5A.5 Monitor compliance and respond to notices involving insurance and tax issues.

5A.6 Monitor compliance and respond to notices involving labor surplus areas.

5A.7 Monitor compliance and respond to notices involving intellectual property.

5A.8 Continue actions as needed to encourage and enforce statutory compliance, and keep others informed.

PART B—In regard to small business subcontracting plans required by prime contract clauses:

5B.1 Monitor compliance with the subcontracting plan.

5B.2 Provide the contractor with written notice of plan violations.

5B.3 Invoke remedies in cases of noncompliance, when appropriate.

5B.4 Determine any incentive for exceeding goals.

INTRODUCTION TO MONITORING STATUTORY COMPLIANCE

Definition of Monitoring Statutory Compliance

Monitoring for ***statutory compliance*** involves those contract administration activities that ensure compliance with contract clauses governing public policy aspects of Government contracts.

Reasons for Statutes

Some of these requirements were meant to further certain goals of our society. Examples are:

- Keeping the workplace drug-free
- Following practices that nurture a clean public environment
- Promoting an environment for small businesses, especially those that are socially or economically disadvantaged.

Still other laws require standard clauses Government-wide as a protection for the Government, the public in general, industry members, or other third parties. Examples are:

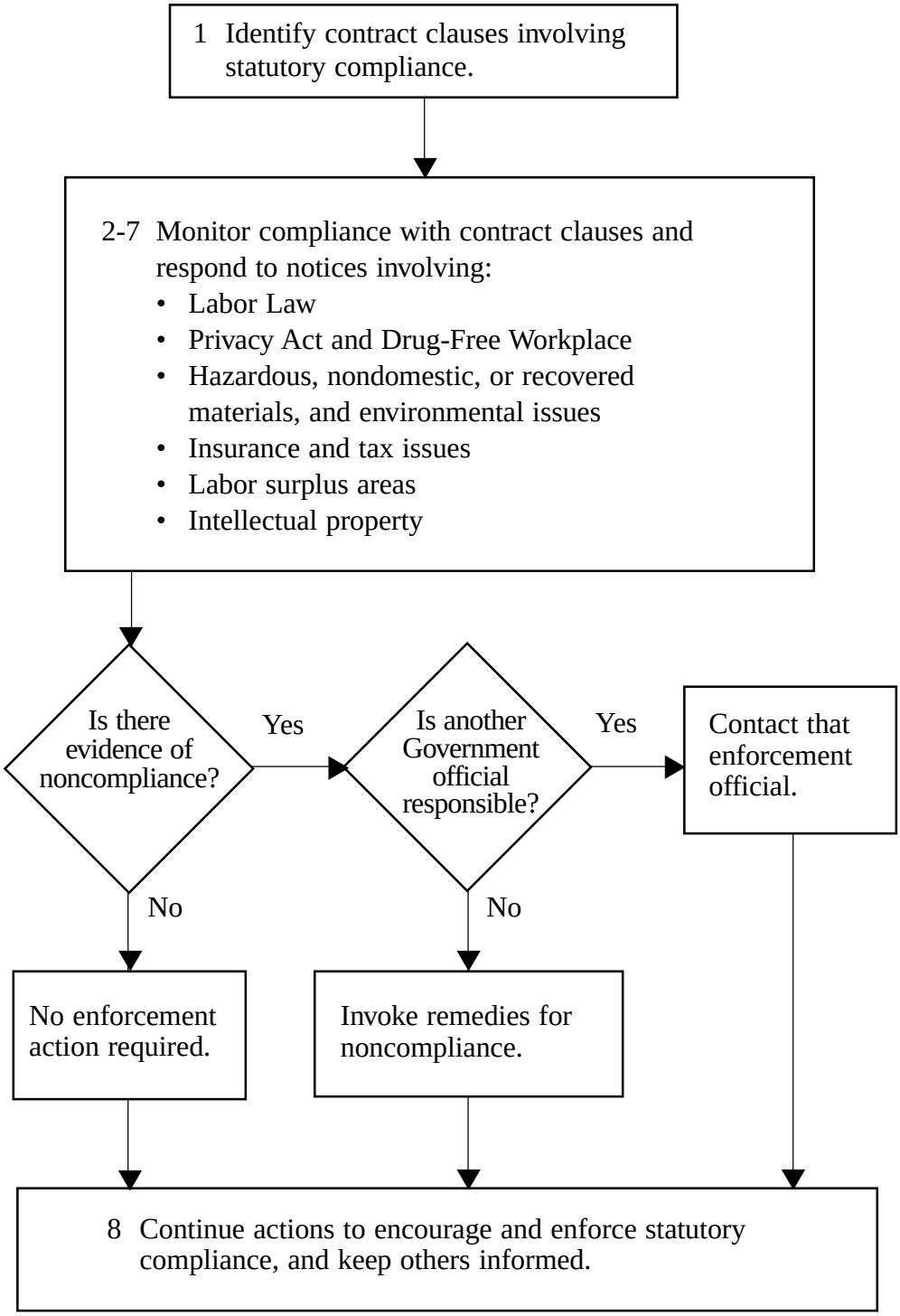
- Properly controlling radioactive material
- Payment of fair wages for employees
- Allocation of rights to intellectual property produced under a Government contract.

Steps in Performance

Part A of this chapter summarizes the steps you must take in regard to various clauses regarding many of these statutory issues, and details procedures for monitoring compliance. These steps are diagrammed on the next page. Each step then is discussed in turn. Other compliance requirements are discussed elsewhere at various points in this Text/Reference.

Part B of this chapter then outlines procedures to follow in monitoring compliance with small business subcontracting plans, a special aspect of compliance monitoring. A second flowchart for successful subcontracting plan monitoring is diagramed and those steps discussed in detail.

STEPS IN MONITORING STATUATORY COMPLIANCE



PART A—MONITORING STATUTORY COMPLIANCE

Overview of General Requirements

Monitoring Government contracts for legal and regulatory compliance involves ensuring that contractors take specific actions or refrain from specific actions as a matter of public policy.

General Methods of Enforcement

Some of these clauses require contractors to provide specific notices of compliance, while others rely on third parties to monitor compliance. For example, the Government requires contractors to provide specific notice in regard to hazardous material. However, the Government itself provides minimum wage posters for the contractor to post at job sites, and relies on contractor employees to provide feedback on underpayment of wages.

It is generally not cost effective to routinely monitor compliance with legal and regulatory clauses, but you can do this when it requires little added effort. For example, you should be conscious of safety regulations to detect any violations when you must go to a work performance site for other reasons.

The burden of proof regarding statutory requirements rests with the contractor. Some well-timed questions may produce valuable information. Do not hesitate to ask them.

FAR 22.103-5(b)

FAR 52.222-2

Sometimes the reason for a notice requirement may not be immediately clear. For example, there is a notice involved when overtime is needed, but only for certain cost-reimbursement contracts. The purpose of this notice is monitoring and cost-control, not statutory compliance with legal requirements for payment of overtime premiums. Therefore, overtime notice procedures are covered in Chapter 8.

5A.1 IDENTIFY STATUTORY COMPLIANCE CLAUSES

Most clauses that address legal or regulatory compliance are contained in Section I, and incorporated by reference in the contract. To properly administer a contract, you must be familiar with these requirements. You gain this knowledge by reading the full text of these clauses carefully. An alternate to a standard clause may alter the rights of the contracting parties.

FAR 52.204-2

For example, Alternate I to the Security Requirements clause, FAR 52.204-2, for cost-reimbursement contracts involving research and development work with an educational institution gives the contractor the right to request and obtain a termination for convenience in whole or in part. However, this right is contingent upon specific written notifications and the inability of the contracting parties to find a mutually agreeable method for continuing performance when the Government changes security requirements contained in the contract.

You need to be intimately aware of any alternate clause language to protect the interests of both contracting parties.

Some examples of areas that are the subject of compliance clauses typically incorporated in most Government contracts are:

- Labor disputes and bargaining agreements
- Anti-discrimination and equal opportunity
- Hazardous and radioactive materials
- Environmental protection
- Drugs in the workplace
- Inventions, patents, and copyrights
- Insurance and tax issues, and
- Use of foreign-made products.

5A.2 MONITOR ISSUES INVOLVING CONTRACT LABOR

Clauses involving labor laws are included in all Government contracts, but their individual application and inclusion varies significantly from one contract to another.

Labor laws ensure employees are hired and treated fairly without interfering with any established union agreements.

The application of Federal labor laws that have an impact on contract requirements after award are summarized in Exhibit 5A-1.

Federal Labor Laws That Typically Apply to Government Contracts

Statute	Affected Contract Employees	Main Clause Implementation	Major Contract Requirements After Award
Service Contract Act	"Blue" collar workers on service contracts over $2,500 with numerous exemptions	FAR 52.222-41, Service Contract Act of 1965, As Amended	Requires specific minimum wage rates by labor category and contains safety and health requirements
Davis-Bacon Act	"Blue" collar workers on construction contracts over $2,000	FAR 52.222-6, Davis-Bacon Act	Requires specific minimum wage rates by labor category
Walsh-Healey Public Contracts Act	Employees on supply prime contracts over $10,000	FAR 52.222-20, Walsh-Healey Public Contracts Act	Requires payment of minimum wages and overtime wages of 1.5 times the actual basic wage rate of the employee for work over 40 hours a week; prohibits the employment of minors or convict labor
Convict Labor Act	Employees on all contracts except when the Walsh-Healey Act applies; other limited exceptions	FAR 52.222-3, Convict Labor	Prohibits the use of convict labor in performing the contract
Contract Work Hours and Safety Standards Act	Employees on contracts over $2,500 except those subject to Davis-Bacon Act, Walsh-Healey Public Contracts Act; other exceptions also apply	FAR 52.222-4, Contract Work Hours and Safety Standards Act—Overtime Compensation	Requires payment of overtime wages of 1.5 times the actual basic wage rate of the employee for work over 40 hours a week
Anti-Kickback Act of 1986	Employees on all contracts and subcontracts	FAR 52.203-7, Anti-Kickback Procedures	Prohibits offering or soliciting wage and other kickbacks involving anything of value as a condition of employment or for other favored treatment; also covers kick–backs between sub and prime contractors
Civil Rights Act	Employees on contracts over $10,000 with some exceptions	FAR 52.222-26, Equal Opportunity	Prohibits discrimination in hiring, assignment, pay, or other employee treatment because of race, color, religion, sex, or national origin; also requires affirmative action as well as maintenance of and access to certain records
Age Discrimination in Employment Act	Employees on all contracts and subcontracts	No specific additional FAR clause implements this Act, but policy and management are contained in FAR 22.9	Prohibits discrimination on the basis of age
The Rehabilitation Act	Employees on contracts over $2,500 with limited exceptions	FAR 52.222-36, Affirmative Action for Handicapped Workers	Prohibits discrimination on the basis of physical or mental handicap and requires affirmative action
Vietnam Era Veterans Readjustment Assistance Act	Employees on contracts over $10,000	FAR 52.222-35, Affirmative Action for Special Disabled and Vietnam Era Veterans	Requires affirmative action to employ veterans to offset the competitive disadvantages many encounter in returning to the civilian workforce and extends to disabled veterans

Exhibit 5A-1

State Law and Standards

FAR 22.102

You should be aware that some states have passed comprehensive wage and overtime statutes and others have enacted mere guidelines—directing state regulatory commissions to prescribe appropriate standards. Therefore, Government contractors may be required to comply with labor standards that are more stringent than the Federal requirements.

Labor Law Enforcement

FAR 22.406

Traditionally, the chief method for detecting labor law violations is through contract employees who do not receive monetary and other benefits to which they are entitled. Therefore, your main monitoring task is to help employees become informed of their rights and avenues of appeal in the event those rights are violated.

Use of Posters

There may be a requirement for contractors to display posters to inform employees. If so, you must provide the poster. Exhibit 5A-2 summarizes the requirements for posters explaining various labor laws clauses.

Conditions for Providing Labor Posters

When the following clause is in your contract...	Then you must provide the following poster...
FAR 52.222-41, *Service Contract Act*	Poster WH 1313 furnished by the Wage and Hour Division of the Department of Labor
FAR 52.222-6, *Davis Bacon Act*	Poster WH 1321 furnished by the Wage and Hour Division of the Department of Labor
FAR 52.222-26, *Equal Opportunity*	Equal Opportunity Poster furnished by the Office of Federal Compliance Programs (OFCCP), Department of Labor
FAR 52.222-35, *Affirmative Action for Special Disabled and Vietnam Era Veterans*	Appropriate notices when prescribed by the Director, OFCCP
FAR 52.222-36, *Affirmative Action for Handicapped Workers*	Poster on the contractor's obligations and the handicapped individual's rights furnished by the Department of Labor Regional Office, Office of Federal Contract Compliance Programs

Exhibit 5A-2

Labor Investigations

FAR 22.1024

When labor law violations are suspected or identified, they are to be reported to the Department of Labor. The Department of Labor may ask the contract administrator for collaboration in any investigation.

Labor Disputes

FAR 22.103-5

FAR 52.222-1

Labor disputes have the potential for disrupting timely contract performance which, in turn, could have an adverse impact on Government operations. Therefore, for the Government's protection, the prime contractor may be required by the contract to provide immediately all pertinent information of potential, as well as actual, labor disputes. Subcontractors also may be required to provide such labor dispute notices. Individual agencies have different distribution requirements for the notice, but the contracting officer usually will receive either the original notice or a copy.

FAR 22.101-1

The notice of a labor dispute is only to provide early warning of a potential schedule slippage. It is ***not*** a summons for your intervention. It is essential that you remain impartial in all labor disputes.

However, you might encourage the parties to the dispute to use all available methods for resolution, including the services of the National Labor Relations Board, Federal Mediation and Conciliation Service, National Mediation Board, and other appropriate Federal, state, local, or private agencies specializing in resolution of such disputes.

Collective Bargaining Agreements

FAR 52.222-41

FAR 52.222-43

FAR 52.222-44

When the Service Contract Act, the Davis-Bacon Act, or the Fair Labor Standards Act apply, contractors are required to provide the contracting officer with any collective bargaining agreements that have or will become effective during contract performance. These may require a change in the wage determination specified in the contract. A wage determination establishes the minimum wages and fringe benefits that must be paid to one or more classes of service employees in a given locality.

FAR 22.1008-3(d)

You are required to forward these collective bargaining agreements to the Wage and Hour Division of the Labor Department supplemented with related documents that specify wage rates and fringe benefits.

When notice of a new collective bargaining agreement is received, you must do any fact finding necessary to verify the notice and then forward it using Standard Form 308, Request for Determination and Response to Request, to the Department of Labor. The Wage and Hour Division is to concur or not concur within 30 days, or reply within that time as to when an opinion will be provided. If the Department of Labor concurs with the new agreement, it becomes a new wage determination applicable to that contract and the contract must be modified accordingly.

5A.3 MONITOR ISSUES INVOLVING PRIVACY AND DRUG-FREE WORKPLACES

Other laws protect contract employees by establishing standards that protect employees working under Government contracts. The ones that most often apply in Government contracts are the Privacy Act and the Drug-Free Workplace Act.

Privacy Act

FAR 52.224-2

Contracts that, on behalf of an agency, collect, store, or retrieve information on individuals that is recorded in such a way that the individual is identifiable must follow agency rules and practices with respect to that information. These agency rules implement the Privacy Act, a law applying to Government contracts and in other circumstances. Virtually all information on individuals is covered, including medical and employment histories, as well as criminal, financial, and educational records.

You have no special monitoring responsibilities under the Privacy Act. You seek enforcement only when violations become evident in the course of your other monitoring responsibilities or when third parties bring violations to your attention.

Workplace Abuses of Controlled Substances

FAR 52.223-6(b)(5)

FAR 52.223-6, *Drug-Free Workplace*, implements the Drug-Free Workplace Act. It requires contractors to provide the contracting officer notice of any conviction by a contract employee for manufacturing, distributing, dispensing, possessing, or using controlled substances at the contract work place within 10 days of becoming aware of that conviction.

FAR 23.506

When you receive such a notice, investigate whether the contractor complied with preventive measures and other requirements of the Drug-Free Workplace clause. Exhibit 5A-3 summarizes these requirements.

Remedies against contractors failing to comply with the Drug-Free Workplace clause include suspension of contract payments, contract termination, or debarment and suspension actions under FAR Subpart 9.4. Initiate a remedy, which can include termination for default, if ***any*** of the three conditions outlined in Exhibit 5A-4 apply.

Contractor Responsibilities Under the Drug-Free Workplace Clause FAR 52.223-6

Publish and provide all employees with a statement notifying them:

- That the unlawful manufacture, distribution, dispensing, possession, or use of a controlled substance is prohibited in the workplace;
- Of specific actions it will take against those employees who violate the prohibition;
- That it is a condition of continued employment that the employee:
  - Abide by the terms of the published statement, and
  - Notify the employer in writing of convictions of drug abuse at the workplace under a criminal proceedings within five calendar days after such conviction.

Notify the contracting officer in writing of an employee's criminal conviction of drug abuse at the workplace within 10 calendar days of receiving any notice of such criminal conviction, identifying the employee convicted and providing his/her position title.

Within 30 calendar days of receiving notice of an employee's conviction, take one of the following actions:

- Take appropriate personnel action, which may include termination of the convicted employee, or
- Require the convicted employee to satisfactorily participate in a drug abuse assistance or rehabilitation program approved by an appropriate Federal, state, or local agency.

Establish an ongoing drug-free awareness program to inform employees about:

- The dangers of drug abuse in the workplace;
- The contractor's policy of maintaining a drug-free workplace;
- Any available drug counseling, rehabilitation, and employee assistance programs; and
- The potential penalties for controlled substance abuse.

Make a good faith effort to maintain a drug-free workplace.

Exhibit 5A-3

Prerequisites for Remedial Actions for Drug-Free Workplace Violations FAR 23.506(d)

1. The contractor made a false certification regarding a drug-free workplace requirement, or
2. The contractor failed to comply with a drug-free workplace certification, or
3. Employee violations are numerous enough to indicate that the contractor failed to make a good faith effort to provide a drug-free workplace.

Exhibit 5A-4

5A.4 MONITOR MATERIALS AND ENVIRONMENTAL ISSUES

A variety of statutes, regulations and contract clauses deal with the materials and processes used by a contractor in performing its work.

Restrictions on Hazardous Material

Prior to a contract award, the contractor must identify any hazardous material to be produced, and submit a Material Safety Data Sheet (MSDS). Both the identification requirements and MSDS requirements are contained in Federal Standard No. 313.

FAR 52.223-3 (Alternate I)

Following award, the contractor must provide a copy of the MSDS to any consignee to which it ships hazardous material, except under Department of Defense contracts where other procedures apply. Compliance with the requirement to notify consignees should be monitored carefully if the contract involves hazardous materials.

FAR 52.223-3(e)

If, after award, there is a change in the composition of the items or a revision to Federal Standard No. 313 that makes the preaward data incomplete or noncompliant, the contractor must submit a new notice.

FAR 23.302(e)

You must provide a copy of any updated MSDSs you receive to an agency safety officer or another individual your agency may designate. Such designations are usually in your agency's supplementation to FAR 23.302(e). These officials make sure personnel at the delivery site are aware of the dangers involved, usually by posting MSDSs at work sites.

Restrictions on Radioactive Material

FAR 23.601

FAR 52.223-7

Additional notice procedures apply to the delivery of hazardous material that is radioactive. Contractors must provide a special notice to the contracting officer prior to delivery of radioactive material.

The time frame for the advance delivery notice varies. It is a "fill-in" to the standard clause determined prior to award in coordination with a radiation protection officer (RPO).

The contracting officer can waive the notification requirement only:

- When the contractor makes a specific, written request for such a waiver, and
- After consultation with technical representatives.

Content requirements for radioactive material notices and waiver requests are specified in FAR 52.223-7, *Notice of Radioactive Materials.*

Restrictions on Using Recovered Material

FAR 52.223-4

Some contracts, implementing the *Resource Conservation and Recovery Act* and following the Government's general policy of being environmentally responsible, incorporate specifications requiring the maximum use of recovered material. Recovered materials mean those reclaimed from solid waste. In these cases, the contractor is required to certify in a preaward notice that it will use recovered materials as provided in the specifications. Your postaward responsibility to that notice is to ensure that this requirement is not overlooked in the inspection and acceptance process.

Domestic Versus Foreign Material and Components

FAR 52.225-3

Contracts that involve producing or otherwise furnishing end products for use within the United States generally contain a clause requiring the product or the components and materials used to produce it be manufactured in the United States. The basic clause is FAR 52.225-3, *Buy American Act—Supplies.* However, any of several alternative clauses may be used in the contract depending on the nature of the end product and the source of components incorporated in it. These alternative clauses are based on trade agreements under the *North American Free Trade Agreement (NAFTA)* and other statutes. You should read the language in the contract clause carefully for a full understanding of what is required.

Exceptions and Violations

FAR 25.108

Due to scarcity and for other reasons, some articles, materials, and supplies are excepted from this domestic preference program. Unless a contract you are administering falls under an excepted category, that contract probably used evaluation factors that gave preference to offers that promised to use domestic material and production. Therefore, it is not only in the interest of implementing public law, but also to preserve the integrity of the procurement process that you report violations to your superior and seek legal advice as to appropriate legal remedies.

Promotion of Clean Air and Water

FAR 52.223-2

Generally, contracts larger than $100,000 will include a clause requiring contractor compliance with the *Clean Air and Water Acts,* and with all regulations issued to implement those acts.

This clause usually must be incorporated in subcontracts in excess of $100,000 if it appears in the prime contract.

FAR 23.103(b)

The Environmental Protection Agency (EPA) has enforcement responsibilities but you should, in conjunction with routine site visits, be alert to any violations. The EPA lists violators on the EPA List of Violating Facilities. Inclusion on this list severely limits Federal contract opportunities for the violator.

5A.5 MONITOR INSURANCE AND TAX ISSUES

Government contracts may contain clauses:

- Requiring that the contractor maintain a specified minimum of liability insurance
- Excusing the contractor from payment of certain taxes.

When liability insurance coverage is required by the contract, you or your preaward contract specialist counterpart accepted and reviewed the contractor's certificate of insurance prior to the start of contract performance. Among other things, that review was to ensure that the certificate contained an endorsement guaranteeing that a notice of cancellation or change would be provided to the Government prior to taking effect.

Notice of Insurance Changes

If you receive a notice of cancellation or change from the insurance company, review the original requirement for insurance in the contract. If it appears that the proposed change in insurance will not protect the Government's interest in case of the contractor's liability, seek the advice of legal counsel immediately.

Required Coverage

FAR 52.228-5

FAR 52.228-7

FAR 28.306(b)(2)

Standard FAR insurance clauses provide for the inclusion of specified kinds and minimum amounts of insurance that a contractor must maintain throughout the entire period of contract performance. These are summarized in Exhibit 5A-5.

Note that these specific types and minimum amounts do not apply if the clause at FAR 52.228-5 was not required, but was used optionally by the contracting officer. Always check the specific contract terms for the specific types and exact amounts required.

Minimum Insurance Standards used with FAR 52.228-5 and FAR 52.228-7	
Minimum Type of Coverage	**Monetary Minimum**
Worker's Compensation and Employer's Liability	$100,000 for each employee
General Liability (bodily injury)	$500,00 for each occurrence
Property Damage	Policy of agency
Automobile Liability	$200,000 for each person $500,000 for each occurrence (bodily injury) $20,000 for property damage

Exhibit 5A-5

Notice of Insurance Suits or Claims Filed

FAR 52.228-7

Cost-reimbursement contracts normally contain FAR 52.228-7, *Insurance—Liability to Third Parties,* that entitles a contractor to recover payments in response to claims that exceed its insurance coverage for liabilities to third persons. These costs may become reimbursable under a cost-reimbursement contract if the contractor is found liable, without regard to any limitations of funds clauses included in the contract. Exhibit 5A-6 summarizes when approval of the recovery of such payments is appropriate.

Approval for Reimbursement of Third-Party Liability Payments Is Appropriate When...	
FAR 52.228-7 is a contract clause, the liability payment is for...	**AND the contractor submits...**
• Death	• Evidence of a final judgment or settlement by the Government of the amount of liability
• Personal injury, or	• A statement that it is not being compensated for the liability by another party
• Loss of or damage to property ***not*** —In use by the contractor, or —Within the contractor's care.	• Evidence that the liability is a direct result of contract performance

Exhibit 5A-6

However, the costs due to third-party liability payments that exceed required insurance amounts cannot be claimed by the contractor if:

- It is specified elsewhere in the contract that the contractor is liable, or
- The required insurance was allowed to lapse, or
- The liability resulted from the willful misconduct of a senior official of the contractor, or
- The contractor fails to notify the containing officer of any suit or claim against it, or
- The contractor fails to authorize the Government's involvement in defending or setting the claim.

Federal Excise Tax Exemptions

Taxes that apply to commercial contract work often do not apply to Federal contract work. General exemptions apply to certain Federal excise taxes. Exhibit 5A-7 lists these.

General Exemptions from Federal Excise Tax
FAR 29.202

Federal excise taxes generally do not apply to supplies and special fuels for:

- Use by any State or political subdivision such as the District of Columbia
- Export, including shipments to U.S. possessions and Puerto Rico, if shipped within six months after title passes to the Government
- Further manufacture, or resale for further manufacture (transactions involving tires and inner tubes do not qualify for this exemption)
- Use as supplies on U.S. war vessels, aircraft, missiles, and so forth
- A nonprofit educational organization, or
- Emergency vehicles

Exhibit 5A-7

State and Local Taxes

Many state and local taxes also do not apply to work done on Federal Government contracts.

FAR 29.3

However, contractors or local taxing authorities may need evidence of exemption. Generally, contracting offices are obliged to provide such evidence to substantiate a claimed exemption. Standard Form 1094, *U.S. Tax Exemption Certificate,* usually can be issued to the contractor for this purpose. The table in Exhibit 5A-8 lists other evidence you or the contractor may need to provide.

If the contractor is entitled to a tax exemption, it is your responsibility under contracts other than fixed-price contracts to make sure that contractor does not invoice the Government for taxes it was entitled to avoid paying.

Examples of Evidence of State and Local Tax Exemption
FAR 29.305

In addition to Standard Form 1094, U.S. Tax Exemption Certificate, other evidence of eligibility for exemption from certain state and local taxes include:

- A copy of the contract.
- Copies of other documents, such as paid invoices, that identify an agency or instrumentality of the United Sates as the buyer.
- Any other State or locally-required document for establishing general or specific exemption.
- Shipping documents indicating that shipments are in interstate or foreign commerce.

Exhibit 5A-8

Steps for Tax Applicability Requests

FAR 29.101(b)

When a contractor inquires as to the applicability of a specific tax:

1. Look first to the contract terms to see if that tax is mentioned.
2. Then consult your agency counsel responsible for tax matters.

Your agency FAR supplement, Part 29, should provide the appropriate legal organization to contact within your agency on tax matters. If it does not, consult your regular legal advisor for agency contract matters.

5A.6 MONITOR LABOR SURPLUS AREA PROGRAM PLANS

You must monitor labor surplus subcontracting programs if the contract contains FAR 52.220-4, *Labor Surplus Area (LSA) Subcontracting Program.* The contractor's responsibilities under LSA program plans are outlined in Exhibit 5A-9.

Monitoring Methods for Labor Surplus Programs

FAR 20.303

FAR 42.1

Your agency may monitor a contractor's labor surplus program by performing its own review or relying on another agency to perform such a review through a cross-servicing agreement. Because these programs are not contract specific, except to the extent that individual contracts contribute to the success of the overall program, reviews are particularly good candidates for cross-servicing agreements among the agencies that contract with a particular contractor.

The review criteria vary with each individual program. Essentially, you review the records that the contractor is required to keep and compare performance data against program objectives.

Contractor Responsibilities Under Labor Surplus Area (LSA) Programs FAR 52.220-4

1. Appoint a liaison officer to act as Government's focal point for LSA programs and to administer the contractor's LSA programs.
2. Consider LSA concerns in all make-or-buy decisions.
3. Ensure that LSA concerns have an equitable opportunity to compete for subcontracting opportunities even if it means taking express measures, such as rearranging solicitation time frames, to ensure that participation.
4. Include the *Utilization of Labor Surplus Area Concerns* clause in subcontracts that offer substantial LSA subcontracting opportunities.
5. Maintain records for at least one year after contract award showing:
   - Procedures adopted to implement an LSA program, and
   - Compliance with the clause and LSA interests.

Exhibit 5A-9

Determine Any Compensation for Program Achievement

FAR 20.301(b)

Labor surplus programs offer no compensation for achieving program objectives. Contractors and subcontractors are to use the program only if consistent with efficient and economical performance.

Provide Information on LSA Program Evaluations

If your agency performs its own review and you participate in it, you owe the contractor feedback and you need to document your review. The documentation is used by others within your agency and, perhaps, by other Government personnel outside your agency. These information requirements are outlined in Exhibit 5A-10.

Government Information Requirements After LSA Program Reviews FAR 20.303

1. Inform the contractor of:
   - The Government's overall evaluation of its program,
   - Specific information on any deficiencies noted, and
   - Specific information on any outstanding achievements noted.
2. Document the evaluation and information you provided to the contractor. In particular, detail suggested improvements and areas where the contractor exceeded contract requirements.

Exhibit 5A-10

5A.7 MONITOR INTELLECTUAL PROPERTY ISSUES

Intellectual property refers to the products of creative ideas or creative means of expressing ideas.

Intellectual property includes rights formally recognized by patents or copyrights, as well as rights that are not recognized in formal processes—such as ownership of trade secrets.

Bases for Intellectual Property

The basis for ***copyrights*** is artistic work—whether it be written material or electronically-stored information, such as the technical documentation for computer software. The criterion of usefulness does not necessarily apply.

The basis for ***patents*** are inventions—that is, creative methods or processes—that have practical use.

For various reasons, a contractor or its employee-inventor may choose not to patent an invention. An unpatented invention is termed a "trade secret". A trade secret is considered a property right that can be bought and sold. However, the terms of the Government contract may give the Government certain rights to that trade secret.

When the Government obtains trade secrets, it is generally barred from disclosing them under the *Trade Secrets Act* and the *Freedom of Information Act.*

FAR 27.404

The FAR distinguishes between "inventions" which are discoveries that are patentable or otherwise protectable, and "data", which is any recorded information, including computer software, regardless of the form in which it is recorded. "Data" encompasses a wide range of interim and final products such as research findings and conclusions, technical drawings, training programs, calibration records, and publication cover designs.

Data and inventions resulting from Government contracts are treated differently because they are protected by different sets of laws. Whether the contractor or the Government holds the "rights," or ownership, of the data or invention depends on several considerations.

Data Rights

FAR 27.404

The Government usually is entitled to rights in certain types of data produced under contract. The types of data rights that the Government usually obtains are shown in Exhibit 5A-11. Note that this exhibit does not detail computer data rights, which are generally spelled out in clauses that are specific to that data. Also, certain exceptions apply to some agencies—for example, Department of Defense, NASA, and the Department of Energy.

FAR 27.405

Also note that the Government may limit the contractor's own use of data it produces under certain types of contracts.

Contract Administration Responsibilities

FAR 52.227-14

The clause at FAR 52.227-14, *Data Rights—General*, as well as other data rights clauses, impose certain rights and responsibilities on both the contractor and the Government. These are outlined in Exhibit 5A-12.

During contract administration, it is important to protect both the contractor's and the Government's rights. You must examine the contract for standard and unique contract terms to determine what these rights are. This is particularly important when the contractor furnishes data with a restrictive claim. If rights are incorrectly claimed by the contractor, you must take action to deny those claims. If the claim is legitimate, you must take action to protect that data against release outside of the Government.

Data Rights Clauses	
Standard Clause:	**Data Rights the Government Obtains:**
FAR 52.227-14, *Rights in Data—General*	**LIMITED.** *Applies only to data that:* • Embody a trade secret; **OR** • Are commercial or financial **AND** confidential or privileged **AND** were developed at private expense, including minor modifications of such data. *The Government has the right to reproduce and use these data, except that it must:* • First obtain the contractor's written permission for usage relating to manufacturing. • Not make a disclosure outside the Government except for purposes specified in the contract.
FAR. 52.227-14, *Rights in Data—General*	**UNLIMITED.** *The Government has unlimited rights in:* • Data first produced in the performance of a contract. • Form, fit and function data delivered under contract—that is, data that are sufficient to enable physical and functional interchangeability. It also includes data identifying source, size, configuration, mating and attachment characteristics, functional characteristics, and performance requirements. • Data used as training or instruction for installation, operation, or routine maintenance and repair of contract deliverables. • All other data delivered under a contract other than limited rights data or restricted computer software.
Various standard Government-wide clauses and unique clauses. Example: FAR 52.227-23	**GOVERNMENT-PURPOSE LICENSE RIGHTS.** The Government has the right to use, duplicate, and disclose data, in whole or in part and in any manner, for Government purposes only, and to have or permit others to do so for Government purposes only. Government purposes include procurement under competitive procedures, but do not include the right to have or permit others to use technical data for commercial purposes.

Exhibit 5A-11

Usual Contractor and Government Data Rights Under Standard Clauses

Contractor's Usual Rights	Government's Usual Rights
Among the contractor's usual rights are the right to: • Use and publish data originated under the contract (aside from classified information, data covered by the Privacy Act, and so forth) • Attach a Limited Rights Notice as specified in FAR 52.227-14 to data furnished to the Government that meet the limited rights criteria • Protect from disclosure data identified with the Limited Rights Notice • Attach a Restricted Rights Notice as specified in FAR 52.227-14 to computer software furnished to the Government that restricts duplication except for Government use • Claim a copyright to scientific publications containing data first produced under the contract without contracting officer approval, and • Seek permission of the contracting officer to copyright data first produced under the contract for all other purposes.	Among the Government's rights are the right to: • Use and publish data originated under the contract ***except*** for data marked with a Limited Rights Notice, Restricted Rights Notice, or copyright notice • Refuse to accept data with an unauthorized Limited Rights Notice or a Restricted Rights Notice (after notifying the contractor and waiting 30 days for a reply) • Consider any data furnished without a notice or copyright notice to be furnished with unlimited rights, and • Use, duplicate, and disclose any data needed to inform persons of hazardous materials that may affect them or, if affected, obtain proper medical treatment.

Exhibit 5A-12

Copyrights

FAR 52.227-14

Under the *Data Rights—General* clause, FAR 52.227-14, the contractor receives the right to use and publish data first developed under the contract. It also may claim a copyright covering that data. The approval of the contracting officer is not required if the data are to be included in a scientific or technical publication. However, the contractor must receive contracting officer approval to claim copyright for any other purpose. This typically would apply to all except scientific data, such as promotional videos, case studies, artistic works, or mathematical models.

When a contractor receives approval to claim copyright to data originating under a contract, it must acknowledge Government sponsorship and cite the contract number along with its copyright notice on any copies delivered to the Government. It also grants the Government and others acting on its behalf a paid-up, nonexclusive, irrevocable, worldwide license to reproduce or otherwise use the data.

Inventions

FAR 27.302

An invention may be a product, a process, a system, a discovery, or a plan that is or may be protected by a patent. In order to promote the commercialization of inventions, a Presidential Memorandum (1983) instructs agencies to award title to patents produced under Government funding to the contractor in exchange for royalty-free use by or on behalf of the Government.

Notices of Inventions

FAR 52.227-11

FAR 52.227-12

FAR 52.227-13

Under standard contract clauses, the contractor is required to disclose any inventions developed under the contract.

The contractor must make this disclosure by the ***earliest*** of the following two time frames:

- Within two months after the inventor discloses an invention, in writing, to contractor personnel responsible for patent matters, or
- Within six months after the contractor becomes aware that an invention has been made.

Applicable Time Frames

Disclosure by the contractor within the specified time frame is critical in that it seriously affects the contractor's right to claim title to the invention. Generally, unless the disclosure notice is filed in a timely way, the Government automatically receives title.

The content requirements of this disclosure notice are listed in Exhibit 5A-13.

Content Requirements for Invention Disclosure Notices
FAR 52.227-11(c)(1), FAR 52.227-12(e)(1), FAR 52.227-13(e)(2)

Invention disclosure notices must:

- Be in the form of a written report.
- Identify
  —The contract under which the invention was made
  —The inventors
  —Any publication on the invention or public use of it
  —Whether the invention has been submitted for publication and, if so, whether it has been accepted for publication.
- Be sufficiently complete in technical detail to convey a clear understanding of the nature, purpose, operation, and physical, chemical, biological, or electrical characteristics of the invention.

Exhibit 5A-13

Additional Disclosures

After the initial disclosure, the contractor is additionally responsible for notifying the agency of the acceptance of any manuscript describing the invention for publication.

If the contractor has title to the invention under the terms of FAR 52.227-11 or FAR 52.227-12, it must also elect in writing, within two years of the initial disclosure, whether or not to retain title. If it retains title, it must then file its initial patent application within one year after its election to retain title unless a specific statute provides for a shorter time frame for filing.

Government Receipt of Title

In addition to receiving title to the invention if the contractor fails to submit a timely disclosure notice, the Government receives title when:

- The contractor waives its right to own the invention, or
- The contract specifies that title will belong to the Government, or
- The contractor fails to file patent application in any foreign countries and the Government elects to do so, allowing the Government to claim title in those countries.

When the Government obtains title to an invention produced under a Government-funded contract, the contractor ordinarily receives a nonexclusive, royalty-free license to use that invention, but only if there was timely disclosure.

If title to an invention developed with Government funding is awarded to a contractor, the Government nevertheless is allowed a nonexclusive, royalty-free license to that invention by or on behalf of the United States. In addition, if directed by the Government, the contractor must grant licenses to others at a reasonable fee; this is called "march-in rights."

March-In Rights

March-in rights are allowed only if:

- The contractor has not made a practical application of that invention, or
- Such a license is needed for public purposes.

However, this Government right has been controversial and you should not initiate any actions toward exercising it without seeking advice from an agency lawyer.

Notices on Subcontract Patent Clauses

When any of the Patent Rights clauses are contained in the prime contract, the contractor must include similar clauses in any subcontracts for experimental, developmental, or research work. The contractor also must provide notice to the contracting officer regarding the award of subcontracts. Requirements for this notice are listed in Exhibit 5A-14.

Additional Subcontractor Disclosures

The contractor is further obligated to furnish, but only upon the specific request of the contracting officer, a copy of such a subcontract. Additionally, it must furnish a listing of subcontracts awarded annually, or for a longer period if mutually agreeable.

Content Requirements for Notices Regarding Patent Rights Clauses in Subcontracts FAR 52.227-13(h)(4)

Notices regarding patent rights clauses in subcontracts must identify:

- The subcontractor
- The applicable patent rights clause
- The work to be performed under the subcontract
- The date of award, and
- Estimated completion date.

Exhibit 5A-14

Reporting Requirements

Under Patent Rights clauses at FAR 52.227-12 and FAR 52.227-13, the contractor also is obligated to list any inventions developed, or certify that there were none, each 12 months during the contract period and within 3 months of the conclusion of the contract.

Patent Applications Containing Classified Information

FAR 27.207

FAR 52.227-10

Other submissions from the contractor may be required in regard to patents involving classified information.

The contractor must provide a copy of a patent application that may involve classified information to your contracting office ***before*** it files the application with the United States Patent Office or with a similar office of a foreign government, providing it is entitled to file for a patent under a contract you are administering.

Experts within your agency, and perhaps experts outside your agency as well, must decide whether the interests of national security make special procedures for safeguarding the secrecy of the information necessary.

Your agency's supplement to FAR Part 27 normally identifies agency personnel who are responsible for copyright and patent issues involving classified information. It is important to refer the application to them immediately.

If you delay, the result could be:

- The loss of valuable patent rights that may belong to the Government or the contractor, or
- A violation of national security interests.

However, a contractor may not file an application with a patent or copyright processing office of a foreign government without express approval from the contracting office if classified information is involved.

Further steps may be necessary on your part after an application for a patent is filed if it involves classified information. FAR 52.227-10, *Filing of Patent Applications—Classified Subject Matter,* describes these.

Requests for Greater Patent Rights

If the wording of the contract allows the Government to determine if it or the contractor has patent rights, the contractor may request greater rights to the invention than awarded by the Government. Exhibit 5A-15 outlines prerequisites for granting such requests.

Allowability of Patent-Related Costs

You may receive an invoice for patent-related costs from the contractor. Such costs are allowable only if certain conditions are met. Refer to Chapter 11.

Factors For Granting Contractor Requests for Increased Patent Rights FAR 27.304-1(b) and FAR 52.227-13(b)(2)

1. Requests must be made within eight months after the first disclosure of the invention unless the contracting officer gave written authorization for a longer period.
2. Agency officials with the authority to approve increased rights must consider if granting the request would have an effect on any of the following objectives:
   - Promoting the use of the invention.
   - Ensuring that the invention is used to promote full and open competition and free enterprise.
   - Promoting public availability of inventions made in the United States by United States industry and labor.
   - Ensuring that the Government obtains sufficient rights in federally-supported inventions to meet the needs of the Government and protect the public against nonuse or unreasonable use of the invention.

Exhibit 5A-15

Contract Administration Responsibilities

Policies and procedures concerning inventions are complex and involve considerable expertise. If you are administering a contract that contains a Patents Rights clause, you have specific responsibilities. These are summarized in Exhibit 5A-16.

These responsibilities extend to subcontracts for research, developmental, or experimental work.

Be alert to the use of restrictive markings or legends on products delivered by contractor when they go beyond what the law allows. Some contractors may claim full rights even if the Government has unlimited rights to an invention.

Notices on Patent and Copyright Infringement

Patents and copyrights provide those owning them exclusive usage rights. When those rights are violated by a third party, it is termed an "infringement."

FAR 52.227-1

FAR 52.227-1, *Authorization and Consent*, provides Government authority for a contractor to use any invention that was patented by others in the United States. With this clause in a contract, if the contractor violates the exclusive rights provided to someone else by a patent or copyright, the Government is liable, not the contractor.

Summary of Your General Responsibilities Regarding Inventions

- All inventions are identified and disclosed by the contractor as required.
- The Government's rights are identified and protected.
- Decisions are made regarding the promptness of patent applications.
- All negotiations and decisions regarding rights to the invention are properly documented.
- Expeditious commercial use of the invention is achieved when possible.

Exhibit 5A-16

FAR 52.227-3

However, the Government usually does not accept liability for patent and copyright infringement. FAR 52.227-3, *Patent Indemnity*, places the liability on the contractor instead.

Basis for Government Acceptance of Liability

Generally, the Government uses the Authorization and Consent clause when contract performance involves work unique to a Government requirement. It uses the Patent Indemnity clause when contract performance involves work of a standard commercial nature with the product or service offered for sale to the general public.

Infringement Notice

FAR 27.202

FAR 52.227-2

The contractor must notify the contracting officer regarding any claim of copyright or patent infringement that results from contract performance, regardless of whether an Authorization and Consent or a Patent Indemnity clause is used. FAR 52.227-2, *Notice and Assistance Regarding Patent and Copyright Infringement*, requires this notice from the contractor.

Information Required

There are no specific content requirements for a notice of claimed infringement except that the notice must be "prompt" and in "reasonable written detail."

However, the contracting officer may ask, and the contractor must provide, all information and evidence that a contractor has in regard to any suit or claim of copyright or patent infringement against the Government. The Government must bear the expense of providing this information if the Authorization and Consent clause is in the contract. The contractor bears the expense if the Patent Indemnity clause is in the contract.

Available Counsel

Seek legal counsel immediately when you receive any notice regarding patent or copyright infringement. Case law and the law itself is very detailed and complex in this area.

5A.8 ENCOURAGE AND ENFORCE COMPLIANCE

Even when you are not responsible for enforcement, you can curb potential violations by letting contractors know that you are aware of ***all*** the requirements in the contract, not just those related to technical and schedule compliance. A well-timed question or observation is usually enough to convey this message.

You could also make suggestions regarding compliance, but do this in a friendly, nonthreatening way. You are obliged to pursue violations, not improve the degree of compliance.

Unless other Government officials are responsible for enforcement, you seek remedies to violations as you would any other breach of contract. Refer to Chapter 15. When other Government officials are responsible for enforcement, inform them immediately of any evidence of noncompliance.

Contact Enforcement Official, If Appropriate

Other Government officials may be partially or totally responsible for compliance with a statutory requirement, as evidenced by some of the procedures reviewed earlier in this chapter. Exhibit 5A-17 summarizes several examples covered in this or other chapters.

Inform Requiring Activity and Others of the Status of Legal Compliance

You need to inform the requiring activity of statutory compliance issues that endanger the contract completion schedule or the quality of the product or services under contract.

FAR 52.227-3

Sometimes you need to advise the contractor of the status of legal issues. For example, FAR 52.227-3, *Patent Indemnity*, requires you to inform the contractor of any suit or other legal action alleging patent infringement so that it can participate in its own legal defense.

Specific Government Agency Responsibilities		
Statute/Clause	**Your Monitoring Effort**	**Enforcement Responsibilities**
False Statements Act, False Claims Act, and other fraud-related statutes	Detect indicators of fraudulent conduct. Report violations.	Agency Inspectors General have investigation responsibilities; Department of Justice has prosecution responsibilities
Equal Opportunity and other affirmative action programs against discrimination	Ensure posters are displayed at job site. Detect any obvious evidence of unequal treatment of contractor personnel. Report violations.	Office of Federal Contract Compliance Programs (OFCCP) regional offices
Clean Air and Water Acts	Report indicators of violations, such as the use of Class I ozone depletion substances, if reported by interested parties or detected at site.	Environmental Protection Agency (EPA)
Fair Labor Standards and Service Contract Acts	Provide posters and ensure they are displayed at job sites. Conduct checks of compliance and report violations to DOL.	Department of Labor (DOL) has major responsibility for enforcement, but procuring agency contracting officials must assist in enforcement when requested by DOL.

Exhibit 5A-17

PART B—MONITORING SMALL BUSINESS SUBCONTRACTING PLANS

Overview of Subcontracting Plan Requirements

During the preaward phase of an acquisition, large businesses specify how they will contribute to promoting the growth of small businesses by outlining a plan for awarding subcontracts under their prime contract. The plan focuses on small businesses in general and small businesses owned by socially or economically disadvantaged groups in particular.

There are several elements to this plan:

FAR 19.704

FAR 52.219-9

FAR 52.219.10

1. Separate percentage goals for using small businesses.
2. The name of a contractor employee responsible for administering the plan and a description of that individual's duties.
3. A description of how the contractor intends to ensure that small businesses have an opportunity to compete for its subcontracts.
4. Assurances that the contractor will include appropriate subcontracting clauses in its first-tier subcontracts.
5. Statements attesting to the contractor's willingness to
   - Cooperate in any studies or surveys as may be required
   - Submit reports for Government analysis on the extent of compliance to the plan
   - Submit Standard Form (SF) 294, *Subcontracting Report for Individual Contracts,* and SF 295, *Summary Subcontract Report.*
6. A list of the types of records the contractor will maintain to show its compliance (an example is the establishment of small business source lists).

Your responsibilities regarding subcontracting plans are summarized in the following flowchart.

Master Subcontracting Plans

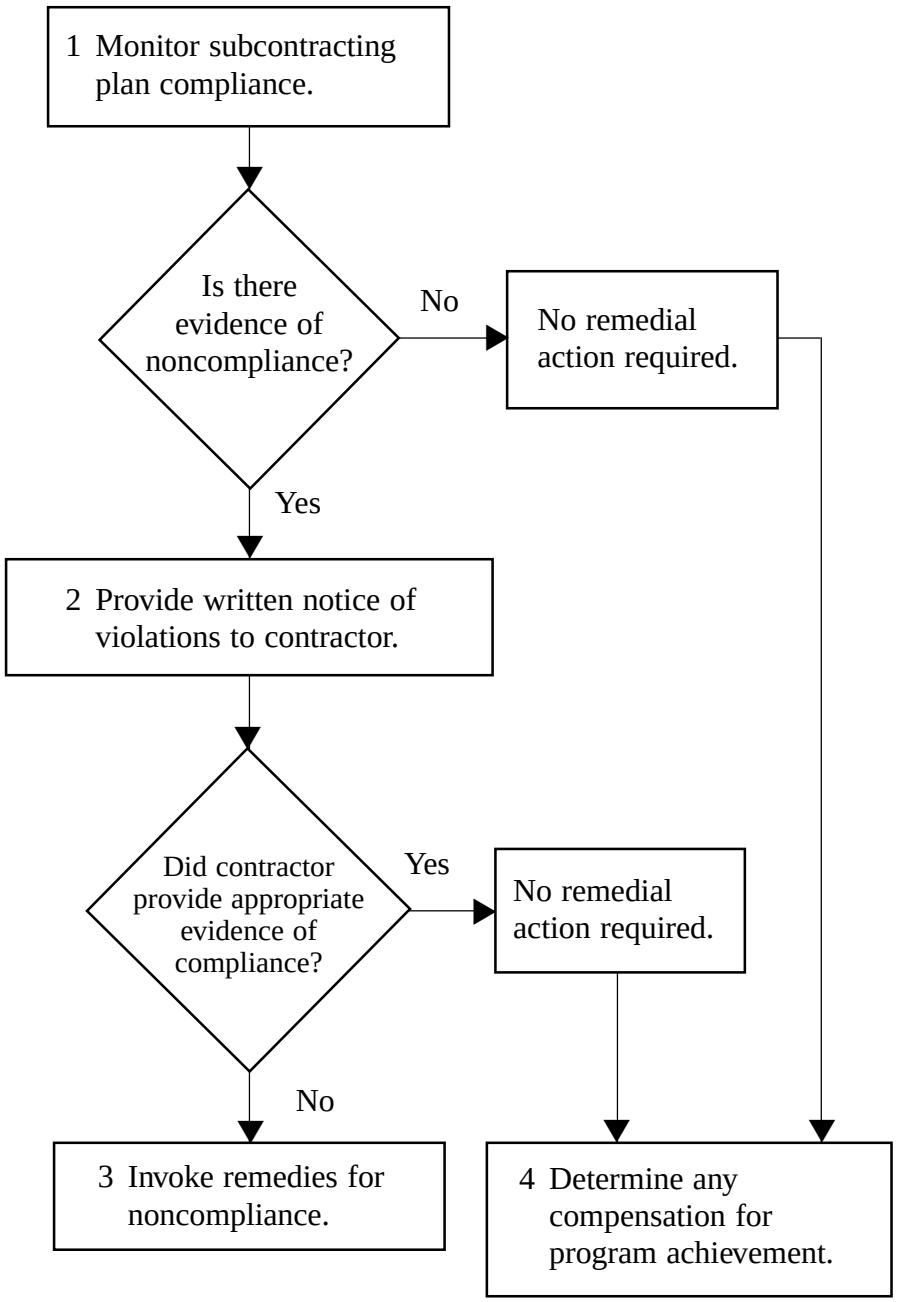
FAR 19.704(b)

Contractors may establish, on a plant or division-wide basis, a master small business and small disadvantaged business subcontracting plan containing the same basic elements required of an individual plan except that separate percentage goals are omitted.

FAR 19.707(a)(4)

SBA representatives may evaluate compliance with a single subcontracting plan for a specific contract or may examine multiple plans of a single contractor, or its master plan.

STEPS IN MONITORING SUBCONTRACT PLAN COMPLIANCE



5B.1 MONITOR SUBCONTRACTING PLAN COMPLIANCE

FAR 19.702

FAR 20.302(b)

You typically find a requirement for small business subcontracting plans only in contracts:

- With significant subcontracting opportunities, and
- Over $500,000, and
- Only in contracts awarded to large businesses.

Diligence in Pursuit of Goals

FAR 19.705-4

FAR 19.705-5

FAR 19.702(c)

One consideration in the award of the prime contract is the acceptability of this plan. Therefore, it is essential to ensure that the prime contractor diligently pursues its goals in awarding its subcontracts. The approved small business and small disadvantaged business subcontracting plan you obtain should have all of the required elements.

A lack of diligent follow-through on the contractor's part is considered a material breach of contract.

You should receive a copy of these plans as part of the contract. You would receive them from the PCO if you are in a separate CAO. Contract administration responsibilities in regard to small business and small disadvantaged business subcontracting plans generally are as follows:

FAR 19.705-6

FAR 19.706

- Ensure that distribution of the plan is made to
  - The Assistant Regional Administrator for Procurement Assistance in the Small Business Administration (SBA) regional office in whose jurisdiction contract performance will occur
  - Assigned resident SBA procurement center representative, if any, and
  - Contractor's main office.
- Monitor and document the prime contractor's compliance to the plan during contract performance.
- Provide appropriate documentation of noncompliance to PCOs, if applicable.
- Assess liquidated damages as described in Chapter 15, if appropriate.
- Submit to SBA officials any revised subcontracting plans that are necessary as a result of contract modifications.

More specific monitoring requirements are contained in Exhibit 5B-1.

Monitoring Task Summary for Small Business Subcontracting Plans

Standard Monitoring Task	Typical Actions Required
For a contract over $500,000, that appears to have substantial subcontracting opportunities and the contractor is a large business, verify evidence of a subcontracting plan	If you have a copy of the plan, ensure that other appropriate Government officials have a copy If you do not have a copy of the plan, verify that it is a contract requirement and seek out preaward contracting personnel for a copy of the plan
Ensure contractor submits SF 294, Subcontracting Report for Individual Contracts, and SF 295, Summary Subcontract Report	If forms are not submitted, contact the contractor and find out: • Why they have not been submitted • When they will be submitted
Review SF 294, Subcontracting Report for Individual Contracts, and SF 295, Summary Subcontract Report, and determine if: • Percentage goals stated are consistent with those in the plan • Contractor achieved the goals	If the percentages are consistent, take no action If the percentages listed on the forms are inconsistent, ask for revised forms If goals are met, take no action If goals are not met, provide a notice regarding specific failures to the contractor, hold discussions on its efforts toward goal achievement during the last reporting period, and document those efforts
At contract completion, assess liquidated damages, but only if: • A contract clause authorizes it • Contractor has not made a good faith effort to achieve the goal	Document evidence that a good faith effort was not made and assess damages in writing, but only after the contract has been completed Some offices require a: • Legal review prior to assessment • Unilateral modification as the method for assessment
When lack of good faith toward goal achievement becomes a pattern, consider other, more severe actions At contract completion, determine if the contractor exceeded plan goals	Decide among the menu of actions appropriate for a breach of contract (refer to Chapter 15) Modify the contract to authorize any reward specified in a contract clause (refer to Chapter 14) For cost-plus-fixed-fee contracts, ensure that the sum of the fixed fee and the reward amount does not exceed statutory fee limitations

Exhibit 5B-1

Documentation

Your records of subcontracting plan compliance should include all of the following, if appropriate:

- Written notices to the contractor on
  - — Specific failures in reaching subcontracting goals
  - — Liquidated damages assessment
  - — Other notices to activate other remedies that may be appropriate when a breach of contract is evident.
- Written file documentation on meetings and discussions with the contractor regarding
  - — Why reports were submitted late and when they are to be expected
  - — Good faith efforts it made toward goal achievement
- Support for determinations that
  - — The contractor failed to make a good faith effort toward goal achievement, documenting the methods you used to investigate the circumstances, citing any evidence of an effort, and explaining why it is not adequate
  - — The contractor exceeded its goals, documenting the percentages and modifying the contract to increase the dollar amount by the award amount specified in the contract.

Documenting Good Faith Efforts

FAR 19.705-7(d)

The only time you need to analyze the contractor's good faith efforts is if it did not reach its goals. The fact that the contractor failed to meet its subcontracting goals does not, by itself, constitute a failure to make a good faith effort. Failures that may, when considered together with other contractor actions, evidence a lack of good faith include:

- A failure to attempt to identify, contact, solicit, or consider for a contract award, small business or small disadvantaged business concerns
- A failure to designate a company official to administer the subcontracting program
- A failure to maintain records or otherwise demonstrate procedures adopted to comply with the plan
- Adoption of company policies or procedures which have the effect of frustrating the objectives of the plan.

On the other hand, evidence you can cite as good faith efforts even when goals are not met include:

- Unavailability of anticipated sources despite evidence of marketing efforts and solicitations
- Unreasonable prices of small businesses in response to frequent solicitations.

Subcontracting Reports

SF 294, *Subcontracting Report for Individual Contracts,* covers a six-month reporting period, and requires:

- Total dollar figures for all subcontracts awarded under the individual prime contract, and
- Dollar and percentage figures for total subcontracts awarded to both small businesses and small disadvantaged businesses.

In addition to updated percentages, the report may have revised goals based on:

- Changes in the amount of subcontracting anticipated or the amount that was actually accomplished
- A changing contract total as a result of modifications adding subcontracting funds, thereby changing the base against which the percentages are calculated.

It includes direct (first-tier) subcontract awards and indirect awards.

SF 295, *Summary Subcontract Report,* contains similar information. However, it combines all prime contracts awarded to a single contractor and reports them on an annual, rather than a semiannual, basis.

5B.2 PROVIDE CONTRACTOR WRITTEN NOTICE OF PLAN VIOLATIONS

Because small business subcontracting plan violations constitute a breach of contract, a written notice of these violations is required before invoking any Government remedies that are available. This notice has specific content requirements that are listed in Exhibit 5B-2.

Content Requirements for Notices on Subcontracting Plan Violations FAR 19.705-7(c)

Government notices on small business and small disadvantaged business plan violations must:

1. Be written and signed by the contracting officer
2. State a specific failure
3. Relate the potential for application of liquidated damages
4. Provide the contractor with an opportunity to demonstrate what good faith efforts it has made before the contracting officer issues a final decision
5. Allow a time frame of at least ten days for the contractor's response to the notice, and
6. State that a failure to respond may be taken as an admission that there is no valid explanation.

Exhibit 5B-2

5B.3 INVOKE REMEDIES FOR NONCOMPLIANCE

Because violations of the small business and small disadvantaged business subcontracting plan constitute a contract breach, noncompliance gives the Government the right to take a variety of remedial actions. However, you must be careful to avoid ignoring good faith efforts simply because they did not achieve the desired results. After all, any plan is merely a strategy to achieve some end result. In this case, the end result is a stated level of subcontracting business (expressed as a percentage of the total) awarded to small businesses and particularly small disadvantaged businesses. The Government initially reviewed and approved that strategy by accepting the subcontracting plan. It can therefore have no legitimate complaint if that strategy did not achieve its goals ***unless*** the contractor did not diligently apply that strategy.

When it is evident that good faith efforts were not made, there is a special clause on the application of liquidated damages that may be appropriate. This remedy is in addition to other remedies that might be suitable, as outlined in Chapter 15.

Liquidated Damages

FAR 19.705-6(f)

FAR 19.705-7

FAR 52.219-16

Liquidated damages for failing to make a good faith effort to comply with a small business and small disadvantaged business subcontracting plan is required by law However, liquidated damages may only be assessed at the end of contract performance. The contractor has until the last day of performance to reach its subcontracting goals or demonstrate good faith.

The amount of liquidated damages is the same dollar amount by which the contractor failed to achieve each subcontracting goal or, in the case of a commercial product plan, that portion of the dollar amount allocable to Government contracts by which the contractor failed to achieve each subcontracting goal.

You will only be involved in assessing liquidated damages on noncompliance with respect to a commercial products subcontracting plan if your agency originally approved the plan for the Government on behalf of all other agencies that awarded contracts covered by the commercial products plan.

5B.4 DETERMINE ANY COMPENSATION FOR PROGRAM ACHIEVEMENT

FAR 52.219-10

You may have a clause in the contract that provides for an incentive of up to 10% of the amount a contractor exceeds its subcontracting goal for small businesses and small disadvantaged businesses. The contracting officer determines an appropriate percentage prior to contract award. So your postaward responsibilities involve only:

- Obtaining documentation of any subcontract amounts that exceed the plan's goals, and
- Looking for any indications that the overachievement is due to the contractor's efforts.

If the overachievement is due to the contractor's efforts, award of the incentive is not discretionary. It is required by FAR 52.219-10, *Incentive Subcontracting Program for Small and Small Disadvantaged Business Concerns,* if this clause is in the contract.

Restrictions on Incentives

Monetary incentives must not be awarded if the goal was exceeded due to some reason other than the contractor's efforts. For example, if the goal was exceeded as a result of a large subcontract to a firm whose status was reduced from a large business to a small business between the time of subcontract award and completion of the SF 294, *Subcontracting Report for Individual Contracts,* then an incentive would not be appropriate.

FAR 15.903

However, you may not award a fee that, when added to the fixed fee of a cost-plus-fixed-fee contract, would exceed:

- 15% of the estimated costs (excluding fee) for experimental developmental, or research work
- 6% of the estimated costs of construction of public works or utilities (excluding fee) for architect-engineer contracts, or
- 10% of the estimated costs (excluding fee) for other cost-plus-fixed-fee contracts.

CHAPTER 6

PROPERTY ADMINISTRATION

TO HAVE AND TO CARE FOR

Harry B. Labours took his job in supply management very seriously. He was in charge of the agency's property records. When the agency furnished property to contractors, he usually become involved—acting as the property administrator.

He carpooled with Bea Ware and played handball with Ernest N. Deavors. So they already had established a good relationship when all the furor arose about the Government-furnished property on the Troubles, Inc. grounds maintenance contract. The agency owned two large "gang" mowers that it furnished to the grounds maintenance contractor. This equipment was fairly expensive. Harry received a request for several new blades from Troubles, Inc., citing normal wear and tear due to the rocky terrain. Harry hadn't thought the terrain was all that rocky. Furthermore, he knew that although his agency had responsibility for replacing the blades when needed due to normal wear and tear, the contractor had the responsibility for preventive maintenance, including sharpening the blades.

He talked about his suspicions with Bea Ware on the way home one night. "Just go out and take a look for yourself," Bea told him. Harry hesitated—his boss was one of those who thought that if you weren't at your desk or at a meeting in the building, you were goofing off. If he could get away from his desk more and act like a normal business person, he could get a lot more accomplished and it would be so much more satisfying.

Bea knew what he was thinking. "I'll call your boss and tell him that I really need you to do some investigative work for us," she told him.

So Harry went to "visit" the equipment and found a small stockpile of perfectly good, but unsharpened, blades in a corner of the warehouse his agency had provided for the contractor's use. He took a look at the engine oil in both mowers. It was unbelievably dirty. After several unsuccessful tries, Harry started both engines. Both "coughed" irregularly. There was other obvious evidence of neglect.

When he asked the grounds maintenance foreman for the preventive maintenance records, he got a blank stare. "What kinda records?" the confused man had responded. He turned out to be the fourth foreman in less than 12 months.

Harry filled out a report of his site visit findings and presented it to Ernest N. Deavors and Bea Ware. Then the fireworks started.

continued. . .

Bea informed the contractor that Harry would not be filling their request for new blades—that they were to sharpen the blades they currently had in their possession. However, the question of the deteriorated condition of the mowers themselves due to a lack of maintenance was still being debated. The company claimed preventive maintenance had been performed regularly.

"Impossible!" said Harry.

So Johnnie I. Dotter was called in to go over the evidence and legal options, and then concur or present an alternative action to what Bea Ware proposed to do.

Harry knew the contract performance time was up in slightly less than three months so he wondered what the Government could really do to correct the situation short of costly litigation.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Monitor the acquisition, control, and disposition of Government property both by Government personnel and by the contractor, and assess contractors for any loss, damage, or destruction to Government property while in their control.

Individual:

6.1 Identify control requirements for keeping the contracting officer abreast of property administration.

6.2 Resolve issues regarding reported deficiencies in a contractor's Government property control system.

6.3 Review postaward requests for Government property.

6.4 Monitor delivery of Government property according to the terms of the contract.

6.5 Approve or disapprove the acquisition or fabrication of special test equipment or facilities by the contractor.

6.6 Monitor the contractor's control and use of Government property.

6.7 Determine whether to decrease the property to be provided or substitute other property and determine the amount of any related equitable adjustment.

6.8 Investigate and resolve reported loss, damage, or destruction of Government property.

6.9 Investigate and resolve reports of unauthorized use of Government property.

6.10 Provide instructions to the contractor, based on lists it provides, regarding special tooling to which the Government has title or has a right to title.

6.11 Upon the contractor's determination that property is excess, monitor disposition of the property.

INTRODUCTION TO PROPERTY ADMINISTRATION

Definitions

Property administration means those policies and procedures:

- You are required to use when providing Government property to contractors
- Contractors must follow in using and managing Government property
- Both you and the contractor must follow in reporting, redistributing, and disposing of Government property.

Several definitions relating to property are key to understanding how and when to apply specific Government property administration procedures:

- **Government property—**All property owned by or leased to the Government or acquired by the Government under the terms of a contract. It includes both Government-furnished property (GFP) and contractor-acquired property.
- **Government-furnished property (GFP)—**Property in the possession of, or directly acquired by, the Government and subsequently made available to the contractor.
- **Contractor-acquired property—**Property acquired or otherwise provided by the contractor for performing a contract and to which the Government has legal title.

Policy on Property Administration

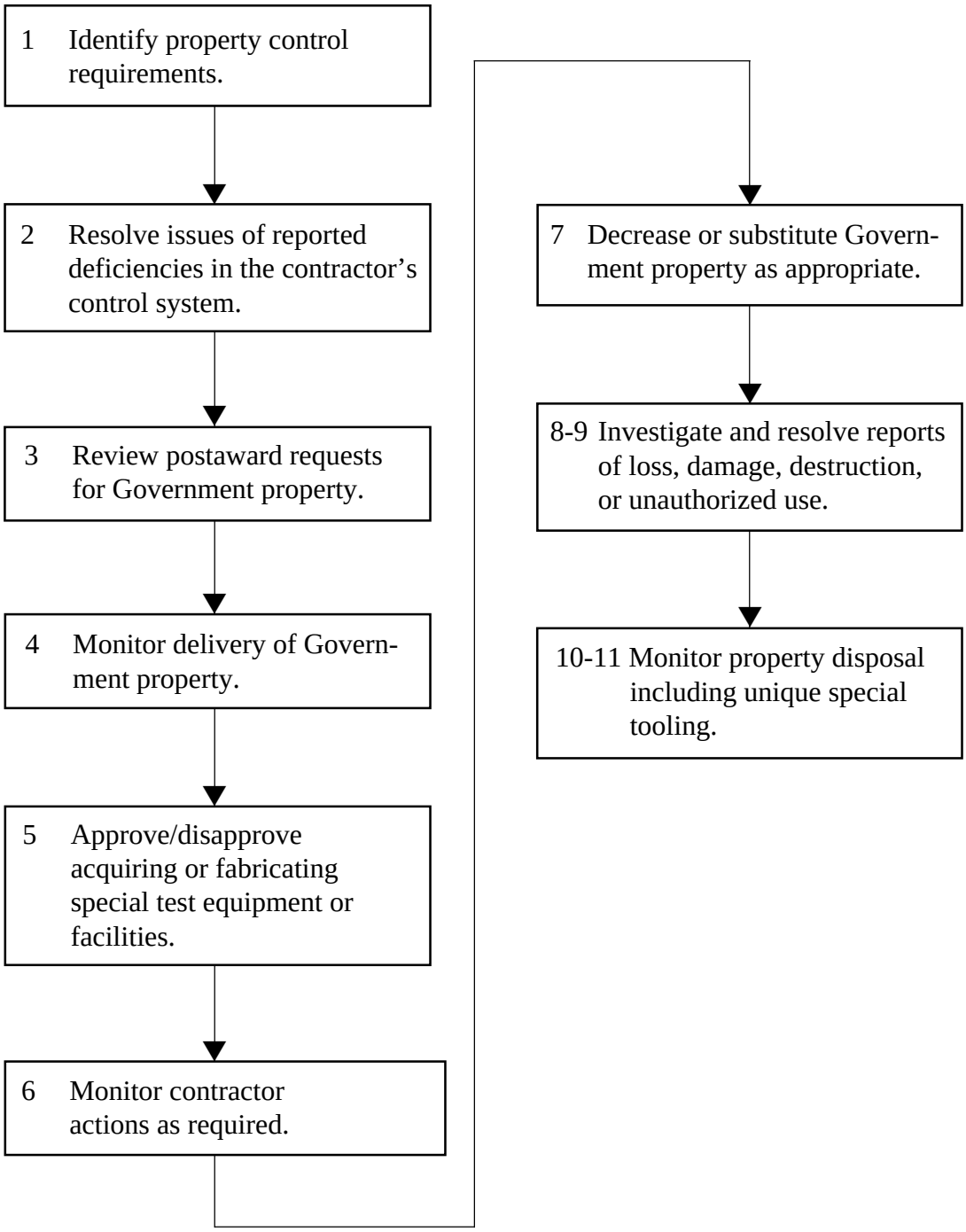
Because contractors are generally required to furnish all property necessary to perform Government contracts, you usually are not concerned with property administration. However, the Government does acquire or furnish property when the result is a clear advantage to the Government. Standard contract clauses relating to property govern:

- Risk assumption (Government and contractor)
- Control and recordkeeping procedures
- Other responsibilities of both contracting parties.

Steps in Performance

The steps in supplying and controlling Government property provided to contractors under the terms of a Government contract are charted on the next page. Following the flowchart, each step is discussed in turn.

STEPS IN ADMINISTERING GOVERNMENT PROPERTY



PROPERTY ADMINISTRATION

6.1 IDENTIFY CONTROL REQUIREMENTS

Carefully review any contract you will administer to identify whether Government property is involved and what reports or other requirements are established by contract clauses. Unless your contract contains the clause FAR 52.245-1, *Property Records*, you will receive a number of standard reports to use for management and control of Government property. Such standard reports include:

- Reports on the contractor's overall property control system
- Receipts for property provided to the contractor
- Periodic property audits
- Contractor notification that equipment is damaged or in need of repair
- Reports of any shortages, losses, damage, destruction, or misuse
- Reports on property that is surplus or no longer needed
- Inventories of property on hand at the end of a contract
- Reports on annual total acquisition cost by Government property classification for which the contractor is accountable under each contract with all Government agencies.

These clauses also provide for other specific reports to be established at the contracting officer's discretion. You should establish reporting requirements that are not mandatory under contract terms only when:

- They would be cost effective in managing Government property under a contract, and
- The contract contains an optional requirement for a report's submission.

FAR 52.245-1

Contracts that contain the *Property Records* clause exempt the contractor from keeping property records. These records are kept by the Government instead.

FAR 52.245-4

If the *Government-Furnished Property (Short Form)* clause is included in the contract, the contractor is responsible for maintaining Government property records, but only in accord with sound business practice.

6.2 RESOLVE DEFICIENCY ISSUES IN CONTRACTOR'S GOVERNMENT PROPERTY CONTROL SYSTEM

Unless the *Property Records* clause is in the contract, the contractor is required to maintain a Government property control system capable of managing and documenting the contractor's Government property responsibilities.

Documentation requirements, as shown in Exhibit 6-1, may vary according to the type of property. The following definitions apply to the classes of property specified in the exhibit.

Definitions

FAR 45.101

FAR 45.601

Real property. Real property consists of land, buildings, or other things permanently attached to or growing upon the land and buildings. Real property includes the area below the surface of the land as well as the area above the land, commonly referred to as "air rights." Generally, all property that is not real property is referred to as ***personal property*** even though it may be owned by a corporation or by the Government and used for business purposes.

Special tooling. Special tooling consists of items that are so specialized that their use is very limited unless they are modified or altered. Generally such items are needed for the development or production of specific items or for the performance of a specific service. Special tooling excludes special test equipment. Examples of special tooling include jigs, dies, fixtures, molds, patterns, and gauges.

Special test equipment. Special test equipment consists of units engineered or modified to accomplish special-purpose testing during contract performance.

Plant equipment. Plant equipment consists of machinery or other items of a capital nature used to manufacture supplies, to perform services, or to achieve any administrative or general plant purpose. By its general use definition, it would exclude special tooling and special test equipment, but would include general purpose test equipment and most machine tools. Plant equipment can include such things as overhead cranes, compressors, generators, desks, chairs, and so forth.

Material. Government-furnished material (GFM) and other material the contractor has, but the Government owns, can be classified in two ways. The material may be:

- Incorporated into or attached to an end item, or
- Consumed during contract performance, such as component parts, raw materials, small tools, and supplies.

Documentation Requirements for Government Property Records	
Type of Records	**Information Required**
Basic (individual records) FAR 45.505-1	1. Name/description, including national stock number, if known or applicable 2. Quantity received (or fabricated), issued, and on hand 3. Unit price and unit of measure 4. Contract number or equivalent code designation 5. Exact location of the property 6. Disposition after use 7. A posting reference and date for each transaction
Summary records FAR 45.505-1	A separate card, form, document, or specific line(s) of computer data used to account for multiple quantities of a line item of special tooling, special test equipment, or plant equipment costing less than $5,000 per unit.
Unique record systems for material FAR 45.505-3	Because material is more cumbersome to control, the following substitute systems are sometimes authorized: 1. **Cross-referenced system in lieu of stock records** that evidence receipt, issue, and use of Government material issued for immediate consumption and is therefore not entered in inventory records. 2. **Multicontract cost and material control system in lieu of the requirement for a physical identification system** that depends on financial accounting rather than a physical accounting and allows: • Commingling of Government material with other material (but possibly reserving exclusions—for example, on the basis of high-dollar value or short supply) • Usage analysis to be the determining factor for whether Government material is being used and expended properly

Exhibit 6-1 (page 1 of 2)

Documentation Requirements for Government Property Records	
Type of Records	**Information Required**
Additional special tooling/test equipment records FAR 45.505-4	This equipment may be identified and reported by a specific retention category such as assembly tooling or critical tooling for spares. However, records must contain an identification number for each item within these categories.
Additional plant equipment records FAR 45.505-5	All plant equipment records must contain: 1. Federal Supply Code for the manufacturer 2. Federal Supply Classification, and 3. Manufacturer's model or part number Additionally, records for plant equipment that exceeds a unit cost of $5,000 must also include: 4. Serial number and year made, if available 5. Government identification/tag number, and 6. References to acquisition and disposition documents and dates
Additional real property records FAR 45.505-7	A record of all alterations and construction work, including sites connected with such work. Such records would include maps, plans, drawings, and specifications. Additionally, FAR 45.505-7 contains guidelines for when the contractor must capitalize costs associated with real property.
Additional records for scrap or salvage items FAR 45.505-8	1. Contract number, if practical, or equivalent code designation from which the scrap or salvage was derived 2. Name or description of salvaged items or a classification by material content of scrap 3. Quantity on hand 4. Posting reference and date of transaction 5. Disposition

Exhibit 6-1 (Page 2 of 2)

Scrap or salvage items. Scrap is an item that has no value except for its material content. Salvage is property that, because of its worn, damaged, deteriorated, or incomplete condition, or specialized nature, has no reasonable prospect of sale or use as serviceable property without major repairs, but has some value in excess of its scrap value.

Authorization of Summary Records

FAR 45.505-5

Summary records are generally authorized for the following specific classes of Government property, but only if the property costs less than $5,000 per unit:

- Special tooling
- Special test equipment
- Plant equipment.

You may authorize the use of summary stock records for Government plant equipment valued at less than $5,000, or require additional recordkeeping for plant equipment below that threshold. Make an individual determination based on what is needed for effective control, calibration, or maintenance.

Authorization of Cross-Referenced Systems for Material Records

FAR 45.505-3

You only can authorize a cross-referenced multicontract cost and material control system as cited in Exhibit 6-1 in lieu of stock records for the following material categories:

- Material charged through overhead
- Material under research and development contracts
- Subcontracted material
- Nonstock or special items
- Material produced for direct charge to a contract, or acquired for installation upon receipt, and not subject to spoilage
- Items issued from contractor-owned inventory direct to production or maintenance.

Authorization of Multicontract Cost and Material Control Systems

Prerequisites for authorizing multicontract cost and material control systems are listed in Exhibit 6-2.

Criteria for Authorizing a Multicontract Cost and Material Control System
FAR 45.505-3

Contracting officers may authorize multicontract cost and material control system if:

1. It will result in:
   - A cost savings
   - Improved operations, OR
   - Other benefits to the Government
2. It is applied to existing Government contracts only
3. The contractor's accounting system is adequate to:
   - Provide a clear audit trail
   - Reflect separate inventory balances for Government-furnished material (GFM) and contractor-acquired material
   - Determine material cost for each material item
   - Calculate amounts for cost-reimbursements and progress payments by applying unit costs to specific contract line items, AND
   - Track GFM from one contract to another follow-on contract for which the same GFM is authorized, assuring credit for the initial contract

Exhibit 6-2

Contractor's General Responsibilities for Government Property Records

FAR 45.105

FAR 45.505(a)

Regardless of the record system authorized, the contractor's Government property records should provide a complete, current, and auditable record of all transactions that have occurred. The records must be:

- Readily accessible to authorized Government personnel, and
- Safeguarded from tampering or destruction.

When the *Property Records* clause is in the contract, the Government, rather than the contractor, has the responsibility for maintaining such records.

Reliance on Property Administrator

Most agencies have a ***property administrator (PA)*** who monitors the contractor's responsibilities associated with Government property and fulfills certain Government responsibilities in regard to Government property. This includes maintaining Government records on the

FAR 45.104

property to the extent required by the contract or by internal agency regulations. In smaller agencies, the contracting officer's representative (COR/COTR) may also function as the property administrator. This Government official usually investigates the sufficiency of a contractor's property control system and decides if it is satisfactory.

When the contractor's system is not satisfactory, the property administrator typically provides a notice to the contractor identifying deficiencies and requesting remedial action.

If the contractor fails to comply, the property administrator requests assistance from the contracting officer. When this request is received, you must:

FAR 45.502(e)

- Obtain a copy of the property administrator's notice to the contractor
- Notify the contractor in writing of any required corrections and establish a schedule for completing them
- Obtain reports from the property administrator on the contractor's adherence to the schedule of corrective action
- Determine whether to withhold or withdraw approval of the contractor's property control system.

FAR 45.104(c)

Requirements for your notification to the contractor are contained in Exhibit 6-3.

If the Government then decides to withhold or withdraw approval, you must provide that notification by certified mail.

Requirements for Property Control System Defect Notices
FAR 45.104(c)

Property control defect notices must:

1. Be in writing
2. Establish a schedule for completion of actions to correct defects
3. Caution that a failure to correct deficiencies may result in withholding or withdrawing system approval, AND
4. Inform the contractor that its liability for loss or damage to Government property may increase if approval is withheld or withdrawn

Exhibit 6-3

6.3 REVIEW POSTAWARD REQUESTS FOR GOVERNMENT PROPERTY

Most decisions on whether or not to provide Government property are made prior to award. However, you may occasionally receive postaward requests for Government property. When you receive such requests, you have four tasks to perform:

1. You must determine whether to provide or authorize use of Government property
2. If you decide to authorize it, then you must decide whether to charge rent for using it or provide it rent free
3. If you decide to charge rent for it, then you must determine the amount of rent or other consideration
4. You must modify the contract in regard to any authorized use of Government property.

Deciding on Use

Generally, postaward requests for Government property can be approved only if the request is for Government-owned special tooling and test equipment, or when it is determined the work cannot be performed without it. Contractors otherwise are expected to furnish all property necessary to perform the contract.

FAR 45.402

Contracting officers may authorize a contractor's use of Government special tooling or test equipment upon request, but only if they:

- Determine such use is in the Government's interest
- Confirm its availability
- Eliminate, to the extent possible, any competitive advantage the contractor might gain as a result of such use (generally, by charging rent).

An example of serving the Government interest would be a direct, measurable cost savings as a result of the use of the property.

FAR 45.403

FAR 45.404

In addition to a fair rental fee or other consideration for the use of Government property requested after award, contractors also may be responsible for rental fees covering the use of Government production and research property arranged prior to award. This may occur, for example, if a contractor proposes the use of Government facilities it already is using for another contract. Some exceptions apply. Refer to Exhibit 6-4.

Circumstances that Permit Rent-Free Use of Production and Research Property FAR 45.404

- When property is located in Government-owned, contractor-operated plants operated on a cost-plus-fee-basis
- When property is left in place or installed on contractor-owned property for mobilization or future Government production purposes (however, apply rent to the extent that it is actually used or authorized for use in a specific time frame)
- When property is part of a general program approved by the Federal Emergency Management Agency (FEMA) and presents unusual problems in relation to the time required for preparation for shipment, installation, and operation because of size, complexity, or performance characteristics
- When any other Government production and research property is excepted by FEMA
- When existing written authorization for rent-free use has already been granted by a contracting officer cognizant of the Government production and research property in the possession of nonprofit organizations if used for research, development, and educational work, AND
  - The use of the property is directly or indirectly in the national interest
  - The property will not be used for the direct benefit of a profit-making organization, and
  - The Government receives some direct benefit (such as rights to use the results of the work without charge) from its use
- If the contracting officer has obtained adequate price or other consideration, Government production and research property may also be used rent-free under
  - Prime contracts that specifically authorize such use without charge, and
  - Subcontracts of any tier, if the contracting officer awarding the prime contract has specifically authorized rent-free use by the subcontractor

Exhibit 6-4

Eliminating Rent After Award

FAR 45.404(d)

You may modify a contract to eliminate rent for using Government production and research property. However, the modification must include an equitable adjustment to reflect the elimination of rent.

Determining a Fair Rental Price

In deciding on a fair rental amount, consider:

- The value of the item (if known)
- Any amount included for the item in the contract price.

To determine the value of the item, consider:

- The useful life of the special tooling and special test equipment
- General adaptability of the property for other uses
- Reasonably foreseeable requirements for future use of the property
- The scrap or salvage value of the item.

If cost and pricing data were not submitted, or do not provide a breakdown in sufficient detail to identify a specific amount for the equipment requested, require the contractor to submit this information as a prerequisite for providing the equipment.

6.4 MONITOR DELIVERY OF PROPERTY TO CONTRACTOR

Ensure that any Government property specified by the contract is made available according to the schedule. Make sure the exact property described in the contract is provided in the quantities stated.

Suitability

FAR 45.308

The Government is responsible for providing property in serviceable condition. The Government, in effect, warrants that the property will be suitable for its intended purpose except when the property is furnished "as is." Under this exception, the contractor is put on notice that if it decides to use the property, it does so at its own risk. This does not mean, however, that the Government is completely protected from contractor claims. Unless disclaimers in the contract are very clear, the courts and boards of contract appeals have usually found them unenforceable.

It is not necessary that material be defective in order to be unsuitable. The standard for suitability is the industry norm. However, if a solicitation puts a contractor on notice that the property does not meet the industry norm and specifies the degree to which it does not, courts and boards generally do not provide relief because of its substandard condition.

Repair or Replacement

FAR 52.245-2

FAR 52.245-5

The contractor is required to provide written notification of any deficiencies in property provided by the Government. When the property is deficient, you must direct the contractor to:

- Repair it
- Modify it
- Return it, or
- Dispose of it.

Unless the defects are readily apparent and can be remedied expeditiously, you should direct the contractor to return or dispose of the property.

Return of Property

FAR 52.247-55

When Government property was delivered to the contractor at Government expense, FAR 52.247-55, *F.o.b. Point for Delivery of Government-Furnished Property*, may be in the contract.

This clause requires the contractor to return any unsuitable property to the F.o.b. point at which the Government property was originally furnished and, unless otherwise specified in the contract, pack all items to conform to the rules of the common carrier originally used. However, the clause gives the contracting officer the discretion to provide other instructions for return of the property.

Equitable Adjustment

Both late deliveries and other deficiencies can result in delay for the contractor. Additionally, the contractor may be due consideration for repair or shipping charges in connection with repair or replacement of deficient property. Therefore, consider whether the contractor is due additional time or money. Demand proof of entitlement prior to processing an official contract modification providing an equitable adjustment.

6.5 APPROVE OR DISAPPROVE ACQUISITION OF SPECIAL TEST EQUIPMENT OR FACILITIES

The contractor's purchase of property not to be included in an end product and which has residual value would be considered an allowable cost if the purchase was approved under a cost-reimbursement contract. Generally, title to that property would revert to the Government at the end of the contract or when it no longer was needed. Prior approval is not required under fixed-price contracts and, unless the contract states otherwise, title to that property remains with the contractor.

FAR 52.245-5 (Alt I)

Usually, approval for the acquisition or fabrication of property under a cost-reimbursement contract will depend on the contract's terms. However, additional criteria apply to approval for the acquisition or fabrication of special test equipment or any facilities.

Facilities means property used for production, maintenance, research, development, or testing. It includes plant equipment and real property. It does not include material, special test equipment, special tooling, or agency-peculiar property.

Approval of Facilities Acquisition or Fabrication

The contractor must generally obtain written approval of the contracting officer before acquiring or modifying real property under a cost-reimbursement contract. A facilities acquisition contract that provides separate line items for specific real property constitutes such approval. Otherwise, specific approval must be obtained. There generally is no specific time frame for the Government to respond to such a request.

Approval is prohibited unless the Government has a facilities contract with the contractor that would cover the acquisition or fabrication requested.

Alternate to Acquiring/ Fabricating Facilities

FAR 45.302-1

When the contractor asserts in writing that it is unable to obtain facilities, those facilities may only be provided as Government property if the agency head or duly authorized designee issues a *Determination and Finding (D&F)* that the contract cannot be fulfilled by any other practical means or that it is in the public interest to provide the facilities.

Criteria for Approval of Special Test Equipment

FAR 45.307-2

Under a cost-reimbursement contract, the contractor may request authorization to either acquire or fabricate special test equipment at Government expense if that equipment is not already itemized in the contract. This request must be made at least 30 days in advance of its intention to acquire or fabricate the equipment. Content requirements for such requests are listed in Exhibit 6-5.

Alternates to Approval

Rather than approving such requests, the Government may furnish the property itself, by a separate contract or otherwise. If, after consulting with the property administrator, furnishing the special test equipment seems to be more beneficial to the Government, the Government may do so. However, the Government is not obligated to deliver these items any sooner than the contractor could have acquired or fabricated them after expiration of the 30-day advance notice.

Effect of Government Inaction

FAR 52.245-18(c)

Unless the Government notifies the contractor of its decision to furnish the items within the 30-day notice period, the contractor may proceed to acquire or fabricate the equipment or components unless there are any other unique contract terms that may prohibit it.

Content Requirements for Written Requests To Acquire or Fabricate Special Test Equipment
FAR 52.245-18

- An estimated aggregate cost of all items and components of the equipment the individual cost of which is less than $5,000, and the following information on each item or component of equipment costing $5,000 or more:
  - The end use application and function of each proposed special test unit, identifying special characteristics and the reasons for the classification of the test unit as special test equipment
  - A complete description identifying the items to be acquired and the items to be fabricated by the contractor
  - The estimated cost of the item of special test equipment or component
  - A statement that intra-plant screening of contractor and Government-owned special test equipment and components has been accomplished and that none are available for use in performing this contract
- If an engineering change requires the need for the fabrication or acquisition, the identity of that Change Order

Exhibit 6-5

6.6 MONITOR THE CONTRACTOR'S CONTROL SYSTEM AND USE OF GOVERNMENT PROPERTY

Unless the short form Government-furnished property clause is in the contract, you normally would rely on the contractor's approved property control system as the basis for your monitoring activity. However, you must also monitor the contractor's use of the property to ensure that the contractor fulfills its responsibilities. Contractor obligations are summarized in Exhibit 6-6.

Required Identification

FAR 45.506

Contractors generally are required to mark Government property with an indication of Government ownership.

A Contractor's Government Property Responsibilities

- Upon delivery of the property:
  - Files a statement of any overages, shortages, or damages
  - Identifies, marks, and records property actually received
  - Furnishes a receipt, if necessary
- During the contract period:
  - Maintains an approved property control system
  - Obtains all required approvals for property use
  - Uses the property for authorized purposes only
  - Segregates Government property from contractor property
  - Maintains, repairs, protects, and preserves the property
  - Periodically inventories the property
  - Keeps required property records
  - Files all required reports
- When the property is no longer needed:
  - Prepares inventory schedules
  - Corrects inaccurate or incomplete inventory schedules
  - Executes the inventory schedule certificate

Exhibit 6-6

Serial Numbered Markings

Additionally, identification by serial number is required in a manner approved by the property administrator for:

- Special tooling
- Special test equipment
- Components of special test equipment that have an acquisition cost of $5,000 or more and are incorporated in a manner that makes removal and reuse feasible and economical
- Plant equipment

- Accessory or auxiliary equipment associated with a specific item of plant equipment, if necessary to assure return with the associated basic item.

Exceptions to Identification Requirements

Exceptions to marked identification on Government property are:

- Items issued to individuals for use in their work (for example, protective clothing or tool crib items) as long as adequate physical control is maintained over such items
- Bulk-type items or where its general nature of packing or handling precludes adequate marking
- Property that is authorized to be commingled
- Other property that the property administrator agrees is impractical to mark.

Commingling with Other Property

FAR 45.507

Generally, Government property must be physically separated from a contractor's own property and the property of its commercial customers. However, there are exceptions. For example, when a multicontract cost and material control system is authorized in lieu of the requirement for physical identification, commingling may be permitted. Another example of an exception is commingling of scrap or salvage items. Such commingling is authorized when:

- Scrap of a uniform nature is produced from both Government-owned and contractor-owned material, making physical separation impractical
- Scrap produced from Government-owned material is insignificant when compared to the cost of segregation and control, or
- Government contracts involved are fixed-price and provide for the retention of the scrap by the contractor.

Preventive Maintenance Program

FAR 45.509

Preventive maintenance is required for Government property. Rather than monitoring individual preventive maintenance tasks, however, you monitor the contractor's program that manages and schedules those tasks, usually through a property administrator or other authorized Government official. **Preventive maintenance** is maintenance performed on a regularly scheduled basis to prevent the occurrence of defects and to detect and correct minor deficiencies before they result in serious damage.

The contractor is responsible for proper care, maintenance, and use of Government property in its possession. This obligation remains even when the property is in storage or is earmarked for transfer. Refer to Exhibit 6-7 for guidelines to assess the adequacy of a contractor's preventive maintenance program.

General Factors for an Effective Preventive Maintenance Program
FAR 45.509

1. Inspection of buildings at periodic intervals to assure detection of deterioration and the need for repairs
2. Inspection of plant equipment at periodic intervals to assure detection of maladjustment, wear, or impending breakdown
3. Regular lubrication of bearings and moving parts as specified by a lubrications plan
4. Adjustment for wear, repair, or replacement of worn or damaged parts and the elimination of causes of deterioration
5. Removal of sludge, chips, and cutting oils from equipment not used for a period of time
6. Exercise of precaution to prevent deterioration caused by contamination, corrosion, and other substances, and
7. Proper storage and preservation of accessories and special tools furnished with an item of plant equipment, but not regularly used with it

Exhibit 6-7

Contractor Inventory Practices

Unless FAR 52.245-1, *Property Records,* is contained in the contract, the contractor is required to periodically inventory Government property under its control.

FAR 45.508

The contractor, with the approval of the property administrator or another authorized member of the Government contract administration team, establishes the type, frequency, and procedures for performing these physical inventories considering:

- The contractor's established practices
- The type and use of the Government property involved
- The quantity and dollar value of Government property involved
- The reliability of the contractor's property control system.

Type and frequency of physical inventories normally do not vary between contracts being performed by the same contractor, but may vary with the types of property being controlled under those contracts.

Unless the contractor's organization is extremely small, personnel who perform the physical inventory should not be the same individuals who maintain the property records or who have physical custody of the property.

Inventory Documentation

FAR 45.508

The contractor is required to submit the following to document the inventories it performs:

- A listing that identifies all discrepancies disclosed by a physical inventory
- A signed statement that a physical inventory of all or certain classes of Government property was completed on a given date and that the official property records were found to be in agreement except for the discrepancies reported.

When requested by the contracting officer, the contractor must prepare inventories on a quantitative and monetary basis and segregate inventory listings by categories of property.

Contractor's Final Inventory Schedule

FAR 45.606

At the completion or termination of a contract, accept the contractor's final inventory schedules only when you or another Government contract administration team member has verified that:

- The property on the inventory is present at the indicated location
- The property on the inventory is allocable to the contract
- The quantity and condition of the property are correctly stated

FAR 45.605-2

- The contractor has tried to direct inventory items to other Government work, or return contractor-acquired property to the original supplier for appropriate credit, at the close of the contract or when it is no longer needed.

FAR 45.605-3

Under cost-reimbursement contracts, property purchased or retained by the contractor or returned to suppliers is not to be reported on inventory schedules. You must arrange for separate audits of such transactions from time to time to protect the Government's interest.

Waiver of End-of-Contract Inventory

The requirement for an end-of-contract physical inventory can be waived when the property is authorized for use on a follow-on contract, but only if:

- The Government has established the adequacy of the contractor's property control system, with an acceptable degree of variance, through past experience with that system, and

- The contractor provides a statement indicating that
  - Record balances have been transferred in lieu of preparing a formal inventory list, and
  - The contractor accepts responsibility and accountability for inventory balances under the terms of the follow-on contract.

Use of Government Property

FAR 45.509-2

One of the purposes of the contractor's property control system is to assure that Government property is used only as authorized under the terms of the contract unless approval for other uses is obtained from the contracting officer.

Specific usage controls are required for plant equipment with a value of $5,000 or more. The contractor must:

- Establish a minimum level of use below which the contractor must analyze the need for that equipment (an exception is inactive plants and equipment retained for mobilization)
- Record authorized and actual use consistent with established usage levels
- Require periodic analyses of production needs for plant equipment based on known requirements
- Report unjustified retention promptly to the contracting officer.

Non-Government Use

All of the Government property clauses prohibit use of Government property for non-Government purposes. Non-Government use not only may potentially provide a competitive advantage to the contractor, but may also diminish its useful life through normal "wear and tear."

FAR 45.407

Nevertheless, the contracting officer may authorize non-Government use if it is in the Government's interest to:

- Keep the equipment in a high state of operational readiness through regular use
- Achieve substantial Government savings through overhead cost sharing and rental receipts
- Avoid an inequity to a contractor who is required by the Government to retain the equipment in place.

FAR 28.303

Non-Government use of plant equipment requires the contracting officer's advance written approval. Before the contracting officer can authorize non-Government use amounting to 25 percent or more of total use for any piece of equipment, special approvals are required. Furthermore, the contracting officer may require the contractor to insure the property prior to approval when non-Government use is likely to exceed 25 percent.

6.7 DETERMINE WHETHER TO DECREASE OR SUBSTITUTE PROPERTY

The contracting officer is authorized by standard Government property clauses to unilaterally decrease the amount or substitute Government property, but must bilaterally modify the contract to increase the amount of property furnished.

You may want to decrease the amount of Government property when the estimated need for it was overstated. This is more common with material than with other types of property.

You may need to substitute different Government property when the property originally specified is deficient or otherwise not suited for contract purposes.

If the quantity of Government property furnished is less than what was specified, you should adjust the contract price to reflect the shortfall by adding an appropriate amount to the fixed price or ceiling amount. Normally substitutions should not require any change in contract price. An exception would be if the substituted item was not as valuable for its intended use as the item originally specified under the terms of the contract.

6.8 INVESTIGATE AND RESOLVE REPORTED LOSS, DAMAGE, OR DESTRUCTION

Evaluate and document any evidence indicating that a contractor has lost, damaged, stolen, destroyed, or misused Government property. Establish a complete record of such information for the official contract file.

FAR 45.103(a)

The basis for contractor liability is contained in the Government property clauses in the contract. Unless these clauses state otherwise, the contractor is responsible and liable for Government property in its possession. Exhibit 6-8 summarizes the contractor's liability under the various standard clauses.

Contractor Liability for Government Property	
Standard FAR Clauses	**Contractor's Liability for Loss, Damage, Destruction**
• FAR 52.245-2, Government Property (Fixed-Price Contracts)—sometimes referred to as the "long form" clause • FAR 52.245-4, Government-Furnished Property (Short Form)	Full liability except for: • Reasonable wear and tear, and • Consumption of the property in normal performance of the contract
• FAR 52.245-2, Government Property (Fixed-Price Contracts)—Alternate I • FAR 52.245-2, Government Property (Fixed-Price Contracts)—Alternate II	Limits the contractor's risk to losses: • Resulting from contractor negligence • That are expressly required to be insured under the terms of the contract • Covered, in fact, by the contractor's insurance, or • For which the contractor is otherwise reimbursed
• FAR 52.245-5, Government-Furnished Property (Cost-Reimbursement, Time-and-Materials, or Labor-Hour Contracts)	Limits liability to: • Incidents of negligence, and • Risks covered under its ordinary business insurance

Exhibit 6-8

FAR 28.303

The contractor may have insurance against such liability under its general business policy or by obtaining specific insurance policies. In either case, the policy covering the liability must disclose the Government's interest in the property.

FAR 45.103(f)

A prime contractor providing Government property to a subcontractor is not relieved of any of its responsibility to the Government under the terms of its prime contract.

Calculate the Loss

If loss or damage has occurred, and the contractor is liable, estimate the value of the loss or damage by:

- Obtaining proposals from the contractor to repair or replace the damaged property, and
- Obtaining Government estimates and/or audit reports.

Prepare the Government's position on the loss amount and the most appropriate Government remedy for the loss or damage. As is appropriate for most actions against a contractor, always give the contractor an opportunity to present its position and the supporting data for it. If the Government has assumed the risk for loss or damage, an equitable adjustment to the contractor for repairing the property may be appropriate.

Demands for Payment

If the contractor is liable, issue a demand for payment due to the loss, damage, or destruction. The method for this demand for equitable compensation for loss when the contractor is liable depends on the contractual circumstances, but a contract deduction is the most common one used (see Chapter 11). Contract deductions usually are based on the current value of the property less any accumulated depreciation.

6.9 INVESTIGATE AND RESOLVE REPORTS OF UNAUTHORIZED USE

Although "whistle blowers" within a contractor's organization sometimes report unauthorized use of Government property, the most likely source of reports on unauthorized use is the property administrator or some other Government official at the work site.

As with other performance problems, you are required to systematically and objectively investigate the issues when unauthorized use is called to your attention. You must:

- Evaluate and document the evidence
- Provide the contractor with an opportunity to present additional facts
- Determine whether unauthorized use has actually occurred
- If it has, assess the contractor rent for its use.

Assessments for Unauthorized Use

FAR 52.245-9

When FAR 52.245-9, *Use and Charges*, is included as a part of the contract terms and conditions, specific rental rates apply. According to the terms of that clause, the contractor is liable for the full monthly rental, without credit, for each month or part of a month during which any unauthorized use occurred. For certain classes of plant equipment, the clause establishes monthly rental rates based on age and percentage of value. For other classes of property, the clause merely requires the assessment of a rate based on commercial practices.

6.10 PROVIDE DISPOSITION INSTRUCTIONS REGARDING SPECIAL TOOLING

FAR 52.245-17

When FAR 52.245-17, *Special Tooling*, is included as part of the contract terms and conditions, the contractor is required to provide a listing of excess or unserviceable special tooling coded as to the reason why it is not useable. Reasons may include:

- Excess to current contract requirements with no known follow-on requirements
- Excess to current contract requirements with possible use for follow-on work
- Excess due to changes in design or specification of the end items
- Excess due to nonserviceable or nonrepairable condition
- Other reasons.

End-of-contract inventories may also identify special tooling subject to the terms of the *Special Tooling* clause.

The Government has title to special tooling it provided as Government-furnished property. It also has the right to ownership of special tooling the contractor acquired or fabricated for use under the contract. Therefore, when provided with lists of excess or end-of-contract inventories containing special tooling, you are required to provide disposition instructions to the contractor.

Time Frame for Disposition Instructions

You must provide these disposition instructions, in writing:

- Within 90 days of receipt of termination inventories that contain special tooling, and
- Within 180 calendar days of receipt of a separate excess special tooling list.

Disposition Alternatives

In your instructions, you may direct the contractor to:

- Transfer specified items of special tooling to follow-on contracts requiring their use
- Enter into an appropriate storage contract for special tooling that is to be retained by the contractor for the Government
- Transfer title to the Government—to the extent not previously transferred—and deliver to the Government those items of special tooling which are specified for removal from the contractor's plant
- Sell the property, or dispose of it as scrap, applying the proceeds as a credit on the Government's account

- Choose its own method of disposition, disclaiming any further Government interest or right in the specified special tooling
- Take some combination of the above actions.

You must also direct that the net proceeds of all sales be either:

- Credited to the cost of contract performance, or
- Paid to the Government by some other specific method.

Contractor Costs for Disposition

If the contractor incurs any costs in following the disposition instructions you provide and is not otherwise compensated for following them, you must provide equitable compensation through a contract modification.

However, restoration of the contractor's premises following disposition is prohibited. An exception is that restoration charges may be proper if the special tooling is withdrawn or substituted by the Government prior to completion of the need for it.

6.11 MONITOR DISPOSITION OF OTHER PROPERTY

At the end of contract performance, or when no longer required, you must also obtain control of other Government property not classified as special tooling or arrange for its proper disposition.

When FAR 52.247-55, *F.o.b. Point For Delivery of Government-Furnished Property,* is in the contract, the contractor must deliver Government property not integrated into contract end items to the F.o.b. point at which the Government property was originally furnished unless:

- Otherwise specified by contract terms, or
- You provide other disposition instructions.

Unless otherwise specified, the contractor must pack all items to conform to the rules of the common carrier originally used.

Delivery and Transfer

FAR 45.311

A Government agency may require delivery of any contractor inventory to which the Government has title, including the transfer of such inventory to another Government contractor. However, you must document transfers of Government property as Government-furnished property to another Government contract by arranging for a modification to be issued on the gaining contract. This not only provides an audit trail, but it ensures that the gaining contract has a valid need for the property.

Other Disposition If the Government does not exercise its right to have Government-owned contractor inventory delivered to the Government (including a contract-to-contract transfer), then the contractor must dispose of it by one of the methods listed in Exhibit 6-9.

Disposal or Recovery Methods for Government-Owned Contractor Inventory (If not returned to the Government) FAR 45.603

Unless directed to return inventory to the Government, the contractor must dispose of Government-owned contractor inventory by using the following methods in the priority listed.

1. Purchase or retention of contractor-acquired property at cost by the prime contractor or subcontractor (refer to FAR 45.605-1)
2. Return of contractor-acquired property to suppliers (refer to FAR 45.605-2)
3. Use by another Government agency through prescribed screening procedures (refer to FAR 45.608)
4. Donations to eligible donees (refer to FAR 45.609)
5. Sale, including purchase or retention at less than cost, by the prime contractor or subcontractor (refer to FAR 45.610)
6. Donation to public entities instead of abandonment (refer to FAR 45.611)
7. Abandonment or destruction (refer to FAR 45.611)

Exhibit 6-9

Restrictions

FAR 45.604

Note, however, that a contractor's or subcontractor's authority to purchase, retain, or dispose of contractor inventory is subject to any contract terms and other Federal, state, or local Government restrictions on the disposition of property that is classified for security reasons, possesses military characteristics, or is dangerous to public health, safety, or welfare.

Equitable Adjustments

A contract modification may be necessary to fund disposition action. For example, funding may be necessary to:

- Provide special storage at the Government's expense
- Pay for disposition not covered under the terms of a cost-reimbursement contract and not included in the ceiling amount or allocable to contract line items.

FAR 45.612

Under fixed-price contracts, the storage, including any cost incident to the transportation to and from the storage area, is normally borne by the contractor under standard contract clauses. An exception is when such storage is for the convenience of the Government in anticipation of future use.

CHAPTER 7

PERFORMANCE MONITORING: TECHNICAL AND SCHEDULE ISSUES

WHEN YOU GOTTA KNOW, YOU GOTTA KNOW

Top managers in Bea Ware's agency tracked contract progress by having their contracting officers establish key milestones and then reporting on their completion or reasons for missing the established dates. Aside from milestone reporting, contracting officers were to report on any major performance problems immediately.

These top management progress updates were provided at a bi-weekly status briefing chaired by the agency's General Manager for Operations, Mr. Hy Upp. Rumor had it that Mr. Upp could singe the hair of a hapless contracting officer with the fire and brimstone he could emit when displeased by a haphazard job of contract management. Contracting officers, contract specialists, and CORs were all required to attend—they dreaded these bi-weekly status briefings with equal fervor.

Mr. Upp and the other top managers weren't interested in every contract—only the high dollar or politically sensitive ones. They were definitely interested in the Tally-Up contract. So Bea and Ernest might be tracking and reporting on several sets of milestones at one time for this single contract because, with a task order contract, several projects or "tasks" might be underway at the same time.

Tally-Up's first task was to determine whether Down-Hill Industries followed generally acceptable accounting standards. Down-Hill was in line to receive a major time-and-materials contract and the reimbursable materials part of the contract was a major component of contract costs. The standards that Tally-Up would follow for this audit were those published in the ***American Institute of Certified Public Accountants (AICPA) Codification of Statements on Auditing Standards****.*

The contract contained time-frames for each type of audit so Ernest had merely calculated the completion date from the start date of the Down-Hill task order. He had worked out interim milestone dates with the Tally-Up project manager, Mr. Digi Talis. Interim milestones included dates for a report on tentative findings, an official draft audit report that would be forwarded to Down-Hill Industries for comment, receipt of comments from Down-Hill Industries, and receipt of the final audit report—the last milestone that marked contract completion of the Tally-Up task order.

The contract also called for bi-weekly meetings between the COR and the Tally-Up project manager, conveniently scheduled on the Thursday before each Friday status briefing that Hy Upp chaired.

continued . . .

Anna Lize wanted Digi Talis to provide minutes of these meetings with her for her records. "The contract does not require minutes from the contractor," she pointed out. "If we require minutes, Tally-Up will do it, I'm sure, but don't forget that we will be paying for their time to write and type them up and they'll probably make big deal out of it."

They were still arguing the pros and cons one week into the performance period of the first task order.

Finally, they decided to specify the content of abbreviated minutes and Digi Talis agreed to the proposed content. The minutes would list attendees and contain a summary of matters discussed in three sections, as appropriate.

The first section would merely report on the date any milestones were met or, if scheduled to be completed and were as yet incomplete, why they could not be met. Any report of a milestone not met required an attachment fully explaining the reasons why the milestone was missed. The second section would list—in a maximum of two sentences—any major problems encountered in conducting each audit. The contractor could expound on these in an attachment to the minutes, but only with Anna Lize's concurrence. If there was a second section, there would also be a third section listing action items for problem resolution—the action would be agreed upon by both Digi Talis and Anna Lize and it might be a Government or a contractor action that was needed. Items listed in this third section could not exceed two sentences and could only be further explained in an attachment if Anna Lize agreed it was necessary.

If nothing was appropriate to include in these sections, the contractor was to merely indicate that the meeting occurred and that no major problems had occurred during the previous two weeks. The minutes in such cases were not to exceed one page.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Monitor technical and schedule performance of both contractor and Government personnel and ensure that any actions required by the contracting officer are accomplished in a timely manner.

Individual:

7.1 Establish a systematic approach for responding to requests and technical notices from contractors.

7.2 Monitor actions of contracting officer's representatives (CORs), contracting officer's technical representatives (COTRs), and other support personnel.

7.3 Obtain data on compliance with technical and scheduling requirements.

7.4 Obtain inspection and acceptance data.

7.5 Inform requiring activity and other interested parties of the contract's status.

INTRODUCTION TO TECHNICAL AND SCHEDULE MONITORING

Definition of Monitoring

Monitoring a contract involves those contract administration activities that contracting officers and their support personnel use to ensure that supplies and services conform to the contract's technical, schedule, and cost requirements. This chapter covers technical and schedule, monitoring. Chapter 8 details cost monitoring, a special concern for cost-reimbursement contracts.

Regardless of contract type, technical compliance—meeting the quality and quantity requirements of the product or service under contract—and schedule compliance—meeting both interim and final timetables for delivery and completion—are monitoring concerns for Government officials.

Impact of Contract Type

Generally, cost-reimbursement contracts are more difficult to monitor because of their unique cost monitoring tasks and also because the statement of work usually is less precise than in a fixed-price contract.

Monitoring Objectives

The Government monitors a contract closely to support many objectives, including those to:

- Identify potential delinquencies
- Isolate specific performance problems
- Support contractor requests
- Point out the need for Government assistance
- Reveal actual or anticipated default
- Identify Government-caused delays.

Government Policy on Monitoring

FAR 46.102

Government-wide policy requires that agencies ensure:

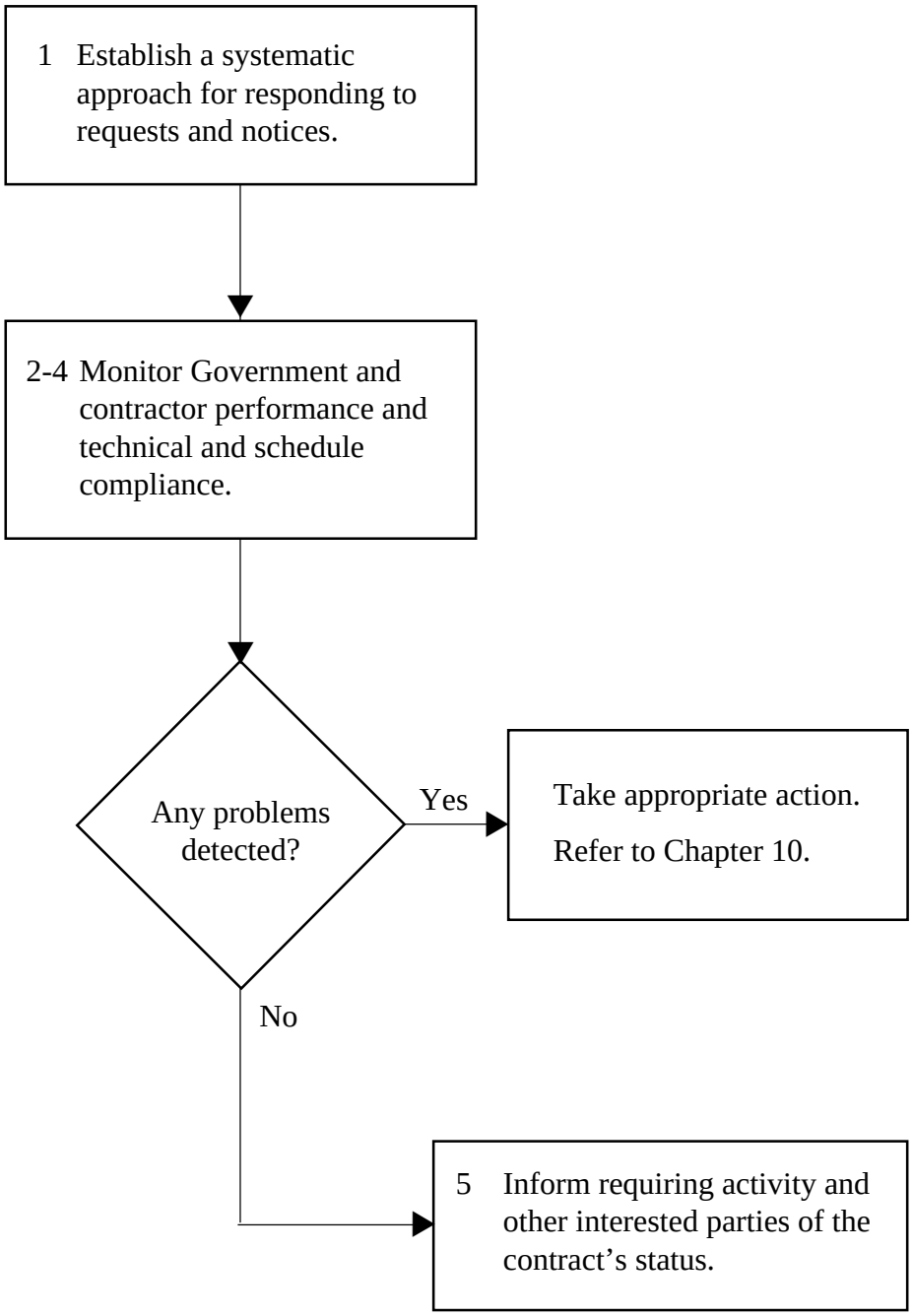
1. Contract deliverables meet contract requirements.
2. These contract requirements are met before acceptance of items or services.
3. No contract precludes the Government from inspecting contract work.

This policy further encourages the use of inspection and acceptance services by other agencies when it is more practical or beneficial to the Government.

Steps in Performance

The steps in executing basic procedures for successful technical and schedule monitoring are charted on the next page. A discussion of each step follows.

STEPS IN SUCCESSFUL TECHNICAL AND SCHEDULE MONITORING



TECHNICAL AND SCHEDULE MONITORING

Benefits of a Systematic Tracking System

If monitoring procedures are to fulfill Government policy for assuring that all contract requirements are met, they must embody a systematic approach for overseeing the actions of both Government officials and the contractor.

By systematically monitoring the actions of other Government officials, you are better able to:

- Identify and, where possible, forestall unauthorized changes before there is an impact on contract performance.
- Ensure that officials are properly carrying out their roles and responsibilities within the limits of their authority.
- Ensure that officials adhere to all work specifications and time limits established in the contract.

7.1 ESTABLISH A SYSTEMATIC APPROACH FOR RESPONDING TO REQUESTS AND NOTICES FROM CONTRACTORS

By systematically monitoring the actions of the contractor, you are more likely to obtain efficient and timely performance. Furthermore, you will be in a better position to preserve the Government's rights in the event of deficient contract performance.

There are times when the Government is called upon to review, approve, make decisions, or take other actions during the performance of a contract. Most Government actions are based on contract requirements. Examples are:

- Interpretation of technical specifications
- Obtaining approval for contractor entry on a Government site
- Providing an escort in controlled areas
- Arranging for utility outages when required by the contractor for maintenance or installation purposes
- Authorizing the use of overtime under certain types of contracts (covered in Chapter 8)
- Authorizing used or surplus material as substitutes for new material.

Because the contractor is responsible for the management of the work, the contractor is in the best position to determine when to submit requests to the Government. As the contract specialist administering the contract, be prepared to handle requests by establishing a system to:

- Track contractor requests, and
- Provide a response that is timely as defined in the contract itself or in applicable regulations.

If there is a conflict between the contract definition of what is timely and what a Government regulation considers timely, only the contract language is binding on the contractor

Timely Responses

A timely response to contractor requests sets the tone for your relationship with the contractor and pays dividends by minimizing the amount of contract administration required for contracts that are running smoothly. A timely response ensures the contractor is held accountable for delivery and performance terms.

Untimely Responses

Contracts may specify a time frame for both contractor requests and Government responses to those requests. If contracts do not specify a Government response time, the Government should establish an adequate and reasonable response date with the contractor. An effective tracking system identifies not only who is handling the response, but also the due date.

Tracking Requests

Responses to many contractor requests require input from other Government officials. Use a manual or automated tracking system to ensure that requests "out of sight" are not "out of mind." The contractor may not even be able to proceed until the Government responds.

For instance, the specifications might call for submission of a material sample for Government approval of color. While the program manager may be charged with overall responsibility for approving the color, other officials may have to concur. The contractor may be at a complete standstill until the approval is received. If you have not set up a tracking system, it may take days just to locate the sample. You can use a tracking sheet such as shown in Exhibit 7-1 to monitor such approval requests.

Material Approval Tracking Sheet

Contract Number: _____

Contractor: _____

Submittal ID No.*	Contract Paragraph Number	Description of Material or Submittal	Date Request Received	Approval Needed by or Due by	Date Review Completed	Date Returned to Contractor	Approved or Rejected	Previous Submittal ID No.

* Give each resubmittal its own ID number; then cite previous number in the column on the far right.

Exhibit 7-1

Approval of Used, Reconditioned or Surplus Material

FAR 10.010

FAR 52.210-5

FAR 52.210-6

FAR 52.210-7

The procedure for processing formal contractor requests usually will be laid out in the FAR. Contractors would have to request approval, for example, to substitute used, reconditioned or surplus material for new material. The contract should have a clause that allows for approved substitutions:

- FAR 52.210-5, *New Material*
- FAR 52.210-6, *Listing of Used or Reconditioned Material, Residual Inventory, and Former Government Surplus Property*
- FAR 52.210-7, *Used or Reconditioned Material, Residual Inventory, and Former Government Surplus.*

Exhibit 7-2 lists the factors contracting officers are required to consider in allowing such substitutions and that contract specialists must consider in making recommendations for approval or disapproval.

Requirements for Approval of Used/Reconditioned/ Surplus Substitutions FAR 10.010(b)

The following factors must be considered:

1. Safety of persons or property
2. Total cost to the Government (including maintenance, inspection, testing, and useful life)
3. Performance requirements, and
4. Availability and cost of new materials and components

Exhibit 7-2

If the total cost to the Government for the substituted material exceeds the cost of new materials and components, approval should not be granted unless the Government verifies that:

- New material is unavailable, and
- The need for the requirement cannot be postponed until new material is expected to be available.

In examining the total cost to the Government, you should also have data that verifies what the contractor expects to pay for the substituted material.

When there is a cost savings to the contractor under a fixed-price contract, approval cannot be given unless the Government is provided appropriate consideration.

FAR 10.010(c)

When a contract calls for material to be furnished at cost, the allowable charge for former Government surplus property cannot exceed the cost the contractor paid for the property.

7.2 MONITOR ACTIONS OF COR/COTRS AND OTHER SUPPORT PERSONNEL

FAR 43.102

As the contract specialist administering the contract, you are responsible for the actions of all other Government personnel involved in the administration of the contract. Government officials overstep their authority at times by requiring the contractor to do something other than what is specified in the contract. Often, these officials are merely reacting to an unforeseen or unplanned situation. Nevertheless, they risk personal liability for directing changes that may have a cost impact because funds have not been specifically obligated for that change. The term used to describe such an unauthorized change is ***constructive change.***

A constructive change occurs when the contracting officer or his or her duly authorized representative changes the contract without going through the required legal or regulatory formalities. A constructive change can result from either a specific action or a failure to act. Examples are:

- Errors of interpretation
- Issuance of changes outside the scope of the contract
- Failure to issue a change to correct a defective specification
- Acceleration of performance.

Technical Direction vs. Constructive Changes

Technical direction is technical guidance within the statement of work. Some more technically complex contracts require technical direction from Government officials, usually the COR/COTR. An example is a Government scientist steering a scientific research contractor away from specific lines of research inquiry and toward others, based on research already conducted by the Government or another contractor.

The need for, and the ramifications of, technical direction are different depending on whether the contract is fixed-price or cost-reimbursement. Work statements are normally more precise under fixed-price contracts than under cost-reimbursement contracts. When a work statement is precise, there is little or no need for technical direction.

While a contractor is not likely to perform extra work resulting from Government technical direction under a fixed-price contract without firm assurances of additional compensation, it does not need such assurances under a cost-reimbursement contract. The costs for the extra work is paid by the Government. However, performing additional work under cost-reimbursement contracts does have consequences that can sometimes be severe. It can:

- Deprive the contractor of a fee for its additional incurred costs, and
- Result in an overrun of the estimated costs, requiring additional funds for completion.

Therefore, it is essential that technical direction be kept within the scope of the original estimated contract work and costs, unless altered by an official contract modification.

Because the contractual technical boundaries in a cost-reimbursement contract may not be clear, neither the Government nor the contractor's technical personnel are likely to have a clear understanding of where technical direction stops and constructive changes begin. Even lawyers dealing with Government contract law have difficulty in clarifying the differences in specific circumstances.

In summary, technical direction does not involve a true change. A constructive change is an implied change and is handled under a contract clause that addresses changes to contract requirements.

Changes Clauses

Contracts must include one of the following clauses (or an applicable alternate) pertaining to changes:

FAR 43.205

- FAR 52.243-1, *Changes—Fixed-Price* (used for supplies and/or services)

FAR 52.243

- FAR 52.243-2, *Changes—Cost-Reimbursement*
- FAR 52.243-3, *Changes—Time-and-Materials or Labor-Hours*
- FAR 52.243-4, *Changes* (used for construction contracts)
- FAR 52.243-5, *Changes and Changed Conditions* (used for small purchases)

Any of these standard changes clauses gives the Government the unilateral right (see Chapter 14) to order the contractor to make a change to the contract in the specific areas listed in the clause. These specific areas vary depending on:

- What clause is used
- What alternate language is included in the clause
- What the basic technical requirement entails.

Refer to Chapter 14 for a detailed summary of these rights. In general, only minor variations in quantity and quality of the technical requirement and administrative details such as the location of inspections, acceptance points, and delivery destinations are permissible. In exchange, the contractor is promised an ***equitable adjustment*** if the change causes an increase or decrease in the cost or time for total contract performance.

FAR 52.232-20

FAR 52.232-22

An exception is when an equitable adjustment would exceed the estimate or ceiling price in a limitation of cost or funding clause contained in cost-reimbursement contracts. Refer to Chapter 8 for further information on these clauses.

Extent of Adjustment

Equitable adjustments include any adjustment in:

- Price (including profit) for fixed-price contracts
- Estimated cost or fixed fee for cost-reimbursement contracts
- Delivery or completion schedule, or
- Other affected terms or conditions.

FAR 43.102

Come to an agreement on price for a change before a contractor performs the change if this can be done without adversely affecting the Government's interest. Constructive changes destroy any possibility of prepricing, putting the Government in a poor negotiation position.

Monitoring for Constructive Changes

There are a number of methods you can use in monitoring the contract for constructive changes:

- Obtain copies of correspondence from other support personnel
- Instruct contractors to submit notices of constructive changes and other potential changes
- Obtain COR/COTR reports as specified in designation letters
- Obtain feedback on meaningful oral communications with the contractor

- Periodically contact COR/COTRs and other support personnel
- Use other methods such as unscheduled site visits.

The methods you use for a specific contract should be outlined in the contract administration plan for that contract.

Obtain Correspondence

Your contract administration plan should emphasize a requirement that support personnel provide the contracting office with copies of all memos or letters written regarding the contract. By reviewing these copies, you are in a better position to identify when other Government officials have inadvertently changed the terms of the contract.

Obtain Contractor Notices

FAR 43.104

A clause in the contract, usually FAR 52.243-7, *Notification of Changes*, may make submission of notices of potential changes to the contracting officer a contract requirement. Notice that the standard clause and most other clauses require the submission of the notice to the contracting officer—not the COR/COTR or another Government official.

FAR 52.243-7

Any Government official other than the contracting officer who receives such a notice should advise the contractor that the notice provided to them does not fulfill the contractor's obligation under the clause. This is important because the contracting officer cannot attempt to honor the contractor's requested response time until the notice is in his or her hands.

The Government's receipt of such a notice is often its first indication of a potential dispute. Disputes are discussed in Chapters 10, 15 and 17. The notification clause is not mandatory, but is most often used for research and development, supply contracts for major systems, and for subsystems over $1 million. The basic requirements for this notice of change are shown in Exhibit 7-3.

Even when your contract does not contain this clause or a similar variation, the guidance these clauses contain are still useful when you inquire about the circumstances of a potential change. Be thorough. *On any contract, equitable adjustments are required when a change affects price or delivery.*

FAR 43.104

You perform several tasks when you receive such a notice. These tasks are outlined in Exhibit 7-4.

Content Requirements for a Notice of Change
FAR 52.243-7

1. The date, nature, and circumstances of the conduct the contractor regards as a change
2. The name, function, and activity of Government or contractor personnel who know about this conduct
3. The identification of any documents and the substance of any oral communication involved
4. The basis for any allegation of accelerated performance or delivery
5. Any element of contract performance that the contractor may use as a basis for seeking an adjustment in time or money, including:
   - Contract line items affected
   - Specific labor or material categories affected
   - To the extent practicable, delay and disruption in the manner and sequence of performance and effect on continued performance
   - Contractor estimates of adjustments to contract price, delivery schedule, or other contract terms
6. The contractor's estimate of a reasonable Government response time that would minimize cost, delay, or disruption of performance

Exhibit 7-3

Responsibilities in Responding to a Notification of Change
FAR 43.104

1. Confirm that the circumstances constitute a valid contract change
2. Recommend to the contracting officer a method for directing further performance
3. Plan for funding the change
4. Take appropriate action by:
   — Canceling the change, or
   — Notifying the contractor that the Government does not believe that a true change has occurred

Exhibit 7-4

Obtain Feedback on Discussions

Not all discussions with the contractor are documented in writing. A contractor may change how it is performing the contract based on discussions with other Government officials. If the Government official who orally directed the contract change had the authority to make the change in writing, a court or board will generally charge the Government with the legal consequences for it even though the changes clauses specify a change by written order. However, even if the person who gave oral direction did not have the general authority to make the directed change, the contractor's ill-advised diligence in following it is likely to cause disruption to the Government's contract performance goals.

So require all Government officials involved in contract administration to report to you any meaningful communications they have held directly with the contractor. Meaningful communications would include any information that might potentially affect:

- Performance
- Price
- Schedule
- Other contract requirements.

FAR 42.1104(d)

This will help you control actions that are inconsistent with contract requirements.

Contact Other Government Personnel

Your contract administration plan may require your COR/COTR or other support personnel to provide periodic progress reports or daily logs of contract activity. Follow up immediately when you do not receive them. Make it a point to analyze them for constructive changes.

If your contract administration plan does not include the submission of reports from support personnel, contact them on a regular basis and ask them how things are going. Sometimes these people will not "bother" you with something they think is insignificant. However, you want to have an early warning of any contract performance difficulties. Often these "insignificant" events can cause major future headaches.

Use Other Methods

Sometimes an unannounced site visit is the most effective way to find out what is really going on. When both contractor personnel and your support personnel are there to listen to the other's answers to your questions, you are less likely to get a one-sided picture of events that have taken place or are currently happening.

Of course, you may have other more direct evidence of constructive changes, such as:

- Contractor requests for change orders, or
- Invoice items or invoice amounts that are not consistent with contract requirements.

The more quickly you identify changes and other problems, the easier they are to resolve.

7.3 OBTAIN DATA ON TECHNICAL AND SCHEDULE COMPLIANCE

FAR 52.212-1

FAR 52.212-2

In addition to monitoring the actions of Government officials for constructive changes, you need to obtain sufficient data to verify satisfactory contract performance. You need to recognize any evidence of potential performance problems by either the contractor or the Government. Sources for obtaining information on potential contractor performance difficulties are summarized in Exhibit 7-5.

Each source provides you with a slightly different understanding of how the contract is progressing.

Progress and Other Monitoring Reports

Early warning indicators of potential changes, delays, or other problems in contractor performance are often provided by reports on contract performance from either the contractor or the COR/COTR. Contract terms specify whether contractors must provide such reports. Contract administration plans specify whether COR/COTRs must provide monitoring reports at scheduled intervals during contract performance.

Sources of Contract Performance Status Information

Sources of information on contract performance include:

- Progress and other monitoring reports
- Requiring activity and end user comments
- Personal site visits/observations of work
- Inspection and acceptance officials
- Other data supporting acceptance or rejection
- Other persons (both Government and contractor officials)

Exhibit 7-5

COR/COTR Reports

In addition to routine progress reports, COR/COTRs may initiate written reports identifying potential or actual delays in performance. Counsel COR/COTRs to provide such reports:

- In sufficient time for necessary action by the contracting office
- With a specific recommendation for action.

Contractor Reports

You can require the submission of written data from the contractor only if it is required by the contract itself. You may ask for a written analysis of a specific contract issue, for example, but unless the contract anticipates responding to such a request, the contractor is under no obligation to provide it. Think about the circumstances before you make such a request. If providing a written response to your request is time-consuming, the Government will end up paying extra for it on a cost-reimbursement contract and may have to pay for it as a result of a fixed-price contract claim.

As an alternate, some well-timed questions may produce valuable oral information. If your information needs are not simple enough to be answered by a brief question-and-answer session, you probably have a contract submission requirement that can be used to fulfill that need. The contract may call for:

- Shop plans
- Shop travelers
- Blueprints
- Stick drawings
- Wiring diagrams
- Reprocurement data packages
- Identification of subcontractor sources
- Progress reports.

FAR 42.1106

Progress reports typically are relied upon as a long-term contract administration monitoring tool. Because your information needs for different contracts are not standard, there are no standard FAR clauses addressing content requirements for progress reports. However, progress reports do tend to have some common elements. These are listed in Exhibit 7-6.

Common Elements of a Contractor's Progress Report

- Actual deliveries or performance milestones met
- Scheduled deliveries or projected performance milestones
- Factors causing delays
- Status of the work, in general, and by specific element often reported as a percentage of work complete
- Reasons for any difficulties or delays
- Actions taken or proposed to overcome difficulties or delays
- Assistance needed from the Government

Exhibit 7-6

Normally, the COR/COTR reviews and verifies the contractor's progress reports, but some contracts require direct submission to the contracting office. For direct submissions, your contract administration plan should include a separate report from the COR/COTR. Make a comparison of corresponding reports and resolve any discrepancies.

The fact that a monthly progress report is required by the contract does not relieve the contractor of its obligation to report anticipated or actual delays to the COR/COTR or the contracting office as soon as such delays are recognized. After an initial analysis is made and reported, the contractor does not need to repeat the analysis in regularly scheduled progress reports, but must track progress toward correction if correction was indicated in the analysis.

Production Contract Reports

FAR 42.1107

FAR 52.242-2

Production progress reports may be required by the contract. There is no standard format, but these schedules are often characterized by reporting on the time required to pass through various stages of the production cycle, such as:

- Planning
- Purchasing
- Plant rearrangements
- Tooling

- Component manufacture
- Subassembly and final assembly
- Testing
- Shipping.

R&D Contract Reports

FAR 35.002

Because the primary purpose of research and development (R&D) contracts is to advance scientific and technical knowledge, they represent some unique monitoring problems. The Government must closely monitor technical progress. Therefore, progress reports are often required from the contractor and may include such things as:

- Number and names of key personnel working on the project during the reporting period
- Facilities currently set aside for the work
- Direction of the work
- Experiments being conducted
- Other work in process
- Negative results of R&D work
- Problems encountered
- Efforts taken to resolve them discussed in terms of

  — costs

  — schedule

  — technical objectives.

FAR 35.010

These progress reports are normally in addition to the scientific and technical reports that become a permanent record of the work accomplished under the contract.

Graphic Progress Presentations

Production contracts and other types of contracts may require the contractor to submit graphic displays for comparing actual and scheduled progress.

At one time this was a time-consuming task, but now computer graphic software programs can create these comparison graphics with relative ease.

Bar charts and milestone charts represent the more simple graphic displays. An example of a milestone chart is shown as Exhibit 7-7.

Sample Milestone Chart

Project Phases and Key Activities

Performance Appraisal Design

1. Interview staff to determine training needs and specifications
2. Review state-of-the-art training designs and those used in other Federal agencies
3. Identify all materials needed for data base
4. Present concept, including linkages with other training efforts and publications

Training Program Design

5. Develop briefing materials
6. Develop training materials for workshops
7. Prepare and produce manuals

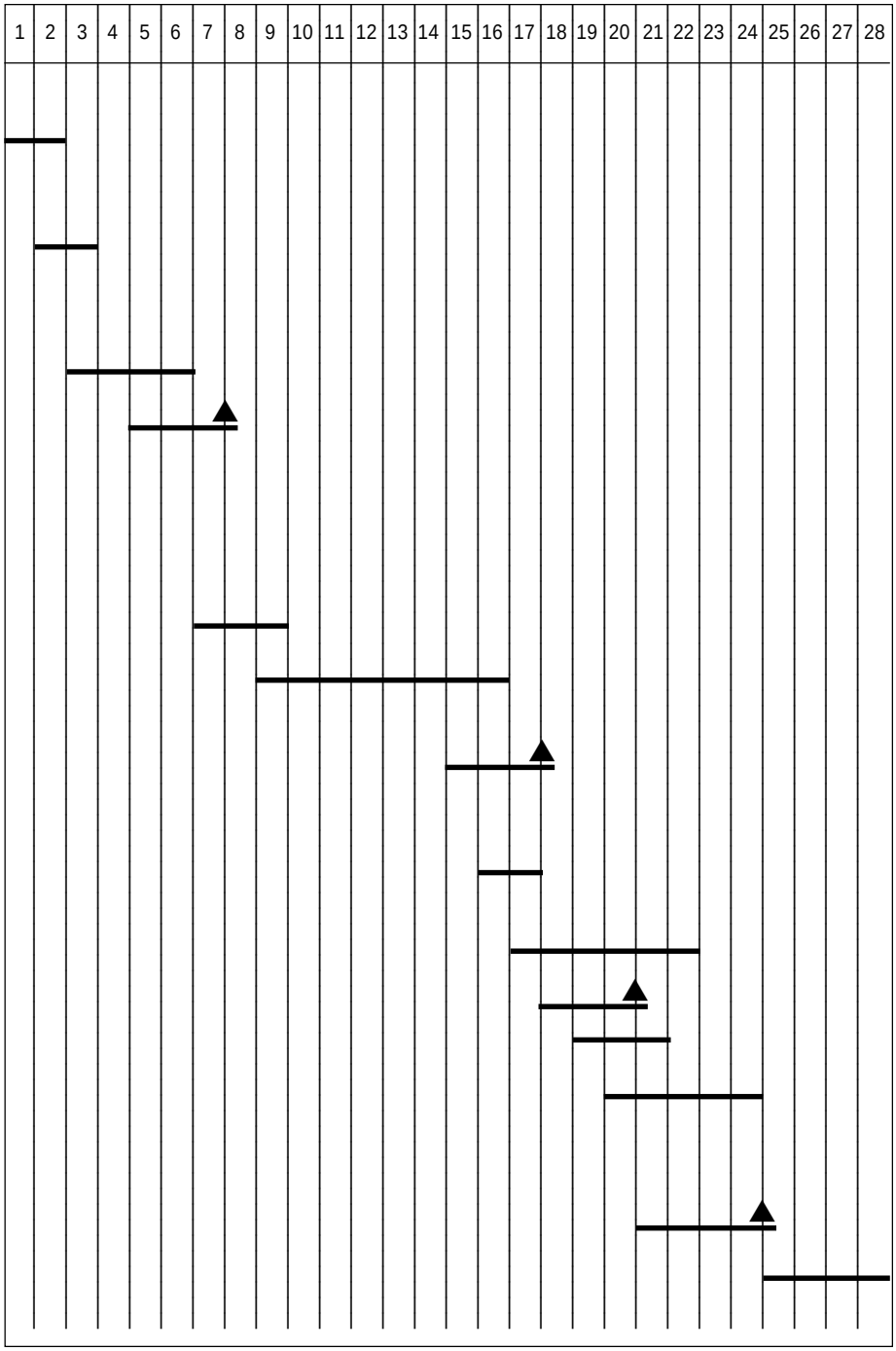
Training Delivery

8. Develop program schedule; register participants
9. Conduct briefings and workshops
10. Train trainers
11. Develop trainer manual
12. Support trainers during initial sessions

Follow-up Evaluation

13. Develop evaluation design
14. Assist with evaluation

Project Schedule (Weeks After Start)



▲ = Project Milestone Event

Exhibit 7-7

Simple milestone charts, however, have limitations. They do not show complex interrelationships among:

- Events
- Tasks
- Time
- Contractor progress.

Moreover, bar and milestone charts are difficult to revise when changes take place.

When a contract involves interdependent relationships among tasks, decisions and resources, the contractor may be required to provide a graph showing what has to be done, and when. These more elaborate graphic displays help the contractor perceive the relationship among various tasks, the order in which events and decisions take place, and the need for specific resources (materials, equipment, and labor). In addition to functioning as a contract performance and management tool, they are a planning aid as well.

Examples of techniques used to make these more elaborate display systems include:

- Program Evaluation Review Technique (PERT)
- Critical Path Method (CPM).

The basic difference in these two techniques is in how they look at potential time variances.

CPM results in a single estimated performance time. PERT creates three time estimates—optimistic time, pessimistic time, and most likely time for performance.

The contract may require the contractor to submit PERT or CPM charts with its offer or after contract award. Occasionally the contractor submits them voluntarily because it uses them for internal project management purposes. When these charts are available to the Government, they are important contract monitoring tools.

Meetings with Requiring Activities

Hold periodic meetings with the requiring activity and end users to obtain, as well as provide, pertinent information on contract status. These meetings help to foster the Government's team approach to contract administration. When the contractor performs on-site work, those they come in contact with can provide early warning of any potential performance problems that may not yet be documented.

Personal Site Visits Hold periodic meetings with contractor and Government technical personnel who have contract administration responsibility at the site. Your goal is not only to identify constructive change situations, as outlined earlier in this chapter, but primarily to obtain monitoring data through your own observation. On-site meetings allow both Government and contractor personnel an opportunity to identify, as well as resolve, problems at the operating level.

FAR 42.402

However, there are certain rules of etiquette that you must follow before making a site visit when your contract administration office has delegated specific contract administration functions to another contract administration office (CAO). This type of delegation often occurs when your office has a production contract in a plant where another agency has an on-site contract administration activity. When making on-site visits to such facilities, prior notification is required, as detailed in Exhibit 7-8. Refer to item #6 in this exhibit. If the CAO has already gathered data that will fill your data requirements, personnel within the CAO generally will notify you that the visit is not necessary and provide you with the existing data. When available, you should rely on the CAO's documentation rather than gathering evidence yourself.

In addition to this notification requirement, you are expected to inform the CAO of any agreements you reach with contractor personnel or of any other results of your visit that may affect CAO operations and decisions.

CAO Notification Requirements for Contractor Facility Visits
FAR 42.402

1. Names, official positions, and security clearance information for all visitors
2. Date and duration of your visit
3. Name and address of contractor facility and personnel you wish to contact within it
4. Contract number, any overall program involvement, and the purpose of your visit
5. Request for CAO representation, if you desire it (note that the CAO may accompany you, whether you desire it or not)
6. Identify data you may wish to obtain in conjunction with this visit

Exhibit 7-8

7.4 OBTAIN INSPECTION AND ACCEPTANCE DATA

The type of data you can expect to receive from Government officials responsible for inspection depends on what inspection and acceptance criteria are in the contract. When a contract is awarded by the Government, the contractor assumes responsibility for timely delivery and satisfactory performance. Performance includes furnishing the Government with the quantity and quality of items the contractor agreed to deliver and for which the Government agreed to pay. Although the contractor is fundamentally responsible, the Government, through contract administration, protects its interests to insure quality and timeliness. Inspection and acceptance requirements that are included in every contract serve as the contractual basis for this protection.

Purpose of Inspection

The purpose of ***inspection*** is to determine whether the product or service conforms exactly to what the Government has ordered. The extent of inspection varies with the dollar value of the contract and the type of product or service.

Inspection Defined

FAR 46.101

Inspection means examining and testing supplies or services (including, when appropriate, raw materials, components, and intermediate assemblies) to determine whether they conform to contract requirements.

Types of Inspection

FAR 46.202

Whenever possible, the contractor's self-inspection systems are used. There are basically three types of self-inspection systems:

1. **Government reliance on inspection by the contractor**. FAR 52.246-1, *Contractor Inspection Requirements*, is the standard clause used to identify this quality level, but variations to the standard are authorized. The clause is used for small purchases unless the contracting officer decides that some form of Government inspection and testing is necessary. The clause does allow some specialized Government inspection and testing, but it relies on the contractor for overall inspection. An example of a specialized test for a small purchase could be an environmental test for an outdoor herbicide product.

2. **Standard inspection requirement.** This is the standard inspection requirement contained in most FAR clauses, including:

   - FAR 52.246-2, *Inspection of Supplies—Fixed-Price*
   - FAR 52.246-3, *Inspection of Supplies—Cost-Reimbursement*
   - FAR 52.246-4, I*nspection of Service— Fixed-Price*
   - FAR 52.246-5, *Inspection of Services—Cost-Reimbursement*
   - FAR 52.246-6, *Inspection —Time-and-Materials and Labor-Hour*

- FAR 52.246-7, *Inspection of Research and Development—Fixed-Price*
- FAR 52.246-8, *Inspection of Research and Development—Cost-Reimbursement*
- FAR 52.246-9, *Inspection of Research and Development (Short Form)*.
- FAR 52.246-9, *Inspection of Research and Development (Short Form)*.

These clauses require that the contractor establish and maintain an inspection system not otherwise defined except that it must be acceptable to the Government. One of these standard inspection clauses can be the only inspection clause in your contract, or it can be the foundation for other Government inspection specifications. Particularly for cost-reimbursement contracting situations where the Government risk is higher and the contractor risk is lower, a decision on how much to rely on contractor controls must be considered carefully. The FAR specifies other additional inspection terms for use in specific situations.

3. **Higher-level quality control requirement.** The clause, FAR 52.246-11, *Higher-Level Contract Quality Requirement (Government Specification),* is used when the technical requirements of a contract require closer control of work processes or attention to such factors as planning. This type of clause requires the contractor to comply with Government inspection procedures or specify quality control specifications the contractor is to follow.

Inspection Methods and Data

The data you see from Government inspections result from several different inspection methods. The most commonly-used methods and the kinds of data that typically result are listed in Exhibit 7-9.

Sensory Checks

Even if the contract calls for reliance on the contractor's inspection system, the Government retains its right to inspect and, at a minimum, inspect for adequacy and perform sensory checks.

Receiving dock personnel at your agency typically use sensory/dimensional checks when accepting commercial products. The essentials involved are outlined in Exhibit 7-10.

Common Inspection Methods and Examples of Use

Type and Description	Product-Related Example	Service-Related Example
Sensory and dimensional checks are examinations by an inspector using his or her eyes, ears, and other senses. The inspector exercises a good amount of personal judgement.	Using this method for a commercially-available automatic pencil sharpener reveals surface defects, missing pieces, noisy operation, and parts out of alignment.	For custodial services, visually inspecting surfaces will detect surfaces that are not clean.
Physical or performance tests provide actual performance data that is compared with required performance or physical characteristics or a range of what is considered acceptable according to the contract.	Requiring that a motor run or an operating system perform at a certain level for a specific period of time is an example of a performance test. Testing for the composition of chemicals or for the density of products against acceptable parameters in the specification are example of physical tests.	On a bus service contract, waiting at a particular bus stop to see if the bus arrives on time is a performance test to check compliance with the required schedule. Performance tests for labor-intensive services are often done using random sampling.
Destructive tests requires that end products meet certain reliability standards or withstand a specific level of stress.	Heating a product until it burns tests the fireproof characteristics of an end product.	Scratching through the new coats of paint shows the number of coats applied on a painting contract.

Exhibit 7-9

Interim Inspections The Government retains the right to inspect all materials and workmanship at any time and any place where work on a contract is being performed. Interim Government inspections may focus on different aspects of performance, for example, to determine whether:

- Performance on schedule can be expected
- Cost will be within the estimate (refer to Chapter 8)
- Resources are being applied at originally predicted levels
- Quality of the end products will be consistent with the contract requirement
- Progress payments are warranted

Elements of a Commercial Item Inspection

1. Proper type/kind
2. Correct quantity
3. Damage check
4. Operability check
5. Preservation check for spoilage and other signs of age deterioration
6. Packaging and labeling requirements check
7. Appropriate packaging, if applicable
8. Proper identification

Exhibit 7-10

- New components need to be incorporated in major systems
- A contractor's own inspection system is adequate
- A contractor has failed to follow its own established inspection or quality control procedures.

Improper Inspections

The inspection clauses give the Government certain rights in contract monitoring. However, improper application of inspection procedures can jeopardize those rights. So you must be alert to any indications of improper inspections. Most improper inspections fall into the following categories:

- **Unspecified tests that are improper.** The Government does not have to specify the method it will use to test a product or service for contract compliance. It can perform tests that are unspecified. Nevertheless, when unspecified tests impose a stricter standard of performance, they are improper. In fixed-price situations, the contractor may be able to recover increased costs caused by unspecified Government tests if it could not have reasonably anticipated such tests during the solicitation phase. In cost-reimbursement situations, the Government pays the increased costs under the terms of the contract unless the Government can prove fraud or gross negligence.

- **Erroneous tests.** Inspection testing is improper if it is not a reasonable measure of contract compliance. However, if your inspector failed to accurately perform an interim test so that a defective item or deficient service passed through an interim inspection undetected, this usually will not prevent rejection later.
- **Repeated tests.** The Government generally has the right to inspect items or services it had inspected previously, but if reinspections are inconsistent with prior inspections, they are improper. Reinspections are also improper if they are unreasonable as to time and place so that undue or unnecessary delays result.

FAR 46.503

When the Government rejects supplies or services based on an inspection conducted exactly according to the contract specifications, that rejection cannot be overturned by another inspection method, even though the other method shows that the supplies or services met the specifications of the contract.

Cost and Management of Rework

Under a cost-reimbursement contract, the contractor is generally entitled to recover the costs of making corrections, but is not entitled to collect any fee on the costs of reperformance. Fixed-price contractors must absorb the cost of corrections.

Because the Government pays for rework on cost-reimbursement contracts, it is entirely appropriate that COR/COTRs provide technical guidance on that rework. However, in fixed-price situations, COR/COTRs should avoid providing any direction on how to rework products and services. If fixed-price contractors diligently follow specific Government direction for accomplishing rework and the product or service is still deficient, it is likely that these contractors can avoid the responsibility for the resulting deficiencies. The result may be that the Government assumes the responsibility for the defects in contract performance because it interfered in the fixed-price contractor's responsibility to manage that performance.

Data Supporting Acceptance or Rejection

The ***acceptance*** procedure is important because, at the time and place of acceptance, title passes from the contractor to the Government. Acceptance is final except for:

- Latent defects
- Fraud, or
- Gross mistakes that amount to fraud.

FAR 52.246-3

FAR 52.246-8

Exceptions to these reasons for overturning acceptance apply to certain research and development contracts and most cost-reimbursement contracts for supplies that limit the contractor's obligation for reworking latent defects to six months after acceptance.

Inspection Standards

Acceptance is based on essentially three types of inspection standards:

- **Strict compliance standards.** The Government generally has the right to enforce strict compliance with contract specifications by either rejecting the work or, for fixed-price contracts, requiring a price reduction for nonconforming work. However, discretionary standards in the form of subjective standards or first article approvals are sometimes necessary.
- **Subjective standards.** "Comfortable fit" or "easy operation" are examples of discretionary standards used in specifications. Brand name "or equal" specifications also fall into this category. Industry standards and common practice govern in these situations.

FAR 52.209-3(b)

FAR 52.209-4 (b)

- **First article approvals.** Because the primary purpose for first article approval is to prove a contractor's capability of producing end items that will meet the contract specifications, easily correctable defects are not cause for rejection of first articles. Instead, the first article approval clauses provide for "conditional" approval.

Point of Acceptance

The contract terms control where items will be accepted. The point of acceptance may be:

- Contractor's plant
- Destination of end products
- Location of service performance
- Anywhere else, if mutually agreeable.

Notification of Rejection

FAR 46.407

A notice of rejection must be provided to the contractor when the product or service has been found unacceptable. There are certain necessary elements for a rejection notice regardless of whether the contracting officer or an authorized representative actually provides it. These elements, which are common to all of the inspection clauses, are listed in Exhibit 7-11.

Time of Acceptance

Standard clauses often state a time by which acceptance occurs by implication when no specific rejection notice is issued.

FAR 52.246-3

For example, most cost-reimbursement contracts for end products require that acceptance take place within 60 days after delivery.

However, research and development contracts for end products extend the time for acceptance to within 90 days after product delivery.

Necessary Elements of a Rejection Notice
FAR 46.407(g)

- The notice must include the reason for rejection
- The notice must be furnished promptly
- The notice must be in writing if:
  - —The rejection took place at a location other than the contractor's plant
  - —The contractor persists in providing nonconforming items or service, or
  - —Late supplies are being rejected and no excusable delay factors were involved in the delinquency
- A written notice requires a written receipt from the contractor in acknowledgement of delivery

Exhibit 7-11

FAR 52.246-8

Even if a contract clause does not clearly state a time frame, the "reasonable" time frame for the lack of rejection to constitute acceptance is still a basic principle of contract law. Obviously, the existence of more precise language provides less room for argument in specific cases.

Measure of Prompt Notice

If the requirement is merely for a "prompt" notice, promptness is measured within the context of the supplies or services that were rejected.

For example, if the Government delayed issuing a rejection notice to the extent that the contractor was prevented from reworking or repairing a defective item or reperforming a deficient service, the contractor would have good grounds for asserting that the notice was not prompt. Similarly, if a delayed notice caused a contractor additional work or expense that would not have been necessary if the notice had been more timely, the notice is not truly prompt.

Consequences of Delaying Acceptance

Although the Government may not have formally accepted items, acceptance may be implied by either the Government's conduct or by the Government's delay. For example:

- If the Government actually uses a delivered product, then acceptance is implied.

- When standard cost-reimbursement contract clauses require specific time frames for acceptance, a Government delay beyond that time frame constitutes acceptance.

Partial Acceptance

When multiple contract line items are involved in contract performance, the Government can and may be required to inspect and accept specific line items unless contract terms prohibit partial acceptance.

Transfer of Ownership

FAR 46.505

Ownership, or title, transfers to the Government upon acceptance. The time of this ownership transfer is significant when damage or loss occurs. The responsibility for damage or loss depends to some extent on whether the contract terms specify F.o.b. Origin or F.o.b. Destination.

- F.o.b. Origin means that the Government is responsible for pick-up, transportation and delivery to the required destination. Title passes to the Government when pick up is made by the carrier. The contractor's risk is limited to loss or damage caused by improper marking or packing.
- F.o.b. Destination means delivery free of expense to the Government to a destination specified in the contract. Title passes to the Government upon arrival of the shipment at the contract's stated destination. The contractor pays the carrier and assumes the risk for loss or damage until delivery to the specified destination.

FAR Clauses

There are 19 standard FAR clauses that deal with postaward aspects of the F.o.b. point or the payment of freight. They are all in the FAR 52.247 series of clauses. You must read the one or ones in your contract thoroughly to make sure you understand all aspects of acceptance.

Evidence of Final Acceptance or Inspection

As evidence of final acceptance or inspection, you usually see one or more of the following documents:

- A receiving report
- An invoice copy with a signature of an authorized Government official
- A contractor bill of lading (CBL)
- A Government bill of lading (GBL)
- A Certificate of Conformance.

Receiving Reports

For end products, a receiving report signed by an official authorized to accept goods or services for the Government is the usual written evidence of final acceptance. The *Material Inspection and Receiving Report,* DD Form 250, is the document normally used to document formal acceptance of supplies and services by DOD. Non-DOD agencies normally have their own unique forms found in their agency FAR supplements.

Approved Invoice Copies

An invoice copy signed by an authorized official can serve as an acceptance document only if the contract terms allow it. This method is most often used for services and cost-reimbursement contracts.

CBLs

Under a CBL, the transportation carrier is responsible to the contractor for any damage or loss to end products it transports, and the contractor, in turn, is responsible to the Government.

GBLs

A GBL is used when the Government has title to the goods in shipment. Therefore, the transportation carrier is responsible to the Government for damage or loss and the contractor has no liability for damage or loss of the goods shipped.

Certificate of Conformance

FAR 46.504

When the Government relies on the contractor's certification that the supplies or services will comply with the contract's terms and conditions, the basis for inspection is a ***Certificate of Conformance.*** You may only allow acceptance on the basis of a Certificate of Conformance if the clause at FAR 52.246-15, *Certificate of Conformance,* is in the contract. Moreover, you can require inspection even though the Government has the right to rely on the contractor's certification because the clause reserves the Government's right of inspection.

7.5 INFORM REQUIRING ACTIVITY AND OTHERS OF CONTRACT'S STATUS

You need to keep the requiring activity and others with a legitimate interest informed of matters that affect those interests on a continuing basis during the length of contract performance.

Additionally, when the contract progresses to a successful completion according to plan, you need to provide notice of that successful completion to all interested parties. This includes successfully "closing out" the administrative file, thereby deleting it from active status on all internal agency records. Chapter 19 discusses how to close out a contract.

CHAPTER 8

MONITORING COSTS

SQUEAL OF FORTUNE

At the first bi-weekly meeting between Anna Lize and the Tally-Up project team, Tally-Up had only been at the Down-Hill plant for two days. So Digi Talis was somewhat reluctant to provide much feedback on initial impressions.

The first two weeks had been spent notifying Down-Hill Industries of the Government's desire to perform an audit and preparing Tally-Up auditors for the work.

Digi Talis showed Anna Lize a copy of the checklist Tally-Up would use for the audit. "Looks good to me!" she had said, agreeing with Talis that it covered the basics without spending time on unnecessary detail.

Digi Talis had added, "Of course, you realize that our task order gives us two reporting tasks. First, we are to report evidence concerning Down-Hill's incongruity or adherence to generally accepted accounting practices. Second, we are to provide an opinion based on the evidence we find as to whether this company has the financial capacity to perform the work. So there will be no analysis of whether or not their practices conform to Government cost principles in the FAR."

Anna wondered why Digi Talis was making a specific point about cost principles. The person authorized to pay invoices on the Down-Hill contract would analyze the allowability of costs before paying each invoice for materials. That analysis would include whether or not the cost was allowable by FAR cost principles. The labor rates were fixed and the contract had been heavily competed so the Government did not have to be concerned about the make-up of those rates.

It would be a different story if Down-Hill had been in line for a cost-reimbursement contract. Then the Government would be very much concerned with indirect overhead charges on both labor rates and material. However, on time-and-materials contracts, Anna's agency limited handling charges applied to materials. The percentage Down-Hill had proposed was within that prescribed limitation.

Bea Ware had ordered the audit because she really did not have enough evidence to deny a contract award to Down-Hill Industries, but had heard rumors about financial difficulties within the company. She had checked data available through financial reporting services, but they had been inconclusive. The firm was privately held so a lot of data was not available to the public.

continued . . .

Digi Talis hurriedly flung open the door to the reception area at his office. He was running a bit late this morning and had only glanced at the front page of the paper.

Merry Greeter at the front desk looked anything but merry. "Where have you been?" Merry boomed without waiting for an answer. "Three of our auditors have called and so have those women from the Government. These phones are driving me crazy."

Two phone lines lit up again. The first line Merry answered was Bea Ware. "Ms. Ware for you again," Merry informed Talis.

"What's this all about?" Digi asked Merry as he swung past her into his office.

"Didn't you read the paper?" Merry yelled after him, again without waiting for an answer. "Down-Hill Industries filed for bankruptcy."

Digi let out a low whistle, but was not really surprised. His auditors had already told him that the company's financial recordkeeping was incomprehensible and that the owners appeared to be milking the company dry. He had tried to give Anna Lize a warning signal without making a definitive statement because he had no facts in hand yet. But she hadn't appeared to pick up on it. No matter now.

"I'll bet we're through with work under this first task order," he thought as he picked up the phone to talk to Bea Ware.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Monitor overall costs to ensure contract completion within budget and funding limitations, and individual cost elements to ensure their appropriateness.

Individual:

8.1 Decide how to monitor the appropriateness of individual cost elements.

8.2 Decide how to monitor overall contract expenditures relative to performance and to the cost or funding limitation.

8.3 If expenditures are above or below expectations, meet with Government contract administration team members to identify possible courses of action.

8.4 When authorized cost/funding levels are or will be exceeded, or other cost issues arise, select the most appropriate course of action.

8.5 Deobligate excess funds, if any.

INTRODUCTION TO COST MONITORING

Definition of Cost Monitoring

Cost monitoring means using various procedures and techniques to verify the appropriateness of costs and to detect variances in planned or budgeted expenses. Some form of cost monitoring is necessary under all contracts other than firm-fixed-price contracts. Cost-reimbursement contracts require the most cost monitoring because of the risk to the Government.

Cost Monitoring Criteria

FAR 31.201-2

Under cost-reimbursement contracts, payments are made to contractors for incurred expenses plus the agreed upon profit. These include labor, materials, and other direct costs, as well as overhead expenses and other indirect costs. In order for such payments to be proper, that is, allowable under the contract, those costs must be:

- Reasonable, that is, not exceed that which would be incurred by a prudent person in the conduct of competitive business
- Allocable, that is, properly assigned to one or more cost objectives under the contract
- And consistent with applicable accounting standards, and prohibitions on the allowability of certain costs.

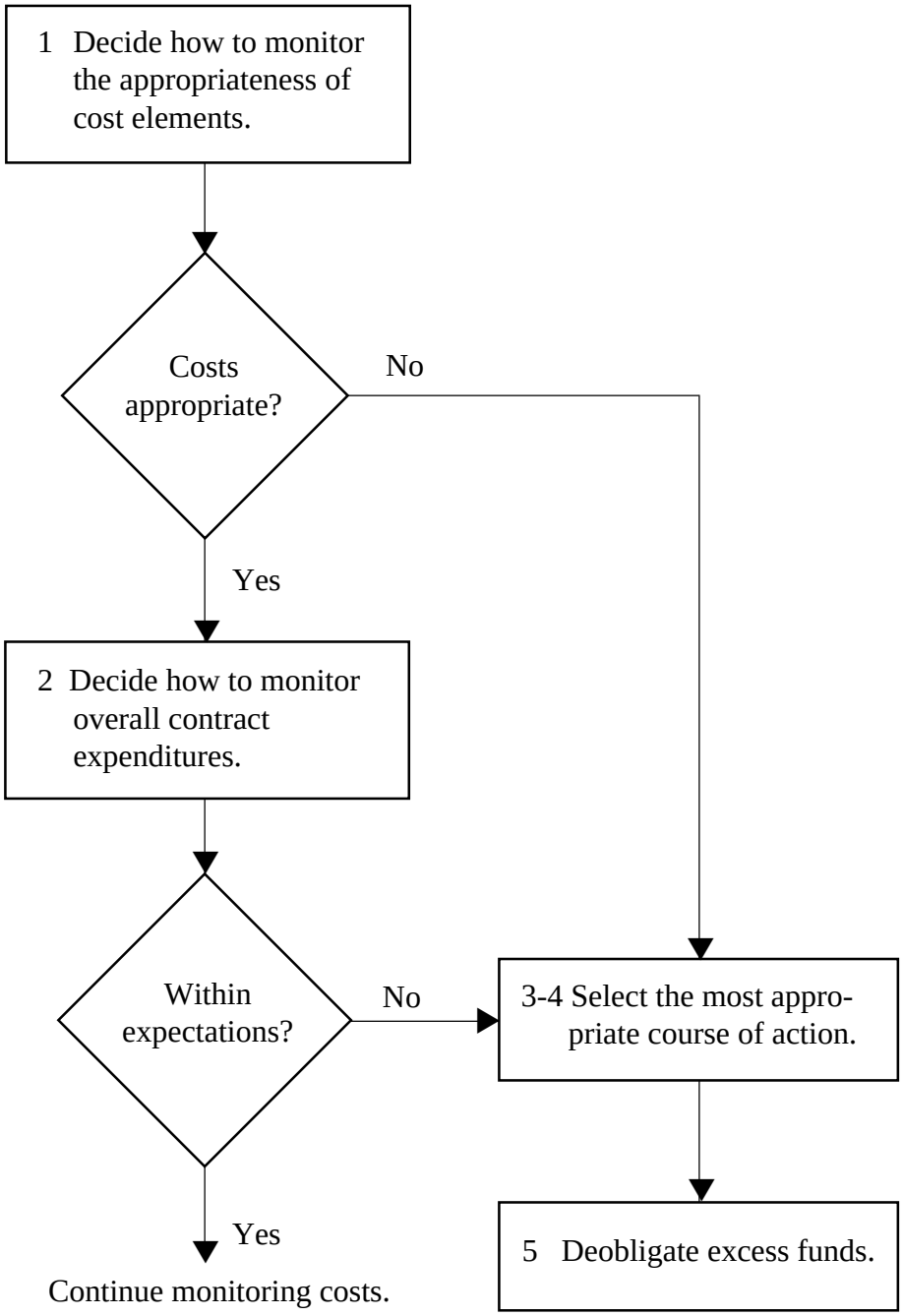
Cost monitoring also involves tracking and analyzing the overall rate of contract expenditures to determine whether the contract will be completed within its budget and according to schedule. If expenses are too high relative to accomplishments, contract funds may not be sufficient to complete the work. If expenses are too low, performance may be behind schedule.

Steps in Performance

The steps in executing basic procedures for successful cost monitoring are charted on the next page. Following the flowchart, each step is discussed in turn.

You must monitor costs on any contract where the contractor is entitled to reimbursement for expenses actually incurred. This includes all cost-reimbursement, time-and-materials, and labor-hour contracts. When a contract establishes a fixed-price for the work to be performed, monitoring of the contractor's costs is not required. Some contracts involve a combination of how costs are treated. For example, a time-and-materials contract specifies a fixed price for each labor hour performed but considers materials provided by the contractor as cost-reimbursement items.

STEPS IN SUCCESSFUL COST MONITORING



MONITORING COSTS

8.1 DECIDE HOW TO MONITOR COST ELEMENTS

Whenever the contractor will be reimbursed for its costs of performance, the Government bears the risk of the funds running out before the work is completed. The Government also must guard against paying for costs that are excessive, improper, or incurred for work not related to the contract. In contrast, when the contract is fixed-price the Government is assured of the deliverables regardless of the contractor's costs. There is no need to monitor how much the contractor spends or for what purposes.

One contract administration responsibility is monitoring costs to determine any costs not appropriately charged to the contract. Although this function is shared with Government auditors who perform reviews of the way a contractor identifies and allocated its costs, you need to understand what costs are allowable so you can examine the contractor's invoices and answer its questions.

Types of Costs

FAR 31.201-1

The contractor's cost of contract performance, which does not include its profit, consists of two portions.

Direct costs generally include those costs that are specific to an individual contract such as the wages of employees working on that job, the cost of materials incorporated in the product, and the cost of subcontracts needed to accomplish the work. These are costs that can be identified specifically with a particular "final cost objective", usually the work unit or operations involved with an individual contract.

Indirect costs are costs that cannot be tied to any one final cost objective but, instead, are common to multiple cost objectives. These costs generally include the cost of management, rent and utilities, accounting, sales, and similar business expenses. These costs are distributed or allocated proportionally among the contractor's various final cost objectives using accepted accounting principles.

Direct Costs

FAR 31.202

A cost is a "direct" cost only if it:

- Relates to a specific contract cost objective, that is, any work unit for which costs are separately accumulated, and
- Benefits no other cost objective.

FAR cost principles state a preference for charging costs directly if this two-fold test is met.

Your daily contract administration duties involve monitoring these direct costs to determine whether they are allowable under the terms of the contract. The criteria that determine whether costs are allowable are contained in Exhibit 8-1.

Criteria for Determining Whether a Cost is Allowable
FAR 31.201-1

A cost is allowable if it is:

- Reasonable
- Allocable (correctly chargeable to one or more contract cost objectives)
- Consistent with Cost Accounting Standards (CAS) or generally-accepted accounting practices
- Not prohibited as an allowable cost under the terms of the contract
- Not prohibited by FAR cost principles

Exhibit 8-1

Rules for Cost Issues

FAR 52.216-7

All contracts subject to cost monitoring incorporate FAR cost principles *in effect on the date of contract award.* FAR Part 31 details 52 specific cost items and provides guidance as to when and to what extent specific costs are allowable on Government contracts. These are summarized in Exhibit 8-2 on the following three pages. If a cost element is listed under more than one cost category (Allowable, Unallowable, or Allowable with Restrictions) within this table, this indicates that specific circumstances have an impact on cost allowability for that cost element. Refer to the FAR reference indicated for details.

Any of these costs may be categorized as a direct cost by one contractor but an indirect cost by another. As part of your cost monitoring, you will review the items of cost being charged as direct costs on invoices or perhaps listed in interim reports required by the terms of a specific contract. You will want to make certain that no unallowable costs are included, such as entertainment expenses, and that costs limited by

Table of Cost Principles				
SELECTED COSTS	**FAR Ref.**	**A**	**UA**	**AWR**
ADPE Leasing Costs	31.205-2	A	UA	AWR
Alcoholic Beverages	31.205-51		UA	
Asset Valuations Resulting from Business Combinations	31.205-52			AWR
Bad Debts	31.205-3		UA	
Bonding Costs	31.205-4	A		
Civil Defense Cost	31.205-5	A	UA	
Compensation for Personal Services	31.205-6	A	UA	AWR
Contingencies	31.205-7	A	UA	
Contributions or Donations	31.205-8		UA	
Cost of Money	31.205-10	A		
Deferred Research & Development Costs	31.205-48	A	UA	AWR
Depreciation	31.205-11	A		AWR
Economic Planning Costs	31.205-12	A	UA	
Employee Morale, Health, Welfare, Food Service, & Dormitory Costs & Credits	31.205-13	A		AWR
Entertainment Costs	31.205-14		UA	
Fines, Penalties, & Mischarging	31.205-15		UA	AWR
Gains & Losses on Disposition of Depreciable Property or Other Capital Assets	31.205-16	A		
Goodwill	31.205-49		UA	
(A = Allowable, UA = Unallowable, AWR = Allowable with Restrictions)				

Exhibit 8-2 (page 1 of 3)

Table of Cost Principles *(continued)*				
SELECTED COSTS	**FAR Ref.**	**A**	**UA**	**AWR**
Idle Facilities & Idle Capacity Costs	31.205-17	A	UA	AWR
Insurance & Indemnification	31.205-19	A	UA	AWR
Interest & Other Financial Costs	31.205-20		UA	
IR&D/B&P Costs	31.205-18			AWR
Labor Relations Costs	31.205-21	A		
Legal & Other Proceedings Costs	31.205-47	A	UA	
Lobbying Costs (Executive)	31.205-50		UA	
Lobbying Costs (Legislative)	31.205-22	A	UA	
Losses on Other Contracts	31.205-23		UA	
Maintenance & Repair Costs	31.205-24	A		
Manufacturing & Production Engineering Costs	31.205-25	A		
Material Costs	31.205-26	A		
Organization Costs	31.205-27		UA	
Other Business Expenses	31.205-28	A		
Plant Protection Costs	31.205-29	A		
Patent Costs	31.205-30	A	UA	
Plant Reconversion Costs	31.205-31		UA	AWR
Precontract Costs	31.205-32	A		
Professional & Consultant Service Costs	31.205-33	A	UA	
Public Relations & Advertising	31.205-1	A	UA	AWR
(A = Allowable, UA = Unallowable, AWR = Allowable with Restrictions)				

Exhibit 8-2 (page 2 of 3))

Table of Cost Principles *(continued)*				
SELECTED COSTS	**FAR Ref.**	**A**	**UA**	**AWR**
Recruitment Costs	31.205-33	A		
Relocation Costs	31.205-34			AWR
Rental Costs	31.205-35	A		AWR
Reserved	31.205-9			
Royalties & Other Costs for Use of Patents	31.205-36	A		
Selling Costs	31.205-37	A	UA	
Service & Warranty Costs	31.205-38	A		
Special Tooling & Special Test Equipment Costs	31.205-39	A		
Taxes	31.205-40	A	UA	
Termination Costs	31.205-41	A		
Trade, Business, Technical, and Professional Activity Costs	31.205-42	A		
Training & Education Costs	31.205-43	A		AWR
Transportation Costs	31.205-44	A		
Travel Costs	31.205-45			AWR
(A = Allowable, UA = Unallowable, AWR = Allowable with Restrictions)				

Exhibit 8-2 (page 3 of 3)

Government-wide, agency, or specific contract restrictions are eligible for reimbursement. You also want to make certain that no direct costs charged to your contract should have been charged to another contract or included among that contractor's indirect costs.

Indirect Costs

FAR 31.203

Costs not classified as direct costs are termed indirect costs and are allocated to the cost objectives through categories such as:

- Overhead
- General and administrative expense
- Other categories of indirect costs such as material handling burden.

An indirect cost can be any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

In order to allocate indirect costs among several contracts, including those for fixed-price and commercial work, a percentage is calculated of indirect expense incurred in a given period relative to the direct labor cost, manufacturing cost, or other appropriate base for the same period. This percentage is termed an ***indirect cost rate.***

A ***billing rate*** is the indirect cost rate established provisionally for interim reimbursement of incurred indirect costs. The billing rate is applied and adjusted, as necessary, until a final indirect cost rate is established either annually or at the completion of the contract.

A contractor will invoice the Government, usually monthly, for the amount due it under a cost-reimbursement contract. The voucher will list direct costs, using categories of costs specified in the contract, indirect costs using the approved billing rates, and a proportionate amount of the profit or fee authorized by the contract.

Analyzing these invoice elements when you process vouchers for payment is one cost monitoring task that you always perform on cost-reimbursement contracts. The procedure for processing invoices is outlined in Chapter 11. However, additional cost monitoring may be necessary to ensure that contract costs meet the criteria of allowability.

Cost Element Monitoring Techniques

In the past, the contract administrator did not receive detailed information on individual costs included in reimbursements claimed on a monthly invoice. Contractors generally will provide only the level of specificity required by the contract, which may be no more than a few broad categories of expenses. However, the trend now is toward requiring detailed information as backup for invoiced costs on cost-reimbursement contracts.

Techniques available to you to obtain more detailed information on cost elements are described in Exhibit 8-3.

Monitoring Techniques	Typical Problems Identified	Restrictions on Use
Reliance on contractor's financial system	None—problems identified by other means would indicate that this technique may not be appropriate	Contractor must have obtained financial system review and approval
Analysis of the backup information to vouchers	Inconsistencies between costs billed and: • Product/service delivered • Contract price agreement, including the appropriate use of billing rates and costs that are allowable	Invoicing requirements must include enough information to identify inconsistencies—if contract requirements are insufficient, negotiate additional requirements
Periodic analysis of data obtained from contractor and Government reports and Government site visits	Problems identified depend on the focus of the report or visit. On-site observations by Government personnel can identify inaccuracies in costs billed, for example, when a COR/COTR's daily log documents that five accountants were working on site on the second Tuesday of the month and the contractor bills the Government for seven accountants for that day.	Written periodic contractor reports can only be required when the contract specifies that they be submitted. However, the contractor may agree to submit a written report. You should negotiate additional written reports on cost-reimbursement contracts only when you can determine that the Government will gain a real advantage commensurate to the contractor's cost to write the report (ultimately paid by the Government)
Reliance on scheduled audits	Audits are regularly scheduled at the end of cost-reimbursement contracts to finalize billing rates and otherwise identify inaccuracies in costs billed for contract performance. For long-term contracts, interim audits may be scheduled—for example, annually or every two years.	Timing and quality of audits reflect the extent of resources and funds available
Analysis through specific audit requests	Specific audits confirm the extent of a problem identified or tentatively identified by other monitoring techniques. Specific audits should never become routine because they are costly.	Timing and quality of audits reflect the extent of resources and funds available

Exhibit 8-3

Contractor's Own Financial Systems

For most contracts, you would rely on the rigor of the contractor's own financial systems to ensure direct costs are properly identified and indirect costs are properly determined.

FAR 16.301-3

Contractors awarded cost-reimbursement contracts must have accounting and financial management systems in place that accurately guide and record the way costs are allocated among cost objectives and indirect cost pools. That system typically will be reviewed during a preaward audit, if one is conducted, and will be the focus of an annual audit by the contractor's cognizant audit agency. For each element of cost, the system will identify whether that element was charged directly to a specific contract, allocated among two or more contracts, or added to a pool of indirect costs. The contractor then uses this system to prepare its monthly invoices in the form required by your agency or activity.

You also can request backup information from a contractor in support of its invoices or review reports required of the contractors by the contract such as a list of individuals performing work on the contract and the number of hours claimed for each person.

Cost Accounting Standards (CAS)

FAR Part 30

FAR 52.230-2

FAR 52.230-3

FAR 52.230-4

FAR 52.230-5

Cost Accounting Standards (CAS) are rules and regulations regarding the disclosure of a firm's accounting practices and its consistent adherence to these practices. CAS are the responsibility of the Cost Accounting Standards Board. A requirement that the contractor adopt CAS is included in the solicitation for many contracts, and the appropriate disclosure and compliance clauses are incorporated into the contract. Acceptance of these clauses by the contractors usually can be relied upon as evidence that the contractor's financial systems are sound and accurate in their treatment of direct and indirect costs. CAS is discussed further in Chapter 13.

FAR 52.215-2

Finally, you can rely on annual or end-of-contract audits performed by Government auditors, or request a special audit if there is some reason to suspect the contract is being charged for costs that are unreasonable, inaccurate, or otherwise unallowable. The Government retains the right for any cost-reimbursement, incentive, time-and-materials, labor-hour, or price redeterminable contract, as well as any fixed-price contract that includes cost-reimbursement for certain expenses, to examine and audit all records relating to costs claimed in performing the contract. See Chapter 13 on requesting audits.

A postaward audit may be performed for any of several purposes, as indicated in Exhibit 8-4. Some of these types of audits will be discussed in subsequent chapters. You should be aware of any planned audits and inform the auditors of concerns you may have so they can include them in their examination.

Contracting audits are normally conducted by either:

- A specialized group established within the contracting organization , such as the Defense Contract Audit Agency (DCAA)
- Auditing specialists in another agency through a cross-agency servicing agreement
- The agency's Inspector General.

Types of Audits Used During Contract Administration

Contract audits generally fall within the following categories:

- Reviews of incurred costs
- Reviews of cost or pricing data submitted for large contract modifications
- Reviews of compliance with Cost Accounting Standards (CAS) and/or estimating system adequacy
- Reviews of contractor practices for inefficiency or illegality, including should-cost audits
- GAO audits
- Audits by organizations specifically charged with auditing functions, usually either Inspector General organizations or DCAA

Exhibit 8-4

Inspector General Responsibilities

Note that contract auditors do not have the authority to review a contractor's records solely for the purpose of researching legal compliance in relation to fraud, waste, and abuse issues. Responsibility for fraud, waste, and abuse audits are within the purview of the agency's Inspector General. These responsibilities were established by the Inspector Generals Act of 1978 and other, earlier legislation. Although contracting audits cannot be focused on illegalities, contracting auditors are expected to be alert to illegal practices and to report them when discovered to the Inspector General. The distinction becomes somewhat irrelevant in agencies where the Inspector General's Office is also charged with contracting audits.

Should-Cost Audits

The most typical type of contracting audit that focuses on inefficiency or unreasonableness is a "should-cost" audit or review.

There are two types of should-cost reviews:

FAR 15.810

- Program should-cost reviews, and
- Overhead should-cost reviews.

Program should-cost reviews are conducted prior to award. They compare the components of the contractor's cost proposal against cost estimates prepared by the Government.

Overhead should-cost reviews are intended to:

- Evaluate significant indirect cost elements in-depth
- Identify inefficient and uneconomical practices, and
- Recommend corrective action.

Overhead should-cost reviews are used to evaluate and make cost-saving recommendations on indirect costs such as fringe benefits, shipping and receiving, facilities and equipment, depreciation, plant maintenance and security, taxes, and general and administrative activities.

Use of Should-Cost Standards

A should-cost review can be accomplished informally by gathering data from Government experts, the COR/COTR, the Labor and Commerce Departments, and elsewhere on prevailing industry standards. You may be able to determine, for example, that security guards where the work is being performed typically receive $8.00 per hour, or that labor costs usually are estimated at $2.75 per foot of fencing, or that the wholesale price of furniture-grade plywood has gone down 10 percent in the last three months.

You also should compare the contractor's reported costs with those in its proposal. If shipping costs originally were estimated at $2,150.00 per truckload, for instance, you should inquire if the costs charged to the contract begin to increase over this amount. Similarly, a question would be in order if market prices for some commodity begin to fall significantly, but these reductions are not reflected in the prices the contractor reports paying. You want to make sure the contractor is using its best efforts to find bargains and keep contract costs as low as possible.

Decisions on Conducting Audits

Although auditing specialists conduct on-site audits, you need to weigh the administrative costs of initiating a should-cost or other kind of audit against the potential benefit to the Government before arranging for auditing specialists to conduct one. Factors to consider in deciding whether to conduct an audit are described briefly in Exhibit 8-5, and more extensively in Chapter 13.

Factors to Consider Prior to Initiating an Audit

- Overall dollar value of Government business
- Level of Government business relative to other business
- Level of noncompetitive Government contracts
- Volume of anticipated changes on current contracts and proposal activity on new Government work
- Company activity in corporate mergers, acquisitions, and takeovers
- Other conditions such as changes in accounting systems, management changes, or a change in the business activity of the firm

Exhibit 8-5

Respond to Requests and Notices

Various clauses regarding specific contract costs may be contained in the contract that involve approval or assistance by the contracting officer. some examples are:

- Approval of a planned subcontract (see Chapter 3)
- Assistance in obtaining an exemption from state and local taxes (see Chapter 5)
- Approval of certain travel and other costs in excess of limits established by regulations
- Determination as to whether some specific cost that might be prohibited by the FAR is allowable.

Contractors working under cost-reimbursement contracts usualy have little incentive to minimize costs by encouraging price competition for subcontracts or avoiding taxes for which an exemption could be claimed. Diligence is needed to make sure the contractor is using sound business policies when working on a cost-reimbursement contract.

Value Engineering

FAR Part 48

FAR 52.248-1

Some cost-reimbursement contracts valued at over $100,000 contain a clause that affords contractors an opportunity to obtain a substantial financial incentive for developing and submitting acceptable ***Value Engineering Change Proposals.*** Value engineering refers to methods for performing requirements more economically. A contractor may devise an improved process for producing precision parts, for example. If the process yeilds the required level of quality while significantly reducing the Government's costs, the contractor is eligible

to receive an incentive amount over and above the fee originally agreed upon. The amount, which can represent savings in both the current contract and future contracts using the process, can be as high as 25 percent of the expected savings if the innovation was first proposed under a cost-reimbursement contract.

The contracting officer is responsible for promptly processing and evaluating all Value Engineering Change Proposals that are received. The proposal must be accepted or rejected within 45 days from receipt. If the evaluation cannot be completed in that time frame, the contractor must be informed in writing of when a decision will be made. If the proposal is accepted, it must be implemented by a contract modification (see Chapter 14).

Value engineering also can be made a requirement of a contract. In these instances, the contracor usually remains eligible to receive an incentive for an acceptable proposal, but at a lower rate than if the value engineering was at the contractor's own initiative.

Authorizing Overtime

Another area where the contracting officer becomes involved in specific cost issues is the approval of overtime. Premium pay for overtime work is entirely the contractor's decision under fixed-price contracts, but prior Government authorization can be required under cost-reimbursement contracts.

FAR 22.103

FAR 52.222-2

Contractors are expected to perform cost-reimbursement contracts, so far as practical, without resorting to overtime. However, the contractor can proceed to pay premium overtime without prior authorization under these exceptions:

- When the overtime is needed to cope with natural disasters, equipment breakdowns, or other emergencies
- When the overtime is needed by indirect-cost employees for administrative, protective, or similar services
- When the overtime is needed to conduct tests, processes, or operations that connot reasonably be interrupted
- When the overtime will result in lower overall costs to the Government.

The contract also may specify a dollar amount up to which discretionary premium overtime is authorized. This form of authorization provides some flexibility for the contractor in industries where overtime customarily is used to balance workloads, achieve efficinecies in the use of equipment, and so forth.

A contractor seeking to pay premium overtime when none of the exemptions apply or the preset limit will be exceeded must request prior approval from the contracting officer. Sufficient justification, as outlined in the clause, is required to permit the contracting officer to evaluate the necessity of the overtime to meet program needs. The evaluation will be based on whether the overtime is required to:

- Meet essential delivery schedules
- Overcome delays beyond the control, and without fault, of the contractor
- Eliminate anticipated bottlenecks that cannot be eliminated in other ways.

FAR 52.232-7

A separate overtime authorization clause applies to time-and-materials and labor-hour contracts.

A prompt response to overtime authorization requests is necessary. Contractors using premium overtime without authorization do so at their own risk under a cost-reimbursement contract, and therefore are unlikely to proceed without approval even if contract performance may be in jeopardy. On the other hand, some contractors may be willing to take this risk when it is to their potential advantage. You must be vigilant to unauthorized uses of overtime and disapprove the premium part of the cost as unallowable. The contractor, however, is entitled to reimbursement at nonpremium rates for the extra hours its employees worked.

8.2 DECIDE HOW TO MONITOR TOTAL COSTS

Although verifying the appropriateness of individual costs charged to a contract is important, you must be at least as careful in monitoring total costs being incurred under a cost-reimbursement contract. Costs to date should be proportionate to performance to date. If contract costs begin to exceed accomplishments, funds may run out before the work is completed. On the other hand, if contract funds are not being expended at a reasonable rate, the work may be behind schedule and the contract might have to pay for expensive catch-up costs down the road.

If expenditures are too high or too low, the outcome or the schedule could be endangered and it may be appropriate to initiate some corrective action.

Total Cost Monitoring Techniques

In deciding how to best monitor total costs on a particular contract, you should first identify the information sources available to you for comparing costs and progress. These vary from contract to contract. Sources of cost monitoring information, typical examples, and conditions affecting their use and their applications are shown in Exhibit 8-6.

Total Cost Monitoring Techniques

Information Sources	Typical Total Cost Monitoring Applications
Contractor's cost proposal	The cost proposal is always the baseline for measuring if cost expenditures are under control and within budget.
Reports required by the contract	If reports are required under the terms of the contract, you use them as an important tool in deciding whether the contract is progressing satisfactorily and within budget. Their inclusion generally allows a reduction in other proactive monitoring techniques.
Other requirements of the contract that address cost and cost monitoring, such as: • award and incentive fees (see Chapter 12) • Other practical effects of the contract type used	A contract type that requires or allows a fee that is not fixed demands that you evaluate and document variable elements upon which the fee is based. Other effects of the contract type or contract terms may also have impact. For example, some might think that labor-hour contracts do not have cost control considerations because the hourly rate is fixed. In reality, labor-hour contracts do not motivate the contractor to use labor efficiently—therefore, the monitoring effort must involve an assessment of whether the hours expended are reasonable to accomplish the work. When cost and performance incentives are used in a cost-reimbursement contract, daily monitoring should be minimal because the contractor does have a monetary incentive to exceed expectations.
Prior acquisition histories	Past performance provides the basis, along with other considerations such as the dollar value of the contract, for determining how closely to monitor cost and performance. You should obviously monitor a contractor with a history of cost overruns more carefully than one with a record for cost efficiency.

Exhibit 8-6

After you review cost monitoring opportunities, consider what mix of cost monitoring techniques will be the most cost effective for that particular contract. You may want to adopt an elaborate, computer-based monitoring approach for a large, multitask effort, but use a minimal system to track total costs on a relatively small and straightforward cost-reimbursement contract. For some contracts, you may need to use several techniques in order to satisfy yourself that costs and progress are in proper balance.

One of your primary concerns in monitoring total contract costs is to avoid a situation where contract funds run out before performance is complete. This is a risk the Government assumes when it awards a cost-reimbursement contract, but careful monitoring on your part can minimize this result or reduce its impact.

Standard Total Cost Clauses

A cost-reimbursement contract contains an estimated cost for the work agreed to by both parties. Standard clauses in the contract warn the contractor that the Government is not obligated to reimburse the contractor for costs in excess of this estimate unless a new limit is agreed upon. At the same time, the contractor is obligated to notify the contracting officer in advance if a cost overrun is likely; that is, if the actual cost of performance may be greater than the estimated amount shown in the contract.

The standard clauses used for this purpose provide the Government with some protection against spending more money than was set aside for the contract. Most cost reimbursement contracts contain either the *Limitation of Cost* (FAR 52.232-20) or the *Limitation of Funds* (FAR 52.232-22) clause. The Limitation of Cost clause is used for cost-reimbursement contracts that are fully funded at the time of award. The Limitation of Funds clause is used for cost-reimbursement contracts that will be funded incrementally over several fiscal years.

FAR 52.232-20

FAR 52.232-22

Both clauses are similar. They both require the contractor to notify the Government in advance when total contract costs are expected to be greater than, or substantially less than, had been previously estimated. Additionally, these clauses both require notification at the time a specified percentage of completion or fund depletion is reached, regardless of whether there is an expected overrun.

Exhibit 8-7 compares the notification terms of these two clauses. Note that this exhibit shows a range for the requirements within each clause. Your contract will show a specific percentage within that variance. The clauses provide for inserting the schedule of when a notice is due. The contract will show the actual number of days and percent of expenditure that will trigger notification.

Notification Requirements for Costs Incurred or Cost Variances	
FAR 52-232-20 **Limitation of Cost**	**FAR 52-232-22** **Limitation of Funds**
Time Frame for Notification: 1. 30-90 days before contractor expects to reach 75 to 85 percent of estimated cost, OR 2. Whenever the contractor determines that the total cost, exclusive of fee, is substantially over or under the current total estimate	*Time Frame for Notification:* • 30-90 days before contractor expects to reach 75 to 85 percent of the total amount currently allotted to the contract by the Government plus, IF a cost sharing contract, the contractor's corresponding share
Supporting Data Required: • A revised estimate of total cost for contract completion	*Supporting Data Required:* 1. An estimate of additional funds required to continue performance for the current incrementally-funded time frame, AND 2. When the funds will be required for continued performance

Exhibit 8-7

Other Clause Requirements

In addition to the notice requirements, both clauses require:

- The contractor's best efforts to perform the work within the cost estimate negotiated before award and stated in the contract (exclusive of any applicable fee)
- No obligation of continued contractor performance when costs exceed the funding level in the contract
- No obligation for Government payment for work above the funding level in the contract.

Other Funding Limiting Clauses

FAR 52.216-24

FAR 52.217-1

Other cost ceiling clauses similarly limit the Government's liability for contract dollars spent, but are special purpose clauses and do not require a notice from the contractor or special monitoring requirements from contract administrators.

Contractor Responsibility

In order to comply with the total cost notice requirements, the contractor must track individual costs by maintaining accurate records of:

- Incurred contract costs (including indirect costs)
- Current commitments, and
- Current estimates of the cost to completion.

Monitoring Use of Cost Tracking Systems

Preaward audits scrutinize whether the contractor has the financial management systems needed to adequately identify potential contract overruns or underruns and provide notice of overruns to the Government. However, you need to make sure that the contractor is both:

- Using those systems, and
- Keeping the needed information in them.

An informal question or two may be sufficient to assure that adequate procedures are being followed.

Additionally, vouchers should track contract expenditures and express them as a percentage of the total funds available. If they do not, and the contractor is not required to provide that breakdown, you or another member of your contract administration team should make that percentage calculation. During contract administration planning, it is always wise to require such a percentage calculation from the contractor as part of the billing process.

Identifying Problems

Your examination of overall contract costs should enable you to detect certain significant problems when there is still time to initiate corrective action. A relatively simple approach is to develop a month-by-month forecast of expenditures based on the contract's requirements and the contractor's cost proposal. By comparing costs incurred to date against your forecast for the same period, you can make a judgement as to whether costs are running too high, too low, or about right. Tracking total costs on your own can alert you to future difficulties well in advance of when the contractor must submit its notice as required under the Limitation of Cost or Limitation of Funds clause.

Cost Fluctuations

Be careful when you make your forecast of monthly expenditures. Do not assume costs will remain even across the life of the project. Expenses during the first few months may be particularly high, for example, because the contractor is purchasing quantities of raw materials. Spurts in costs may occur during periods of peak production. The mix of labor performing on the contract may change over time, raising or lowering labor rates. You often can use milestones, subbudgets, or other data from the solicitation and the contractor's proposal to refine your forecasts.

You also must consider expenditures in light of the contract schedule of deliverables. Contract costs greater than you expected may be due to the contractor accelerating work, perhaps because of idle capacity elsewhere in the plant.

Contract Risks

There are two problems to look for when monitoring total costs. First, expenditures may be higher than they should be in light of what has been accomplished. The risk under these circumstances is that the contract will run out of funds before the work has been completed—there is a potential overrun. Second, contract expenses may be less than they should be in light of the schedule. The risk here is that the work will not be completed on time or that costs eventually will be greater than expected as the contractor plays catch-up. The contractor may be experiencing problems in recruiting labor, for example, or deferring production because priority is being given to more profitable work.

A more elaborate technique for monitoring costs is the Cost/Schedule Control System (C/SCS). This method is used by many agencies to track contract costs against work actually accomplished rather than spending forecasts.

8.3 IDENTIFY POSSIBLE COURSES OF CORRECTIVE ACTION

When a cost-reimbursement contract first appears to be overspending or underspending, you should contact the contractor for an explanation. Also meet with the COR/COTR to see if there actually is a problem that cannot be resolved quickly.

As part of your investigation, you should gather information on which party may be responsible for what has happened. The contractor may be less competent than expected. The Government may have misdirected the work or caused delays. Both may have contributed to the problem. And, of course, the reason could be that the work itself was more difficult than either party anticipated.

If you do conclude that the contract is in an overrun status or is nearing cost or funding limitations, further steps are required. Do the following:

- Notify Government representatives of the specifics of the contract's cost/funding status
- Set up a meeting with Government representatives to
  - Obtain feedback
  - Discuss alternatives.

Possible topics for discussion are shown in Exhibit 8-8.

Discussion Topics for Cost Limitation Issues Agenda

- Alternatives available under contract terms and conditions
- The requiring activity's or program office's best estimate of:
  - Cost to complete the work
  - Time required to complete the work
  - Minimum tasks yet to be completed and
  - What can be accomplished within the current level of funding
- The requiring activity's or program office's ability and desire to provide sufficient additional funds to cover a cost overrun

Exhibit 8-8

A decision on how to proceed is required as early as possible to select a course of action that minimized the consequences of a potential overrun to the Government. A number of alternatives can be considered.

Additional Funds If additional funds are needed to complete the effort as planned, early knowledge enables the requiring office to minimize the effect on other projects and avoid a gap in the contractor's performance. The requiring office is the key decision maker on funding issues for continuing or terminating the contract effort.

Additional Time The contractor may be able to complete contract performance within the remaining funds if economies can be achieved by stretching out the schedule. If additional time is needed and is provided to the contractor, the Government should receive consideration when the contractor bears the responsibility for requiring additional time.

Change in Scope It may be possible to reduce the amount of work remaining by discontinuing less essential tasks, redoing quantities, or allowing substitutions. This may be the most desirable course of action when the requiring activity is unable to provide additional funding.

Discontinue Performance In some instances, the best solution can be to discontinue the contract. The difficulty of the effort may have been substantially underestimated, the contractor may be unable to manage the effort efficiently, or the value to the Government of completing the work may have diminished.

8.4 SELECT THE MOST APPROPRIATE ALTERNATIVE

There usually are several alternatives available to address potential overrun situations or to correct problems associated with individual costs charged to the contract. Those alternatives available in overrun situations are listed in Exhibit 8-9. Alternatives typically available for resolving other cost issues are contained in the next section.

Possible Responses to Notices Regarding Real or Potential Overruns

- Continue performance by taking one of the following actions:
  - Provide extra funds or time to allow the contractor to complete the contract without statement of work changes
  - Defer a decision (for further factfinding)
  - If the contractor is liable for the overrun, but is otherwise meeting contract objectives, take no action
- Discontinue or limit performance, deobligating and removing any excess funds, by taking one of the following actions:
  - Downscope the statement of work to fit the remaining funds
  - Temporarily stop work
  - Terminate the contract (as a last resort)

Exhibit 8-9

Continue Performance

When the best course of action is to complete the requirement as it is currently stated in the contract, the requiring activity needs to provide funds and the Government contracting officer may need to provide additional time. Either requires a contract modification with consideration to the Government, if appropriate. Be sure you complete all necessary steps for continuing contract performance. These are summarized in Exhibit 8-10.

Overrun Responsibility If No Notice Was Provided

The contractor is responsible for the cost of overruns only if it did not show diligence in controlling costs, including avoiding costs that are unallowable. However, the contractor will not be able to avoid responsibility for providing the required advance overrun notice unless it can demonstrate that, despite its adequate accounting and budgeting system, it was not possible to predict the overrun.

Required Tasks for Funding Overruns

- Meet with the contractor to review the statement of work and verify that the contractor and the Government understand the tasks remaining.
- Negotiate the contractor's proposal on additional funding and time to complete the work.
- Establish the amount of additional funds required, and a new delivery schedule.
- Obtain clearance from the finance office to obligate additional funds.
- Determine Government consideration due (normally, additional funds to complete the contract but with no increase in fee).
- Prepare and execute a supplemental agreement.

Exhibit 8-10

Examples of Contractor Responsibility

Contractors have difficulty proving an impossibility of prediction position. For example, contractors have been unsuccessful in proving that they were unable to predict overruns and therefore should be excused from the notice requirement and receive payment for costs above the contract limitation when:

- Final indirect overhead rates are substantially higher than the billing rates included in the contract, thereby creating an overrun when the final rates are applied to direct costs.
- The Government suddenly allowed costs to be charged to the contract that previously had been questioned, resulting in the overrun.

Examples of Contractor Avoidance of Responsibility

Cases where contractors have been successful in recovering cost overruns despite their failure to provide a required notice include:

- Cases where overhead rates increased due to an unexpected loss of other business and, when applied to direct costs, resulted in an overrun.
- Cases where the Government clearly *promised* that it would conduct an audit (more than a mere reliance on a clause that states contractor costs are "subject" to audit) and did not, thereby preventing a contractor from determining its costs in a timely manner.

Taking No Action

Occasionally, factfinding will result in the discovery that there is no actual or impending overrun after all. In this case, no action would be necessary. Also, no action is necessary when it can be shown that the contractor is liable for the overrun because it continued performance without authorization after spending limitations were reached. The Government is not obligated to reimburse the contractor for those additional costs.

Discontinue or Limit Performance

FAR 32.704(a)(2)

When you learn that no additional funds will be made available, the contracting officer is required to give the contractor notice of the decision to provide no further funding.

Downscoping

If you decide to downscope the statement of work to fit the remaining contract funds:

- Obtain the contractor's proposal for an adjustment of the fee to reflect contract objectives not met
- Negotiate a new statement of work and fee
- Prepare and execute a supplemental agreement.

Factfinding

If you defer a decision to allow further factfinding, notify the contractor that:

- The Government may allot additional funds to the contract or increase its estimated cost
- It is entitled to stop work when the dollar limitation under the contract has been reached
- Any work done beyond the contract's dollar limitation is at the contractor's own risk.

Resist the temptation to do something just to take some action. If you simply do not have all the information you need, defer a decision until you can get all the facts. Try to reach a decision before the funding limit is reached, however. If the contractor elects to cease performance when funds run out, considerable expense may be incurred to restart the work when that is the Government's choice.

Stopping Work Temporarily

If the contract contains a stop work clause, you may want to consider whether a stop work order would be appropriate. Refer to Chapter 15.

Terminating Work

You also may want to consider terminating the contract. If you do, proceed as discussed in Chapter 16. Only choose termination if no other practical alternative is available.

Actions to Resolve Other Cost Issues

Practical alternatives for resolving cost-related issues other than overruns vary. The issue under consideration and the contract type involved are important determining factors. Typically, the cost issues involve two overriding concerns. Exhibit 8-11 provides a summary.

Cost Issue	Typical Alternatives	Contract Type Considerations
Billed costs are defective (based on inaccurate data)	• Demand reduction under standard contract clauses • Initiate an audit, if needed and cost effective, to determine the amount of the reduction • If there may have been an intent to deceive, initiate agency fraud investigation (usually through the Inspector General) • Charge contractor for Government costs involved in correcting the defective data, if appropriate • Terminate, if appropriate (as a last resort)	Rework formulas for incentive fees. Reconsider award fees (Refer to Chapter 12). Reexamine the basis for economic price adjustments.
Billed costs are unallowable (including unreasonable)	• Issue a notice to the contractor on the amount that will be disallowed and the reason for the disallowance, and take final action based on contractor feedback and other considerations. Note that the Government has the burden of proof for disallowance of costs (Refer to Chapter 11).	Rework formulas for incentive fees. Reconsider award fees (Refer to Chapter 12). Reexamine the basis for economic price adjustments.

Exhibit 8-11

8.5 DEOBLIGATE EXCESS FUNDS, IF ANY

FAR 32.704(a)(2)

If you are discontinuing performance and have excess funds, remove them by taking the actions listed in Exhibit 8-12. You also must take action to deobligate funds when performance is completed below contract funding levels, but you need only comply with the fourth step in Exhibit 8-12—that is, issuing a unilateral modification, in these cases.

Necessary Steps for Removing Excess Funds When Performance Is Incomplete

1. Notify the contractor of the Government's intent to remove excess funds under the contract.
2. Obtain feedback from the contractor regarding this action.
3. Consult the requisitioner or program office and obtain a revised estimate detailing:
   - Cost to complete the work, and
   - The amount of excess funds remaining.
4. Issue a unilateral modification to the contract deobligating and removing the excess funds.

Exhibit 8-12

NOTES

CHAPTER 9

MONITORING FINANCIAL CONDITION

WHO SAID LIEN IS GOOD?

"Thank goodness Down-Hill Industries filed for bankruptcy before contract award," Bea Ware thought. Nonetheless, she was confident that Tally-Up would have found enough evidence for her to base a determination of nonresponsibility even if Down-Hill had not filed for bankruptcy before the audit had been completed.

"What if we had awarded the time-and-materials contract to Down-Hill and they later filed for bankruptcy?" Ernest asked her.

"It would have been a real administrative headache at best," Bea had told him, shuddering at the thought. "We would have gotten Johnnie I. Dotter involved and he would have had a time investigating liens that material suppliers might have filed against the company and, if liens affected delivery of any of our materials, whether he could get a subordination agreement from the material supplier."

"A what-kind-of agreement?" Ernest asked.

"Subordination agreement," Bea said again. Don't get too concerned about knowing any of the fine details about them—that's why Johnnie I. Dotter is on the staff. Basically, it states that a creditor agrees to give up its right to payment in favor of another individual or entity."

"Why in the world would a creditor do that?" Ernest wanted to know.

"Well, often they would have no incentive at all to do it," Bea admitted. "But occasionally, if delivery of a finished product or materials to the bankrupted company's customer is imminent, circumstances could be such that the creditor's only hope of payment might be to allow delivery and, therefore, payment from the customer. The creditor, of course, would want to get assurances from the bankruptcy court that it would receive a payment as a result of the payment to the company that went bankrupt."

"Hmm. That makes sense, but something else doesn't. We didn't get any notice of the bankruptcy filing," Ernest noted. "Isn't Down-Hill required to give us notice of the filing before it actually files?"

"Only if they have a contract with us, but they don't have any current contracts with us." Bea said. "A standard contract clause entitled ***Bankruptcy*** *requires the notice you're thinking about. But Down-Hill isn't bound to the terms of that clause until they actually have a contract with us."*

continued . . .

"Oh, right," Ernest said remembering the requirement as she was stating it.

"Well, I think Tally-Up was already beginning to see danger signs," Ernest continued. Anna read me the minutes of the first meeting she had with them. They hadn't actually provided evidence of a lack of financial capacity, but they were clearly sending out warning signals."

Bea was pleased that not only was her Government monitoring team on the Tally-Up contract working well together, but apparently they were also working well with the Tally-Up contract managers. Establishing a good rapport was important. As with anything else in life, success usually hinged not only on what you know—in other words, your technical knowledge, but also on how well you got along with people—that is, how you handle yourself and motivate others.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Monitor the financial condition of a contractor.

Individual:

9.1 Determine whether to monitor financial condition when alerted to circumstances that might endanger Government interests.

9.2 Protect the Government's interest if a lien is placed against a contractor's inventory.

9.3 Protect the Government's interest if the contractor is facing bankruptcy.

9.4 Furnish information to interested parties upon request.

INTRODUCTION TO MONITORING FINANCIAL CONDITION

Definition of Financial Monitoring

Financial monitoring means detecting and acting upon changes in a contractor's financial condition that have a potential for endangering contract performance.

Policy on Financial Monitoring

The only time you would consider investigating the details of a contractor's financial status is when others bring changing financial conditions to your attention. It would be too time consuming to monitor financial indicators routinely.

However, even when you have evidence of changing financial conditions, you only would intervene if you determined that inadequate financial capacity would be detrimental to Government interests and that the Government can take actions to protect those interests.

FAR 32.108

Your agency should have financial analysts with expertise in evaluating credit and financial problems. Contracting officers are generally required to consult these individuals when financial analysis of a specific contractor appears to be warranted.

Steps in Performance

The steps in executing basic procedures for monitoring a contractor's financial condition are charted on the next page. Following the flowchart, each step is discussed in turn.

STEPS IN MONITORING FINANCIAL CONDITION

1 Determine whether to monitor financial condition.

↓

2 Protect Government interests regarding liens.

↓

3 Protect Government interests regarding bankruptcies.

↓

4 Furnish appropriate information to interested parties.

MONITORING FINANCIAL CONDITION

9.1 DETERMINE WHETHER TO MONITOR FINANCIAL CONDITION

You normally will not monitor a contractor's financial condition. It simply is not cost effective. You would consider monitoring a contractor's financial status only when you could take action to protect the Government interest if the contractor were experiencing financial difficulty. Therefore, three things need to happen before you would consider monitoring a contractor's financial condition:

1. You receive an indication that the contractor is in financial trouble,
2. You determine that the Government would be harmed by the contractor's financial difficulties, and
3. You determine that the Government could take positive steps to protect its interests.

Typical indications you may receive about a contractor's changing financial condition are listed in Exhibit 9-1 along with their potential impacts and possible Government actions.

The Government's interest is not always in jeopardy as the result of a contractor's failing financial condition. For example, contracts for services having no upfront materials costs and with monthly payment terms should not cause substantial concern. Service workers are typically not paid until after the service is provided.

Agency Financial Advisors

FAR 32.108

If it is appropriate to monitor the contractor's financial condition, you should have specialists available for consultation within your agency who can provide an analysis of possible credit and financial problems. However, you may need to provide them with the data they need for their analysis. Discuss with these experts what assistance, if any, they will need from you.

Typical Indications of Changing Financial Condition and Potential Impact		
Indication of Changing Financial Condition	**Potential Consequences to the Government**	**Actions That May Protect Government Interests**
Notification of change in ownership	New ownership may not have sufficient financial resources to complete contract performance.	Initially, none. If performance problems occur, then standard contractual remedies can be used, as appropriate, including termination proceedings.
Complaints of nonpayment by employees or subcontractors	Contractor may not be able to pay for materials or labor needed to complete the contract.	For temporary shortfalls, the Government may find a basis for offering progress payments (if they are not currently included) to save the disruption of a contract termination. However, some form of consideration should be obtained from the contractor. Also, make sure contractor knows how to obtain a loan for completion of the contract using a payment assignment on the contract as collateral.
Notification of a lien on contract materials	This would prevent the transfer of ownership of the materials to the Government.	Arrangement of a subordination agreement might assure contract completion. Refer to Section 9.2 in this chapter.
Notification of bankruptcy	Sometimes contractors reorganize and fulfill current obligations; however, it is not likely that the contractor will be able to pay for material or labor needed for completion of the contract.	It is essential that you involve agency legal counsel because agency actions must not be contrary to the mandates of the Federal court involved in the bankruptcy. Standard contract remedies for deficient performance may be limited. For example, “automatic stay provisions” of the court prevent a termination for default while they are in effect. Refer to Section 9.3 in this chapter for other information regarding bankruptcy.

Exhibit 9-1

If you must obtain financial data on the contractor, you can use one of the following sources:

- Current financial statements
- Data from commercial sources or other Government agencies
- On-site analysis through periodic audits.

Financial Statement

A current financial statement includes balance sheets and income statements covering each of the contractor's immediate past two fiscal years, normally the most recent annual reports together with the most recent interim report. The minimum standards for acceptability for these statements are contained in Exhibit 9-2. Your agency's financial analysis expert may have additional criteria. If you obtain statements, check the certification and income statement requirements. Your financial advisor can detect accounting principle discrepancies with the uncodified Generally Accepted Accounting Principles (GAAP) or pronouncements made by the Financial Accounting Standards Board (FASB).

Minimum Requirements for Financial Statements

- They are certified by a company executive for accuracy or accompanied by the opinion statement of an independent auditor
- They contain a recent income statement that incorporates a *Schedule of Cost and Goods Sold* reflecting:
  - Direct materials
  - Direct labor
  - Overhead
- They are prepared in accordance with generally accepted accounting principles (GAAP)

Exhibit 9-2

Interpreting Financial Statements

Your financial adviser makes comparisons among the data in financial statements and provides an overall assessment. A summary of some terms your financial advisor may use in providing reasons for his or her overall assessment are contained in Exhibit 9-3.

Terms Typically Used by Financial Advisors

- **Total Assets.** This is the total of current assets, fixed assets, and other miscellaneous and intangible assets. An example of an intangible asset is the value of a patent.
- **Total Liabilities and Stockholders' Equity.** The total liabilities figure represents what the company owes and is the total of both current and long-term liabilities. Current liabilities are debts that are due within one year of the date of the balance sheet. Stockholders' equity is that part of the company's worth that belongs to the owners of the business.
- **Net Worth.** Total assets less total liabilities other than stockholder's equity.
- **Net Working Capital.** This is the difference between total current assets, such as cash and amounts receivable, and total current liabilities. Working capital represents the amount left free and clear if all current debts are paid off.
- **Current Ratio.** This is the ratio of current assets to current liabilities.
- **Quick Assets.** Quick assets are those current assets that are quickly convertible into cash. This excludes merchandise inventories, because such inventories have yet to be sold. Therefore, quick assets are current assets minus inventories.
- **Quick Assets Ratio.** This is computed by dividing quick assets by current liabilities. The resulting ratio should be positive.
- **Current Debt to Equity.** This is computed by dividing the current debts (liabilities) by stockholders' equity. Stockholders' equity is the equity of the business owners obtained by subtracting total liabilities from total assets and then deducting intangibles. Ordinarily, a business begins to get in trouble when this relationship exceeds 80 percent.
- **Total Debt to Equity.** This is computed by dividing total current debts plus long-term debts by stockholder's equity. When this relationship exceeds 100 percent, the company is generally considered "at risk."
- **Profit Margin.** An efficiency measure obtained by dividing profits (after taxes) by sales. Your financial advisor may advise you of an upward, downward, or steady trend by comparing profit margin figures over several years.

Exhibit 9-3

Third-Party Sources Commercial sources and other Government agencies can provide data on changes involving relative ratings, for example:

- **Credit reports** assign ratings based on prompt bill payments. A change to a lesser rating signals financial difficulties.
- **Financial ratings** assigned by companies like Dun and Bradstreet indicate the overall financial health of a company in comparison to other companies. A lower rating from one given previously can signal financial trouble, but also may reflect improved financial strength for others in the industry.

Your financial advisor will investigate the basis of the rating before drawing any conclusions.

On-Site Analysis Because of the expense, on-site investigations are generally not a popular choice for financial monitoring. However, if a periodic audit is scheduled for other reasons, you might discuss with auditing officials whether they also can collect financial data and what the additional administrative cost of doing so is likely to be. In any event, only consider such on-site assessments if all of the prerequisites in Exhibit 9-4 apply.

Prerequisites for Postaward On-Site Analysis of Current Financial Condition

- The contractor refuses to submit current financial statements
- There is reason to doubt the contractor's financial capacity (for example, employee complaints of nonpayment)
- Commercial or other Government sources provide no conclusive data on the company's financial health
- Financial deficiencies would have a potentially serious impact on performance or meeting requirements
- The Government could take action to protect its interests

Exhibit 9-4

9.2 PROTECT GOVERNMENT INTERESTS REGARDING LIENS

When a company is in financial difficulty, it usually is in debt to other commercial firms. Your Government lawyer can investigate these issues and may become involved in such things as liens and subordination agreements.

Liens

A ***lien*** is a contractual arrangement used to protect a creditor by giving the creditor control over the disposition of property in the hands of a debtor until the debt is paid. A lien might be used, for example, to prevent a manufacturer of powerboats from delivering them to customers, including the Government, until the firm that supplied the engines has been paid.

You may not become aware of a lien that affects the delivery of products or services until the contractor explains that delivery cannot be made for that reason. A lien is *not* the basis for an excusable delay. Depending on the circumstances, you should proceed as with any other delay that is the contractor's responsibility. You may, however, decide to contact your agency's legal staff for assistance if the Government's interests are at a significant risk.

Subordination Agreements

Subordination agreements acknowledge that one creditor has temporarily waived its right to payment of an obligation in favor of another creditor if specific circumstances detailed in the agreement occur.

The Government is considered a creditor of the contractor when the contractor owes the Government something of value. For example, until a Government contract is complete, the contractor owes the Government whatever goods or services are stated in the contract.

Motivation for Subordination

A creditor may decide to defer payment in favor of another creditor to better assure its own payment by the debtor (contractor). For example, a material supplier may obtain a lien for protection against continued nonpayment for material items it has provided to a contractor on credit. The lien gives the supplier a first right of payment against the sale of the resulting product. Suppose the product is being manufactured for the Government. The supplier may agree to "subordinate" its senior right to payment and have title to the supplies pass to the Government upon assurances that, by so doing, the Government will make a progress payment to the contractor that will allow it to pay off its debt to the material supplier.

Legal Involvement

You should never attempt to deal with a lien or subordination agreement yourself. Commercial contract law and state law are involved and you could easily do something contrary to the Government's interest without even realizing it. Your Government lawyer, however, may ask for your assistance with some of the administrative work if the Government becomes involved to protect its interests.

9.3 PROTECT GOVERNMENT INTERESTS REGARDING CONTRACTOR BANKRUPTCIES

Government contractors are required by FAR 52.242-13, *Bankruptcy*, a required clause, to provide written notice by certified mail of a bankruptcy filing within five days of the initiation of the proceedings relating to that filing. The content requirements for such notices are listed in Exhibit 9-5.

Content Requirements for Bankruptcy Notices
FAR 52.242-13

- The date on which the bankruptcy petition was filed
- The identity of the court in which the bankruptcy petition was filed
- A listing of all outstanding Government contracts, detailing:
  - Government contract numbers
  - Contracting offices

Exhibit 9-5

FAR 42.902

Upon receipt of such a notice, contract administrators have specific responsibilities. These are listed in Exhibit 9-6.

Contract Administrator's Responsibilities Regarding Contractor Bankruptcy

- Notify the agency legal counsel
- Notify the contract payment office
- Notify the requiring office
- Notify any other interested party, such as the Small Business Administration
- Determine the amount of any potential claim against the contractor (considering all contracts not yet closed out)
- Furnish claim information and other pertinent data such as the list provided by the contractor of other Government contracts affected by the bankruptcy to agency legal counsel
- Safeguard any Government property in the hands of the contractor
- Check agency regulations for other administrative requirements
- Take any other action that would protect the Government's financial interests

Exhibit 9-6

9.4 FURNISH INFORMATION UPON REQUEST

Only provide financial information to others that is authorized for release. Contract clauses often specify what information to release and to whom. When in doubt, consult Freedom of Information and Privacy Act experts within your contracting office or within your agency. Examples of information that you are typically required to provide are shown in Exhibit 9-7.

Conditions for Providing Financial Contract Data to Typical Interested Parties

These interested parties...	Are entitled to the following information...	But only if...
Sureties and Assignees	• Information on the progress of work and contract payments • Copy of termination notice	They request information on work status and contract payments. No special request is needed for a receipt of a copy of the termination notice per FAR 49.102(b)
Subcontractors and Suppliers	• Progress of work • Information on contract payments • Name and address of surety	They request such information
Individuals who have supplied labor and materials to the contractor	A certified copy of: • Any payment bond, and • The contract itself	They request such information and provide an affidavit that they have supplied labor or materials for contract work and have not been paid

Exhibit 9-7

CHAPTER 10

INFORMAL PROBLEM RESOLUTION

WITHOUT PROBLEMS, WE'D HAVE NO SOLUTIONS

Sometimes, a smaller contract causes the worst contract management headaches. Such was the case with the personal computer training contract Ernest N. Deavors was administering.

This contract called for the contractor, Tutors-R-Us (TRU), to first develop a uniform and customized training program for agency users in the basic skills necessary to perform their office automation functions within the "windows" environment. Then the contractor was to conduct training sessions based on the approval of the customized training program it submitted. The statement of work was two-and-a-half pages long. Ernest never expected a problem. But, as Bea Ware always said, "Problems occur when you least expect them."

It had been a dilly of a an orientation conference. It quickly became evident that the Government expected the contractor to provide the computer equipment on which the training was to be conducted and the contractor expected that the Government would provide the equipment. A review of the statement of work revealed a sentence that said simply: "Each student will have his or her own PC and printer for hands-on training and printing during class."

The language was clearly ambiguous and recognition of that fact slowly dawned on everyone at the meeting. "But we told you in our proposal that we would provide early notice of our facility location so you'd have plenty of time to deliver the equipment!" the TRU project manager had pointed out excitedly. The project would end up in deep red ink if his company had to absorb computer equipment costs. All agreed to think over the situation and get together again in two days.

"How did that get by me!" Bea moaned, referring to the statement of work language. "Did their proposal really refer to a Government equipment delivery?" Bea asked peering over Ernest's shoulder at the open solicitation file on his desk.

"The TRU project manager will provide early notification of the location of the classroom facility to assure timely delivery of the computers and printers—that's all it says," Ernest related. "Clear as mud," he further observed.

So they called the Government proposal evaluators. Both noted the early notification but attached no significance to it. Upon reflection, they both said they thought it must mean that TRU wanted to make sure that the Government found the location acceptable before arranging for delivery of the computer equipment under a commercial contract.

continued . . .

The Government had awarded without discussions for several reasons: everything appeared to be straightforward, the TRU proposal was acceptable, it was the lowest of four proposals, and it was judged the best value. So there was no record of negotiations to help resolve this problem.

Both parties had talked to their lawyers when they met again. Bea dug out the rules of contract interpretation and the risk allocation rule from Exhibit 10-3 in her contract administration text. Johnnie I. Dotter, who was familiar with the rules, said that the Government would be liable in a court of law. He said that not only did the Government write the ambiguous language, it was also the last one with the opportunity to request clarification and correct the deficient language—that is, inquire about the statement on equipment delivery in the contractor's proposal.

There was much heated discussion, but no resolution after a full day of attempts to reach an agreement. Johnnie I. Dotter suggested using a neutral advisor. He pointed out that with the prices from all the firms that submitted a proposal now a matter of public record, it would not be fair to terminate the contract for convenience and conduct a resolicitation.

Bea Ware and the TRU project manager agreed to try an alternative disputes resolution (ADR) technique with a neutral advisor. Each training class under the contract had a maximum of 10 students. So the issue involved ten computer equipment hardware sets per class.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Resolve problems informally.

Individual:

10.1 Determine if informal problem resolution is appropriate.

10.2 Investigate the cause and likely impact of the problem.

10.3 Consult appropriate sources and devise a plan of action to resolve the problem considering alternative solutions and selecting the solution that best satisfies the Government's overall interest.

10.4 Discuss the optimal plan for correcting the problem with the contractor to negotiate an informal resolution.

10.5 When informal resolution fails, pursue formal action.

10.6 Document the file and keep interested parties informed of problem resolution status.

INTRODUCTION TO INFORMAL PROBLEM RESOLUTION

Definition of a Performance Problem

A performance problem is any situation that has a potential for disrupting the efficient execution of contract terms and conditions, regardless of whether that situation was caused by the contractor, the Government, or if both share responsibility for the existence of the problem.

Policy on Problem Solving Methods

FAR 33.204

The Government's policy is to try to resolve all contractual issues by mutual agreement at the contracting officer level. In fixed-price contracts, the concern is generally to resolve the issue before issuance of a formal claim. In cost-reimbursement contracts, the Government pays the costs that result from the problem and its resolution unless the Government can prove contractor negligence. Therefore, the idea is to solve the problem before it takes up an inordinate amount of administrative time, adding to the Government's cost for resolving the issue.

Alternative Disputes Resolution Techniques

There are a number of techniques for resolving contractual problems informally. These include "alternative dispute resolution" techniques which can be used if regulatory limitations are not violated. However, less structured problem solving techniques also can be used. Proactive problem solving involves careful thought, a sense of practicality, and a positive approach. Consult regulatory guidance only to ensure that it does not prevent you from trying a proposed contract solution and to survey the full range of concerns regarding the problem.

Creative Approaches

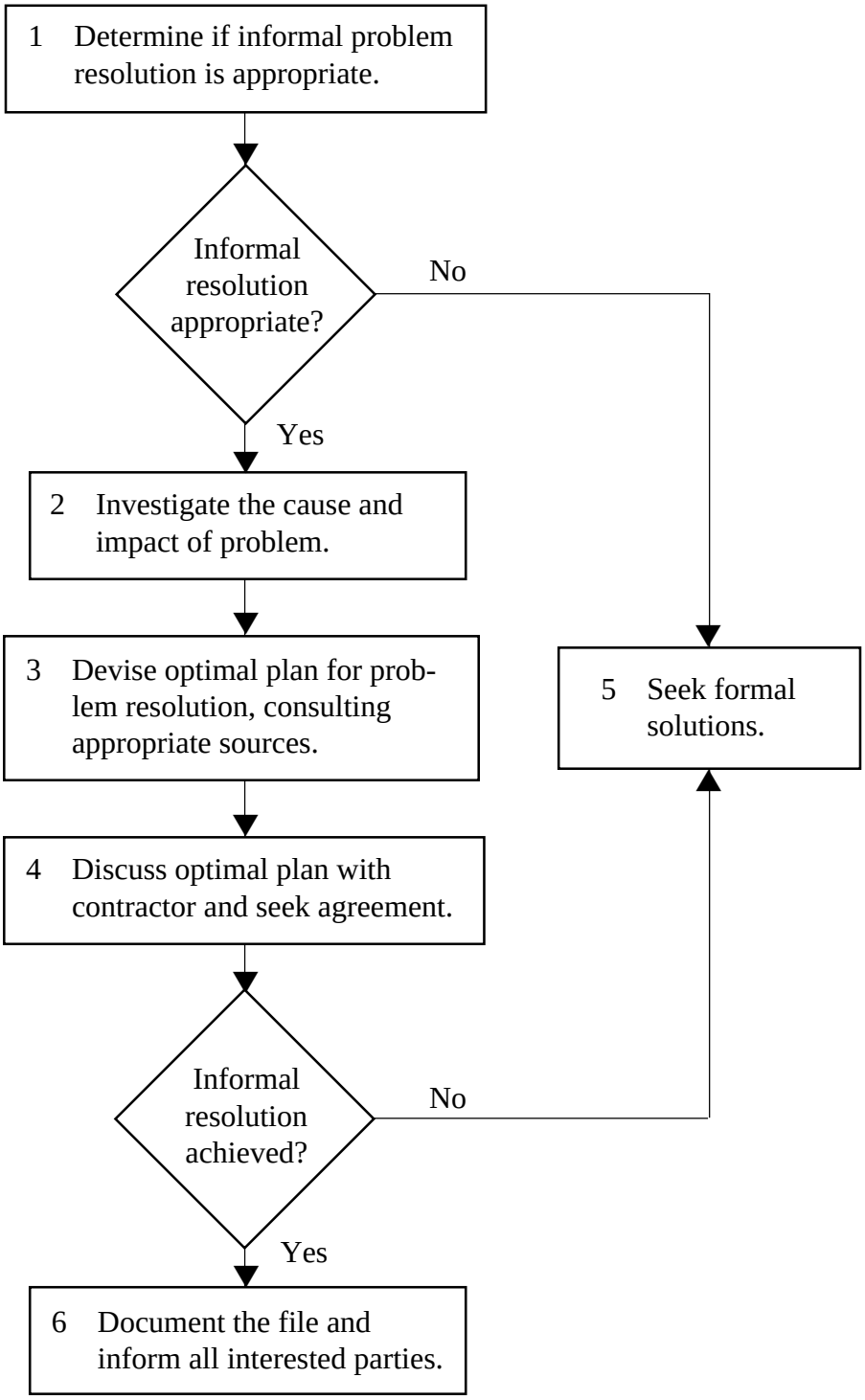
This chapter provides some specific ideas for creative approaches to resolving contract performance problems by seeking solutions that might satisfy all sides:

- The contractor,
- Government officials, and
- Interested third parties.

Steps in Performance

The steps for resolving problems informally are outlined on the next page as a flowchart. Following the flowchart, each step is discussed in turn.

STEPS FOR RESOLVING PROBLEMS INFORMALLY



INFORMAL PROBLEM RESOLUTION

10.1 DETERMINE IF INFORMAL RESOLUTION IS APPROPRIATE

Formal contract resolution procedures are time consuming and expensive for both the Government and the contractor. Therefore, it is beneficial to resolve problems informally whenever possible. Many problems can be resolved informally.

When Informal Resolution is Possible

The contracting officer can resolve problems informally if he or she has the authority to settle a formal claim involving the issue at the heart of the controversy.

Pursuit of Informal Solutions

To resolve problems informally, aggressively use problem solving techniques. Bring in other participants if negotiations are at an impasse, but only elevate the issue to the next managerial level as a last resort. Elevating issues is an admission that you cannot solve the problem on your own—generally not a sensible move for career advancement. However, if that is what it takes to resolve the problem, that admission will be less damaging and forgotten sooner than a long term dispute that devours agency resources. First, however, look to others on the contractor or Government teams who are already playing a direct role in contract administration. Third parties who have expertise in the issues under discussion are also a good possibility—such as a Government cost analyst on a cost-related issue.

Some general guidelines for informally resolving problems are outlined in Exhibit 10-1.

Formal vs. Informal

Formal avenues of resolution involve the contract claims procedures detailed in Chapter 17. Strict procedures must be followed in the formal claims process that include time frames for both contractor and Government action. Boards of contract appeals and federal courts usually become involved when a disagreement escalates.

Practical Guidelines for Pursuing Informal Resolution	
General Rule	**Additional Points**
Meet the issues head-on	Before arguments get too heated and emotional, pinpoint exactly what is at the heart of the disagreement. Sort out the side issues and concentrate only on issues that are at the core of the problem. For instance, separate technical and monetary issues, allowing the parties to first agree on merit considerations at the heart of the problem. Discuss financial considerations only after some agreement on technical merit is reached.
Recognize the need for quick action	More than likely there is some form of time sensitivity involved with the problem, regardless of whether the issue is technical or administrative. Time pressures can come from a number of sources: • Practical results of delay (such as increased contractor costs that the Government will have to pay under cost-reimbursement contracts) • Internal administrative pressures (your supervisor has informed you that if you do not have the problem resolved before the Director's monthly project briefing, you will be in big trouble) • Pressures from the contractor (contractors have internal administrative pressures just like you do; a lack of cooperation on your part now will likely be remembered in the future when you need some quick action merely to satisfy internal pressures) However, even if there is no specific pressure involved, it is generally true that the longer an issue remains unresolved, the harder it is to resolve. Over time, positions tend to become polarized.
Cultivate a problem-solving attitude	• Remain objective. Opportunities slip away when an opposing position is immediately labeled "unreasonable." Always ask "why?" before making a judgement. • Dismiss negative feelings. Situations are never hopeless, but you may have to find an unconventional (but still permissible) way to deal with them.
Follow traditional standards for negotiation	Be prepared. Know the issues on which you may compromise and those that cannot be surrendered. Be fair. Be professional. When agreement is reached, delineate all elements of the understanding and promptly obtain written agreement.

Exhibit 10-1

When Informal Resolution is Prohibited

Some performance problems cannot be resolved informally. Most notably:

FAR 33.209

FAR 33.210 (b)

- When an issue of fraud, waste or abuse is evident, contracting officers must refer the issue to the official within his or her agency responsible for these matters. In the larger agencies, this official is the Inspector General.
- Issues that categorically fall within the jurisdiction of another agency must be referred to that agency. For example:

FAR 23.107

  – Pollution control laws and related requirements are the enforcement responsibility of the Environmental Protection Agency.

FAR 22.808

  – Resolution of contractual equal employment opportunity complaints are the enforcement responsibility of the Department of Labor.

FAR 33.210 (a)

- Issues outside the contract cannot be resolved by the contracting officer, who has authority for that contract only. For example, a contract administration office (CAO) in the Department of Defense cannot negotiate overhead rates for all of a contractor's Government business.

Before you can determine if your contracting office has the authority to resolve the problem, you must decide what the true nature of the problem is.

10.2 INVESTIGATE THE CAUSE AND IMPACT OF THE PROBLEM

When you identify a problem, you want to devise a plan for resolving it if you can. The sooner you identify problems, the easier they are to resolve. Aggressive monitoring of the contract results in early identification of performance problems.

Types of Performance Problems

Types of performance problems and typical examples illustrating them are shown in Exhibit 10-2. Only after you have investigated the cause and impact of the problem, can you develop a plan for resolving it.

Recognize that a problem originating in one area is likely to have an effect on other areas. For example, a schedule problem will very likely affect cost. However, you must identify the origin of the problem as well as accurately identify all of its potential consequences.

Types of Performance Problems	
Type of Problem	**Typical Examples**
Schedule Problems	Contractor fails to deliver on time or make progress toward timely delivery
Cost Problems	Contractor exceeds cost estimates on a cost-reimbursement contract or provides inadequate documentation for fixed-price progress payments
Quality Problems	Supplies or services in process or being delivered do not meet contract requirements or are not expected to do so
Other Problems	Contractor is not complying with other terms and conditions, typically those outlined in Chapter 5, such as: • Paying labor rates below those minimally required • Violating clean air and water guidelines • Failing to meet established subcontracting goals • Failing to maintain a drug-free workplace

Exhibit 10-2

Decision Factors Affecting Problem Resolution

Devising a plan of action involves making three decisions, deciding on the:

- Causes of the problem, including who is responsible (contractor, Government, both parties, neither party),
- Potential impact of the problem on overall contract performance, and
- Best approach for settling the dispute, considering all possibilities for resolution.

Investigating Causes

Although finger-pointing is not conducive to problem resolution, determining who caused the problem often is essential for deciding the most appropriate way to resolve it. Two examples illustrating how important it is to systematically investigate problems are:

- Contract interpretation issues, and
- Delay issues.

Contract Interpretation Issues

Problems involving the quality of products or services often arise from different interpretations of what the contract says. The disagreement may center on the specifications, the acceptance criteria, or statements as to how the contractor is to perform its work.

Accountability for Misinterpretation of Contract Terms

When contracting parties have different ideas as to what is required by the terms of the contract, read the contract language carefully. You must determine if the contract language is:

- Ambiguous—that is, whether there are two reasonable but different interpretations.
- Conflicting—that is, whether the contract contains opposing statements.

Use the rules of contract interpretation in Exhibit 10-3 to help decide.

Rules of Contract Interpretation

1. Everyday words are given their dictionary definition.
2. Technical words are defined as is usual in the trade or technical area, unless the context or usage indicates a different meaning.
3. Words defined by the contract are interpreted as the contract defines them.
4. The same word, used in different parts of the contract, is presumed to mean the same thing.
5. Contract language should not be interpreted or defined so as to render the language meaningless or the rights and obligations of one or the other party unrealistic.
6. The contract should be read as a whole and, wherever possible, read consistently.
7. When there is a conflict between two contract sections and there is no specific direction to the contrary:
   - Handwritten language takes precedence over typed language,
   - Typed language takes precedence over printed language, and
   - Specific clauses take precedence over general clauses. The presumption is that the specific clause qualifies the general clause, and therefore, carries more weight.
8. Where the public interest is affected, an interpretation is preferred which favors the public.

Exhibit 10-3

Intent of the Parties

If the words themselves don't point to a solution, then see if there is any evidence as to what the Government and the contractor both intended when they entered into the contract. Look for inconsistencies with a past interpretation of the same language by either the Government or the contractor. Courts and boards will generally hold a contracting party to interpretations that it held, or at least did not challenge, prior to the dispute.

So, a Government interpretation of language in the specifications at the postaward orientation conference will prevail over a later contradictory Government opinion.

Similarly, when the Government can show that the contractor originally calculated certain work as required by the contract and is now trying to claim that the work is extra, the work will be considered as part of the basic contract and not as additional work.

Risk Allocation Rule for Contract Interpretation Issues

The "risk allocation" rule for contract interpretation is so named because you use it to assess the "risk" of misinterpretation against the party who ultimately caused it. The general rule is that ambiguous language usually is interpreted against the drafter, that is, the party that wrote the language. However, there are several other points to consider before making a final determination:

- If the ambiguity is obvious, the other party (the "nondrafter") has the duty to request clarification before contract award.
- If the nondrafter does not request clarification and the ambiguous language is obvious, the courts would probably say that the nondrafter had the last opportunity to correct the deficiency and did not.
- If the nondrafter did request clarification and the drafter refused to provide any, the courts would probably say that the drafter had the last opportunity to correct the deficiency and did not.

The Government is not always the "drafter." For example, a contractor's technical proposal is often incorporated into the contract document.

Problems in contract interpretation are not the only quality problems you may want to resolve informally. But, as interpretation issues illustrate, you do have to thoroughly investigate the origin of the problem before taking a position. If you are wrong, it will only make things worse later on.

Delay Issues

Failure to deliver products or services when scheduled is called a delay. A contractor also may fail to make sufficient progress so that a delay in deliver is likely. Identifying the cause of a delay or a pending delay is critical in deciding what action is appropriate for resolving the problem.

Identifying Causes for Delay

Depending on who is at fault, delays are classified as follows:

- **Excusable delays.** These are delays that are beyond the control and without the fault or negligence of the contractor or subcontractor. When you can establish that the Government is at fault or when no one is to blame—so-called Acts of God—the contractor may be "excused" from meeting the completion date or paying the Government for costs it incurred because of the delay.

- **Nonexcusable Delays.** These are delays the Government has not authorized and for which the contractor is totally responsible. In fixed-price contracts, the contractor is:

  – Not excused from meeting the delivery requirements at the price agreed upon when it cannot justify the delay as being beyond its control.

  – Responsible for all costs incurred to make up for "lost time" resulting from a nonexcusable delay.

  In cost-reimbursement contracts, the practical effect is that the contractor loses its reputation for timely delivery, but the Government bears the cost for the delay unless it can prove negligence.

- **Co-mingled or Concurrent Delays.** Unfortunately, not all delays can be categorized as either an excusable or nonexcusable delay. Concurrent or co-mingled delays do happen. A concurrent delay occurs when two or more delays happen at the same time. Co-mingled delays are when both parties are at fault for one or more delays.

Normally, the contractor will be given additional time to meet delivery requirements following an excusable delay. When a delay is co-mingled, but the results can be segregated and measured separately, you can deduct that portion of the delay that was contractor-caused when extending contract performance time for the total delay.

When the results are not separately measurable, try to document who is primarily responsible. For example, you may be able to document which party's delay caused the greatest impact on delivery or performance. Then, you may be able to use this as a basis for determining whether any modification extending performance time is fair. However, do not use this documentation to recommend assessing the contractor any damages at all, either liquidated or actual, following a co-mingled delay. Boards and courts will overturn such assessments.

Additional Considerations for Contract Delays

FAR 22-101-2(b)

Contractors may be held liable for delays that are otherwise excusable if the delay was within its own or its subcontractor's control. For example, a delay caused by a strike is normally considered an excusable delay. However, it cannot be excused if the contractor (or subcontractor) could have acted to end the strike by:

- Filing for injunctive relief with the National Labor Relations Board
- Using other Government procedures, or
- Using private boards or organizations to settle disputes.

When the Government is totally responsible for the delay, you must use your documentation as backup for an official modification to the contract (refer to Chapter 14).

Impact Assessment

When a potential performance problem has been identified, you must determine the possible consequences of the problem. Examine possible effects on:

- Time
- Price/Cost
- Quantity
- Quality.

The amount of time and effort you should spend on problem resolution should be based on your determination of how serious the impact would be if a prompt resolution is not found.

Impact Factors

The significance of a contract performance problem varies.

Contract type is a factor because it may make a difference in who pays to correct the problem, the contractor or the Government.

Another factor is the type of performance criteria in the contract, whether the contract specifies end products (including finished services) or a level of effort.

- **End Products.** Some contracts call for a measurable amount of work, such as preparation of training course materials to be delivered in camera ready form, or the manufacturing of a product as required by applicable specifications. The "end product" type of performance requirement states a specific time for delivery or completion.
- **Level of effort.** In other contracts, the purchase is for the contractor to apply a stated level of effort toward a specified objective or kind of work during a specified period. In these contracts, the expiration date of the contract marks the end of the contractor's obligation. When that date has passed, the contractor is not obligated to provide additional service effort, even if the objective was not met during the life of the contract.

So documenting which type of performance criteria is contained in the contract is key in assessing long term consequences and devising a plan of action.

Assessing Impacts of Problems

Assessing the impact of a problem will probably be among the most troublesome tasks you will encounter. Approach impact assessments systematically:

- First, decide which party caused the problem or potential problem.
- Next, list the potential effects of the problem, classified by

  – effects on cost/price

  – effects on schedule

  – effects on quality.

You will use your impact assessment to decide what should be done. In addition, you may decide that the impacts are so slight that it is not in the Government's best interest to take any action at all.

Impacts on Cost/Price

Even on cost-reimbursement contracts where the Government assumes the monetary burdens for risks associated with contract performance, you need to carefully examine the costs of delays or other problems for any hidden surprises. It is well established that even a small problem can have an effect not only on costs directly associated with the work, but may also have a "ripple effect" on other contract costs.

Impacts on Schedule

The "ripple effect" can also impact the schedule in items and services not directly associated with the original problem. For example, delay in acquiring state-of-the-art equipment also might delay user training on that equipment unless other identical equipment were available. A minor shipping mistake involving critical parts could delay work on a separately funded major system.

Impacts on Quality

Problems can arise that affect the quality of contract deliverables. Errors in Government-furnished materials, misjudgments by the COR/COTR, or a detail overlooked by the contractor's inspection system could diminish the value of what was received even though acceptance is still appropriate. Under fixed-price contracts, the contractor cannot be held liable for its mistakes unless the requirements were not met. Under cost-reimbursement contracts, performance that is marginal in quality is a risk the Government takes. The result can be an unhappy end user, whether it elects to fund corrective action or not.

10.3 DEVISE A PLAN FOR RESOLUTION

You typically will make many contacts in verifying the facts of the case and assessing potential impacts. You will want to use these opportunities to devise a plan for equitably resolving the problem.

Sources for Plan Development

Potential sources for your ultimate action plan are quite varied. Recommendations for what may eventually become the best action plan, or what may commonly be called the Government position may come from:

- Contractor officials
- Interested third parties, and
- Government officials, such as
  - legal advisors
  - technical advisors, such as CORs/COTRs, inspectors, testing specialists, engineers, and so forth
  - budget and finance officials, and
  - end users.

Obviously, you would seek advice from these Government officials on different issues. For example, you would ask the lawyer's advice on any proposed changes in the legal terms of the contract, but would defer to the end user on any proposed changes to the quality of performance or delivery date. Also seek the advice of Government officials as new information becomes available later during the negotiation process.

One of these sources may provide the optimal plan or several may make contributions to what may eventually be the plan that will work best. The plan must be flexible because you very often need to modify it during discussions and negotiations.

Alternatives for Action Plans

Exhibit 10-4 lists likely plans of actions for resolving performance problems. These alternatives generally are available for either fixed-price or cost-reimbursement contracts. They often will be used in combination as, for example, to provide additional funding if a time extension is used. All alternatives but the last would require a contract modification.

Possible Plans of Action For Resolving Performance Problems

- Adjust the contract schedule
  - – Issue a time extension
  - – Accelerate performance
- Adjust price/cost
- Adjust performance requirements
  - – Use a different method of shipment
  - – Delete a low priority task
  - – Change the place for inspection
  - – Allow a material substitution
  - – Allow other specification changes
- Make no adjustments

Exhibit 10-4

The plan you choose will depend on your analysis of all the circumstances. In addition to the criticality of the requirement, you need to consider the:

- Type of contract, whether fixed-price or cost-reimbursement,
- Source of the problem, whether it is excusable or not, and
- Likely impact, whether it is sufficient to justify making a change.

When to Take No Action

The optimal plan normally involves specific actions, but when there is no justification for action, the best action plan can be to make no adjustments. When appropriate, you can hold the contractor accountable and demand reperformance at the contractor's expense under a fixed-price contract or at no additional fee under a cost-reimbursement contract. You also may decide to pursue various formal remedies as described in Chapter 15.

When to Take Action

Conversely, it is essential to make adjustments when these are justified. As noted in Exhibit 10-4, these actions may involve adjustments to technical or administrative requirements, cost/price adjustments, or schedule adjustments.

Government Responsibilities

When the Government is liable, or shares liability, for the need for a change, the contractor can be entitled to an equitable adjustment.

The contractor's right to contract adjustments under fixed-price contracts is derived from language in the standard Changes clause for fixed-price contracts:

FAR 52.243-1

> *If any such change causes an increase or decrease in the cost of, or the time required for, performance of any part of the work under this contract, whether or not changed by the order, the Contracting Officer shall make an equitable adjustment in the contract price, the delivery schedule, or both, and shall modify the contract.*

FAR 52.243-2

The standard cost-reimbursement Changes clause contains similar language, but the equitable adjustment that must be made is in:

> *...the (1) estimated cost, delivery, or completion schedule, or both; (2) amount of any fixed fee; and (3) other affected terms...*

Adjustments to Performance Requirements

Changes to specifications or other performance requirements may require a compensating equitable adjustment under fixed-price contracts. However, the specifications in most cost-reimbursement contracts contain relatively broad descriptions of the work, so it may be difficult for a contractor to establish that it is being required to perform work beyond what was originally contemplated.

Boards and courts, when deciding proper adjustments for formal claims, examine evidence as to the parties' intent regarding contract performance to establish a baseline of work. It may be beneficial for you to establish such a baseline for informal resolutions as well. You may find evidence to establish such a baseline in preaward documentation, such as preproposal conferences and negotiation sessions. This evidence may clarify what was the understanding of both parties but what the contract did not clearly state.

Don't overlook the possibility of reducing performance requirements by deleting tasks; for example, when the contractor would be entitled to additional funds under a fixed-price contract because of a Government error, but no funds are available.

Cost-reimbursement contracts require an adjustment in funding levels and estimated costs for added or deleted work. It is appropriate to include associated costs in adjusting funding levels and estimated costs.

Adjustments to Cost/Price

Cost-reimbursement contractors will not experience a monetary loss for increased costs. Additionally, a change in work beyond the contemplation of the parties at the time the contract was negotiated requires an adjustment in fees established under cost-reimbursement contracts. Increases and decreases in a contractor's fee due to changes are discussed in Chapter 14.

Adjustments to Schedules

Even though costs are covered and fees are adjusted under cost-reimbursement contracts, the schedule may need to be adjusted to reflect time for additional or deleted work. It is important to keep time frames commensurate with work required for the purposes of cost and schedule control. The contractor will also be interested in extending schedules when additional work is called for so that it may officially remain timely and preserve a good business reputation.

Acceleration of contract performance is one form of schedule adjustment. It refers to speeding up the work to complete performance earlier than otherwise anticipated. Acceleration includes adhering to the original delivery schedule when the contractor otherwise would be entitled to a time extension. By not granting a timely extension, you in effect "change" the contract schedule by shortening the time allowed for delivery under its terms.

Therefore, acceleration can result from Government inaction as well as its specific action. In response to a Government acceleration of performance, the contractor may have to take one of the following actions to meet the accelerated delivery schedule:

- Hire more employees
- Add additional shifts
- Pay overtime, or
- Purchase more expensive products from other sources.

As a result, a change in work requirements may involve not only a schedule adjustment, but an adjustment to cost (including fee) as well.

Government Liability for Acceleration

An important thing to remember is that there is no acceleration unless Government action or inaction causes the contractor to perform the work at a faster rate. Therefore, it is crucial to determine if the contractor was on or ahead of schedule when acceleration began.

Unduly postponing action can only increase the Government's liability. However, the contractor must prove that it is entitled to an official time extension, as outlined in Exhibit 10-5.

Criteria for Contractor's Proof of Acceleration

- An excusable delay existed
- The contracting officer (or authorized representative) had knowledge of the delay
- Action by the Government indicates delivery was accelerated
- The contractor actually accelerated performance
- The contractor incurred extra costs as a direct result of the acceleration
- The contractor notified the Government of the existence of an excusable delay and a time extension was not granted

Exhibit 10-5

Because the contractor has the burden of proving the length of a proper time adjustment, it should be able to explain how it could have met the schedule had it not been accelerated.

Coordination and Selection of the Best Plan

The requisitioning activity and technical advisors are indispensable sources for:

- Determining the feasibility for alternatives, and
- Identifying alternatives you have not already considered.

Therefore, you are expected to consult requisitioning offices in formulating your optimal plan. There may be technical reasons why a seemingly insignificant change to the requirement would be unacceptable.

Features of the Best Plan

The plan you select as the optimal one should be realistic. It should be fair to the contractor as well as to the Government. Overall Government interests requires fairness within the Government contracting system. However, the best plan for informal resolutions will not compromise basic Government rights under the terms of the contract.

10.4 HOLD DISCUSSIONS WITH THE CONTRACTOR

After you have identified the causes and potential impacts of contract performance problems and have chosen the best method to resolve them, you must plan a strategy for coming to an agreement with the contractor. Prepare for negotiations by working through all of the details in your plan. Don't make suggestions if you have not thought out their consequences.

If your previous discussions were limited to verifying facts and identifying impacts, discuss with contractor officials who have the authority to settle the dispute the Government's plan for correcting the problem. You can do this in writing, over the telephone, or in a face-to-face meeting. Do not bring up issues harmful to the Government. Present the plan in positive terms the contractor will find attractive and could result in a mutually beneficial resolution. Your strategy may change as you gain additional information through expanded discussions and negotiations.

The contractor may have its own plan for resolution. Listen and be open to new lines of thought. Seek an agreement that will satisfy the needs of both parties.

Alternative Dispute Resolution (ADR) Methods

If agreement through traditional negotiation techniques fail, consider using ***alternative dispute resolution (ADR)*** techniques.

ADR techniques include those procedures that are used consistently enough to be defined as a specific ADR method. They also include any other administrative approach that you structure independently to solve a specific contractual problem.

Essentially, ADR emphasizes agreement on how resolution of the problem can be achieved. It often will involve the participation of a "neutral person" who assumes whatever responsibilities the parties decide that person should have. If a neutral person is to be involved, it should be someone both sides accept as both impartial and knowledgeable. Former administrative judges who served on contract boards frequently are selected; representatives from local or national arbitration organizations are another possibility. Typically, the Government recruits an appropriate neutral person and pays his or her fee, but this is negotiable at the time ADR is agreed to.

FAR 33.202

FAR 33.204

FAR 33.214

Normally, you would suggest ADR to resolve an impasse before the contractor files a claim under the Disputes clause. However, ADR techniques can be used even after the formal claims process has been initiated. But, if a claim has been filed, certain legal requirements must be met within the ADR process. Exhibit 10-6 lists the prerequisites for the use of ADR techniques.

Prerequisites for Using ADR Methods

- Existence of an issue in controversy
- A voluntary election by both contracting parties to participate in the ADR process
- An agreement on alternative procedures and terms to be used in lieu of formal litigation
- Participation in the process by officials of both parties who have the authority to resolve the issue in controversy
- A fully compliant and certified claim, but only if the basis for using the procedures is the submission of a claim

Exhibit 10-6

Many agencies have used ADR methods successfully. Exhibit 10-7 describes some of the pros and cons typically involved in their use.

Avoiding Disadvantages

Many of the disadvantages can be avoided by carefully selecting the method in light of the peculiarities of specific contractual circumstances. For example, if the Government believes it has strong legal case precedent, it could suggest a factfinding technique that includes a look at court precedent rather than a negotiated settlement offered by a third party that may or not include legal case history as a settlement consideration. However, remember that the contractor must agree to the technique.

Recognized ADR Techniques

Some of the more commonly recognized ADR techniques are shown in Exhibit 10-8, but any technique that Government and contractor officials can agree on is worth a try. It need not be sanctioned in a textbook or a law journal. However, make sure that no aspect of the technique is in violation of mandatory regulations or public law.

Advantages and Disadvantages of ADR Methods

Advantages	Disadvantages
Reduction in settlement time. Caseload backlogs are not a factor and the procedures themselves are streamlined.	*Lack of Basis for Predicting Settlement.* ADR settlements need not follow previous court and board decisions. Therefore, it is harder to evaluate the Government's chances for success.
Cost reduction. Board proceedings and court litigation is very costly in administrative time.	*Public Suspicion of Secrecy.* Agencies that have had any recent adverse publicity may be more uneasy about this disadvantage than others.
Privacy. The parties may be more forthright knowing that the proceedings do not become a matter of public record. Also, if trade secrets are involved, privacy is essential.	*Potential for Waiving Legal Rights.* Some critics cite lack of constitutional due process, forfeiture of the right to future litigation, and so forth.
Expertness and independence of a neutral person. Someone not involved in the controversy is more likely to be able to put feelings aside and decide on merits alone.	*Knowledge and Neutrality.* That person may not have in-depth knowledge of Government contracting. Contractors often do not consider agency administrative judges knowledgeable in contracting as truly neutral.

Exhibit 10-7

Features of Common ADR Techniques			
ADR Method	**Use of Third Party**	**Issuance of Decision**	**Process Summary**
Factfinding	Optional	No	A neutral investigator or, more likely, a panel of investigators issues a report of pertinent facts. Parties then may negotiate a settlement or use another ADR technique.
Facilitation	Yes	No	A neutral person assists in defining issues and setting priorities.
Mediation	Yes	No	A neutral person assists in communications between the disputing parties and may suggest possible solutions without issuing an actual decision.
Settlement Judge	Yes	No	A neutral judge acts as negotiator and advises the disputing parties. This method is commonly used by certain boards of contract appeals and some federal courts in an attempt to reduce their caseload.
Arbitration	Yes	Yes	A neutral person hears evidence, reviews written records and issues a decision. Traditional arbitration decisions are binding. Parties can agree to use a nonbinding form.
Mini-trial	Optional	Yes	Each side presents abbreviated evidence to a panel usually made up of representatives from each side. A single decision is issued by the panel.

Exhibit 10-8

Factors for Success In addition to the legal and regulatory requirements listed earlier in Exhibit 10-6, some tips for successful use of most ADR methods are generally recognized. These are summarized in Exhibit 10-9.

Factors For Successful Use of Most ADR Methods

- Negotiate ground rules before starting the proceedings
- Limit the total time frame for resolution
- Have a neutral person moderate and comment when:
  - Potentially large dollar settlements are involved, or
  - The acquisition program is highly sensitive
- When the method involves a hearing, hold settlement talks immediately after the hearing
- Provide for confidentiality

Exhibit 10-9

Factfinding Because most Government contract disputes involve questions of fact and because highly technical issues often separate the parties, factfinding has strong potential application to the Government contracting resolution process.

By insisting on a problem-solving attitude rather than a finger-pointing approach, you can use ADR factfinding techniques in a unique way. The seriousness of the situation and the amount of a potential claim may not warrant the involvement of neutral persons. When approached unemotionally with all key persons involved in the dispute given an opportunity to provide input, the very process of isolating problems and examining their causes may point to a solution that the Government and contractor can agree to.

Source for Neutral Persons You can obtain suggested sources for neutral persons who are knowledgeable in the Federal procurement process from the Administrative Conference of the United States, (202) 254-7065.

10.5 WHEN INFORMAL RESOLUTION FAILS, SEEK FORMAL ACTION

When no mutual agreement can be reached, recommend, as appropriate:

- A formal remedy (remedies under Government contracts are outlined in Chapter 15),
- The contractor's preparation and submission of a formal written claim, or
- The Government's preparation of a claim against the contractor.

Procedures for claims are summarized in Chapter 17.

10.6 DOCUMENT THE FILE AND ADVISE INTERESTED PARTIES

The contracting officer will need written documentation from you reporting any Government action or inaction regarding informal resolution of performance problems. Documenting unsuccessful attempts at an informal resolution is important if a formal claim is filed later.

What to Document

Your documentation should include, but not be limited to:

- Written verification of the facts, including names and phone numbers of individuals with direct factual knowledge of events
- Impact assessments
- Rationale for taking the recommended action in lieu of other actions that might be taken, and
- A record of negotiation, clearly setting out the rationale for cost/price and other changes.

Who Is Typically Interested

Advise the requisitioning activity of the final decision. They may need to make adjustments in other program actions affected by the decision. Furthermore, if the contractor wishes to appeal the final decision, you may need the requisitioning activity's support.

Other interested parties might include:

- Program offices
- Legal advisors
- Union officials
- Any others that might be directly affected by the outcome of the decision.

NOTES

CHAPTER 11

PAYMENT

A PENNY HERE, A PENNY THERE

Ernest N. Deavors was responsible for processing invoices on the Tally-Up contract. His agency and most others processed interim invoices for cost-reimbursement contracts on a standard form that indicated the invoice was actually a "voucher." Consistent with the general business definition of that term, vouchers only contain costs actually incurred. If amounts billed had not actually been incurred, it is considered fraud and the contractor could be prosecuted under civil statutes relating to fraud. Additionally, the contractor would become subject to administrative sanctions available to the procuring agencies.

Ernest had read in the standard Allowable Cost and Payment clause in the Tally-Up contract that if a voucher from a large business contains material costs, the contractor is required to have paid those amounts. Tally-Up is a large business. However, there would be very few material costs under these auditing service task orders.

Most of the charges would be based on preapproved interim billing rates for various classes of labor. Under the terms of this task order contract, the billing rates to be used for each task were reviewed before the task order was issued. This was done because some tasks might require the expertise of an individual that was not an accountant by profession and whose skills were not characteristic of the labor categories and billing rates negotiated previously. Additionally, the Government might want an individual with a specialized accounting expertise.

For example, Bea and Ernest negotiated a separate billing rate for the services of a former member of the Government-wide Cost Accounting Standards (CAS) Board prior to issuance of the second task order—a CAS systems audit.

Tally-Up had proposed the use of this individual for approximately a week to review and, if necessary, revise the internal checklist his auditors would be using, to be on call to assist with any tough problems the auditors might encounter, and to provide input for the draft audit report. Ernest's agency had enthusiastically endorsed the use of this individual. His expertise, especially on the first CAS systems audit Tally-Up would perform, seemed money well spent.

continued . . .

Ernest received the four copies of the first Tally-Up invoice in the mail delivery on a Monday afternoon. He immediately date-stamped all four copies and sent one copy on to Anna Lize. During their initial discussions on contract management responsibilities, it was agreed that Anna would review the hours billed per labor category and determine whether they seemed appropriate from any observations she may have made at the work site. It had been further agreed that she would contact Ernest verbally two working days after receipt of the invoice and then send the invoice back with any discrepancies noted or a statement that indicated she could detect no discrepancies in the number of hours billed.

So Ernest proceeded to review the Tally-Up invoice with the help of Exhibit 12-4 from Bea's contract administration course. But he would wait until he heard from Anna before certifying the invoice for payment.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Determine whether to forward the invoice for payment, or partial payment, or whether to return the invoice to the contractor.

Individual:

11.1	Inspect invoice for completeness and notify contractor of any defects.
11.2	Identify terms and conditions pertinent to payment.
11.3	Obtain documents and determinations pertinent to payment.
11.4	Review invoices for overall allowability, including reasonableness.
11.5	Identify deductions and withholdings.
11.6	Determine whether an assignee is protected from deductions and withholdings.
11.7	Determine the amount due the contractor.
11.8	Notify the contractor of differences in invoiced amounts and amounts to be paid.
11.9	Notify the contractor of final decision on paying a lesser amount and document the rationale for the decision.
11.10	Forward the invoice and monitor its payment.

INTRODUCTION TO INVOICE PAYMENTS

Definition of Payment

Payment is an essential contract element, consideration. It satisfies the Government's obligation to compensate the contractor according to the terms of the contract.

FAR 52.232-1

Fixed-price contracts call for payment following delivery and acceptance of the required product or service. If various deliverables are separately priced in the contract, payment for those portions that have been accepted is permitted.

FAR 31.201

Cost-reimbursement contracts focus on the contractor's incurred costs rather than on completion of the work. Therefore, so long as the contractor is making satisfactory progress, payment processing for these contracts is largely a matter of deciding whether invoiced costs are allowable under the terms of the contract, including FAR cost principles incorporated by reference in standard contract clauses.

Invoice Payment Policy

Nevertheless, the underlying payment process is essentially the same for both fixed-price and cost-reimbursement contracts.

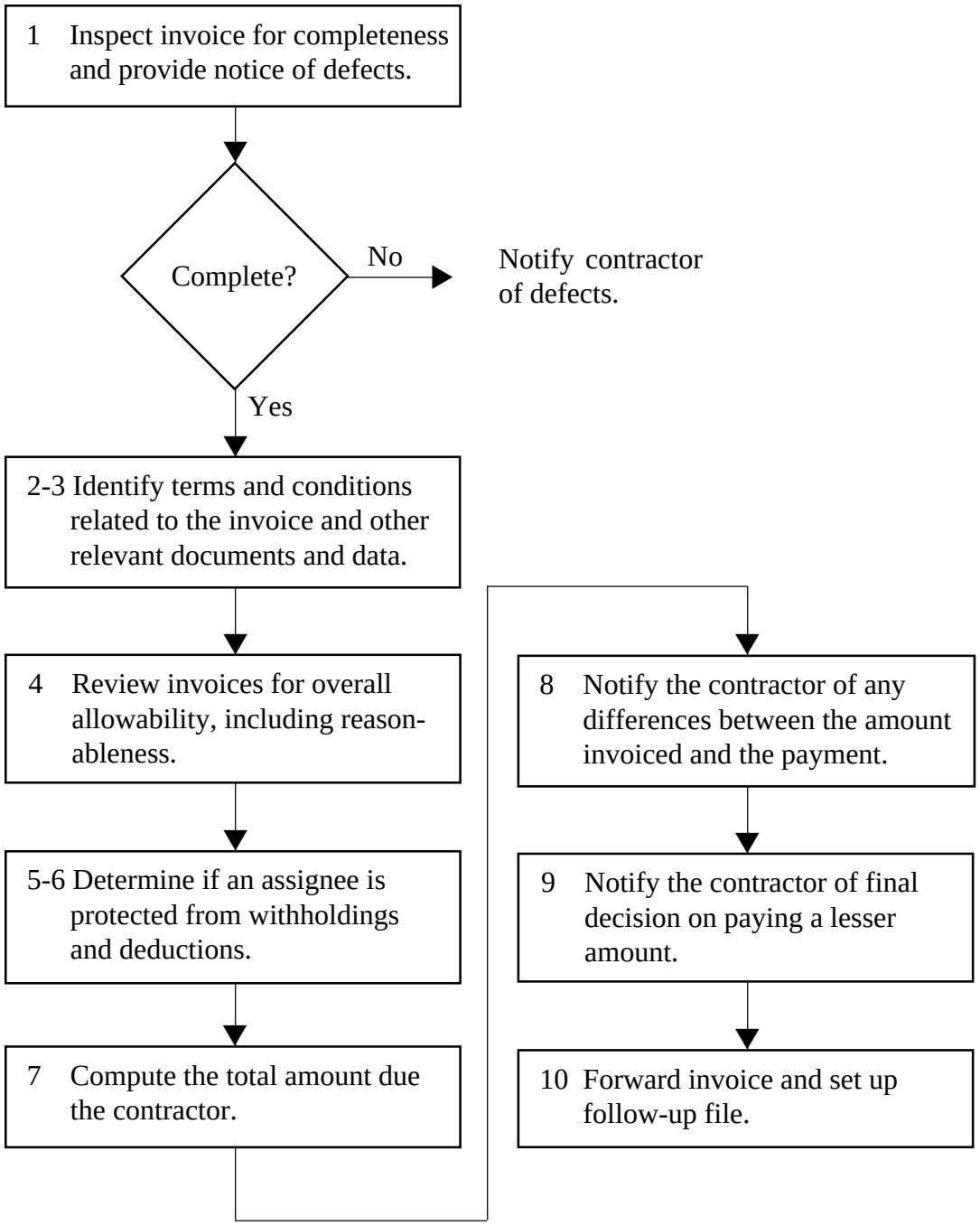
FAR 32.901

The Prompt Payment Act, 31 U.S.C. 3901, as amended, is a source of many payment policies. Among other things, it requires payment of a complete and otherwise proper invoice within 30 days of receipt.

Steps in Performance

The steps in determining the appropriateness of invoice payment, including the amount paid, are charted on the next page. The steps are then described.

STEPS IN PAYING CONTRACT INVOICE



PAYMENT

11.1 CHECK FOR COMPLETENESS AND NOTIFY CONTRACTOR OF ANY DEFECTS

In order to receive payment, a contractor submits an ***invoice,*** sometimes called a voucher, to the Government. The contract normally will specify where the contractor is to send its invoice. Usually, this will be to:

- The contract administrator
- The contracting officer's representative (COR/COTR), or
- The payment office directly.

Prompt Payment Considerations

However, the Prompt Payment Act infers that the person who first receives the invoice in the agency "receives" it for the agency with respect to calculating payment processing time. Agencies must pay the contractor within strict time frames after receiving a proper invoice or the Government owes interest for late payment.

Annotate Invoice Receipt Date

The contractor may inadvertently send its invoice directly to you even if you are not specified as the billing addressee. If so, date stamp the invoice and forward it promptly to the place designated in the contract.

FAR 52.232-25(a)(2)(ii)

The date of the contractor's invoice will be used as the receipt date if the invoice is not annotated at the time it was received by the Government.

Check Invoice for Completeness

An invoice must have eight basic elements to be considered administratively "complete." These are outlined in Exhibit 11-1.

Notify the Contractor of Any Defects

Notify the contractor of any defects you found in the invoice. There are two basic rules for this notice:

FAR 32.905(e)

- It must be made within 7 calendar days after the agency receives the invoice (a lesser time frame for perishable items)
- It must specifically state the defect.

Annotate When Defects Are Corrected

Keep a record of the number of days the contractor caused a delay along with supporting information. If you are sent a new invoice showing the date of the original invoice, annotate a statement substantially as follows before sending to the payment office:

> "After receipt of invoice, the contracting office waited _____ days for the contractor to supply necessary information for invoicing. Therefore, the invoice was not proper until _____ and any interest payment that may be due the contractor shall be based on this later date.

Criteria for an Administratively Complete Invoice
FAR 32.905(e)

1. The contractor's name and address.
2. An invoice date.
3. Contract number or other authorization for the items or services that are the subject of the invoice.
4. Description, quantity, unit of measure, unit price, and extended price of supplies delivered or services performed.
5. Adherence to shipping and payment terms.
6. Name and address of contractor official to whom payment is to be sent (must be the same as the address shown on the contract or on a proper notice of contract assignment).
7. When practicable, name, title, phone number, and mailing address of person to be notified in event of a defective invoice.
8. Any other information or documentation required by the contract or agency-specific policy. This kind of information may include items such as:
    - Taxpayer or Employer Identification Number.
    - Evidence of shipment or completion.
    - Signature of an authorized contractor official.
    - Certification that the costs claimed are allowable and for performance of the contract.
    - A detailed breakdown of costs, labor hours, or other supporting evidence as may be required.

Exhibit 11-1

11.2 IDENTIFY TERMS AND CONDITIONS PERTINENT TO PAYMENT

Contract terms and conditions that generally affect the payment amount include those that address:

- Contract price
- Type of payment
- Method of payment
- Discounts.

Standard Fixed-Price Clauses

Payments under fixed-price contracts are covered, in general, by FAR 52.232-1, *Payments.* Related clauses apply to contracts for research and development, personal services, and other specialized purposes.

Standard Time-and-Materials and Labor-Hour Clauses

Requirements concerning payments for work under Time-and-Materials and Labor-Hour contracts are specified by FAR 52.232-7.

Standard Cost-Reimbursement Clauses

There are two standard FAR clauses covering general payment requirements under cost-reimbursement contracts. The two basic clauses are:

- FAR 52.216-7, *Allowable Cost and Payment*
- FAR 52.216-13, *Allowable Cost and Payment–Facilities.*

The one that most often applies is FAR 52.216-7. The other merely addresses the peculiarities of facilities contracts.

In addition to the circumstances under which payments are provided for by these clauses, certain other payments may be authorized by the contract. These include:

- Partial payments
- Progress payments
- Advance payments.

Partial Payments

FAR 52.232-1

Partial payments for increments of supplies or services that have been delivered and accepted under a fixed-price contract are permitted. The contractor must request partial payments, and the amount requested must be at least $1,000, or 50 percent of the total contract price.

Progress Payments

FAR 32.502-1

FAR 52.232-16

Progress payments may be allowed under fixed-price contracts when the contract amount is in excess of $1 million and no separately priced items are expected to be delivered for six months or more. Under the Progress Payments clause, the contractor may invoice the Government for costs incurred much like under a cost-reimbursement contract, and receive payments for up to 80 percent of these costs.

To be eligible for progress payments, the contractor must have an approved accounting system (see Chapter 8) and be in sound financial condition. Small businesses are eligible for progress payments under smaller contracts and can receive a higher percentage of their costs. Other exceptions can be made by the contacting officer under certain circumstances.

Liquidation of Progress Payments

FAR 32.503-8

The Government recovers progress payments made to the contractor by deducting amounts that otherwise would be due to the contractor when billable deliveries have been accepted. These deductions, or ***liquidations,*** are taken at the same percentage rate, often 80 percent, as was used in calculating progress payments. A simple example of how progress payments and liquidations are calculated is shown in Exhibit 11-2.

Calculations of Progress Payments and Liquidations
FAR 52.232-16

Company X is awarded a 12-month fixed-price contract for $1,200,000. The first deliverable under the contract, for $400,000, is due in the seventh month. The contractor incurs costs of $100,000 each month for the first six months. The contract provides for progress payments.

Progress Payments

$100,000 in costs are incurred each month x 6 months =	$600,000.
$100,000 is invoiced each month x 80% payment =	$80,000.
Total progress payments for 6 months =	$480,000.

Liquidation

$400,000 is invoiced in month 7 for deliverable =	$400,000.
$400,000 x 80% is subtracted from invoice as liquidation =	$320,000.
Contractor receives difference =	$80,000.

Balances

Progress payments left to be liquidated, $480,000 - $320,000 =	$160,000.
Contractor's current investment in contract, $600,000 - $480,000 = $120,000 - $80,000 =	$40,000.
Government payments to date, $480,000 + 80,000 - $320,000 =	$240.000.

Exhibit 11-2

Subcontract Progress Payments

FAR 32.504(f)

Progress payment clauses are not used for prime contractors under cost-reimbursement contracts except for reimbursement of fixed-price subcontractor progress payments made under the prime contract. They are unnecessary for prime cost-reimbursement contracts because standard clauses provide payment of all allowable costs incurred during the billing period.

Advance Payments

FAR 32.402

FAR 52.232-12

Advance payments are used to provide financing to a contractor not reasonably able to obtain financing from other sources. Advance payments are a form of a loan to the contractor, who must meet various criteria to be eligible and generally must pay interest on the amount outstanding.

FAR 32.402

The contractor usually is required to establish a special bank account and agree to close monitoring of withdrawals from that account as a condition for receiving advance payments. Advance payments can be authorized under fixed-price, cost-reimbursement, and other types of contracts. The advance payment agreement will specify the conditions under which the amount will be replenished by the Government as withdrawals are made by the contractor and the terms for liquidating the amount.

By law, advance payments for certain contractor costs are authorized without special approval or authority. These are listed in Exhibit 11-3.

If invoiced amounts include advance payments, approve payment only if:

- The cost is one included within one of the categories outlined in Exhibit 11-3 or you have evidence of specific authority and approval, and
- All statutory requirements for advance payments have been met.

11.3 OBTAIN DOCUMENTS AND DETERMINATIONS PERTINENT TO PAYMENT

Supporting data from other Government officials that may be needed before authorizing invoice payment depend on the contract type. For a fixed-price contract, the information needed might include things such as:

- Inspection/receiving reports and other official documents acknowledging acceptance
- Commercial or Government shipping documents
- Determinations to reduce progress payments
- Determinations for the adjustment of liquidation rates for progress payments.

Circumstances that Allow Advance Payment of Costs Without Special Authority or Approval FAR 32.404

- The cost is for rental of equipment or other property
- The cost is for tuition
- The cost is for insurance premiums
- The cost is for investigations in foreign countries
- The cost involves extension or connection of public utilities for Government buildings or installations
- The cost is for subscriptions to publications
- The cost is for supplies or services in foreign countries and
  - The cost is $10,000 or less, and
  - The advance payment is required by the laws or government regulations of the foreign country
- The cost involves enforcement of customs or narcotics laws

Exhibit 11-3

For a cost-reimbursement contract, you may need to have:

- Determinations on the allowability of invoiced costs from contract auditors
- Determinations from contract auditors and the contracting officer that the cost ceiling will not be exceeded
- Reports on contractor indebtedness.

FAR 32.905(a)(1)(ii)

In addition to official documents acknowledging acceptance, implied or constructive acceptance may also have a bearing on when payments are due under a fixed-price contract. For the sole purpose of computing an interest penalty, Government acceptance is based on:

1. **Constructive acceptance period.** Government acceptance is considered to have constructively occurred on the 7th day after delivery of supplies or performance of services unless the contract states a longer period.

2. **Actual acceptance.** The actual acceptance—not the constructive acceptance date—is used for computing interest when:
   - Actual acceptance occurred within the constructive acceptance period, or
   - Acceptance was beyond the constructive acceptance period due to a properly documented disagreement over the allowability of costs incurred, the quality or quantity of work performed, or other compliance issues.

11.4 REVIEW INVOICES FOR OVERALL ALLOWABILITY, INCLUDING REASONABLENESS

Invoice review for cost-reimbursement contracts is simply a matter of deciding whether costs are allowable under the terms of the contract. As you should recall from Chapter 8, deciding whether costs are allowable is deciding whether costs are:

- Reasonable—that is, not excessive to costs a prudent person would incur in the conduct of competitive business
- Allocable—that is, properly assigned to one or more cost objectives under the contract
- Consistent with:
  - — Industry or Government accounting standards
  - — Specific contract terms such as cost or funding limitations
  - — Specific limitations and prohibitions on cost allowability in FAR Part 31.

Extent of Review

You also must verify that the payment will not bring the cumulative total over the cost-reimbursement ceiling indicated in the contract.

The extent and thoroughness of an invoice review for a cost-reimbursement contract largely depends on whether the invoice is an interim payment or a final payment. An interim, or provisional, payment relies largely on the contractor's financial system with respect to what direct costs were incurred that are chargeable to the contract and what indirect rates can be applied. As will be described in Chapter 19, these amounts are more closely scrutinized prior to the final payment, when necessary adjustments are made.

The primary purpose of the examination and approval of interim vouchers is to obtain a reasonable assurance that the amounts claimed are not in excess of what is properly allowed under contract terms and conditions.

Impact of Allowability Determinations for Interim Payments

All members of the Government contract administration team must exercise care in dealing with allowable cost determinations for interim payments. You may receive an inquiry, for instance, as to whether a particular cost is allowable under the contract.

Paragraph (g) of FAR 52.216-7, *Allowable Cost and Payment*, permits the Government to audit payment invoices at any time and to make adjustments for overpayments if such an audit discloses that costs included in the invoice were not allowable. However, if a formal determination of allowability is communicated to the contractor, the contractor may be able to argue for payment regardless of a later determination to the contrary. Consequently, make determinations of disallowance only, and refrain from making determinations of allowability unless Government auditors and the contracting officer intend to be held to that determination.

Also, the Government is entitled to recover payments made because of contractor fraud or defective pricing, or because a cost prohibited by FAR was reimbursed, even if the contractor was notified that the item was allowable.

Therefore, generally restrict your review of interim payments to the steps outlined in Exhibit 11-4.

Reimbursement for Actual Costs

FAR 52.216-7(b)

A contractor is eligible to receive reimbursement only for costs actually paid for during the period being invoiced. It cannot request reimbursement, for example, for raw materials ordered but not yet paid for. It may, however, receive payment for direct costs recorded in the ordinary cause of business but not yet paid out providing it is not delinquent in making these payments and the costs are for:

- Items of material issued from the contractors's inventory and placed in the production process for use on the contract
- Direct labor
- Direct travel
- Other direct in-house costs.

Royalty and Patent-Related Payments

When reviewing an invoice, you should give close attention to any royalty and patent-related costs. Even though they may be directly related to contract performance, they may not always be proper. Approve such payments only when they meet the conditions listed in Exhibits 11-5 and 11-6.

Steps for Reviewing Interim Invoices for Inappropriate Charges

1. Compare allowable billable costs in the contract schedule with direct costs claimed on the invoice, questioning any apparent discrepancy
2. Reject invoices that are inconsistent with standard payment terms and conditions and other unique contract payment terms, such as:
    - A large business invoicing weekly (bi-weekly invoicing is the maximum per FAR 52.216-7, Allowable Cost and Payment)
    - A large business invoicing for items it has not yet paid for when prior payment is required per FAR 52.216-7, Allowable Cost and Payment
    - A direct cost that is clearly unallowable per FAR Part 31 incorporated into the contract by FAR 52.216-7, Allowable Cost and Payment (review Chapter 8, Exhibits 8-1 and 8-2)
    - Royalty and patent-related costs that are improper (see Exhibits 11-5 and 11-6)
    - Elements of cost that constitute an advance payment not specifically authorized by the terms of the contract
3. Verify that amounts claimed for reimbursement of indirect costs are computed using the billing rates currently in effect
4. Verify that interim fees claimed are consistent with the formula or basis in the contract
5. Check mathematical accuracy

Exhibit 11-4

Final Payment Implications

You should track withholdings on multiyear contracts and on contracts expected to have difficult, lengthy close-outs. Monies withheld revert to the U.S. Treasury after 5 years. If this happens, the agency would have to tap other resources to pay contractors amounts withheld but due the contractor as part of the final payment.

Prerequisites for Royalty Payments
FAR 27.205

Reimburse the contractor for its royalty payments only when:

- The Government does not have a royalty-free license covering the royalty
- Amounts billed do not exceed the rate for which the Government is licensed
- The royalties in whole or in part are otherwise proper (the charge is not excessive, etc.)
- The Government is not entitled to a refund under FAR 52.227-9, Refund of Royalties

Exhibit 11-5

Prerequisites for Payment of Patent-Related Costs
FAR 31.205-30

1. The contract calls for the Government to acquire patent rights
2. Payment is for one of the following:
   - Preparing invention disclosures, reports, and other documents
   - Necessary research for documenting that the invention is new
   - Filing and prosecution of a U.S. patent application
   - General counseling services relating to patent matters, such as advice on patent law, regulations, clauses, and employee agreements to the extent allowable by FAR 31.205-33

Exhibit 11-6

Your review of an invoice for final payment under a cost-reimbursement contract must be particularly thorough. A final payment is the last payment the Government makes on a contract when the parties believe that all obligations under the contract have been closed out. Consequently, there is a unique set of "closeout" procedures that you are required to perform after or concurrent with final payment. These are outlined in Chapter 19.

However, for the purpose of examining the final invoice for inappropriate charges, you must also perform additional tasks and be aware of the legal consequences of payment.

Final payment itself represents an allowability determination regarding costs under the contract. Except for fraud, mistake, or lack of authority, final payment itself represents a determination of allowability for the costs included not only in the final payment, but also for prior interim payments made under the contract.

Therefore, in addition to the steps you would normally take to review interim invoices for inappropriate charges, you would additionally have to gather enough information to decide the allowability of all costs billed under the contract, including costs billed as part of indirect cost rates. You would do this by obtaining an end-of-contract audit. Refer to Chapter 13. This also in the last opportunity to seek a reduction in the cost of performance due to defective pricing as explained in Chapter 13.

11.5 IDENTIFY APPROPRIATE WITHHOLDINGS/ DEDUCTIONS

A ***withholding*** implies that a subtracted amount may be paid at a later date. A ***deduction*** implies that an amount is permanently subtracted. However, payment of deducted amounts can be made if the contractor later provides appropriate supporting evidence.

Identify Appropriate Withholdings

Exhibit 11-7 identifies several common withholdings.

Common Withholdings

FAR REF.	TOPIC
52.232-16	Suspended or reduced progress payments
52.216-11	Retaining 1% of total estimated costs, when appropriate in cost-no fee contracts
52.216-8, 10	Retaining up to 15% of the fee or target fee after 85% of the fee has been paid for cost-plus-fixed fee or cost-plus-incentive fee contracts
52.232-7	Retaining up to 5% of amounts billed for time charges under time-and-materials and labor-hour contracts

Exhibit 11-7

Identify Appropriate Deductions

Deductions are authorized by various contract clauses, such as for liquidated damages, disallowed costs, or discounts for early payment. Common deductions are listed in Exhibit 11-8.

Special terms of each contract may specify other deductions under certain circumstances. Late delivery is an example. Some service contracts specify deductions for defects that do not meet a specific "acceptable quality level," usually referring to the number of defects in a sampled service area.

Setoffs

FAR 32.611

Setoffs are provisions for collecting debts due to the Government. The Government has the right to deduct amounts from payments on a contractor's invoice when the contractor owes the Government for liquidated damages, for failure to repair or replace defective deliverables, for compensation agreed upon for acceptance of products or services with minor nonconformities, and for other reasons (see Chapter 19).

Setoffs can be used to collect debts from the contractor even when the debt arose on another, unrelated contract.

11.6 DETERMINE WHETHER AN ASSIGNEE IS PROTECTED FROM DEDUCTIONS AND WITHHOLDINGS

As you learned in Chapter 4, an assignee is a bank, trust company, or other financial institution that has been transferred the right to receive a contractor's payment due under a Government contract.

FAR 32.803 (d)

You may find a "no-setoff" commitment in a Government contract that protects the assignee from withholdings or deductions. A no-setoff agreement is authorized only in time of war or national emergencies.

FAR 32.804

When the no-setoff provision applies, most deductions and withholdings are protected and the assignee is due the full amount.

11.7 DETERMINE THE AMOUNT DUE THE CONTRACTOR

After all appropriate deductions and withholdings have been identified, determine the amount due. Your calculation should include any adjustment of fee as well as costs. Fee adjustments are covered in detail in the next chapter.

Common Deductions

FAR REF.	TOPIC	APPLIES TO
52.232-8	Discounts for early payment.	FP only
46.407	Invoiced items not received or accepted.	FP only
52.232-11	Extras.	FP only
52.232-1(b)	Requested partial payments amounting to less than $1,000 or 50% of the purchase price.	FP only
52.222-4 52.222-41	Unpaid wages.	FP and CR
52.212-4	Liquidated damages.	FP only
52.233-1(c)	Adjustments for amounts that are disputed.	FP and CR
32.804	Setoffs for the collection of contractor debts, UNLESS – An assignee has not made a loan or commitment for a setoff, or – The amount due on the contract exceeds the amount of any loans made or in process under a firm commitment for financing.	FP and CR
52.216-10(c)	Payment on the basis of a lesser fee under cost-plus-incentive fee contracts when the contractor is not likely to achieve the target.	CR only
52.242-1	Unallowable costs.	CR and FPI
52.232-10	Discrepancies between invoiced prices and billing prices when billing prices are reduced under fixed-price incentive contracts.	FPI only
52.232-10	Discrepancies between billing prices and final prices for deliverables under fixed-price incentive contracts.	FPI only
52.232-12	Liquidation of advance payment balance.	FP and CR
52.232-12(e)	Excess advance payments.	FP and CR

continued

Exhibit 11-8 (page 1 of 2)

Common Deductions *(continued)*

FAR REF.	TOPIC	APPLIES TO
52.232-16	Liquidation of progress payment balance.	FP only
52.216-7(g)	Discrepancies between billings of indirect costs, and billing rates or final indirect cost rates for the period.	CR only
	Costs that are in excess of a contract ceiling amount. Ceiling amount restrictions may be in reference to:	
52.232-20	– A limitation of cost in a cost-reimbursement contract;	CR only
52.232-22	– A limitation of funds in a cost-reimbursement contract;	CR only
52.232-7	– Time-and-materials or labor-hour contract ceilings;	TM/LH
52.216-26	– The limitation of reimbursement and reimbursement rates in letter contracts;	Letter
52.216-12	– The cost share limit on matching payments;	C Share
35.003(c)	– Recoupment under research and development contracts; that is, recovery by the Government of Government-funded nonrecurring costs from contractors that sell, lease, or license products.	FP and CR
	Taxes for which the Government is exempt. These include:	
52.229-3	– "After-imposed" Federal taxes;	FP and CR
52.229-6	– "After-imposed" or "after-relieved" foreign tax;	FP only
52.229-8,9	– Any tax or duty by a foreign Government from which the U.S. is exempt by specific agreement and that is billed under the terms of a cost-reimbursement contract.	CR only
42.1403	Improperly supported reimbursement for transportation charges.	FP and CR

Exhibit 11-8 (page 2 of 2)

11.8 NOTIFY THE CONTRACTOR OF DIFFERENCES BETWEEN INVOICED AMOUNTS AND AMOUNTS TO BE PAID

FAR 42.801(a)

As with other notifications to contractors, your main reason for giving notice of payment of a lesser amount is to get feedback. Present all factual data that justifies the lesser amount and be willing to listen to any evidence for paying an increased amount or the full amount.

Note that you must make a reasonable effort, through discussions with the contractor, to reach a satisfactory mutual settlement on cost disallowance issues.

Discuss with the contractor costs which the auditor determines should be suspended or disapproved to ensure the auditor's conclusion is based upon a proper understanding of the facts, and inform the contractor of the auditor's determination. If the contractor agrees that the costs in question should be suspended or disapproved, you can accept a revised invoice from the contractor that excludes the inappropriate costs.

If agreement is not reached, issue an official notice.

11.9 NOTIFY THE CONTRACTOR OF FINAL DECISION ON PAYING A LESSER AMOUNT

If the contractor presents no conclusive evidence refuting the initial reason for questioning the invoice, advise the contractor of the Government's decision to:

- Pay in full
- Pay after deducting or withholding inappropriate amounts, or
- Reject the invoice, specifying the exact reasons for rejection, and returning it to the contractor for correction and resubmission.

This notice must be made within 7 days after receipt of a properly submitted invoice. Carefully document the notice to avoid an interest payment that might otherwise be due.

Notice of Intent to Disallow Costs

If the notice involves disallowance of costs under a cost-reimbursement contract, specific requirements apply. These are listed in Exhibit 11-9. Specific authority to issue such a notice is contained in FAR 52.242-1, *Notice of Intent to Disallow Costs.*

Coordination Responsibilities

FAR 42.801

You must furnish copies of a notice of disallowance of costs to all contracting officers cognizant of any segment of the contractor's organization.

FAR 42.705

If the notice involves elements of indirect costs, you must coordinate the notice prior to its issuance with the contracting officer or auditor having authority for final indirect cost settlement.

Contractor Response and Government Decision

FAR 52.242-1

The contractor must respond within 60 days with justification for allowing payment. Within 60 days of receiving such a response, the Government contracting officer must either issue a written:

- Withdrawal of the notice, or
- Decision to disallow the cost.

Minimum Content Requirements for A Notice to Disallow Costs FAR 42.801

- The contractor's name and address
- A reference to the contract's Notice of Intent to Disallow Costs clause (FAR 52.242-1)
- The contract identification numbers of affected contracts
- A description of the costs to be disallowed, including:
  - Estimated dollar value by item and applicable time periods
  - Reasons for the pending disallowance
- A description of the potential impact on billing rates and forward pricing rate agreements
- Effective date of the notice
- Date by which the contractor must provide a written response
- A list of those who received copies of the notice
- A request that the contractor acknowledge receipt of the notice

Exhibit 11-9

11.10 FORWARD THE INVOICE AND MONITOR ITS PAYMENT

Certify a proper invoice for payment and send it to the payment office. Because agency procedures vary somewhat, follow those procedures your agency uses. One of the purposes for certifying the invoice is to acknowledge that the supplies or services are acceptable. Paying offices cannot make a payment until they have received:

- A proper invoice, and
- Evidence of acceptance of deliverables (fixed-price) or satisfactory progress (cost-reimbursement).

You may be required to provide certification on the original or duplicate invoice evidencing approval of the supplies or services, or you may need to provide a separate receiving report.

Set up a Follow-up File

You need to follow up invoices approved for payment to make sure no slip-ups occurred. Untimely payments result in unnecessary interest costs. A reasonable follow-up date is 30 days after receipt of a proper invoice. However, individual contract terms may require quicker payment. They would rarely, if ever, authorize a later payment.

Electronic Funds Transfer

FAR 52.232-28

Actual payment will be made by check. If authorized by the contract, and at the contractor's request, payment can be made by electronic funds transfer. The amount is then credited immediately to the contractor's bank account—an advantage if mail is slow reaching the contractor's address.

CHAPTER 12

PRICE AND FEE ADJUSTMENTS

SOMETIMES YOU HAVE TO ADJUST

Bea Ware's agency supports the national defense and she remembered using the extraordinary contract adjustment authority outlined in her contract administration course to resolve a mutual mistake many years ago. Even though Johnnie I. Dotter had advised that the Government had liability for the Tutors-R-Us (TRU) computer equipment issue, she thought it could also be characterized as a mutual mistake.

So Bea reviewed the FAR coverage on extraordinary contractual relief for any information that might be useful to the TRU controversy.

It didn't take her long to figure out that it simply didn't apply. She really would have a hard time justifying that the training contract was key to the national defense. The computer programs that were the subject of these training classes were simply standard commercial word processing and spreadsheet systems with some unique twists added by agency programmers. "Hardly key to the national defense," she reasoned.

"Anyway," she thought, "I'm ahead of myself. First we have to come to an agreement on what to do. Then, I can figure out how to do it."

She had another matter to attend to this morning. Her most experienced contract specialist had just retired and Bea was reviewing notes that this specialist had left concerning a cost-plus-incentive-fee contract. The contract contained the standard FAR Incentive Fee clause. The contract was complete and final cost data had just come in. Actual costs were almost 5 percent below target costs, so a calculation for a fee adjustment would be necessary.

Prior to leaving, the retired specialist had worked up the increased fee amount. However, it was based on preliminary data from the auditor over the telephone.

"This will be a good exercise for Ernest to go through," Bea thought. "He is so nervous about cost-reimbursement contracts. He can verify the final cost data against the preliminary data used in the formula and if it is different, he will only have to rework it rather than starting from scratch." An existing example would help him figure out how the formula worked.

Bea gave Ernest a copy of Exhibit 12A-6 from the course she attended so he would understand the calculations.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Make appropriate adjustments in contract prices or fees based on adjustment clauses in the contract, and assist in making extraordinary adjustments.

Individual: PART A—In regard to contractual price and fee adjustments:

12A.1 Implement an economic price adjustment according to the terms of the contract.

12A.2 Renegotiate prices under a price redetermination clause.

12A.3 Implement an incentive price adjustment according to the terms of the contract.

12A.4 Implement an award fee adjustment according to the terms of the contract.

12A.5 Implement an incentive fee adjustment according to the terms of the contract.

PART B—In regard to extraordinary adjustments:

12B.1 Determine whether extraordinary relief is applicable.

12B.2 Evaluate the contractor's request for relief and obtain additional data, as necessary.

12B.3 Determine whether to recommend any form of relief, and document the recommendation.

12B.4 Prepare, execute, and issue the contract action.

12B.5 Document the file.

INTRODUCTION TO PRICE AND FEE ADJUSTMENTS

Types of Price and Fee Adjustments

There are several types of price and fee adjustments you may be required to make:

Contractual Adjustments

- **Economic price adjustment** clauses allow upward or downward changes in the price of deliverables under a fixed-price contract to reflect changes in the contractor's costs or established unit prices.
- **Price redetermination** clauses provide for revisions in price under a fixed-price contract for work performed after an initial period because a fair and reasonable price could not be negotiated.
- **Incentive price adjustment** clauses provide adjustments to profit under a fixed-price contract based on the relationship between the final cost and a targeted final cost.
- **Incentive fee adjustment** clause is used to adjust the fee under a cost-reimbursement contract based on the relationship between the total cost and a targeted total cost.
- **Award fee adjustment** clause is used to set the amount of fee under a cost-reimbursement contract based on the Government's judgmental evaluation of contractor performance.

Extraordinary Adjustments

FAR 50.101

FAR 50.102

In addition, you may be responsible for providing contractual relief in the form of Extraordinary Adjustments under the authority of Public Law 85-804 (as amended by Public Law 93-155). In general, these adjustments can be made only when continued contract performance is essential to the national defense or the continued existence of a contractor essential to the national defense.

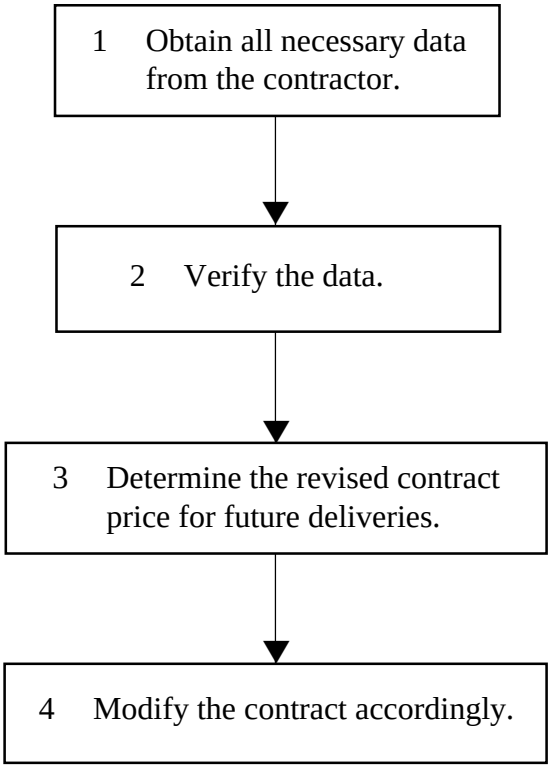
Steps in Performance

Part A of this chapter provides flowcharts and describes the steps in determining various price and fee adjustments specified in Government contracts.

Part B presents a flowchart and summarizes procedures for pursuing extraordinary adjustments to a contract's terms when such adjustments are authorized by law.

PART A—PRICE AND FEE ADJUSTMENTS

STEPS FOR ECONOMIC PRICE ADJUSTMENTS



12A.1 IMPLEMENT AN ECONOMIC PRICE ADJUSTMENT

FAR 16.203

The Government permits the redetermination of contract pricing when there is reason to believe such contracts will result in lower costs. Economic price adjustment clauses are used when a fixed-price contract is desirable but potential contractors are unwilling to risk instability in their costs over an extended period of time. They also may be used when the Government expects labor or material costs will go down substantially over the life of the contract.

Economic price adjustments usually provide for increasing ***or*** decreasing the contract price based on:

- Contractor's unit (published market) prices
- Actual costs of labor or material
- Cost indexes of labor and material.

Data Verification

Data supplied to support a price adjustment request must be verified by the contracting officer. This may involve verifying prices in effect for the contractor's commercial customers, confirming changes in economic indexes such as the US Treasury interest rate published in the *Federal Register* and commercial periodicals, or verifying changes in the contractor's actual cost of labor or raw materials.

Economic Price Adjustment Clauses

Several different economic price adjustment clauses can be used in fixed-price contracts, depending on the supplies or services required and the nature of the costs that determine the contractor's prices.

FAR 16.203-4

FAR 52.216-2

Economic Price Adjustment—Standard Supplies clause can be used when the items being purchased have established catalog or market prices that may change over the life of the contract. The contractor is responsible for notifying the contracting officer of any increase or decrease in the items's catalog price. The price to the Government, which may be less than the catalog price, is then increased or decreased by the same percentage. However, increases usually are limited to 10 percent of the original contract unit price.

FAR 52.216-3

Economic Price Adjustment—Semistandard Supplies clause is similar except that it is applied to items customized for the Government. The adjustment is based on relative changes in the market price of the most equivalent commercially sold supplies, rather than those to be delivered under the contract.

FAR 52.216-4

Economic Price Adjustment—Labor and Material clause is used when any adjustment in the contract price is to be based on changes in certain costs, such as gold bullion, rather than on the contractor's market prices. The contract may specify the use of the contractor's actual costs or some cost index in calculating the redetermined price. The clause requires a cost change of at least 3 percent before a price change is made, and limits any increase in price to 10 percent.

Data Requirements

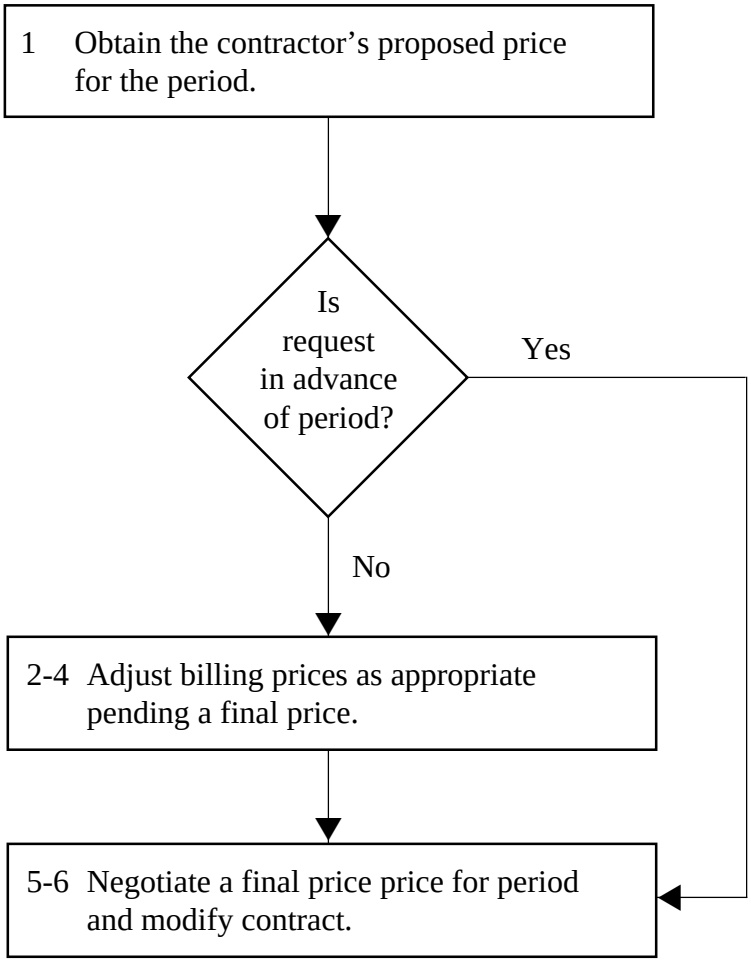
These clauses require the contractor, in its request for a price adjustment, to submit data for calculating upward or downward revisions in the contract price based on changes in the contractor's established unit prices or costs. Exhibit 12A-1 describes the data contractors are required to submit for economic price adjustments covered under standard FAR clauses.

Data for Economic Price Adjustments	
If making adjustment under standard clauses...	**Then, the contractor is required to provide the following as supporting data for the adjustment...**
FAR 52.216-2, Economic Price Adjustment—Standard Supplies, *or* FAR 52.216-3, Economic Price Adjustment—Semistandard Supplies	*For decreases:* 1. Prompt notice of the amount and effective date of each decrease in any established price 2. Certification on each invoice that each unit price reflects all decreases required by the clause 3. Certification on the final invoice that all required price decreases have been applied *For increases*: 1. Written request for an increase with verification of an actual increase in price
FAR 52.216-4, Economic Price Adjustment—Labor and Material	1. Notice of an increase or decrease in the rate of pay for labor or unit prices of material, including: • Proposal for an adjustment • Supporting data explaining the cause, effective date, and amount of the adjustment 2. Certification that either: • There were no decreases, or • The Government was notified of all decreases

Exhibit 12A-1

Processing Requests Contract terms usually require that you implement economic price adjustments soon after the contractor has furnished the needed data. When the information is received, it is your responsibility to verify the data, calculate the upward or downward revision in price, and prepare a contract modification. The new pricing will apply to items scheduled for delivery *after* the new price becomes effective or the price adjustment request is received, whichever is later.

STEPS IN PRICE REDETERMINATION



12A.2 IMPLEMENT A PRICE REDETERMINATION

FAR 16.205

Price redetermination clauses are another way to provide for adjustments in unit prices under a fixed-price contract. They are used when a fixed-price contract is desirable but a fair and reasonable price cannot be agreed upon either because of the duration of the contract or because it is one that involves a small amount of R&D work over brief performance period.

Either of two clauses allowing price redetermination may be included as a contract.

FAR 52.216-5

Price Redetermination—Prospective clause provides for prices to be reviewed at intervals stated in the contract, usually 12 months or more. A new price replacing the price in the contract is negotiated for the period following the effective date of the price redetermination. When appropriate, interim adjustments in billing rates under the contract also may be agreed upon, subject to final adjustment when the new firm price is established.

FAR 52.216-6

Price Redetermination—Retroactive clause can be used when a final, firm price cannot be established until performance is complete. At that time, the contractor prepares and submits a price redetermination proposal which includes a detailed accounting of the costs it incurred. However, interim billing prices may be increased or decreased by negotiation if the billing prices in the contract are substantially different from those anticipated based on costs incurred.

Data Requirements

The data a contractor must provide in support of its price redetermination request is shown in Exhibit 12A-2. The contractor also must provide data identified in Exhibit 12A-2 at the end of each quarter until a final price is established.

Basis for Price Redetermination Adjustments

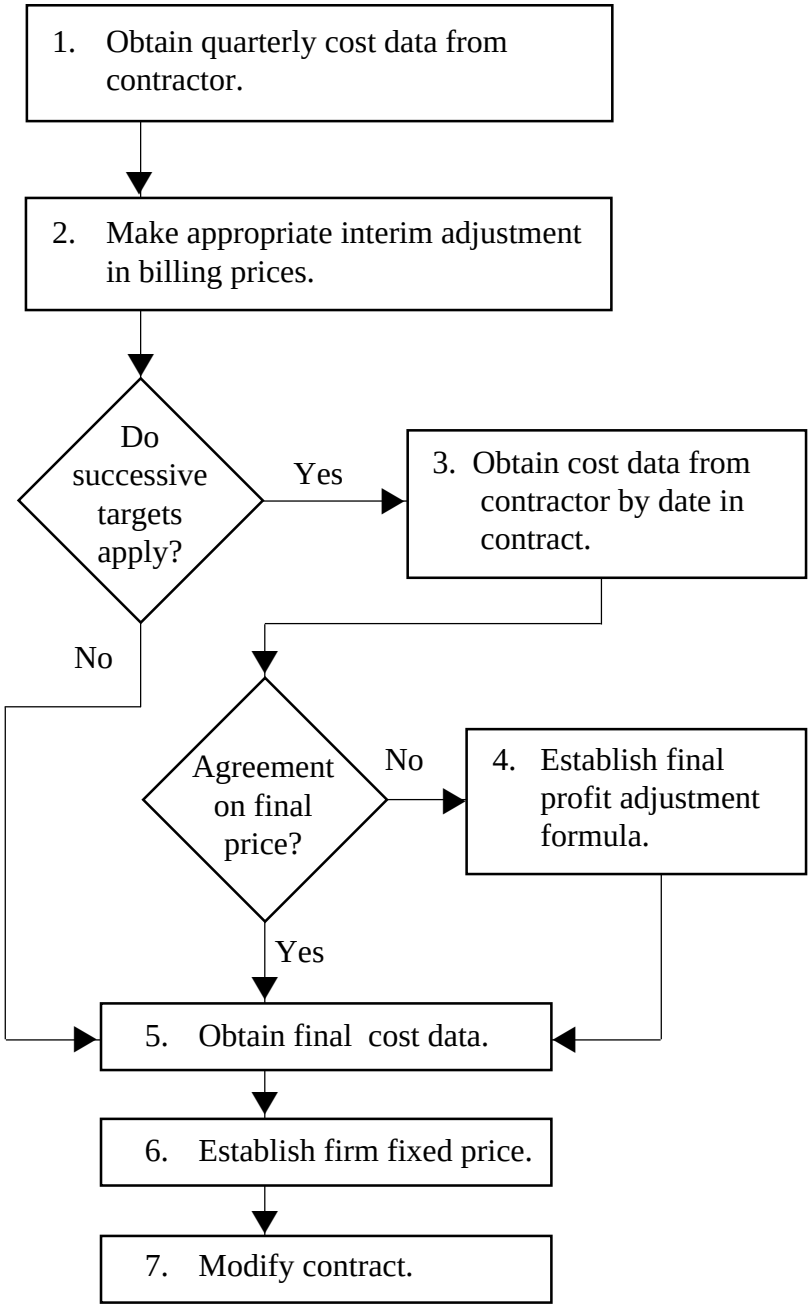
In determining adjusted pricing under both prospective and retroactive pricing, your objective is essentially the same. You must negotiate a realistic basis of what the work should cost or should have cost. For retroactive situations, the costs have been incurred and it may be difficult to focus negotiations on what should have been the cost of performance. Analytical data provide the foundation for establishing reasonableness and necessity of costs incurred and the relative effectiveness of a contractor's management and performance.

Under both clauses, the final, firm price must be implemented by a contract modification. Adjustments in interim billing prices do not require a modification.

Data for Price Redeterminations	
If making redetermination in response to...	**Then, the contractor is required to provide the following as supporting data for the redetermination...**
Price proposal under FAR 52.216-5, Price Redetermination—Prospective	1. Proposed prices for supplies that may be delivered or services that may be performed in the next succeeding redetermination period, including: • A breakdown of costs • Data supporting the accuracy and reliability of the overall prices and breakdowns • An explanation of the differences between the proposed prices and —The original contract price, or —The last estimate covering the same items or services 2. A statement of all costs incurred during a specified preceding monthly period (and any additional information available after the required monthly period) with sufficient supporting data to disclose unit costs and costs trends for: • Supplies delivered and services performed • Inventories of work in process and undelivered contract supplies on hand 3. Any other relevant data that the contracting officer may reasonably require
Price proposal under FAR 52.216-6, Price Redetermination—Retroactive	1. Proposed prices 2. A statement of all costs incurred during contract performance 3. Any other relevant data that the contracting officer may reasonably require
Quarterly data under FAR 52.216-5 *or* FAR 52.216-6, Price Redetermination	1. Total contract price for all deliveries to date with firm final prices 2. Estimated total costs for all deliveries to date with no final prices 3. Portion of interim profit attributable to deliveries to date with no final prices 4. Total invoices for all deliverables to date

Exhibit 12A-2

STEPS FOR INCENTIVE PRICE ADJUSTMENTS



12A.3 IMPLEMENT AN INCENTIVE PRICE ADJUSTMENT

Fixed-price contracts may incorporate an incentive price adjustment clause that increases or decreases the contractor's profit within preestablished limits. The price adjustment is intended to reward the contractor with a higher profit margin for completing the work at a reduced cost. However, an incentive price adjustment clause also adds to the contractor's risk by diminishing its profits if costs exceed expectations.

There are two types of incentive price adjustments applicable to fixed-price contracts.

Incentive Price Adjustments

FAR 16.403-1

FAR 52.216-16

A **firm target** price revision is based on a target cost, a target profit, and a target price negotiated prior to award and specified in the contract. These targets may apply either to some or all items to be delivered. If the final cost for the covered items is less than the target cost, the target profit is increased by a percentage specified in the contract. If the final cost is greater than the target cost, the target profit is reduced, again by a specified percentage. The final cost and final profit are then added following delivery to arrive at a final price.

FAR 16.403-2

FAR 52.216-17

A **successive target** price revision clause is used when firm target costs and, therefore, firm target prices cannot be specified at the time the contract is awarded. The contract will, however, specify a ceiling and floor for the contractor's profit, an initial adjustment formula, an initial or provisional target cost, and the stage of contract performance agreed upon as the point when firm target costs, profit, and price will be negotiated. If agreement cannot be reached then on a firm fixed price, a final formula is to be negotiated for calculating the final price instead. The contractor's actual profit is determined at the end of the contract when final costs and profit are established and the final price is calculated using the formula.

Interim Billing Adjustments

Both types of incentive price adjustments provide for quarterly redetermination of interim billing prices for affected items, subject to reconciliation when final prices are established by a contract modification. Interim billing price adjustments are not subject to the Disputes clause.

Both types require the contractor to have an accounting system capable of adequately allocating costs. The two types differ in that under the firm target clause, a price ceiling limits the contractor's profit potential, while the successive targets clause provides for both a ceiling and a floor on the contractor's profit.

Data Requirements As with the other adjustments already described, incentive price adjustments require the contractor to submit data upon which the adjustments will be made. Adjustments may be made as often as quarterly if there is evidence that expenses are running substantially above or below the projected target cost. Data requirements for interim adjustments under either type, the scheduled adjustment under the successive targets type, and the final adjustment under the firm target or, if one is needed, under the successive targets type are shown in Exhibit 12A-3.

Data Required for Incentive Price Adjustments	
If making adjustment in response to...	**Then, the contractor is required to provide the following supporting data for the adjustment...**
For Interim Adjustment: FAR 52.216-16, Incentive Price Revisions—Firm Target *and* FAR 52.216-17, Incentive Price Revisions—Successive Targets	• Total contract price for firm-price deliverables to date • Total costs for deliverables with no final price • Portion of total target profit for deliverables with no final price adjusted by incentive formula • Total of invoices for all deliverables to date
For Scheduled Adjustment: FAR 52.216-17, Incentive Price Revisions—Successive Targets	• Proposed firm fixed price or total firm target price for items delivered and to be delivered • Detailed costs to date for items to be delivered and work in progress • Estimate of total costs for items delivered and to be delivered • Any additional data the contracting officer may require
For Final Adjustment: FAR 52.216-16, Incentive Price Revisions—Firm Target *or* FAR 52.216-17, Incentive Price Revisions—Successive Targets (if final price not yet agreed to)	• Total costs to date for all deliverables with no final price • Estimated additional costs to be incurred for these deliverables • List and value of all residual inventory • Any additional data the contracting officer may require

Exhibit 12A-3

STEPS AWARD FEE ADJUSTMENTS

1. Collect data on performance against the award fee criteria.
2. Brief the award fee panel.
3. Determine the amount of the award fee and modify the contract.

12A.4 IMPLEMENT AN AWARD FEE ADJUSTMENT

Cost-Plus-Award-Fee Contracts

FAR 16.404-2

FAR 16.305

Award Fee Panel

Award Fee clauses may be included in cost-reimbursement contracts. They provide for a lower than usual base fee plus an award amount which the contractor may earn, in part or whole, depending on its performance. The contract will specify the factors or conditions to be applied in determining the award fee amount, and the intervals (often yearly) when award fee determinations will be made.

Even though the basic elements for determining an award fee are disclosed to contractors during the procurement, the award is considered subjective because the award official has a significant amount of discretion in establishing the exact amount of the fee. Usually an *award fee panel* makes recommendations on the award amount.

The award fee panel may include the COR/COTR and other officials familiar with the contractor's work over the award period. The contract administrator is responsible for briefing the panel on the criteria for determining the amount of the award and the minimum and maximum fee amounts permitted under the contract. The contract administrator also may provide the panel with relevant information compiled during

performance and cost monitoring. The panel rates the contractor's performance on the award factors and weights the results as specified in the contract to arrive at the award amount. The size of the award fee is not subject to the Disputes clause.

Award Fee Weights

Often, award fee determinations use predetermined weights, much like preaward evaluation plans do. An application of an award fee plan using weights is provided in the example in Exhibit 12A-4.

Notice that when one subfactor (such as "budgeting" in the Exhibit 12A-4 example) is weighted heavily, an unsatisfactory rating in that subfactor can result in loss of fee for the entire factor (refer to the "cost control" factor in the sample shown in Exhibit 12A-4). Underlying assumptions are crucial to an award fee plan. Do not overlook them. In the Exhibit 12A-4 example, if there was an additional stipulation that any unsatisfactory score equates to zero performance points, the total performance score (and overall fee) would be much lower.

FAR 16.405(e)

No standard FAR clause is used to describe the award fee plan—the methods the Government will use to decide on the fee amount. Agencies that use award fees generally have developed such clauses, however, with the particulars to be filled in at the time of procurement.

Under a Cost-Plus-Award-Fee contract, the contractor typically invoices the Government for its costs plus the base, or minimum, amount of fee specified in the contract. When the amount of additional fee is decided, a contract modification is issued specifying the award fee amount. That amount can be added to the next invoice for payment.

Award Fee Adjustment

An award fee adjustment usually requires only the contracting officer's signature. Nevertheless, it is standard practice in most agencies to tell the contractor of an award fee panel's findings and tentative conclusions before they are submitted to the award official. This allows the Government to acknowledge meritorious contract work and to notify the contractor of areas needing correction or improvement. The contractor also is given an opportunity to respond, and can furnish information on its own behalf. The objective is to assure that the award official's decision is based on both the panel's findings and conclusions, and any contractor feedback regarding them.

Sample Award Fee Plan and Results

Assumptions and Ground Rules

1. Award fee available for the evaluation period is $360,000.
2. Award fees will be based on overall weighted performance points as follows: 100-96 is superior; 95-86 is excellent; 85-76 is good; 75-66 is fair; 65-57 is poor; 56 and below is unsatisfactory.
3. Total weighted performance points will be converted into percentages of available award fee in accordance with a predetermined conversion table.
4. Evaluation factors and subfactors and assigned weights are as follows:

	Assigned Weights	
Evaluation Factor: Technical Excellence		***56***
Design	57	
Quality	29	
Schedule	14	
Evaluation Factor: Business Management		***33***
Planning	80	
Subcontracts	20	
Evaluation Factor: Cost Control		***11***
Budgeting	75	
Overhead Control	25	

Calculations of Weighted Performance Points for Evaluation Factors

As a result of evaluation, the following performance points and weights are assigned and factored:

	Performance Points	X	**Assigned Weights**	=	**Weighted Performance Points**
Design	95		.57		54
Quality	88		.29		26
Schedule	85		.14		12
		Total for Technical:			**92** (Excellent)
Planning	70		.80		56
Subcontracts	86		.20		17
		Total for Business Management:			**73** (Fair)
Budgeting	70		.75		53
Overhead Control	55		.25		0
		Total for Cost Control:			**53** (Unsatisfactory)

Calculations of Total Weighted Performance Score

	Performance Points	X	**Assigned Weights**	=	**Total Weighted Performance Points**
Technical	92		.56		52
Business Management	73		.33		24
Cost Control	53		.11		6
		Total for All Factors:			**82 (Good)**

Note: The predetermined conversion table listed 82 total weighted performance points as converting to 65% of the total available fee, so the award fee recommendation using this award fee plan would be $234,000 (65% of $360,000).

Exhibit 12A-4

STEPS IN INCENTIVE FEE ADJUSTMENTS

1. Monitor contract costs against cost target.
2. Adjust fee on invoices based on anticipated final fee.
3. Apply incentive fee formula at end of contract to calculate total fee.

12A.5 IMPLEMENT AN INCENTIVE FEE ADJUSTMENT

FAR 16.402-1

FAR 16.402-2

FAR 16.402-3

FAR 16.402-4

Incentive Fee clauses can be incorporated in cost-reimbursement contracts to adjust the contractor's fee relative to the costs charged to the Government. Although cost is the most common basis for calculating an incentive fee, unique clauses can be used to encourage a contractor to exceed other targets:

- Technical performance incentives are sometimes used in major systems contracts to reward contractors for products that meet targeted performance goals.
- Delivery incentives are sometimes used when rapid delivery is a significant Government objective.
- Multiple-incentive contracts can be used to balance emphasis on cost, performance, and delivery so that none of these goals are stressed to the detriment of the others.

FAR 16.404-1

FAR 52.216-10

When the standard Incentive Fee clause is used, the contract specifies a target cost, a target fee, a minimum and maximum fee, and a fee adjustment formula. If, at the end of the contract, actual costs are below the target cost, the target fee is adjusted upward. Similarly, if actual costs exceed the target cost, the fee is reduced.

Most contracts with an incentive fee limit the size of the adjustment. One way is through the use of ceilings. Another way, outlined in FAR 52.216-10, is through the use of a range of incentive effectiveness (RIE). The contractor's fee varies inversely with costs as long as actual costs fall within the range where the maximum and minimum fees take effect. Below the minimum and above the maximum, the fee becomes fixed at the minimum or maximum points. The range between the minimum and the maximum fee in which the sharing arrangement is effective is the RIE. You must be careful to make adjustments only within the RIE. Refer to Exhibit 12A-5 for a visual display of this concept.

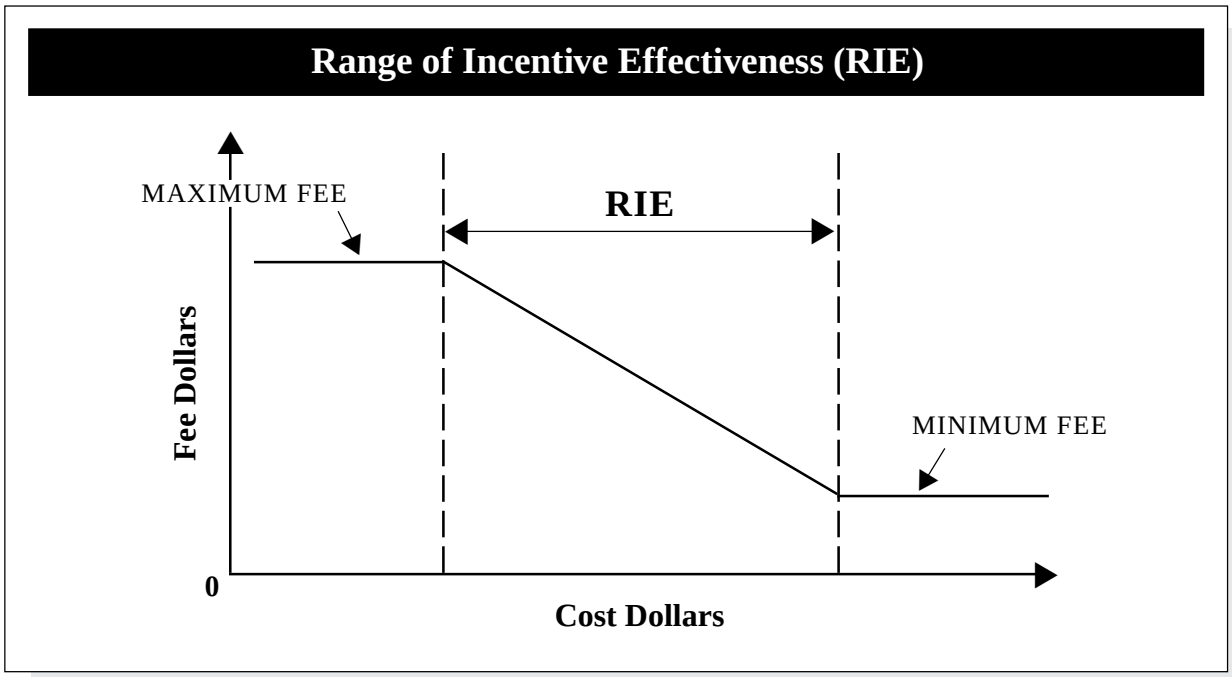


Exhibit 12A-5

Cost-Plus-Incentive-Fee Formula

The basic formula in FAR 52.216-10 raises or lowers the contractor's fee based on a percentage of the difference between the total allowable cost and the target cost. By specifying 15 percent, for example, the adjustment formula increases or decreases the fee by 15 cents for each dollar the actual cost is below or above the target cost. Exhibit 12A-6 contains an example of an incentive fee calculation.

Formulas Using Multiple Incentives

When fee incentives are tied to other aspects of performance in addition to cost control, unique incentive formulas are used to calculate the appropriate fee. An application of an incentive formula that incorporates both cost control and other performance aspects is detailed in the sample application in Exhibit 12A-7. Base fees can be established through the standard cost-plus-fixed-fee clause, FAR 52.216-8, *Fixed Fee*, when using such unique incentive arrangements.

Sample Incentive Formula and Results
Based on the Standard Formula in FAR 52.216-10, Incentive Fee

Pertinent Data Negotiated for Formula Application Prior to Award:

Target Cost:	$10,000,000
Target Fee:	$750,000
Maximum Fee:	$1,350,000
Minimum Fee:	$300,000
Formula:	15 cents per dollar above or below target cost

Final Cost After Completion of Performance and Subtraction of Unallowables is:

$9,000,000

Application of the Formula:

The contractor receives 15% or $150,000 of the $1,000,000 difference between target and final cost, as an *increase* in fee. The Government benefits by 85%—or $850,000—of the $1,000,000 difference between target and final cost.

In this example, the incentive would be effective over a range of $7 million, from an underrun of 40% to an overrun of 30%. The contractor's added fee from a $4 million underrun would be 15% or $600,000. The contractor's fee reduction from a $3 million overrun would be 15% or $450,000. Added or subtracted from the target fee of $750,000, the share could result in a fee at the maximum level of $1,350,000 or the minimum level of $300,000. If the actual variation from target costs is greater than plus $3 million or minus $4 million, the effect of the incentive arrangement in this example would be to fix the fee at no more than the maximum or at no less than the minimum level.

Exhibit 12A-6

FAR 52.216-10

The theoretical purpose of the standard incentive fee formula based on cost control is to transfer a portion of the cost risk to motivate more efficient performance. Consequently, costs not under the contractor's control are excluded. Examples are:

- Costs covered by the Excusable Delays clause, FAR 52.249-14
- Any tax or duty or increased tax or duty not included in the target cost

Sample Incentive Formula and Results Incorporating Cost Effectiveness and Performance Criteria

Assumptions and Ground Rules

1. Performance standards within each task will be rated as follows: Standard not met=0 points; Standard met=.5 points; Standard exceeded=1.0 points.
2. Additionally, each task will be individually rated for cost effectiveness as follows: Unsatisfactory=(.25) negative points; Marginal=0 points; Satisfactory=.5 points; Excellent=1.0 point; Outstanding=1.25 points.
3. Projected fee will be calculated using the following formula:

$$\frac{\textbf{Total Performance Objective Points + Total Cost Effectiveness Points}}{\textbf{Total Number of Performance Objectives + Total Number of Tasks}} = \textbf{Percent of Incentive Fee to be Awarded}$$

4. If application of the formula yields a percentage higher than 100%, the fee shall be limited to 100% of that available.

Application of Formula Based on Sample Evaluation Points

As a result of evaluation, the following performance points were assigned:

Task 1—Performance Objectives	**Did Not Meet**	**Met**	**Exceeded**
Design		X	
Quality		X	
Subcontracts			X
Schedule	X		
Total for Task 1:	***1***	***2***	***1***

Task 1—Cost Effectiveness	**Unsat.**	**Marg.**	**Sat.**	**Excell.**	**Outstanding**
			X		

Task 2—Performance Objectives	**Did Not Meet**	**Met**	**Exceeded**
Design		X	
Quality		X	
Subcontracts			X
Schedule		X	
Total for Task 2:	***0***	***3***	***1***

Task 2—Cost Effectiveness	**Unsat.**	**Marg.**	**Sat.**	**Excell.**	**Outstand.**
			X		

Summary Rating and Formula Application

Task 1 performance points=	2.0 points	Task 1 cost effectiveness points=	.5 points
Task 2 performance points=	2.5 points	Task 2 cost effectiveness points=	1.5 points
Total performance points=	**4.5 points**	**Total cost effectiveness points=**	**1.5 points**

$$\frac{\textbf{4.5 Performance Points + 1.5 Cost Effectiveness Points}}{\textbf{8 Performance Objectives + 2 Tasks}} = \frac{\textbf{6.0}}{\textbf{10}}$$

6.0/10=60% of Incentive Fee Available

Exhibit 12A-7

- Any direct cost attributed to the contractor's involvement in litigation
- The purchase and maintenance of additional insurance not in the target cost and required by the contracting officer
- Claims for reimbursement for liabilities to third persons pursuant to the Insurance Liability to Third Persons clause, FAR 52.228-7
- Claims, loss or damage resulting from a risk for which the contractor has been relieved of liability by a Government Property clause in the contract
- Claims, loss, or damage resulting from a risk defined in the contract as unusually hazardous (for example, a nuclear risk).

Fee Limitations

FAR 15.903(d)

When calculating the final amount of fee due to the contractor under the incentive fee clause, be careful not to inadvertently exceed the contract's ceiling price. Also, do not exceed the statutory limitations on fees:

- 15% of estimated cost, excluding fee, for experimental, development, or research work performed under a cost-plus-fixed-fee contract
- 10% of the contact's estimated cost, excluding fee, for other cost-plus-fixed-fee contracts
- 6% of the estimated cost of construction, excluding fees, for architect-engineer contracts.

Fee Withholdings

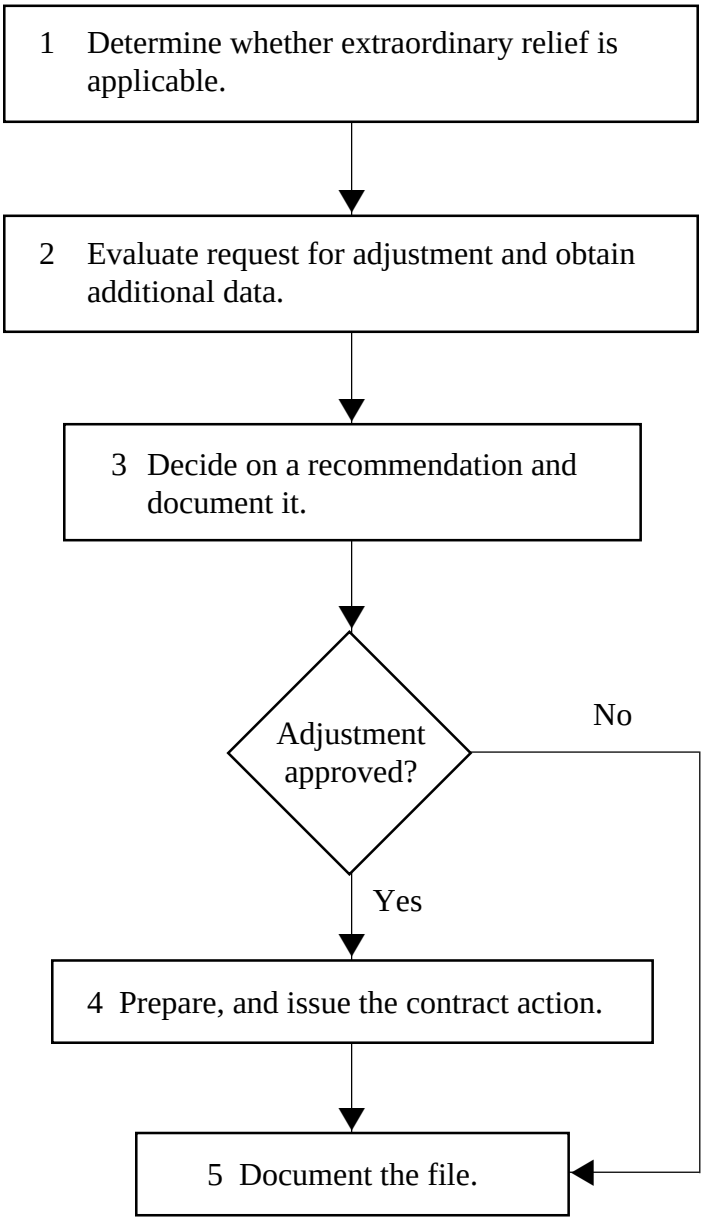
Finally, the standard incentive fee clause specifies that, after 85 percent of the expected final fee is paid, the contracting officer may elect to withhold up to the remaining 15 percent of fee or $100,000, whichever is less. The fee withheld provides protection to the Government should allowable costs accelerate before performance is complete. The final amount of fee is calculated at the time final payment to the contractor is made.

Incentive adjustments may require additional monitoring of costs and other aspects of performance.

Obtain Contractor Input

In many instances, discussions with the contractor will be needed to ascertain whether an interim increase or decrease in billing rates is warranted. The contractor may have relevant information concerning costs incurred to date or misunderstandings of how the incentive clause affects interim billings.

STEPS FOR EXTRAORDINARY CONTRACT ADJUSTMENTS



PART B—EXTRAORDINARY CONTRACT ADJUSTMENTS

12B.1 DETERMINE IF EXTRAORDINARY RELIEF IS APPLICABLE

Under certain circumstances, adjustments in contract prices, fees, or terms are permitted without "consideration", or something in return, from the contractor. This extraordinary relief can be used only to assist contractors whose continued operations are essential to national defense.

FAR 50.101

Extraordinary relief is only available to agencies that support the national defense as a part of their mission. The procedures in this Part apply only if you work for one of these agencies. Currently these are:

- Government Printing Office
- Federal Emergency Management Agency
- Tennessee Valley Authority
- National Aeronautics and Space Administration
- General Services Administration
- Defense Department agencies
- Treasury
- Interior
- Agriculture
- Commerce
- Transportation
- Energy.

Coordinate Extraordinary Relief Adjustments Early

Extraordinary relief actions begin formally upon written request by the contractor. However, you will probably become aware of the need for extraordinary relief before you receive a formal request. For instance, the possibility of using extraordinary relief may first arise during informal discussions. When it does, do the following:

- Make sure the action being discussed is not prohibited by a general limitation of the authority for extraordinary relief,
- Seek advice from legal advisors, agency experts, or the official with the authority to grant the adjustment, and

- Provide informal advice to the contractor on structuring a request for extraordinary relief.

General Limitations on Authority

Authority for extraordinary relief is provided through statute and executive order, and contains restrictions that all authorized agencies must comply with. These limitations are spelled out in FAR 50.203.

Seek Expert Advice

As soon as the possibility is discussed and is tentatively identified as an appropriate approach, identify who in your agency has the authority to approve contract adjustments under the extraordinary relief provided in FAR Part 50. The individual is likely to be at a very high level in the agency organization.

FAR 50.202

An administrative board usually investigates the details and makes recommendations to this individual. Start with informal discussions with someone on that board, explain the problem, and find out what kind of supporting data they would want to see to evaluate contractor's request for extraordinary relief.

FAR 50.102

Remember that you should only pursue the use of extraordinary relief if there are no other alternatives available under the terms of the contract, or otherwise within the agency, for resolving the problem.

Be aware that since the Contract Disputes Act (CDA) was revised, some situations that previously could be resolved only through extraordinary contract relief adjustments now come under the authority of the CDA. An example is recision or reformation due to a mutual mistake. Consult a legal advisor immediately if there is any question on whether other existing procedures could be used to resolve the problem in place of extraordinary relief.

Provide Advice to the Contractor

If a thorough review of the general limitations and informal coordination with agency experts result in insights you had not previously discussed with the contractor, convey this new information to the contractor. It will save preparation time for the contractor and processing time for the Government.

12B.2 EVALUATE REQUEST FOR ADJUSTMENT AND OBTAIN ADDITIONAL DATA

Types of Adjustments Generally Authorized

FAR 50.302

Adjustments that typically are authorized under the extraordinary relief authority granted under Public Law 85-804, as amended by Public Law 93-155 and implemented by Executive Order 10789, are:

- When continued contract performance or continued existence of a contractor essential to the national defense is in serious jeopardy.
- When Government action, while not creating any liability on the Government's part, increases performance cost and results in a loss, so that fairness dictates that some adjustment is appropriate.
- When the effects of mutual mistakes seriously hinder efficient performance of contracts essential to the national defense—examples are
  - — The failure to express, or express clearly, in a written contract, the agreement as both parties understood it
  - — A contractor's mistake so obvious that it was or should have been apparent to the contracting officer
  - — A mutual mistake as to a material fact.

However, although these are typical categories, you may find any number of situations that do not fall neatly within these categories.

General Administrative Requirements

Review the contractor's request to ensure that all general administrative requirements are met. These are outlined in FAR 50.303.

Additional Documentation

Also determine whether supplemental documentation is needed. Additional facts and evidence you may need are summarized in FAR 50.304.

12B.3 DECIDE ON A RECOMMENDATION AND DOCUMENT IT

Except for the limitations established by law, there are no strict guidelines for making recommendations to approve or deny extraordinary relief. You must use good business judgement in making such recommendations to the administrative board or approving official.

Draft a Memorandum of Decision

However, there are guidelines for documenting the recommendations that you make. At a minimum, provide documentation in a draft Memorandum of Decision that your agency's approval official is required to sign. Minimum Government-wide content requirements for such memoranda are listed in FAR 50.306. Your agency may require others.

Assemble Documentation Package

Documentation supporting a Memorandum of Decision must show how the adjustment was calculated and the rationale for it.

FAR 50.306(f)

If audits or other independent reviews do not support the entire amount, the case file must contain a detailed explanation for deviating from the auditor's or independent reviewer's recommendation.

Your agency or contract adjustment board may have precise administrative requirements in regard to how it wants other aspects of the documentation assembled. Make sure you find out what they are before you begin the documentation process.

If your agency official denies the contractor's request, you must advise the contractor. If the request is approved, you must implement that approval.

12B.4 PREPARE AND ISSUE THE CONTRACT ACTION

FAR 50.307

If your agency approves an adjustment for extraordinary relief, the contract action may involve either a contract modification or the issuance of a new contract.

Regardless of whether a modification or new contract is used, there are Government-wide content requirements for them in addition to any others that you may be required to follow under agency procedures. These are listed in FAR 50.307.

12B.5 DOCUMENT THE FILE

If an extraordinary relief adjustment was not granted, you should retain, in the contract file, the request for relief and all the documentation that you accumulated in the approval process. Additionally, you should include evidence that you notified the contractor that the request was denied.

If an extraordinary relief adjustment was approved, you should retain the original approval, the dated Memorandum of Decision, and all accompanying documentation in the contract file as evidence of the contracting officer's authority to make the adjustment.

CHAPTER 13

REQUESTING AN AUDIT

OUGHT WE AUDIT?

"We're going to audit the auditors!"

Everyone in the contracting office got a chuckle out of this bit of a "turn about." But Tally-Up, being on the cutting edge of technology, had just installed a new computer system which changed, to some extent, their cost estimating system. So Bea Ware had requested a systems review from the agency's Inspector General (IG).

Bea wanted to be sure that the billing rates initially negotiated for this contract, which included indirect cost charges, were not excessive in light of the new system changes at Tally-Up. Furthermore, because the Tally-Up contract was a task order contract with each task negotiated prior to its issuance, the Government would be relying on estimates from the new system for the ceiling prices of each task.

Bea turned to Exhibit 13-8 in her Text/Reference and reviewed the standard factors considered in estimating system audits. She reasoned that this audit would not be as lengthy as a first-time estimating system audit. Digi Talis had assured her that source data, estimate documentation, internal controls, communications, and approval and training procedures had not changed. So she merely asked the IG to verify that there had been no change in policy and procedures in this regard. The main focus of the audit was to be on the actual procedures for developing estimates. In particular, she asked advice on whether any of the interim billing rates would change if Tally-Up's new estimating system had been used as the basis for computing them.

After quickly reviewing the IG's draft audit report when it came in, Bea passed it on to Ernest. "Read and let's discuss," her note to him said.

Apparently, the essence of the changed computer system involved the use of trend data in the development of indirect cost estimates. The auditors provided several pages detailing the differences in trend analysis under the old system versus the new system. Ernest simply did not understand it and said so when he met with Bea later that day.

"I don't understand that part of the report either!" Bea said. "But neither one of us is an economic trend analyst or statistician so it's not surprising that we don't. That's why the IG has access to such experts!"

continued. . .

"What I do understand is the bottom line of the report," she continued. "By accounting for data not previously considered under the old system, the new system has the effect of slightly increasing current indirect rates that Tally-Up is using for their estimates. So our billing rates are considered reasonable—as a matter of fact, we'd probably pay more if we negotiated those same interim billing rates today. Furthermore, the estimating system is otherwise sound."

"So what are we going to do?" Ernest asked, sounding a little puzzled.

"Nothing!" Bea exclaimed. "Except that we'll talk to Digi Talis and make sure that Tally-Up takes no exception to the facts in the report. If they don't take exception, we'll just tell them we plan no further action. Then, if Tally-Up decides that they want to request an increase in the billing rates, we'll consider that request when it comes in. They may just decide it's not worth the administrative hassle."

"Then we shouldn't have asked for the audit at all, should we have?" Ernest wanted to know.

"Why, no, Ernest, I don't feel badly about requesting that audit," Bea responded. "We narrowed down the scope so that the auditors were in and out of there in less than a week. And the outcome could have been entirely different."

"We will have to live with this contract for almost a full year yet—maybe longer if we decide to exercise the options," Ernest mused. "So the cost was worth the potential payback and we now have peace of mind that their estimating system is okay."

"Exactly," Bea agreed.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Make audit requests in appropriate circumstances and respond to auditor's recommendations.

Individual:

13.1	Determine the need for an audit.
13.2	Request an audit, if appropriate.
13.3	Review audit report and take appropriate action.
13.4	Brief contractor or otherwise provide notice of preliminary decisions and obtain feedback on audit findings and recommendations.
13.5	Seek resolution of problems identified.
13.6	Take necessary corrective actions and document actions taken.
13.7	Monitor further action by the contractor when appropriate.

INTRODUCTION TO AUDIT REQUESTS

Definition of an Audit

A ***financial audit*** is the systematic examination of contractor financial records and other documents, and the securing of evidence by confirmation, physical inspection, or by some other means.

General Criteria for Audits

FAR Part 31 details 52 specific cost items and provides guidance on whether and to what extent these costs are allowable on Government contracts. Cost allowability was summarized in Chapter 8. FAR cost principles and accepted accounting practices represent the standards for auditing a contractor's records. Agencies may establish additional cost principles for a specific contract by specifying them in unique contract terms that supplement, but do not conflict with, established FAR cost principles.

Additional Audit Criteria

Some contracts also are subject to ***Cost Accounting Standards (CAS)*** requirements. CAS requirements further specify how cost principles must be administered by the contractor. Contracts that include modified CAS requirements specify general accounting system requirements for identifying, segregating, and tracking costs. Contracts requiring full coverage demand more detailed adherence to a standardized system.

Policy for Obtaining Audits

For cost effectiveness, Government auditing authority is centralized. Overall authority is vested in the Comptroller General, but most audits for specific contract purposes are provided within each agency. Most of the civilian agencies delegate this authority to an Inspector General's Office. Defense agencies use the central audit authority of the Defense Contract Audit Agency (DCAA). DCAA also processes many audit requests from civilian agencies through cross-servicing agreements.

The deciding factor for requesting an audit is the potential for fruitful results when balanced with the high administrative costs to the Government of performing an audit.

Steps in Performance

The procedural steps for requesting an audit are charted on the next page and each step is then discussed in turn.

STEPS IN REQUESTING AN AUDIT

1 Determine the need for an audit.

↓

2-3 Request audit and review audit report, if appropriate.

↓

4 Brief contractor and obtain feedback.

↓

5 Seek resolution of problems identified.

↓

6 Take corrective actions and document them.

↓

7 Monitor any further actions required.

REQUESTING AN AUDIT

13.1 DETERMINE NEED FOR AUDIT

During contract administration, there will be occasions when an audit of a contractor's financial records is required. You also may want to request an audit if you suspect irregularities in contractor invoices or proposals for changes in contract pricing.

There are several basic reasons why you may need an audit of a contractor's records. These basic reasons are listed in Exhibit 13-1.

Basic Reasons for Requesting A Postaward Audit

- To verify the appropriateness of accounting and estimating system changes
- To verify appropriateness of large-dollar or complex change proposals
- To investigate irregularities detected during cost monitoring
- To verify costs at contract closeout
- Other reasons

Exhibit 13-1

General Decision Factors

The contracting officer decides whether to actually obtain an audit and how extensive it will be. Factors to consider are whether:

- Expected benefits would offset expected audit costs, and
- Any delay in the completion of the audit would have an adverse impact.

Notice that the first reason for requesting an audit in Exhibit 13-1 is to identify potential deficiencies in a system. This type of audit is called a **system review.**

The Government requires contractors to have an acceptable accounting system in place to receive awards where the contractor's costs determine what the Government pays. This applies to virtually all situations where the amount is negotiated:

- All cost-reimbursement contracts and their modifications
- The cost-reimbursable portions of time-and materials contracts
- Fixed-price contracts with price redetermination (see Chapter 12)
- Modifications to firm-fixed-price contracts other than to exercise options.

Preaward and periodic audits, or system reviews, routinely are conducted to verify how well the contractor's accounting system treats and allocates direct and indirect costs, and whether the system follows sound and acceptable accounting principles.

Transaction Audits

Other reviews usually focus on particular transactions. You use a ***transaction audit*** to verify costs. These include both costs incurred on current contracts and costs projected for future business. Therefore, any transaction audit may result in the identification of ***defective pricing*** issues. When Government contracting personnel talk about "defective pricing" issues, they are usually referring to defective cost and pricing data furnished by Government contractors in the course of negotiating price or costs.

Cost and Pricing Data Defined

FAR 15.801

Cost or pricing data means all facts as of the date of a price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data are factual, not judgmental, and are therefore verifiable. Examples are the price of a proposed subcontract, the current cost of labor, or the expense of shipping the product to a specified location.

Defective Cost and Pricing Data

FAR 15.804-2

FAR 52.215-23

FAR 52.215-25

Unless an exemption applies, contractors and subcontractors generally are required by the Truth in Negotiations Act to supply certified cost and pricing data to support proposals for contract modifications that, for NASA and defense agencies, exceed $500,000 or, for civilian agencies, $100,000. You also may require cost and pricing data prior to negotiating a modification on a contract you are administering if the amount is under these limits.

Furthermore, if FAR 52.215-22, *Price Reduction for Defective Cost or Pricing Data*, is in the contract, certified cost and pricing data was submitted as part of the negotiation process that led to the award. As a result, you might be responsible for handling any deficiencies in cost and pricing data discovered after award.

Pricing data that is *certified* by the contractor only applies to data that is significant, is based on factual information, and is reasonably available at the time the certification was made. Exhibit 13-2 provides examples of data that would be encompassed by contractor certification. The Government uses pricing data to arrive at a fair price when, for example, an existing contract is modified to increase quality specifications.

Examples of Cost and Pricing Data
FAR 15.801

- Recorded or actual cost data
- Facts that can reasonably be expected to contribute to the soundness of estimates of future costs
- Vendor quotations
- Nonrecurring costs
- Information on changes in production methods and in production or purchasing volume
- Data supporting projections of business prospects and objectives, and related operations costs
- Unit cost trends such as those associated with labor efficiency
- Make-or-buy decisions
- Estimated resources to attain business goals
- Information on management decisions that could have a significant bearing on costs

Exhibit 13-2

Subcontractor Data

FAR 52.215-24

If the prime contractor does not include similar clauses covering defective cost and pricing data in its subcontracts, it is liable for the amount of any defective pricing on the part of its subcontractors.

Burden of Proof

It is important to remember that the Government has the burden of proof in regard to defective pricing issues. Ask the contractor to explain what you suspect may be defective pricing. It may have a satisfactory explanation that would eliminate the need for an audit. However, if it does not, and is unwilling to concede that the pricing is defective, you must then decide if the potential adjustment amount is significant enough to justify the expense of an audit.

If you decide to seek an audit and audit findings indicate defects, you will have to consider what further actions to take. These are reviewed as part of section 13.5.

Audit Requirements Under CAS

An accounting system audit may be necessary if a contract you administer is subject to cost accounting standards (CAS) requirements. There are four clauses that contain CAS requirements. These are summarized in Exhibit 13-3. If none of these clauses are in the contract, it is not subject to CAS requirements.

Summary of Clauses That Contain CAS Requirements

Clause Title	Key Overall Requirement
FAR 52.230-2, Cost Accounting Standards	Requires full compliance will all CAS requirements (termed “full coverage”)
FAR 52.230-3, Disclosure and Consistency of Cost Accounting Practices	Requires compliance with CAS Standards 401, 402, 405, and 406 only (termed “modified” coverage)
FAR 52.230-4, Consistency in Cost Accounting Practices	Requires consistency with disclosed accounting practices for United Kingdom contractors only
FAR 52.230-5, Administration of Cost Accounting Standards	Establishes mechanisms to administer and enforce CAS requirements required by other clauses

Exhibit 13-3

FAR 30.101

CAS generally applies to negotiated contracts in excess of $500,000, although there are various exceptions. Contractors subject to CAS must comply with detailed rules and regulations issued by the Cost Accounting Standards Board and fully disclose their cost accounting practices.

Purpose of CAS

The purpose of CAS is to ensure that the contractor's accounting system can accurately identify, segregate, and track costs incurred against the contract. A contractor's cost accounting system is only adequate if it ensures that CAS standards are met in a systematic manner.

FAR 30.601

You should receive notification within 30 days of award of a new contract or subcontract subject to CAS requirements if you will administer that contract or subcontract.

Subcontracts Subject to CAS

FAR B9903.202-8(a)

Prime contractors (or higher-tier subcontractors) are responsible for administering CAS requirements contained in subcontracts they award.

Reasons for Accounting System Changes

Contractors may need to change their accounting systems for a variety of reasons during contract performance. Exhibit 13-4 lists typical reasons.

Typical Reasons for Cost Accounting System Changes

Mandatory Changes:

- To reflect changes the Government makes to cost accounting standards
- To correct noncompliant aspects of existing accounting systems

Voluntary Changes:

- To reflect changes in the contractor's organizational structure that may result from
  - An organizational merger or acquisition
  - An internal reorganization
- To better manage fiscal operations within the company

Exhibit 13-4

Reporting Responsibilities

FAR B9903.302-2

Contractors subject to CAS requirements must report any change in their accounting system that affects a cost accounting practice to the contracting officer. Exceptions are:

- The initial adoption of a cost accounting practice the first time a cost is incurred, or a function is created
- The partial or total elimination of a cost or the cost of a function
- The revision of a cost accounting practice for a cost which previously had been immaterial.

To obtain authorization for changes in accounting practices, the contractor is required to:

FAR 52.230-1

FAR 52.230-2

FAR 52.230-3(a)(3)

- For voluntary changes, obtain a contracting officer determination that the change is desirable, or at least not detrimental to the interests of the Government
- For all changes, revise its disclosure statement, if it was required to file one prior to contract award.

Format for Disclosure

FAR B9903.202-3

FAR B9903.202-9

When changes are extensive, contractors must complete a new *Disclosure Statement Form.* Exhibit 13-5 outlines the major sections of this 40-page form. If changes are not extensive, amendments or revisions to the original form are encouraged.

Major Sections of the Disclosure Statement Form

- A cover sheet
- Contractor certification
- Part I—General Information
- Part II—Direct Costs
- Part III—Direct vs. Indirect Costs
- Part IV—Indirect Costs
- Part V—Depreciation and Capitalization Practices
- Part VI—Other Costs and Credits
- Part VII—Deferred Compensation and Insurance Costs
- Part VIII—Corporate or Group Expenses

Exhibit 13-5

Required Distribution

For a CAS-covered contract, the contractor is required to submit the original and one copy of the new disclosure statement to the contracting officer responsible for contract administration, and a copy to the Government auditor if one has been identified.

Prohibited Distribution

FAR B9903.202-4

FAR B9903.202-8(c)(1)

When disclosure statements are marked with a notification that they contain trade secrets or other privileged and confidential information, you may not release them to anyone outside the Government. In these circumstances, subcontractors may submit disclosure statements directly to the contracting office so the contents are not revealed to the prime contractor.

Review of Disclosure Statement for Adequacy

Before you decide if you need an audit, you must review the new disclosure statement for a CAS-covered contract to determine if it is adequate. You must decide whether it meets established criteria for adequacy as outlined in Exhibit 13-6.

Required Deadline for Adequacy Determination

FAR 30.202-7(a)

You must furnish notification of adequacy or inadequacy within 30 days after receipt of the disclosure statement. Note that a contracting officer's determination of adequacy does not constitute an approval of the accounting practices detailed in the disclosure statement. Compliance with CAS requirements is a separate issue.

Potential Problems of Estimating Systems

Estimating systems used by the contractor are another reason to consider the need for an audit. Estimating systems are used before award to calculate expected contract costs and after award to price modifications. You may encounter situations that indicate problems in a contractor's estimating system. Some examples are in Exhibit 13-7.

FAR 52.215-2

If you question the adequacy of a contractor's estimating system, and will be relying on it for cost/price negotiations, you may want to request an audit before proceeding.

Approving Progress Payments

FAR 32.503-3

FAR 32.503-4

FAR 52.232-16

If a contractor requests progress payments on a fixed-price contract, you must—among other factors—determine that the contractor's accounting system is adequate. Your determination may be based on previous experience with the contractor or on a recent system audit. However, you will need to request an audit if there is reason to question the accounting system prior to approving progress payments.

Criteria for Adequacy of Disclosure Statements FAR 30.202(a)	
Criteria	**Descriptive Characteristics**
Currency	A disclosure statement is current if it describes the cost accounting practices the contractor: • Currently uses • Intends to implement on a specific date • Intends to use with the incurrence of a new cost
Accuracy	A disclosure statement is accurate if it correctly, clearly, and distinctly describes the actual method of accounting that the prime contractor or subcontractor uses or intends to use It must also be clerically accurate—checking appropriate boxes and inserting applicable code letters, and so forth
Completeness	A disclosure statement is complete if it includes all significant cost accounting practices the contractor uses or intends to use and provides enough information to fully understand the accounting system being described.

Exhibit 13-6

Typical Indications of Deficient Cost Estimating Systems

- History of inaccuracy on estimates provided for change proposals or other required documentation
- Use of judgment without analytical support on contract administration issues
- Inadequate documentation of supporting rationale on contract administration issues
- Cost accounting systems that are judged inadequate

Exhibit 13-7

13.2 REQUEST AUDIT, IF APPROPRIATE

Standard clauses provide authority for examining the contractor's cost accounting system:

- FAR 52.214-26, *Audit—Sealed Bidding*
- FAR 52.215-2, *Audit—Negotiation*
- FAR 52.232-16, *Progress Payments*

Reasons for Requesting an Audit

There are a number of reasons to request an audit. If you have doubts about the contractor's accounting system you should ask for an audit prior to authorizing progress payments. If you have doubts about changes in a contractor's indirect cost billing rates, an audit is in order. You also may request an audit on a CAS contract if an accounting change is proposed. Finally, an audit is appropriate if you suspect defective cost or pricing data, or irregularities on invoices, for which the contractor has no legitimate explanation.

Do not consider an audit, however, unless the amounts involved are substantial. Conducting an audit is very costly. One should not be requested unless the potential loss to the Government justifies it and no other alternatives, such as tenacious negotiations, are available.

Obtaining Audit Information

Many agencies have cross-servicing agreements with other agencies to perform their contract audits. When they do, you normally will be required to process audit requests through a central coordinator. Know you agency's rules and follow them.

General Considerations

FAR 15.805-5(c)(1)

At a minimum, the audit request should specify the scope of the audit—for example, request an accounting or estimating system review, ask for an indirect cost audit, or cite specific costs for review. The more specific you are, the more cost effective the audit process will be. Include a deadline for receipt of the report in your request.

Regular Annual Audits

Many Government contractors holding cost-reimbursement contracts receive annual audits that review their accounting systems, set indirect cost billing and final rates, and often include an examination of a sample of direct costs to verify that they are allowable., Before requesting a separate audit, investigate to determine if there is an annual audit, what agency is responsible for the audit, when one is scheduled, and what it covers. That audit may serve your purposes. You also can request to have the next audit include practices or cost details you want examined. Explain the reason in your request.

Specific Needs

FAR 15.805-5(c)(1)

Government auditors consider the factors listed in Exhibit 13-8 when reviewing a contractor's estimating system. However, you may request any particular information you need. For example, if you are encountering inaccuracies on proposals for contract modifications but generally have found the contractor's original proposals accurate, ask for an in-depth analysis of the handling of updated estimates within the system.

Also, provide the auditor with any other information that might be needed for the audit—for example, a revised disclosure statement from the contractor.

Standard Factors Considered in Estimating Systems Audits
FAR 15.811(c)

- The accuracy, currency, and completeness of source data
- The documentation to support the estimate
- The assignment of responsibilities for creating and approving estimates
- The procedures for developing estimates
- The extent of internal coordination and communication regarding the estimates
- Management support, including approval, internal controls, and appropriate training

Exhibit 13-8

13.3 REVIEW AUDIT REPORT AND MAKE INITIAL ASSESSMENT

The contracting office is usually responsible for making the ultimate decision in regard to the issues raised by an audit report. However, the auditor is the Government's accounting expert and, therefore, contracting personnel must carefully examine recommendations and document reasons for varying from them.

Standard Audit Information

FAR 15.805-5(e)

As part of the audit report, the auditor usually provides a statement of opinion, an explanation of discrepancies, and a note on whether any discrepancies noted were discussed with the contractor.

Steps for Report Analysis

In your review of the report:

- Separate relevant facts from opinion
- Analyze findings for any insufficient factual basis for opinions or recommendations that are included in the report
- Identify any illogical conclusions.

Information in Transaction Audits

Reports following transaction audits will label costs for your attention as follows:

- **Questioned Costs**—Costs that are unallowable, unreasonable, or technically unacceptable.
- **Unsupported Costs**—Costs that lack sufficient documentation and support.
- **Unresolved Costs**—Proposed costs for which requested information has not been received.

Make sure that the auditor is not automatically treating the questioned, unsupported, or unresolved costs as defective. They may not be. Remember that the Government has the burden of proving that cost and pricing data submitted by contractors are defective or that specific costs are unallowable.

Information in System Audits

FAR 30.202-7(b)

There are eight basic types of noncompliance based on Cost Accounting Standards Board rules, regulations, and standards, or with cost principles in FAR Part 31. These are listed in Exhibit 13-9. The audit report may cite any one of them as a reason for considering the system inadequate or not in compliance with requirements.

Standards

The Government norm is that direct and indirect costs are allocated to contracts according to the cost accounting standards outlined in FAR Appendix B. However, because of circumstances of a particular contractor's business, that contractor may vary from this norm or the auditor may recommend that it vary from this norm.

You must examine the reasons for these variations and develop a Government position on whether the variations are justified.

Variations to Prevent Unit Price Distortion

FAR 15.812-1

FAR 52.215-26

FAR policy states that distribution of indirect costs for supply items must be on a basis that ensures unit prices are in proportion to the reasonable cost of these supply items. Therefore, any method for distributing costs to line items that distorts unit prices is prohibited. This policy prevents the application of excessive overheads to a minor low cost item, such as a hammer, on a contract that has major indirect costs that appropriately apply to the majority of direct costs under that

Types of Auditor Findings of Inadequacy of Accounting Systems

- Disclosed practices not in compliance with CAS
- Disclosed practices not in compliance with FAR cost principles
- Actual practices of estimating costs not in compliance with CAS
- Actual practices of estimating costs not in compliance with FAR cost principles
- Actual practices of estimating costs not in compliance with the disclosure statement
- Actual practices of accumulating or reporting costs not in compliance with CAS
- Actual practices of accumulating or reporting costs not in compliance with FAR cost principles
- Actual practices of accumulating or reporting costs not in compliance with the disclosure statement

Exhibit 13-9

contract. Obviously, it would be appropriate to vary from the cost accounting standards to avoid the inappropriate application of such overheads.

Other Variations Other justifiable variations may include compliance with an industry-wide accounting practice or to implement the practical effects of company policy—for example, the company may treat and recycle waste water on environmental grounds even if this is more expensive than buying municipal water.

Seek Clarification If you do not understand the language in the report, or if you want additional information, contact the auditor and ask for clarification or discuss your concerns. You need to understand all available information and the point of view of all knowledgeable Government officials in order to establish a Government position that represents a reasonable solution. Recognize, however, that you may not get a clear understanding of the problems involved until you have discussed them with the contractor.

Documentation If, after informal communications, you still disagree with an audit finding or recommendation, make sure that you document the rationale that you used in reaching your initial decision.

13.4 BRIEF CONTRACTOR OR PROVIDE NOTICES AND OBTAIN FEEDBACK

It is always a good idea to discuss the facts from an audit report with the contractor informally and obtain its views. Contractor personnel may have logical explanations.

You should not proceed with authorizing progress payments, awarding a contract modification, approving an invoice, or implementing other actions in light of an adverse report.

CAS Compliance Notices

FAR 30.602-214.4

You must take particular care in instance where an auditor has found a contractor not in compliance with CAS on a contract with a CAS clause. Time limits apply. The contacting officer must make an initial finding of compliance or noncompliance within 15 days or receipt of the audit report. If the determination is noncompliance, you must notify the contractor in writing of the exact nature of the noncompliance and allow 60 days to obtain official feedback.

If the contractor disagrees with the initial noncompliance finding, it must submit reasons why its existing practices are in compliance. The contracting officer makes a final determination of compliance or non-compliance after analyzing these reasons and must officially notify the contractor of that final determination.

If the contractor agrees with the initial finding of noncompliance, the contractor is required to submit all of the documentation listed in Exhibit 13-10. The contractor is also required to submit this documentation if the contracting officer ultimately makes a final determination that the contractor is noncompliant.

Contractor Submissions For Correction of Noncompliance
FAR 52.230-5

- A description of cost accounting changes that will be necessary
- A revision or amendment to the original disclosure statement if changes result in changes to a previously submitted disclosure practice
- The total potential impact of these changes
- A general dollar magnitude of the changes, identifying the potential shift of costs between CAS-covered contracts by contract type and other contractor business

Exhibit 13-10

Notice of Noncompliance

FAR 30.202-7(b)

If the contracting officer determines that a disclosed or an established practice is not in compliance, you must provide a notification signed by the contracting officer to both the contractor and any auditor that may have provided auditing assistance on the issues involved.

Content of Notification

FAR 30.602

Before you issue this notification, you must obtain a determination from the contracting officer in regard to obtaining a cost impact statement and a contract adjustment. These are required to remedy the results of instances of CAS noncompliance, new standards, or voluntary changes, but only if the contracting officer determines that the amounts involved would be material.

Cost Impact Statements

FAR 30.602-2(c)

If the contracting officer decides that the potential cost is material, you must require the contractor to submit a cost impact statement. Cost impact statements are due within 60 days after the contracting officer's decision that the potential cost is material, or other time frame to which both the Government and contractor agree.

FAR B9903.305

You obtain cost impact statements for two basic purposes:

- In instances of CAS noncompliance, the purpose for obtaining cost impact statements is to determine if the failure to comply resulted in increased costs to the Government.
- In instances that involve changes to a cost accounting practice, the purpose for obtaining cost impact statements is to identify and measure the difference in contract costs before and after the accounting practice change.

13.5 SEEK RESOLUTION OF PROBLEMS IDENTIFIED

Before meeting with the contractor to resolve issues that have been identified, prepare a meeting agenda that systematically outlines each deficiency in the audit report.

Be receptive to any contractor feedback that is logical, but obtain verification when appropriate.

Resolution of General Issues

Resolve disagreements with the contractor as you would any other contract performance problem—by using the techniques outlined in Chapter 10.

Be sure to establish a timetable for correction of deficiencies in the accounting system acknowledged by the contractor. The schedule should be considered reasonable by the Government and the contractor.

Resolution of Defective Pricing Issues

In the case of defective pricing, the Government must *prove* data are defective, but having proved that, the contractor has the burden of proving that the defect did not result in a price increase. In other words, the Government is entitled to a price decrease unless the contractor provides evidence that the Government is not entitled to a decrease.

There are three possible bases under which the Government can seek sanctions for defects:

- Sanctions available under the contract
- Sanctions available under the civil fraud statutes
- Sanctions available under criminal fraud statutes.

For contract remedies and civil fraud, the Government's burden for proving the existence of a defect is the same—*a preponderance of the evidence*. For criminal fraud, the Government's proof must be *beyond a reasonable doubt.*

Fraudulent Sanctions

Your contracting office is not authorized to settle defective pricing cases involving fraud. In such cases, refer the matter to your Government legal advisor and the Inspector General in your agency responsible for coordinating their actions with the Department of Justice. Exhibit 13-11 provides examples of indications and evidence that might lead you to consider fraud.

Even if fraud is indicated, you should impose sanctions available under the contract for the defects. When implementing sanctions by contract modification, be sure to indicate that the modification does not waive the Government's right to other sanctions.

Cost/Price Adjustments for Defective Pricing

FAR 52.215-22

FAR 52.215-23

Contract terms and conditions assume that the natural and probable consequence of defective data is an increase in the contract price in the amount of the defect plus related indirect costs and profit or fee. Therefore, unless there is a clear indication that the defective data were not used, or were not relied upon during negotiations, you should take action to reduce the contract price by that amount.

However, a contractor may offer a rebuttal to this assumption and present information demonstrating that the result was not an increase in the contract price. In these circumstances, it is the responsibility of the Government to prove that the defective data did, in fact, result in an increase. It also must demonstrate the amount of the increase.

Examples of Potential Fraud in Defective Pricing

- Falsification or alteration (without notice to the Government) of supporting data
- Failure to update cost or pricing data even when it is known that past activity showed that costs or prices have decreased
- Failure to make complete disclosure of the data known to responsible contractor personnel
- Distortions of overhead accounts or baseline information by transferring charges or accounts that have a material impact on Government contracts
- Failure to correct in a timely manner known estimating or pricing system deficiencies which directly and repeatedly result in defective pricing
- Repeated denial by the responsible contractor employees of the existence of historical records that are subsequently found
- Proposing one vendor while intending, at the time of the proposal, to use another, lower-priced vendor
- Intentional failure to update cost or pricing data when clearly required by law or regulations
- Selectively disclosing work orders with higher costs while knowingly not including additional pertinent work orders with lower costs
- Altering the dates on material or subcontract purchase orders from dates prior to the prime negotiations to after negotiations
- Repeated instances of lost or destroyed records (other than those destroyed consistent with the contractor's normal document destruction policy) which would provide supporting details for proposed costs that were based on experience
- Fabrication of supporting information for a proposed cost factor when no historical information is actually collected or segregated for this type of expense
- An undisclosed change in a make-versus-buy-decision which is known by the contractor prior to the conclusion of final price negotiations
- Not disclosing total company material requirements for items qualifying for quantity/sale discounts, thereby knowingly proposing a higher unit price than the combined purchase will actually generate

Exhibit 13-11

In establishing that the defective data caused an increase in the contract price, it is inappropriate to reconstruct the negotiation by speculating as to what would have been the mental attitudes of the negotiating parties if the correct data had been submitted at the time of agreement on price. Use facts—not conjecture.

Preparing a Position on System Changes

When seeking resolution following accounting changes, contract clauses contain guidance that you must follow. The amount of the adjustment depends not only on the contract type, but also on the type of change or changes under consideration. Exhibit 13-12 summarizes the adjustments required for specific types of changes.

Considerations for Making Contract Adjustments As a Result of Accounting System Changes FAR 52.230-2 FAR 52.230-3

Reason for Proposed Change	Basis for Negotiating Position
Implementation of new Government standard	Equitable adjustment—the net result can be either an increase or a decrease
Voluntary changes to a disclosed or established practice that are not detrimental to Government interest, but are not known to provide any particular Government benefit (sometimes termed a "discretionary" change)	Recovery of increased costs paid by the Government—an adjustment that would benefit the contractor is prohibited
Voluntary changes that have a known benefit to the Government and are also not detrimental to Government interests in any way (sometimes termed a "sanctioned" change)	Equitable adjustment—the net result can be either an increase or a decrease
Changes to correct aspects of the system that are in noncompliance	Recovery of increased costs paid by the Government plus interest—an adjustment that would benefit the contractor is prohibited

Exhibit 13-12

Resolution of CAS Issues

When the contracting officer's final decision regarding a CAS contract is that the contractor's system is inadequate, demand the submission required by FAR 52.230-5, *Administration of Cost Accounting Standards.* Accounting system changes will be required to bring the contractor's system into compliance with CAS.

Uncooperative Contractors

FAR 30.602-2(d)

If the contractor refuses to provide the information required, the contracting officer, with the assistance of the contract auditor, must estimate the general dollar magnitude of the change on CAS-covered contracts.

If that estimate results in a material net amount due to the Government, then the following actions must be taken:

- Withhold up to 10 percent of each payment on CAS-covered contracts until the estimated amount due is reached
- When the entire estimated amount due has been withheld, request agreement on the final amount within 20 days
  - If agreement is reached, issue a bilateral contract modification
  - If agreement is not reached, issue a unilateral modification.

13.6 TAKE CORRECTIVE ACTION AND DOCUMENT IT

As a matter of courtesy, you should always provide documentation for contract auditors on the disposition of any recommendations they provided. Sometimes such feedback is specifically required by regulation.

Corrective Action for Defective Pricing

FAR 15.804-7

If cost and pricing data are found defective and were relied on for negotiations, determine the amount due the Government and collect the overpayment.

Remember—unless the contractor presented strong evidence to the contrary after you briefed its management and obtained its feedback—you should generally reduce the contract price a dollar for each dollar difference that results when proper cost and pricing data are used.

In addition to the amount of the adjustment, the Government is also entitled to interest on any overpayments. Overpayment occurs only when payment is made for supplies or services accepted by the Government. Overpayments would not result from amounts provided as progress payments.

In calculating the interest amount due, use the three-step procedure described in Exhibit 13-13.

Steps for Calculation of Interest Amounts on Overpayments Resulting From Defective Pricing FAR 15.804-7	
Step	**Description of Action**
1	Determine the defective pricing amounts that have been overpaid to the contractor
2	Determine the exact date of overpayment—that is, the date payment was made for the related completed and accepted contract items or services
3	Apply interest rates in effect for each quarter from the time of overpayment to the time of repayment, using rates prescribed by the Secretary of the Treasury under 26 U.S.C 6621(a)(2)

Exhibit 13-13

Penalties

Some agencies provide for penalties in addition to accrued interest. Follow your agency's procedures. The advice of legal counsel is required whenever such penalties are applied.

Documentation of Repayment Amounts

In the price reduction modification or demand for repayment that results from a determination of defective pricing, show the following amounts separately:

- The repayment (adjustment) amount
- The penalty amount (if any)
- The interest amount (showing the time frame for which interest was calculated).

Additionally, state that interest will continue to accrue until repayment is made.

Negotiation Memorandum for CAS Compliance

FAR 30.602-1(c)

You are required to prepare a negotiation memorandum on the agreement reached regarding contract adjustments for new or modified cost accounting standards. In addition to your agency's general requirements for negotiation memorandum distribution, you also must distribute copies to:

- Government auditors
- Contracting officers in other agencies affected by the negotiation.

Withholding for Estimating System Deficiencies

FAR 32.503-4

When deficiencies in the contractor's estimating system may impact indirect billing rates applied to progress payment vouchers, the contracting officer should withhold any amount that represents a reasonable estimated cost variance that may be the result. Be sure to document how you arrived at the withheld amount and obtain input from the contract auditor.

Exceptions for Minor Defects

If outstanding estimating system deficiencies are relatively minor, consider negotiating adjustments in billing rates or progress payments based on the probable effects of these minor deficiencies. Discuss dollar impacts with the Government auditor.

If a minor deficiency has no effect on data submitted, you may rely on it. For example, if a minor deficiency concerns subcontracting cost data for only one contract line item and cost and pricing data are submitted for a modification to another contract line item, it would be appropriate, and probably cost effective, to rely on the submitted data.

Effect of Lack of Reliance on Estimating Systems

A lack of reliance on submitted data produced by deficient estimating systems may mean that contractors have to meet additional administrative requirements for approval of individual actions. On contract modifications, for example, it may mean demonstrating that subcontracted items were estimated using competitive proposals. These added requirements can be an extensive paperwork burden on large contracts.

Documentation of a Lack of Action

If suspected deficiencies on either a transaction or a system audit are not verified, you must also document the file as to the reasons for the lack of corrective action.

13.7 MONITOR CONTRACTOR FOLLOW-THROUGH

The results of negotiation following deficiencies identified by an audit may include requirements for further action by contractor personnel. In these cases, you would have to monitor how well the contractor fulfills these new responsibilities.

Action on Subcontractor Defective Pricing Issues

Under cost-reimbursement contracts and under all fixed-price contracts except firm-fixed-price contracts and contracts with economic price adjustments, the Government may have a continuing and direct interest in subcontractor defective pricing issues. Payments to subcontractors that are higher than they would be had there been no defective subcontractor cost or pricing data must be considered as a basis for disallowance or nonrecognition of costs under prime contract clauses. Therefore, you must monitor the status of these subcontractor issues.

Estimating System Monitoring

To effectively monitor estimating system improvements:

- Set up a follow-up system for any timetable to which the contractor may have agreed for accomplishing improvements, and
- Refuse to rely on data contractors submit that result from the use of deficient systems—for example, sometimes the auditor may report that an audit was not feasible because
  - Deficiencies in an estimating system were so major that detailed evaluation was pointless, or
  - Access to records unavailable or otherwise denied were so crucial that detailed evaluation was, in effect, impossible.

  In these cases, you should not rely on cost and pricing data submitted to back up contract modifications that result from the use of such a system and you may not rely on data submitted as the basis for progress payments until:
  - Crucial records are made available, or
  - The contractor notifies the Government that major deficiencies have been corrected and the Government auditor provides verification.

CHAPTER 14

CONTRACT MODIFICATIONS

BUT DOES IT FIT?

With the help of a neutral advisor, the Government and Tutors-R-Us (TRU) reached an agreement on the computer equipment controversy within a month.

TRU was not about to purchase the equipment—the Government was obviously not willing to pay for it and TRU did not have additional business to make such a capital expenditure worthwhile. So TRU would lease the equipment at Government expense. The cost for leasing the equipment that the Government wanted was $250 per station per month or $2,500 per month with the 10 student maximum.

Under the terms of the original contract, the Government would order 40 training courses any time during the 12-month performance period. Schedules were to be finalized three months before the start of any one course. In order to minimize the equipment cost, the parties decided to change the statement of work in regard to course scheduling. They would limit the scheduling of courses to four months out of the year—one month each quarter. This change would reduce the equipment leasing costs by two-thirds.

While the agreement was being worked out, TRU completed the initial phase of the work—the course development. It was subsequently approved and, with the equipment controversy settled, TRU conducted the pilot training course. It was so successful that the requisitioners want to obtain intermediate-level training as well as the basic level training called for under the current contract.

As Ernest read the new purchase requisition, it was clear from the documentation that the requisitioners presumed that the current contract would be modified to include the intermediate-level training. Each basic course under the current contract was for two calendar days. Each intermediate-level training would take three calendar days.

Ernest already had written a bilateral modification for Bea Ware's signature to formalize the agreement negotiated with the contractor. It increases the contract price, clearly makes TRU responsible for providing computer equipment, and restricts the times that courses may be offered to four months out of the year. Because of the statement of work changes that would be needed, Bea decided it was appropriate to use the Changes clause as her authority for issuing the modification. The modification did not include the requirement for intermediate-level training.

continued . . .

After conferring with Bea Ware, Ernest called the requisitioner and explained that because the intermediate-level training was at least as much work as required by the original contract and probably even more, it was not appropriate to add the requirement to the current contract. Additionally, he explained that even if the amount of work could be considered a minor amount under the contract, there were other indications that adding this work was improper—no intermediate-level training currently was required at all and a 50 percent expansion of the statement of work would be needed to implement the change.

"You need to talk more about your possible future requirements," Ernest pointed out to his requisitioner. "If we had included the intermediate-level training as a contract option on the basic contract, we could have gotten competition on it without awarding it right away. That way we'd save time and administrative effort if it turns out that you really needed or could afford to purchase the additional, similar requirement." Ernest was unsure whether this requisitioner just didn't want to be tied down contractually to a contractor he might not like for all his computer training needs or whether he did not have the money for the additional requirement when the basic training requirement was solicited. However, the logic he advanced applied regardless.

"The bottom line is that the intermediate-level training is not within the scope of the original contract," Ernest explained. "We'll have to process your request as a new requirement."

Ernest and Bea considered the factors outlined in Exhibits 14A-3 and 14A-4 from her contract administration course to reach their decision on how to handle this intermediate-level training request.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Determine whether a modification is needed, then select and issue the appropriate type.

Individual: PART A—In regard to modifying the contract to make contract changes:

14A.1	Consider contractor requests for modifications.
14A.2	Consider Government-initiated modifications.
14A.3	Consider whether the scope of the contract will be changed.
14A.4	Estimate the impact of the change.
14A.5	Determine if any consideration is appropriate.
14A.6	Provide notice of rejection of a proposed change.
14A.7	Determine the type of contract modification that is appropriate.
14A.8	Prepare and issue a contact modification.

PART B—In regard to modifying the contract to exercise an option:

14B.1	Identify options in the contract.
14B.2	Determine the current need for the additional supplies or services.
14B.3	Determine if a synopsis is required before exercising an option.
14B.4	Determine whether to exercise the option.
14B.5	Provide written notice and exercise the option.

INTRODUCTION TO CONTRACT MODIFICATIONS

Definition

A ***contract modification*** is any written change in the terms of a contract.

An ***option,*** when it is exercised, is one form of a contract modification. Before it is exercised, it is a unilateral right in a contract by which, for a specified time, the Government may elect to purchase additional supplies or services called for by the contract, or may elect to extend the performance period of a services contract.

The reasons for modifying a contract and the procedures used apply to both fixed-price and cost-reimbursement contracts. Options may be incorporated into either type of contract.

Policy on Contract Modifications

Only contracting officers acting within the scope of their authority may legally execute contract modifications.

FAR 43.102

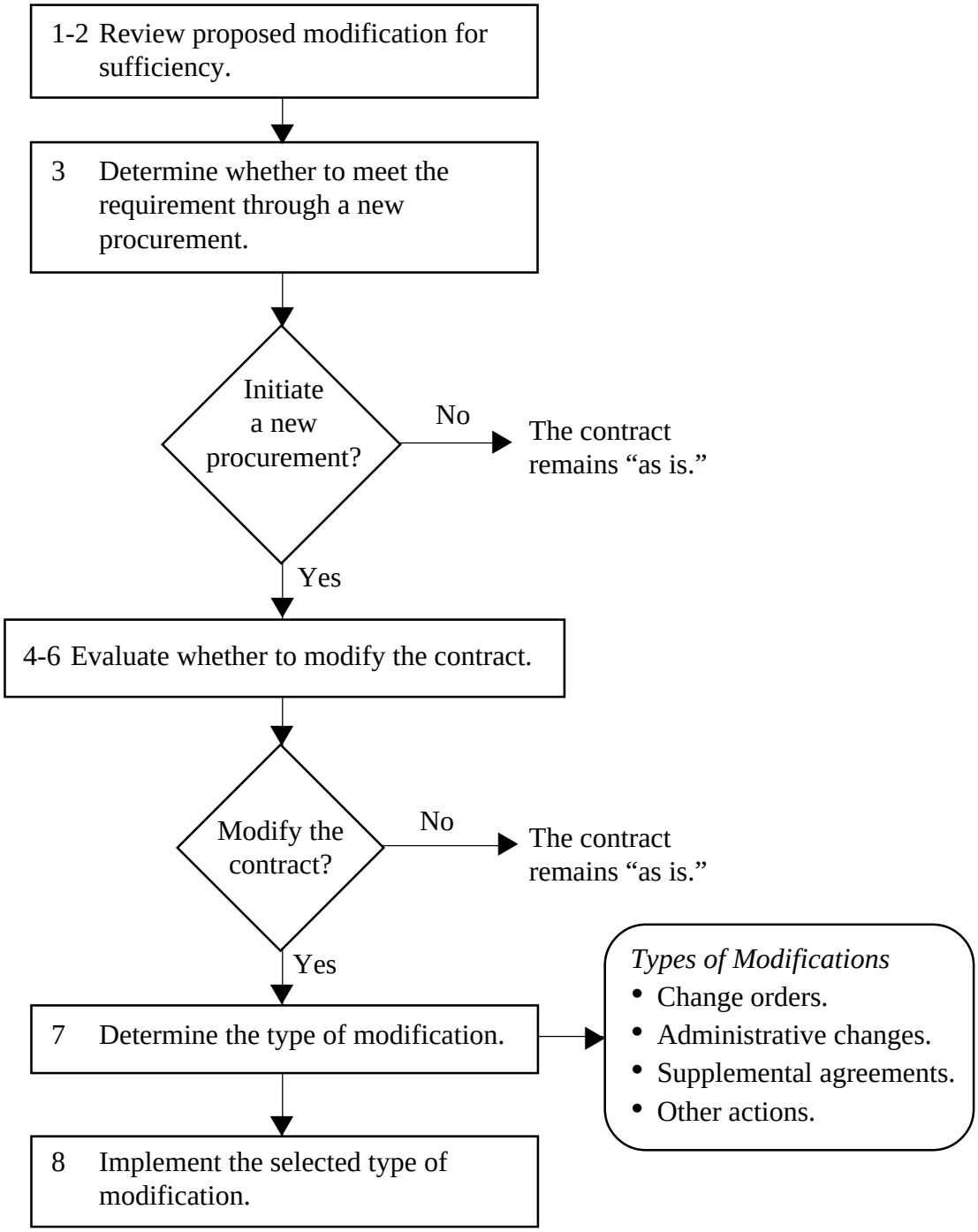
It is the Government's policy that all contract modifications be priced, including modifications that contracting officers may issue unilaterally, unless delaying the modification to include pricing will adversely affect the Government's interests.

Steps in Performance

Part A of this chapter provides a flowchart for determining if and how to implement modifications to change the existing terms of a contract. This chart is on the next page and the steps it provides are then discussed in turn.

Part B summarizes procedures for exercising contract options. These involve modifying the contract to include the work outlined in the option. A second flowchart outlines those procedures and they are then discussed in detail.

STEPS FOR ISSUING CONTRACT MODIFICATIONS (CHANGES)



PART A—CONTRACT MODIFICATIONS (CHANGES)

Origin of Contract Changes

As contract performance proceeds and events unfold, the contracting parties may find that they must modify their original expectations and plans to adjust to changing circumstances. As they do, they must modify the terms and conditions of their contract so that it reflects current conditions. You first may hear about the need for a contract modification from the contractor or from someone in your own agency or another Government organization.

14A.1 CONSIDER CONTRACTOR REQUESTS FOR CHANGES

The contractor may request a contract modification for various reasons. Typical motives are outlined in Exhibit 14A-1.

Typical Reasons for Contractor Requests for Changes

Response to Contract Requirement	Contractor Initiated Action	Response to Government Action
• DOL wage rate increases when continuing services by exercising an option • Economic price adjustment • Price redetermination	• Name change • Value engineering proposal • Consideration offered for nonexcusable delay • Novation agreement	• Excusable delay • Stop Work Order issued • Constructive change • Settlement for contract terminated for convenience

Exhibit 14A-1

Documentation

The contractor is required to submit documentation with its request that provides sufficient evidence to support a change in price, delivery, or performance. The documentation varies with the reason for the change.

Obtain Guidance from the Requiring Activity

Many requests from the contractor for a contract modification involve the technical requirements of the contract.

You may need to contact the requiring activity and any technical advisors participating in the project. Requiring activities are the best source for determining the:

- Impact of any delivery delays on the mission
- Value of proposed considerations other than cost/price
- Acceptability of a value engineering proposal
- Acceptability of substitute materials.

Requiring activities may be opposed to any change to the original terms of the contract for justifiable business reasons. Consider their point of view carefully. You are the middle person between the contractor and the user. You may want to ask the contractor to provide a briefing or further documentation to support the request. Make sure your user attends such briefings.

Make the Determination

After you have all the documentation from the contractor and the requiring activity, decide if a modification to the contract is called for. Do not approve the modification when:

- The requirement is already covered by the contract
- Technical changes cannot be supported to the requiring activity's satisfaction
- Changes to nontechnical business terms and conditions are unacceptable
- Additional funds are not available, if needed.

Funding is always a consideration for approving a modification. Even when the contractor is entitled to an equitable price adjustment, the modification cannot be just summarily approved and issued. If funds are unavailable, the contract may have to be otherwise adjusted so that the overall cost does not change. Decreasing the total quantity is one means of otherwise adjusting the contract.

14A.2 CONSIDER GOVERNMENT-INITIATED CHANGES

At any time after award, the Government may have to make changes to the requirements of the contract. You must examine Government-proposed modifications as well as those you obtain from the contractor. At a minimum, a Government-proposed change request should:

- Be clear and understandable as to what the change encompasses
- Not be covered currently by the contract
- Be agreeable to all appropriate Government officials
- Contain adequate documentation to support the need for the change.

In particular, you must be sure that any Government-proposed changes in specifications or performance requirements are clear, unambiguous, and necessary.

Additionally, the requestor must detail, or your must find out, the contractor's position as to the proposed change's impact on:

- Quality
- Quantity
- Completion date
- Cost/price.

14A.3 CONSIDER SCOPE-OF-CONTRACT ISSUES

You must determine whether any change, initiated by either the Government or the contractor, is within the ***scope of the contract.*** Adding work under an existing contract permits the Government to avoid the costs associated with issuing a new procurement. There are definite limits, however, on such additional work. These limits are outlined in the Changes clause in the contract. The FAR prescribes several variations for this clause. The specific clause cited in your contract determines what those limits are. A summary of limitations is provided in Exhibit 14A-2.

Changes Authorized by Standard FAR Clauses

Clause	Changes Authorized by the Clause
FAR 52.243-1, *Changes—Fixed Price*	This "basic supply" clause authorizes changes within the scope of the contract regarding: • Design/specification, but only if items are being manufactured for the Government • Method of shipment or packing, or • Place of delivery.
FAR 52.243-1, *Changes—Fixed Price, Alternate I*	This alternate substitutes language in the basic supply clause to conform to the peculiarities of service contracts, allowing changes in the time and place of performance as well as the description of services.
FAR 52.243-1, *Changes—Fixed Price, Alternate II*	This alternate allows changes as outlined in both the basic supply clause and the Alternate I services clause.
FAR 52.243-1, *Changes—Fixed Price, Alternate III*	This alternate allows changes within the general scope of a professional services contract in the services to be performed.
FAR 52.243-1, *Changes—Fixed Price, Alternate IV*	This alternate allows changes within the scope of the contract in: • Specifications • Work or services • Place of origin • Place of delivery • Tonnage to be shipped • Amount of GFP.
FAR 52.243-1, *Changes—Fixed Price, Alternate V*	This alternate adds the place of inspection, delivery, or acceptance to the list of items that may be changed in the basic supply clause.

Exhibit 14A-2 (page 1 of 2)

Changes Authorized by Standard FAR Clauses *(continued)*

Clause	Changes Authorized by the Clause
FAR 52.243-2, *Changes—Cost Reimbursement*	This basic cost-reimbursement clause allows the same within-scope changes as the basic supply changes clause and its alternates, but limits the contractor's duty to perform changes that that exceed the: • Estimated cost of the contract, or • Amount of the funds allocated to the contract.
FAR 52.243-2, *Changes—Cost Reimbursement, Alternate I*	This alternate allows the same changes as the basic fixed-price services clause (FAR 53.243-1, Alternate 1) but limits the contractor's duty in the same way as the basic cost-reimbursement Changes clause.
FAR 52.243-2, *Changes—Cost Reimbursement, Alternate II*	This alternate allows changes as outlined in both the basic cost-reimbursement services clause and the Alternate I cost-reimbursement services clause.
FAR 52.243-2 *Changes—Cost Reimbursement, Alternate III*	This alternate allows the same changes as the basic clause for cost-reimbursement contracts, except that it only allows changes in the plans and specification or other instructions incorporated in the contract.
FAR 52.243-2, *Changes—Cost Reimbursement, Alternate IV*	This alternate allows changes in the facilities or work described in the contract schedule.
FAR 52.243-2, *Changes—Cost Reimbursement, Alternate V*	This alternate clause adds the place of inspection or acceptance to the list of items that may be changed in the basic cost-reimbursement Changes clause.
FAR 52.243,-3, *Changes—Time-and Materials or Labor Hours*	This alternate clause only allows changes in: • Drawings, designs, or specification • Method of shipment or packing • Place of delivery, or • Amount of GFP. By referring to adjustments in hourly rates and the ceiling price, as appropriate, this clause addresses adjustments within time-and-materials and labor-hour contracts.

Exhibit 14A-2 (page 2 of 2)

Basic Guidelines Under these clauses, the Government has the right to direct a contractor to accept and proceed with the change if it falls within the categories of change specified by the clause. This is accomplished through a written change order. On the other hand, this right does not extend to changes that alter the nature of the requirement and are therefore outside the scope of the contract. These are called ***cardinal*** changes.

You must determine whether a change is within the contract's scope. Do this by making comparisons between the work covered by the change with the work required by the original contract. If the function of the end item is generally the same as originally solicited, the change falls within the scope of the contract.

Determining if a proposed contract change is "within scope" is subjective, but allowable changes usually have several of the characteristics listed in Exhibit 14A-3.

Factors Indicating "Within Scope" Changes

- The function of the item or service has not changed
- The basic contract purpose has not changed
- The magnitude of funds requested for the change is proportionate to the price or estimated cost of the original contract
- Competitive factors at the time of the original solicitation are the same
- Specification or statement of work changes are not extensive

Exhibit 14A-3

The questions you will need to answer are:

- Does the changed work represent what both parties reasonably contemplated at the time of award?
- Is the changed work essentially the same as was bargained for?
- Is the nature of the requirement altered by the change?
- Would this type of change normally be expected for this kind of requirement (sophisticated, complex requirements)?
- Was the specification defective, requiring extensive redesign?

It may appear that any change resulting in either an increase in the number of items or a longer period of performance would be considered outside the scope of the contract. The courts have suggested thinking in terms of major and minor variations. This helps determine whether quantity changes are within the scope of the contract. Refer to Exhibit 14A-4.

Examples of Minor Versus Major Variations

Minor Variation	Major Variation
Situation: The Government's design for a sophisticated machine required the use of 100 widgets. The contractor had to use 150 widgets to make the machine function properly. *Analysis:* The increase of 50 units was within scope because the function of the end item did not change.	*Situation:* An existing contract covered the purchase of 100 widgets as a line item. The Government increased the total to 150. *Analysis:* The increase of 50 units was not within the scope of the contract because the widgets were the end item.

Exhibit 14A-4

Generally, contractors are less concerned with changes to their own contracts that are beyond the scope of the contract than they are with such changes in their competitor's Government contracts. When out-of-scope changes are made to a competitor's contract, a contractor is likely to view it as a missed business opportunity. However, when a contractor is faced with an out-of-scope change to its own contract, it will not object on the basis that the change is not within the contract's scope because additional compensation is clearly due.

The key is whether the modification is within the scope of the competitive basis of the basic contract. "Within scope" determinations are less judgmental when a specific contract term covers a proposed change. Obviously, competitors could anticipate the change in such circumstances.

Comptroller General's Focus

The contractor's competitors have the right to protest any change that would be considered outside the scope of the contract by the Comptroller General (CG). The Comptroller General describes changes that are "within scope" as those that the competing offerors would have "reasonably anticipated" under the terms of the contract. The CG's focus is the competitive process. At times, the CG concludes that the change is new work and should have been issued as a new solicitation. In these circumstances, the CG may rule that the agency's appropriate action is to terminate the modified portion of the contract.

If you obtain full and open competition or get required approvals on a justification for not obtaining it, there is no prohibition against issuing a modification that is outside the scope of the original contract.

Constructive Changes

In some instances, the change could be the result of unauthorized new directions to the contractor provided by a COR/COTR or some other Government official. These ***constructive changes*** (see Chapter 7) must be dealt with promptly, as soon as you learn of them. The consequences could be severe under a fixed-price contract to the extent the contractor would be entitled to an equitable adjustment in time or price. The consequences also could be significant under a cost-reimbursement contract if the change detracted from achieving the basic purpose of the contract.

You would have determine what action would be in the Government's best interest. You could decide to follow up with a change order, formally modifying the contract to reflect the constructive change. Or you could reverse the unauthorized directions to the contractor and, if appropriate, negotiate an equitable adjustment as to cost or time lost because of the constructive change and modify the contract accordingly.

14A.4 ESTIMATE THE IMPACT OF THE CHANGE

Before issuing a contract modification, you must determine what impact the change will have on:

- Cost/Price
- Delivery
- Performance.

Estimate Cost/Price Impact

Changes to basic contract requirements can be classified in three ways, according to the effect the change has on the resulting equitable adjustment. Usually a single change will embody elements of more than one type. These categories of change are:

- **Additive Changes.** Work added to the contract, resulting in more money to the contractor.
- **Deductive Changes.** Work a contractor has not yet performed deleted from the contract, resulting in a reduction of the contract price or estimated cost.
- **Substitution Changes.** Added work being substituted for deleted work, resulting in either no change in contract price or estimated contract cost, or a change that is tempered by the monetary effect of the substitution involved. (Even when work of equal cost is substituted, it is important to get the change in writing so that the requirement is accurately documented.)

Contractor's Pricing

In pricing modifications, contractors may attempt to make up losses they would have incurred had there been no change. Contractors may also see the opportunity to increase their profit margin. Carefully evaluate every request for additional funds. You must be satisfied the contractor is not proposing or agreeing to the change primarily for its own benefit.

You should examine the contractor's proposed price/cost in the same way you would examine these numbers for a basic contract. If your independent Government estimate appears to be somewhat off the mark, use other means of comparisons—for example:

- A history for similar requirements, or
- Current market prices.

Ask the technical evaluators if there is any evidence that the contractor anticipated the change in its original pricing and technical proposal.

Cost and Pricing Data

FAR 15.804-2(a)

When the amount of increase that results from the changes(s) is $100,000 or more, a contractor must submit certified cost and pricing data as a part of its proposal.

You may request an audit if necessary to establish the reasonableness of the proposed price or estimated cost (see Chapter 13).

FAR 15.804-3

Contracting officers can provide an exemption from cost and pricing data for modifications in excess of $100,000 only when prices are:

- Based on adequate price competition
- Based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or
- Set by law or regulation.

Usually you are in a sole source position because normally it is practical to discuss changes to the basic requirement only with a contractor who has a contract for the basic requirement. However, you could still estimate what the price would be based on adequate price competition by making comparisons to other prices that were established with adequate price competition.

FAR 15.804-4

When cost or pricing data is required, also obtain a Certificate of Current Cost or Pricing Data with the initial price change proposal.

Additional Administrative Requirements

You may need to comply with legal or administrative requirements that apply to the work as changed. Typical examples are the need for Equal Employment Opportunity (EEO) clearances and wage determinations for the new work.

EEO Clearance

FAR 22.805(a)(1)(ii)

When a change brings the contract total over $1 million, you must obtain an equal opportunity compliance approval. If the Department of Labor has no compliance approval on record for the contractor, there would be a delay while an approval was processed.

Wage Determinations

FAR 22.1007(b)

When a modification includes a significant amount of new work covered by the Service Contract Act and/or performed by new categories of service workers not included on wage determinations obtained for the basic contract, you are required to obtain a wage determination covering these new categories.

The regulations are not clear as to when the amount of new service work is significant, but certainly when the dollar value of work to be performed by persons within these new service categories exceeds $2,500, the threshold for applicability of the Act on a new procurement, an additional wage determination would be appropriate for a modification as well.

14A.5 DETERMINE IF ANY CONSIDERATION IS APPROPRIATE

Because you must ensure fairness to both contracting parties, evaluate the relevance of consideration to both the contractor and the Government. Base your evaluation on what is equitable and reasonable for the particular circumstances surrounding this change. Chapter 15 provides guidance on what to consider for determining if consideration is appropriate when there is a delay in contract work.

Sometimes, consideration has been predetermined, as with a Liquidated Damages clause, or is limited, based on a formula or a restriction contained within the contract itself.

Consideration for Value Engineering Changes

FAR 48.104

An example of consideration specified by the contract is the sharing arrangements relative to acquisition savings calculated for value engineering change proposals. The contractor is entitled to both current and future monetary rewards for value engineering changes. The calculations used with value engineering change proposals (VECPs) that are accepted by the Government are specified in FAR 48.104-1.

14A.6 PROVIDE NOTICE OF REJECTION OF CHANGE

You must notify all the parties involved when the Government rejects a contractor's proposed change in the contract. You must advise the contractor in writing and also notify the requiring or program office of the official rejection.

If the requiring or program office initiated the modification, you would obviously owe the initiating office notification of any decision to reject the change. You may choose not to notify a requiring or program office on a contractor-initiated modification when its input was not required in the decisionmaking process for the initial work that the change would alter.

FAR 48.103

The terms of the contract or regulatory guidelines may state when a specific type of response is due. For example, you must respond to value engineering change proposals within 45 days from the Government's receipt of the proposal by either providing:

- Notice of the decision, or
- The anticipated decision date with an explanation for the delay.

Otherwise, notify the contractor promptly to avoid costly delays or other performance problems.

14A.7 DETERMINE THE TYPE OF MODIFICATION

FAR 43.103

There are two main classifications of contract modifications:

- Supplemental agreement (bilateral), and
- Unilateral.

Bilateral Modifications

Supplemental agreements are used to:

- Make negotiated equitable adjustments resulting from the issuance of unilateral changes
- Definitize letter contracts
- Implement changes required by the contract, such as economic price adjustments, or
- Reflect other changes to contract terms and conditions requiring agreement between the contractor and the Government.

Most supplemental agreements involve negotiation of cost/price and other terms, usually entailing the process similar to award of the basic contract.

A supplemental agreement is appropriate when:

- The change has an effect on the substantive rights of either party
- There is sufficient time to negotiate a supplemental agreement
- There is no basis in the contract's terms for issuing a unilateral modification.

Unilateral Modifications

Unilateral modifications are of three basic types:

1. ***Administrative changes.*** These are changes that are minor in nature and do not materially affect contract performance. Examples of administrative changes include:
    - Correction of a fund citation
    - Addition of a zip code on a delivery address
    - Recognition of novation agreements
    - Recognition of name-change agreements.
2. ***Change orders.*** This term refers to the actual issuance of a change authorized by the Changes clause in the basic contract. The Changes clause is cited as the authority for the modification. Change orders can be used when performance requirements need

to be modified but no change in cost/price or delivery is anticipated or when there is not enough time to negotiate with the contractor.

3. Changes authorized by other contract clauses. Although these are not termed change orders, they can be issued unilaterally. Examples are the issuance of a stop work order or termination notice.

Select a unilateral modification when:

- The change has no effect on the substantive rights of the contractor or the Government
- The change can be made unilaterally under a specific contract term, such as FAR 52.249-6, *Termination (Cost-Reimbursement)*
- The contractor's agreement with the change is not otherwise required
- The time required to negotiate a bilateral agreement would cause a delay that would adversely affect the Government's interests.

You may not realize that there is a time problem until you begin negotiations for a bilateral modification and experience a lack of progress in reaching an agreement.

Except for administrative changes, unilateral changes should be followed up with bilateral contract modifications when negotiations are concluded on the change. If exhaustive negotiations do not result in a mutual agreement, the contracting officer may issue a final decision as the basis for definitizing the unilateral change. The contractor may then seek relief under the Disputes clause if it continues to disagree with the Government's position.

14A.8 PREPARE AND ISSUE A MODIFICATION

Contract modifications can be issued only by contracting officers acting within their authority.

For contractor-initiated changes, most Government agencies prescribe formal procedures. Typically they focus on the following activities.

FAR 43.103

You should first review the contractor's proposal. The proposal should include cost, schedule, and performance data as well as an indication of the maximum equitable adjustment that could result from the change.

Make sure that the proposal covers all elements of the change, that is, increases, decreases, and substitutes.

Never enter any negotiation without being adequately prepared. Extensive factfinding is necessary when the change covers issues not required by the original contract or when you suspect that the contractor is in a loss position. Invite other Government officials involved in the change to provide pertinent facts to use during the negotiations. Be prepared to counter any contractor arguments.

FAR 15.805

FAR 15.807

You must develop a prenegotiation position on cost/price. Select and use whatever price analysis techniques will ensure a fair and reasonable price. Price analysis techniques used prior to award may provide a sound foundation for developing the prenegotiation position for the change.

You can additionally use cost analysis techniques as the basis for the Government cost/price position, addressing:

- The pertinent issues to be negotiated
- The cost objectives, and
- A profit or fee objective.

For a fixed-price contract, when negotiating a contract change, you must also consider the current profit/loss position of the contractor. This task is often more complex than a preaward analysis.

An Example

One case that is often cited to illustrate the concept of maintaining the contractor in the same profit or loss position is Keco Industries, Inc. *(176 Ct.Cl. 983, 1966)*. Keco had been awarded a contract for 200 refrigeration units. One hundred of the units were to be electricity-driven, and 100 gasoline-driven. Before any of the gasoline units were produced, the Government issued a change order directing that all 200 units be electricity-driven.

A Government audit revealed that the contractor was in a loss position on both types of units. However, the loss position on the electric units was $332.58 per unit; whereas the loss on the gasoline units was only $148.80 per unit.

The contractor's total loss position before the change was $48,138. For the contractor to be left in the same position it had been in before the change was issued, the adjustment had to be figured as shown in Exhibit 14A-5.

Example of Calculations that Maintain a Profit/Loss Position

Price per gasoline unit	*$1,720.00*
Less cost difference of gas and electric units ($1,868.80—$1,603.58)	265.22
Price per unit for the 100 units covered by the change order	***$1,454.78***
Contractor's loss position after the adjustment:	
100 electric units unchanged by the order,	
$1,603.58 (cost per unit)	
minus 1,271.00 (contract price per unit)	
$332.58 (loss per unit) x 100 units =	$33,258.00
100 units covered by the change order—	
$1,603.58 (cost per unit)	
minus 1,454.78 (equitable adjustment per unit)	
$148.80 (loss per unit) X 100 units =	$14,880.00
Total loss on contract after the adjustment:	***$48,138.00***

Exhibit 14A-5

Negotiation May Be Required

A price adjustment reflecting only the price difference between the electric unit and the gas unit would put the contract into an even greater loss position than was originally intended. An adjustment giving the contractor its actual cost for manufacturing the units altered by the change order would enable the contractor to recoup some of the loss it would have suffered originally.

In addition to developing a Government position, you must develop negotiation strategies and tactics. Review the methods and techniques used to successfully negotiate with the contractor previously. Question other contract administrators or contract negotiators who have negotiated with this particular contractor about the contractor's strategies and tactics. Be prepared to counter contractor strategies and tactics you can anticipate.

Prepare the Modification

FAR 43.301

Practically speaking, the principle of equitable adjustment for contract changes means that the Government will do whatever is fair, right, or reasonable if the contractor can prove that it is entitled to the cost it claims. Have the flexibility to change your objectives as new information is provided by the contractor during the negotiation process. If required, take a break and meet with appropriate officials before making a final decision on new information.

Most agencies use the SF 30, Amendment of Solicitation/ Modification of Contract, to modify their contracts, but your agency may require its own form. A sample of an SF 30 used as a supplemental agreement is shown at Exhibit 14A-6. In block 13C of the form, always cite the clause in the contract that authorizes you to make the change.

Obtain Release of Claims

To indicate the finality of the settlement and to avoid further controversy on supplemental agreements that result from unilateral modifications, a ***release of claims*** is recommended. Refer to Exhibit 14A-7 to review the FAR-prescribed terminology.

A release of claims generally terminates a contractor's right to further claims unless it exempts a particular issue, reserving both parties' rights in future settlement of that issue. There are some exceptions recognized by courts and boards of appeal that may make a signed general release of claims invalid. These are summarized in Exhibit 14A-8.

Sample Supplemental Agreement

AMENDMENT OF SOLICITAITON/MODIFICATION OF CONTRACT

1. CONTRACT ID CODE

PAGE OF PAGES 1 1

2. AMENDMENT/MODIFICATION NO. 004

3. EFFECTIVE DATE 1/8/91

4. REQUISITION/PURCHASE REQ. NO. ENG 91-046

5. PROJECT NO. (if applicable)

6. ISSUED BY CODE

Jill Jackson, Administrator
Your Agency
888 Main Street
Your Town, LL XXXXX-XXXX

7. ADMINISTERED BY (If other than Item 6) CODE

(Same)

8. NAME AND ADDRESS OF CONTRACTOR (No., street, county,

Attn: John Smith
Smith Brothers Engineering, Inc.

729 Scientist Row
Urban Heights, WX XXXXX-XXXXX

CODE FACILITY CODE

9A. AMENDMENT OF SOLICITATION NO.

9B. DATED (SEE ITEM 11)

X

10A. MODIFICATION OF CONTRACT/ORDER NO. OSR 91-04182

10B. DATED (SEE ITEM 13) 10/9/90

11. THIS ITEM ONLY APPLIES TO AMENDMENTS OR SOLICITATIONS

☐ The above numbered solicitation is amended as set forth in Item 14. The hour and date specified for receipt of offers ☐ is extended, ☐ is not extend
Offers must acknowledge receipt of this amendment prior to the hour and date specified in the solicitation or as
following methods:
(a) By completing Items 8 and 15, and returning ____ copies of the amendment; (b) by acknowledging receipt of this amendment on each copy of the offer submitted; or (c) by separate letter or telegram which includes a reference to the solicitation and amendement numbers. FAILURE OF YOUR ACKNOWLEDGEMENT TO BE RECEIVED AT THE PLACE DESIGNATED FOR THE RECEIPT OF OFFERS PRIOR TO THE HOUR AND DATE SPECIFIED MAY RESULT IN REJECTION OF YOUR OFFER. If by virture of this amment you desire to change an offer already submitted, such change may be made by telegram or letter provided each telegram or letter makes reference to the solicitation and this amendment, and is received prior to the opening hour and date specified.

12. ACCOUNTING AND APPROPRIATION DATA *(if required)*
XX 91-SOFXXX-XX $50,000

13. THIS ITEM APPLIES ONLY TO MODIFICATIONS OF CONTRACT/ORDERS, IT MODIFIES THE CONTRACT ORDER NO. AS DESCRIBED IN ITME 14

✓ A. THIS CHANGE ORDER IS ISSUED PURSUANT TO: (Specify authority) THE CHANGES SET FORTH IN ITME 14 ARE MADE IN THE CONTRACT ORDER I ITEM 10A.

B. THE ABOVE NUMB ERED CONTRACT ORDER IS MODIFIED TO REFLECT THE ADMINISTRATIVE CHANGES (such as changes in paying office, appropr dae, etc.) SET FORTH IN ITEM 14, PURSUANT TO THE AUTHORITY OF FAR 43.103(b)

X C. THIS SUPPLEMENTAL AGREEMENT IS ENTERED INTO PURSUANT TO AUTHORITY OF:
General Provision XX, FAR 52.243-1, Changes

D. OTHER (Specify type of modification and authority)

E. IMPORTANT: Contractor ☐ is not, ☐ is required to sign this document and return 3 copies to the issuing office

14. DESCRIPTION OF AMENDMENT/MODIFICATION *(Organized by UCF section headings, including solicitation/contract subject mater where feasible)*
(

a. This definitizes Modification #3, Engineering Change #2 to the specifications, whicl redesign of peripheral equipment to the contract.

b. The contract delivery date is changed FROM: June 28, 1991 TO: September 23, 199:

c. The contract price is changed from $130,000 to $180,000

d. In consideration of the preceding paragraphs a, b, and c, the Contractor hereby rel Government from any and all liability under this contract for further equitable adjustm to Engineering Change #2.

Except as provided herein, all terms and conditions of the document referenced in items 9A or 10A, as heretofore unchanged and in full force and effect.

15A. NAME AND TITLE OF SIGNER (Type or print)
John Smith, Executive Vice Presidient

16A. NAME AND TITLE OF CONTRACTING OFFICER (Type or print)
Jane Justice, Contracting Officer

15B. CONTRACTOR/OFFEROR
John Smith
(Signature of person authorized to sign)

15C. DATE SIGNED 1/3/91

16B. UNITED STATES OF AMERICA
Jane Justice
(Signature of Contracting Officer)

16C. DATE SIGNED 1/8/91

NSN 7540-01-152-8070
PREVIOUS EDITION UNUSABLE

30-105

STANDARD FORM 30 (REV. 10-83)
Prescribed by GSA
FAR (48 CFR) 53-243

Exhibit 14A-6

Contractor's Statement of Release
(for supplemental agreements definitizing unilateral changes)
FAR 43.204(c)

In consideration of the modification(s) agreed to herein as complete equitable adjustment for the Contractor's _____(describe)_____ "proposals for adjustment," the Contractor hereby releases the Government from any and all liability under this contract for further equitable adjustments attributable to such facts or circumstances giving rise to the "proposal(s) for adjustment" (except for.....).

Exhibit 14A-7

Document the File and Distribute the Modification

The supplemental agreement should be signed by both parties on three copies. Signed copies are to be distributed to each of the following:

- The official Government file
- The contractor
- The paying office.

Other offices may be on your normal distribution list for duplicates of the signed copies in accordance with your agency regulations.

Circumstances that Invalidate a General Release of Claims

- A modification increases the cost/price for a change to the contract and the change is later recognized as being part of the original contract
- The Government breaches the contract or fails to perform in accordance with a supplemental agreement
- The mutual mistake exists, but not a mistake about which only one of the parties knew or reasonably could have known
- The Government uses economic duress, such as threats to terminate for default, in getting the contractor to sign the release
- The circumstances involve fraud, unless both parties had knowledge of the fraud when the settlement agreement and/or claims release was signed, or
- The official who signed the release lacks the authority to sign it

Exhibit 14A-8

Implement a Change Order

Implementing unilateral modification to accomplish an administrative change is different from other unilateral changes. Refer to Section 14A.10. Implementing other kinds of unilateral modifications that will be followed by supplemental agreements require additional steps.

Use a Suspense System

Incorporate the change in the contracting office suspense system. Issuing a supplemental agreement is the most common method for definitizing a unilateral agreement. It is important that you establish goals for definitizing any unilateral change. Establish due dates for interim steps in the process, in addition to a date for the overall goal.

Identify Authorizing Clause

The Changes clause is not the only clause that can authorize a modification. One example is when the Government issues a stop work order. The contractor is required for stop work until the order is officially lifted or expires. The clause allows the contractor to obtain an equitable adjustment for the delay. Make sure you cite the appropriate clause for the modification that provides the equitable adjustment.

Issue Telegraphic Messages, If Needed

FAR 43.201(c)

When unusual or urgent circumstances demand quick action, you may implement unilateral changes by telegraphic message, but only if you comply with all requirements as listed in Exhibit 14A-9.

Prerequisites For Unilateral Issuance by Telegraphic Message

1. The contractual circumstances are urgent or compelling.
2. You furnish copies of the message promptly to the same address who received the basic contract.
3. You take immediate action to confirm the change by issuing an SF 30, Amendment of Solicitation/Modification of Contract.
4. The message contains substantially the same information required by the SF 30, except that you would:
   - Not indicate the estimated change in cost/price, and
   - Include in the body of the message the statement: “Signed by (Name), Contracting Officer”.
5. The contracting officer manually signs the original copy of the message.

Exhibit 14A-9

Prepare and Issue the Unilateral Change

Prepare your unilateral change on the SF 30, Amendment of Solicitation/Modification of Contract (see Exhibit 14A-6), or another agency-prescribed form.

Citation of Authority

When you are issuing a change order, always cite, in block 13A of the form, the specific Changes clause in the contract that authorizes you to issue the change order. For other unilateral changes, always cite the specific clause in the contract that authorizes you to issue the unilateral change in block 13D of the SF 30.

Advise of Duty to Proceed

FAR 33.213

When a Government contracting officer issues a unilateral change, the contractor must proceed with the work as changed. This holds true even if an agreement as to adjustment in price and performance time has not been reached and even if there is open and intense disagreement on these adjustments.

Exceptions to Duty to Proceed

There are a few exceptions. A contractor need not proceed if:

- It needs and requests, but does not obtain, clear direction from the contracting officer on how to proceed with the change
- The change would exceed the estimated contract cost or funds currently available on a cost-reimbursement or incrementally-funded contract
- The Government's action leaves the contractor in an untenable position—an example of this is when faulty Government testing procedures result in rejection of a delivered item

FAR 52.216-24

FAR 52.232-7

FAR 52.232-20

FAR 52.232-22

- A contract clause permits the contractor to stop work when funds are exhausted or when a certain percentage of the costs has been expended
- The Government grossly and materially breaches its duties and obligations under the contract, or
- Performance is impossible.

However, when performance is temporarily impossible, as in the case of temporary unavailability of Government-furnished materials, the contractor's duty to proceed will remain effective and the contractor must continue performance after the obstacle to performance has been removed.

Ensure Segregation of Cost

FAR 43.203

FAR 43.205(f)

Cost-reimbursement contracts often require that a contractor's standard accounting methods be capable of segregating the costs of performing changed work. However, fixed-price contracts generally do not contain that requirement. You can demand this cost segregation only when the contract terms require a contractor to do so.

When there is such a requirement, alert the contractor to the possible need for a revision to its normal accounting procedures to track the following direct cost categories:

- Nonrecurring costs—Examples are engineering costs and costs of obsolete or reperformed work.
- Costs of specific work caused by the change—Examples are new subcontract work, new prototypes, or new retrofit kits.
- Costs of recurring work—Examples are labor and material costs.

Document the File and Distribute the Modification

It is important to adequately document the file for unilateral changes. You need to identify what follow-up action is required for definitizing the change.

Definitizing a Unilateral Change

After the unilateral change has been issued, you need to issue a bilateral agreement or otherwise definitize the change. The steps for definitizing unilateral changes are the same as for supplemental agreements:

- Establish a prenegotiation position
- Negotiate the amount of the equitable adjustment and other terms
- Obtain a release of claims or resolve the claim, and
- Document the file and distribute the supplemental agreement or other documents used to definitize the change.

Administrative Changes

Most administrative changes correct nonsubstantive errors or acknowledge the need to update the original contract document. Ordinarily, no adjustment in cost/price or other terms of the contract is required. No subsequent supplemental agreement is therefore needed.

You will perform three tasks:

1. Verify that the change does not affect the substantive rights of the parties. Normally this is merely a matter of reading the change request and making a judgement.
2. Prepare and issue the change. Use SF 30, Amendment of Solicitation/Modification of Contract.
3. Document the file and distribute the modification. Send signed copies of the modification to the contractor and the paying office. Retain one signed copy for the contract file.

Novation Agreement

FAR 42.1201

One example of an administrative change is acknowledgement of a ***novation agreement.*** A novation is a transfer of rights and obligations under the contract from one party to another. This will occur, for example, when a contractor is bought out by, or merged into, another contractor. The original contractor (or transferor) must originate a request to the Government to recognize the successor (or transferee) as the entity responsible for completion of the work and entitled to receive further payment for the work.

The Government's acceptance of a novation is not automatic. Several aspects of the novation request must be reviewed before a modification accepting the change in ownership can be issued. These include:

- Compliance with the procedures in FAR 42.1204, *Agreement to Recognize a Successor in Interest*
- Verification of the successor's capacity to perform the contract
- Analysis, and perhaps audit, of the successor's financial condition, and
- Confirmation by agency legal officials that the transfer is consistent with all applicable Federal and state laws.

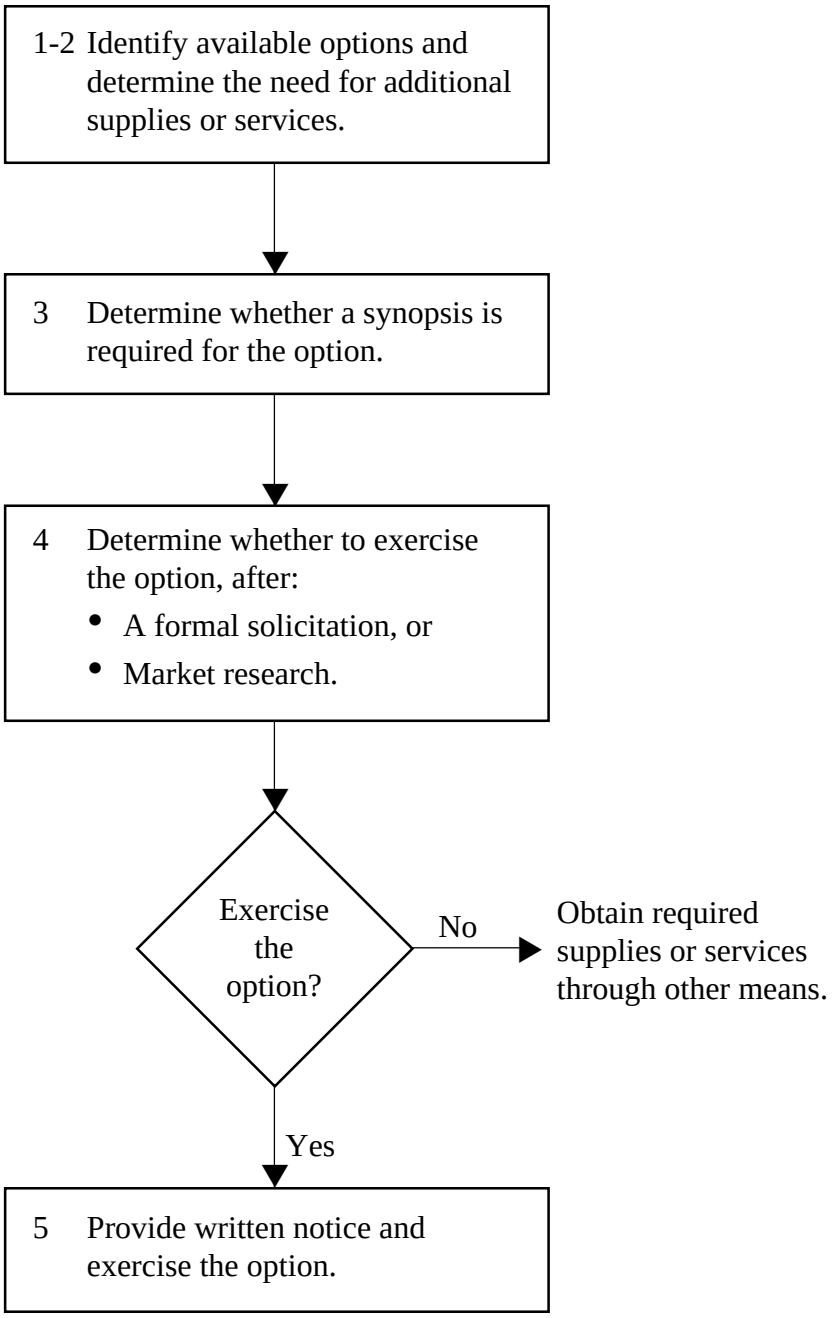
A novation request normally is the responsibility of the agency having the greatest volume of contracts in force with the contractor. If all aspects of the novation are acceptable, that agency will issue a SF 30 modifying all affected contracts.

Other Administrative Changes

Other examples of an administrative change are:

- Substitution of a new COR/COTR for one named in the contract
- Correction of a typographical error in the citation of a specification
- Changing the mailing address where invoices are to be sent
- Acknowledging a name change of the contractor
- Actions requiring formal contracting officer approval under the contract, such as accepting a replacement under the key personnel clause.

STEPS FOR EXERCISING CONTRACT OPTIONS



PART B—CONTRACT MODIFICATIONS (OPTIONS)

14B.1 IDENTIFY OPTIONS IN THE CONTRACT

FAR 17.204

Options provide the Government with firm prices or a schedule of costs for additional quantities or periods of performance, but only for a specific period of time. That time period may extend beyond the basic contract period and must be identified in the contract. The inclusion of options also must be described in the synopsis for the original procurement.

Options can be incorporated into fixed-price and cost-reimbursement contracts at the discretion of the contracting officer and when consistent with agency policy. Normally, the total length of the base and option periods cannot exceed 5 years in the case of services or the total quantity cannot exceed requirements for 5 years in the case of supplies.

There are four standard FAR clauses that pertain to options. These are summarized in Exhibit 14B-1. Read the clause provided in the contract carefully because the contracting officer has the discretion to alter the language to some degree to fit a particular situation.

FAR 52.102-1(b)(2)

If the clause is incorporated by reference, it is the standard clause without adaptation.

If a contract contains an option clause, care must be taken to make a timely decision on whether or not to exercise the option. This decision will be based on which alternative, exercising the option or initiating a new procurement, is more favorable to the Government's interests.

14B.2 DETERMINE THE NEED FOR THE ADDITIONAL SUPPLIES OR SERVICES

Several steps are required before deciding whether to exercise the option. First, you must consult the requiring activity to verify that:

- The requirement covered by the option fulfills an existing Government need, and
- Funds are available for exercise of the option.

Standard Contract Clauses for Options		
Clause	**Use**	**Substance**
FAR 52.217-6	Used for option quantities expressed as a percentage of the basic contract quantity or as an additional quantity of a specific line item	Specifies that— • Contracting officer may increase the quantity at the unit price specified • A written notice within a specified time must be given to the contractor prior to exercising any options • Option deliveries must be at the same rate as the basic requirement unless the parties agree otherwise
FAR 52.217-7	Used if the contract— • Is not a service contract, and • Has an option identified as a separately priced line item with a corresponding basic line item	• Calls for a written notice within a specified period of time • Specifies that option deliveries will be at the same rate as the basic requirement unless the parties agree otherwise
FAR 52.217-8	Used if the contract is for recurring and continuing services to assure continued performance in the event of delays in the follow-on procurement process	• Limits the total extension of line item services to 6 months • Provides for a written notice within a time frame specified in the contract schedule • Allows adjustment in line item prices only for Service Contract Act wage rates
FAR 52.217-9	Used if— • There is start-up or phase-in work, or • Contract extensions should be addressed, and • The contract is for services	• Provides for a preliminary written notice of the Government's intent to exercise the option 60 days before contract expiration • Specifies a time frame for exercise of the option • Limits the total contract duration to a specific time frame • States that a contract extension extends the option as well

Exhibit 14B-1

14B.3 DETERMINE IF A SYNOPSIS IS REQUIRED

FAR 5.202

Prior to exercising an option, a notice in the *Commerce Business Daily* is required for options over $25,000 unless:

- The original contract synopsis provided sufficient detail on the option, or
- Another synopsis exception applies.

Additionally, you may use a "sources sought" announcement as a market research tool. See section 14B.4.

14B.4 DETERMINE WHETHER TO EXERCISE THE OPTION

You must exercise an option exactly as it is stated in the contract. You may not reduce quantities or the period of performance unless the option itself, not the basic contract, authorizes a reduction. You may *never* order more than the quantity or performance period stated.

You may *not* mutually agree to vary the price or any other term or condition for the additional quantity or continued performance period *except* for:

FAR 22.1001

- Any increase in wages contained in a new wage determination from the Department of Labor when services a contractor will provide under an option are subject to the Service Contract Act, or

FAR 17.207 (b)

FAR 16.203

- Economic price adjustment, but only if the
  - — Contract contains specific terms that allow economic price adjustment in contract prices, and
  - — Contractor specifically requests a price revision in strict compliance with those contract terms.

Factors to Consider

In deciding whether or not to exercise an option in response to a continuing need and the availability of funds, there are two additional factors to consider:

- Contractor performance—The contractor may be delivering products or services that are only marginally satisfactory. On a cost-reimbursement contract, the contractor may not be properly controlling costs. It may be to the Government's advantage to initiate a new solicitation.
- Improved market conditions—When exercising an option, you save considerable time and administrative expense. However, if market conditions changed favorably for buyers of the supplies or services contained in the option, the savings realized by issuing a new procurement may be worth the time and trouble of a resolicitation.

Preliminary Market Considerations

If market conditions may have changed:

1. Consider if the terms of the option reflect current market conditions by reviewing whether:
   - Options were considered in evaluating the basic contract award, and
   - The time between contract award and the option exercise is negligible.

FAR 17.207(d)(2)

2. Consider if informal market research might reveal improved market conditions. Some factors to consider for informal investigation of market prices are contained in Exhibit 14B-2.

Factors For Obtaining Comparative Data For Option Prices

- The relationship of the option price to the price for the initial contract period
- The adequacy of competition at the time of initial award as compared with the competition at the time of the potential option exercise
- Changes in the general economy with a potential effect on the cost of performance
- The findings of an informal poll of other contracting activities surveying significant changes in offered prices for similar items or services
- Potential savings in administrative costs of exercising the option as compared with awarding a new contract, including service disruption costs
- Administrative or budget constraints that cause an inability to process a new solicitation

Exhibit 14B-2

FAR 15.404

When the contract award was noncompetitive, your informal research is primarily to identify whether any competitors have entered the market. Your primary tool in seeking new competition is a "sources sought" synopsis, in which you describe the services and request interested and capable suppliers of those items or services to respond. This avoids the expense of a formal solicitation if you determine no other sources are available.

Formal Solicitation

FAR 17.207(d)(1)

Use a formal solicitation only if you do not obtain sufficient data through an informal investigation. Use it when there is no other way of confirming that the option price is at least equal to current market prices.

The Government's right to exercise an option may not be decided prior to when a preliminary notice is required. In this case, discontinue the option unless the contractor is willing to waive its right to the preliminary notice. The Government's right to exercise an option when the actual date for the expiration has passed cannot be restored. Items or services under the expired option must be procured through another contracting procedure.

14B.5 PROVIDE WRITTEN NOTICE AND EXERCISE THE OPTION

FAR 17.207

The standard FAR option clause for services that would extend the term of the contract requires preliminary notice. Refer to Exhibit 14B-1. The specific time period used most often is "60 days before the contract expires." You must provide notice within the time frame specified or lose the Government's unilateral right to exercise the option. You could still exercise the option bilaterally, but the contractor would have to specifically waive its right to the preliminary notice.

New Wage Determinations

If the basic contract contained a Service Contract Act wage determination, then the option will probably also requires one. The only time it will not is when:

- The basic contract contained both supplies and services, but the option applies only to supplies
- No personnel within the service categories subject to the Service Contract Act will be used to perform services contained in the option.

An example of when the last exception would apply is when both professional services and services subject to the Service Contract Act are in the basic contract, but only professional employees will be used to provide services contained in the option.

When in doubt, question the contractor on the categories of labor it uses in performing specific option services.

When filling out the SF 98a, *Notice of Intention to Make A Service Contract and Response to Notice*, indicate "Mod—Exercise of Option" in Block 2 of the form, which asks for the estimated solicitation date.

Option Exercise

To exercise a contract option, use SF 30 or the form that your agency prescribes for modifications. This ensures that everyone who was provided a copy of the basic contract is aware that the option was exercised. It also provides the most uniform way of documenting it. Generally, follow the procedures for implementing unilateral contract modification changes. In rare instances you will be issuing a bilateral modification so the contractor can acknowledge that it has waived a required preliminary notice. In these cases, follow the procedures for implementing supplemental agreements.

Before presenting the SF 30 to the contracting officer for signature, double check to ensure that there is enough time to provide it to the contractor within the period specified by the terms of the contract. Provide a note to the contracting officer calling his or her attention to the expiration date.

File Documentation

FAR 17.207(f)

When exercising an option, you also must prepare a written determination for the contracting officer's signature. Exhibit 14B-3 provides content requirements for this determination.

Content Requirements For a Determination to Exercise an Option

Determinations to exercise options must show a positive assessment in regard to the following:

1. The option exercise complies with the terms of the option
2. Funds are available
3. The requirement covered by the option fulfills an existing Government need
4. The exercise of the option is the most advantageous method of fulfilling that Government need, price and other factors considered
5. The option exercise was synopsized or a reference is cited to the exception that authorized not synopsizing
6. The option exercise complies with the requirements of FAR Part 6 regarding full and open competition

Exhibit 14B-3

CHAPTER 15

CONTRACT REMEDIES

WHEN IS A DEFECT?

Because the Tutors-R-Us (TRU) computer controversy had been settled prior to the time for the pilot training session, no stop work order was needed. Ernest was relieved. He knew that delays in contract performance could have a "ripple" effect on costs not directly associated with the work that was stopped, and these were often hard to pin down.

Of course, if the work was not to be resumed, there was no "ripple" effect. Such had been the case on the first task order under the Tally-Up accounting contract. Bea Ware had issued a Stop Work Order orally, with Mr. Hy Upp's oral approval, as soon as she had heard and confirmed that Down-Hill Industries had filed for bankruptcy. She did this even though she already had determined that it was necessary to terminate the task order for the convenience of the Government. Termination notices require legal approval. Obtaining the approval and issuing the written termination notice would probably consume several work days—work days she did not want to pay for under the terms of that cost-reimbursement contract.

Ernest and Bea sent the Tally-Up Stop Work Order documentation through for approval and issuance at the same time as the termination for convenience paperwork.

Meanwhile, performance under the TRU contract had continued. Although the pilot training course had been a huge success, Jack B. Pickee, the COR, had noted some minor deficiencies. The way in which the user must transfer data among several of the programs was not covered—this was clearly required by the statement of work. Jack also pointed out that additional coverage on compiling a table of contents was needed. Ernest could find no mention of a requirement to cover table of contents compiling in the statement of work.

When questioned, Jack pointed out that the agency head had directed that all documents over 10 pages must have a table of contents, so it was basic information that the students needed to know.

Jack had already provided his short list of deficiencies to the TRU project manager. He considered the defects as minor, but stipulated that acceptance of course development work was contingent on the correction of these two deficiencies.

Ernest reviewed the two deficiencies using the guidelines in Exhibit 15-12 of Bea's text. If they were truly minor defects, Jack's action was appropriate.

continued . . .

"Is TRU really responsible for providing table of contents training?" Ernest asked Bea after updating her on the facts.

"Since there's no mention of it in the statement of work, it's appropriate only if compiling a table of contents is normally considered a part of basic-level training within the computer industry. When the statement of work is silent on an issue, the standard of acceptance is the industry norm—if there is one," Bea advised.

"So what do we do now, Chief?" Ernest asked.

"We sit tight." Bea responded. "It is now up to TRU to question its appropriateness. At this point, we don't have much time to search for an industry norm. And it may not be necessary. TRU has recourse through contract terms and conditions if they think a Government action is inappropriate and detrimental to their interests."

"The good business working relationship we maintained with them during the computer controversy and the extra effort it would take to document what the industry norm is in regard to table of contents compilation will probably be factors they'll consider if they don't agree with our action," Bea added.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Select and pursue a formal contract remedy for a performance problem.

Individual: In regard to modifying the contract to make contract changes:

15.1 Identify remedies that might be appropriate.

15.2 Issue a stop work order, if needed.

15.3 Issue a cure or show cause notice, if appropriate.

15.4 Determine if liquidated damages are appropriate and prepare the notice.

15.5 Reject nonconforming supplies or services.

15.6 Pursue Government rights under express warranties.

15.7 Pursue Government rights under implied warranties.

15.8 Determine the appropriate remedy if acceptance resulted from fraud, gross mistake, or a latent defect.

INTRODUCTION TO CONTRACT REMEDIES

Definition of Government Contract Remedy

Government contract remedies are forms of relief the Government can seek to compensate for a contractor's nonperformance or noncompliance with a contract term or condition. These forms of relief derive from contract clauses or basic rights provided in Government contract law and, occasionally, in commercial contract law.

Government Policy on Choosing Contract Remedies

There are certain policies that are standard in seeking contract remedies. These require that you:

- Document and verify the sufficiency of evidence for the remedy sought
- Notify the contractor of the Government's intentions to seek relief, and
- Seek and obtain contractor feedback on the proposed Government action.

The preferred approach is to reach mutually agreeable solutions to problems rather than taking unilateral action. However, unilateral Government action is sometimes needed.

This chapter outlines remedies not covered in other chapters:

- Stopping contract performance temporarily, if required
- Issuing preliminary notices before default actions
- Assessing liquidated damages
- Rejecting work and demanding rework
- Accepting work with minor defects for a reduced contract price or other consideration
- Pursuing rights under a warranty, and
- Seeking postacceptance relief from
  - — Latent defects
  - — Fraud, or
  - — Gross mistakes of the contractor.

Steps in Performance

The beginning steps in taking remedial actions are charted on the next page. The steps in implementing specific remedies are charted and discussed in the sections that follow.

STEPS FOR CHOOSING REMEDIES

1 Identify one or more contractual remedies that may be applied.

2 Decide if a stop work order should be issued.

3 Select and implement the appropriate remedy.

Remedies

1. Stop Work Notice.
2. Cure or Show Cause Notice.
3. Liquidated damages.
4. Rejection of noncomforming supplies or services.
5. Invocation of rights under an express warranty.
6. Invocation of rights under an implied warranty.
7. Remedies for fraud, gross mistake, or latent defect.
8. Any other remedy specified in the specific clause at issue.

CONTRACT REMEDIES

15.1 IDENTIFY APPLICABLE REMEDIES

Monitoring contract performance may result in identifying performance failures or other breaches of contract terms, such as:

- Anticipated or actual late delivery
- Failure to adequately control costs, or
- Unsatisfactory performance.

The Government has several methods at its disposal to remedy a given situation without resorting to terminating the contract. Remedies include:

- Issuing cure or show cause notices
- Imposing liquidated damages
- Rejecting nonconforming supplies or services
- Invoking written warranties
- Invoking implied warranties
- Taking action for latent defects, fraud, or gross mistakes.

Each of these remedies will be discussed in this chapter. Other remedies have been discussed in other chapters. These include:

- Reducing progress payments and disallowance of costs, in Chapter 11.
- Violations of the drug-free workplace and failure to provide notice of inventions, in Chapter 5.
- Reducing award and incentive fees, in Chapter 12.

In addition to the remedies listed above, it may be necessary to issue a stop work order to mitigate the effects of a contractor's noncompliance with, for example, safety regulations. Stopping work is a remedy that is taken ***in addition*** to any others that may be appropriate to address the basic problem.

These formal remedies apply primarily to fixed-price contracts. However, most also apply to cost-reimbursement contracts, at least under certain circumstances. For example, liquidated damages can be assessed under a cost-reimbursement contract if it contains the clause at FAR 52.219-16—*Small Business Contracting Plan* (see Chapter 3).

The more common remedy under a cost-reimbursement contract is to disallow costs that are unreasonable, including those claimed for products and services that are late, poor in quality, or outside the scope of work (see Chapter 8).

15.2 ISSUE A STOP WORK ORDER, IF NEEDED

A stop work order is a unilateral order of the contracting officer requiring the contractor to stop all or any part of the work called for under a Government prime contract or subcontract that contains a stop work clause.

FAR 52.212-13

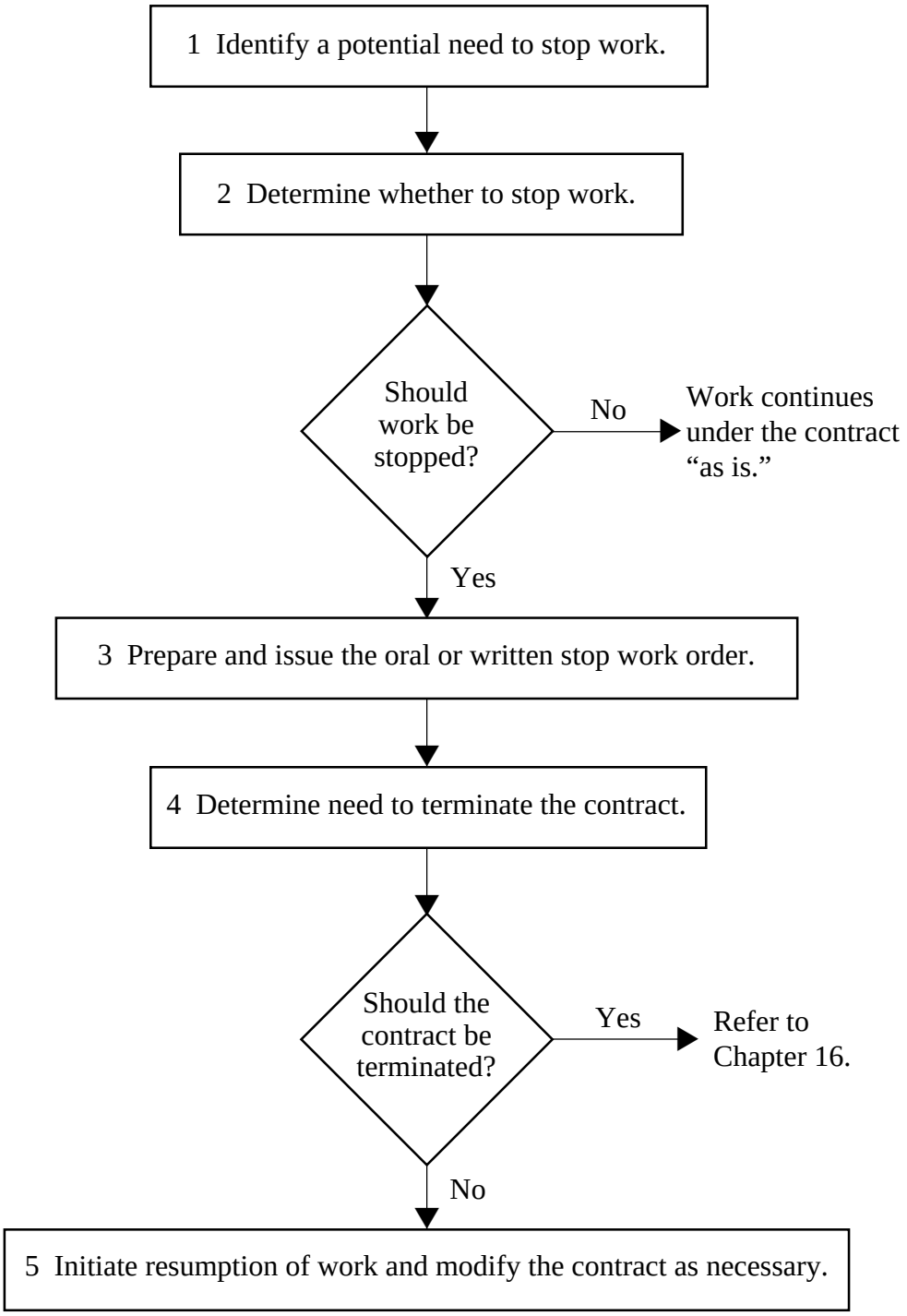
The standard stop work clause can be incorporated in fixed-price and cost-reimbursement contracts. It's use is optional, however, so not all contracts contain this clause.

One of the first issues you must deal with when a serious problem surfaces is whether the contractor should continue performance. Some of the questions you need to ask are:

- How serious is the problem?
- How long will it take to correct the problem?
- Which is more costly to the Government—paying additional money for stopping the work until the problem is fixed or paying money for the work to be corrected later?

You are responsible for making decisions that are in the Government's best interest, not only as that interest relates to one contract, but as it relates to the Government's overall well-being.

STEPS IN ISSUING A STOP WORK ORDER



Identify a Potential Need to Stop Work

The necessity for a stop work order can result from actions initiated by either Government or contractor personnel.

FAR 12.503

1. **Government actions necessitating a stop work order.** These include actions taken by the contracting office on its own initiative, for example, to reduce Government liability when:

   - Correction of defective specifications is necessary
   - Government-furnished supplies or services will be delivered late
   - Termination for default is being considered (provided that the stop work order is not used in lieu of termination)
   - There is lack of progress or deficient performance that appears to be correctable
   - Cost/funding limitations on cost-reimbursement contracts have been reached.

   The contracting office may also take action when other Government organizations disclose the need for a stop work order. Examples are when:

   - Quality assurance or inspection personnel notify the contracting office that the production line must be stopped for tool calibration.
   - Requiring activity notifies the contracting office that it needs time to initiate changes that may substantially alter the end product or service.

2. **Contractor actions necessitating a stop work order.** For example:

   - The contractor submitted a value engineering proposal that will take the Government time to totally evaluate, but that appears to offer a production or engineering breakthrough that would be in the Government's interest to pursue.
   - The contractor notifies the contracting office of conditions at a Government work site that make the performance of work unsafe and are not immediately correctable.

FAR 52.233-3

A stop work order also may be issued if a protest is received after an award.

You should issue a stop work order only if you cannot negotiate a satisfactory supplemental agreement with the contractor to achieve the same result or, if there is time, to negotiate without harm to the Government.

Establish a Time Frame for the Work Stoppage

There is an automatic 90-day period for work stoppages. The 90-day period can be changed as follows:

FAR 12.505(b)

- The Government may cite a lesser period at the time the stop work order is issued
- The Government may cancel the stop work order before the expiration of the 90-day period
- The Government ***and*** the contractor may extend the period by written agreement.

The Government should cite a lesser amount of time if a precise time can be determined. The contractor will be better able to plan and hold down any costs associated with the work stoppage if it has a more precise estimate of the time involved.

Determine the Impact of Stopping the Work

Work stoppages should only occur after the Government has made a determination of the potential impact. Factors that determine impact are listed in Exhibit 15-1.

Factors That Determine Stop Work Order Impact

1. Estimated cost for delaying the work
2. Potential effect on labor (loss of skilled labor, loss of efficiency, and so forth)
3. Potential damage to perishable goods
4. Estimated effect on overhead (inventory, indirect labor, etc.)
5. Any adverse effects of the potential delay on contract completion

Exhibit 15-1

Decide and Document Whether or Not to Stop Work

You are now ready to make a decision based on an estimation of the risks and benefits involved in letting the work continue versus those involved in halting it. This risk/benefit analysis involves several areas of consideration:

- **The origin or purpose for stopping work—**This may override any other consideration. An example would be when the Occupational Safety and Health Administration orders a Government job site closed.
- **A cost assessment—**Analyze the estimated cost for work stoppage versus the cost of the Government's liability if it lets the work continue.
- **Other alternatives—**There may not be other alternatives, but often there are. A Termination for Convenience may be a practical alternative, for instance.

In documenting the risk/benefit analysis for other alternatives, include documentation of why a supplemental agreement that redefines contract requirements and makes an equitable adjustment, for example, is not possible.

You may not issue a stop work order unless certain prerequisites exist, as shown in Exhibit 15-2.

Prerequisites for Issuance of a Stop Work Order
FAR 12.503

- There is a clause in the contract that allows the Government to issue a unilateral order to stop work
- It is advisable to suspend work pending a decision by the Government
- A supplemental agreement covering the suspension is not feasible
- The issuance of the stop work order is approved at least one level above the contracting officer

Exhibit 15-2

Document the reasons for that determination as the most cost effective or practical solution to the problem.

Issue the Order, If Appropriate

Contracting officers can issue stop work orders orally or in writing.

Oral Orders

Highly urgent reasons, such as life-threatening safety violations, may make oral orders necessary. Contracting officers should issue oral orders only when the situation precludes the preparation and issuance of written ones. The decision to issue an oral order should be based on minimizing Government cost liability. Immediately follow up oral orders with written ones.

Before issuing oral orders, the contracting officer should attempt to get the oral approval of the agency official charged with approving written stop work orders.

Written Orders

FAR 12.503

Whether you issue a written order initially or are following up on an oral order, include all of the content requirements listed in Exhibit 15-3. Oral orders should also cover as many of these minimum content requirements as is practical.

Orders should be followed up, when feasible, with further information on the time frame for the duration of the stop work order. For instance, if a contract is stopped because of realignment of program priorities within an agency due to budget cuts, there may not be a resumption of work at all. In situations like this, keep the contractor informed of the other alternatives that the Government may be considering. This will allow the contractor to make better business decisions in regard to its other commercial and Government work.

Contractor's Written Acknowledgement

Regardless of whether you present the stop work order to the contractor in person or send it, make sure you obtain the signature of a contractor employee acknowledging receipt of the stop work order. Without this acknowledgement, your documentation is incomplete as to when the stop work order actually became effective. You need to establish when the Government is released from the responsibility for payment of any costs incurred for contract work as a result of the stoppage.

Minimum Content Requirements for a Stop Work Order
FAR 12.503(c)

1. The effective date and time
2. Nature or reason for the stop work
3. A description of the work to be suspended
4. Instructions concerning the contractor's issuance of further orders for materials or services
5. Guidance to the contractor concerning subcontractors
6. Other suggestions to the contractor for minimizing costs
7. When a written order follows an oral one, the written order should reference the oral order by identifying:
   - The date and time of the oral order
   - Who conveyed the order for the Government
   - The contractor employee who was given the oral order
   - The method of transmission (for example, telephone, personal conference, and so forth)
   - The location where the oral order was presented in person, if applicable

Exhibit 15-3

Discuss the Order With the Contractor

FAR 12.503(d)

You must fully inform the contractor of all the circumstances and considerations that led up to the issuance of the stop work order and to identify other factors that you may have overlooked. In the interests of minimizing disruption and promoting better planning for both parties, your goal should be to keep the lines of communication open. At a minimum, include in your discussions those topics listed in Exhibit 15-4.

Do not commit to covering any specific costs for delay and disruption unless the contractor provides full written justification, or unless such justification is very obvious.

Topics for Stop Work Order Discussions with Contractors

- Fully discuss the reasons for issuing the stop work order
- Explain the factors being considered, the time frame, and the degree to which the outcome is certain or subject to revision
- Explore the appropriateness and the impact of possible time frames for the work stoppage
- Obtain an estimate of labor and other costs due to the work stoppage
- Discuss any alternate actions to continuing the stop work order, and ask the contractor for suggestions
- Investigate the contractor's amenability to bilaterally extending the stop work order beyond a 90-day interval in the event that becomes necessary
- Discuss the type of costs that the Government can agree to cover and those for which it is unable to provide compensation

Exhibit 15-4

Decide Whether to Terminate

After temporarily stopping work, you may determine that it would be best to terminate the contract. Any decision to terminate should be made and formally initiated within the period of the stop work order. Preliminary actions for termination are covered in the next section. Termination procedures themselves are covered in Chapter 16.

Resume Work/Modify Contract

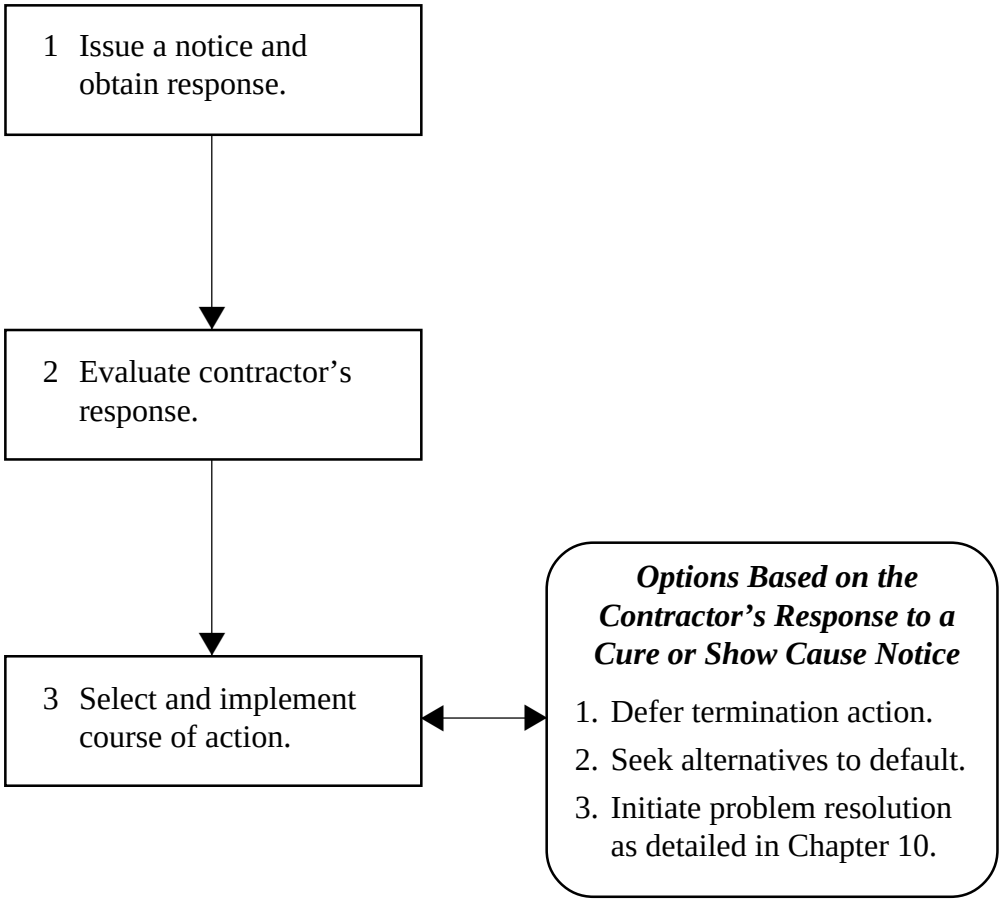
FAR 52.212-13

The contractor should only resume work:

- Upon receipt of a notice canceling the stop work order, or
- When the period of the stop work order as initially written, or formally extended, expires.

You may need to modify the contract to make an adjustment in cost/price or schedule to account for the stop work period, or to terminate the remainder of contract performance. The contractor is entitled to an equitable adjustment in schedule and price should work be resumed following a stop work order. The contractor also is entitled to payment for reasonable costs incurred during the stop work period whether work resumes or not.

STEPS IN ISSUING A DELINQUENCY NOTICE



15.3 ISSUE A CURE OR SHOW CAUSE NOTICE, IF APPROPRIATE

A delay in accomplishing contract requirements, whether due to lack of progress or the rejection of deficient deliverables, may require corrective action. If the delay is excusable under the terms of the contract—because of Government error or causes beyond the contractor's control—a revised delivery date can be negotiated.

When the delay or late delivery is nonexcusable under the terms of the contract, you basically have three remedies as outlined in Exhibit 15-5.

Remedies for Late Delivery

Remedy	Considerations for Use
1. Defer any action or officially extend the delivery date in exchange for consideration	Appropriate when (1) there is a reasonable probability of delivery by the new date, and (2) the requiring activity can live with the new date
2. Accept late delivery and invoke the Liquidated Damages clause if one is included in the contract	But only if there is a reasonable probability of delivery by a date that the requiring activity can tolerate
3. Pursue termination of the contract	When there is little probability of delivery by a date that the requiring activity can tolerate and/or the contractor has not offered adequate consideration

Exhibit 15-5

Often you would only obtain enough evidence to decide among these remedies by issuing delinquency notices to the contractor and getting an official response from its top management.

Contractors should be notified of the possibility of being terminated for failing to perform their contractual obligations. Notification will take one of two forms:

- Cure notice, or
- Show cause letter.

FAR 49.402-3

FAR 49.403

If practical, a cure notice is to be provided to the contractor under either a fixed-price or cost-reimbursement contract at least 10 days prior to invoking the Default clause. A show cause notice is issued only when less than 10 days remain, and only for fixed-price contracts. A cure notice is not required prior to termination under a fixed-price contract when the contractor fails to meet the delivery schedule unless the Government has somehow indicated late delivery is acceptable.

Cure Notice Issuance

A ***cure notice*** is used when:

- The contractor fails to make progress and performance is endangered
- The performance problem does not involve delivery requirements
- At least 10 days remain for contract performance and correction of the problem can reasonably be expected to take place within the time remaining, or
- The intent is to terminate the contract prior to the delivery or completion date.

Cure Notice Requirements

FAR 49.607(a)

At a minimum, a cure notice must:

- Specifically state the failure you believe is endangering performance
- Allow the contractor at least ten days to "cure" the failure, and
- Be in writing and sufficient to support a default termination.

Format

The FAR format for a cure notice is contained in Exhibit 15-6.

Restriction

After a cure notice has been issued, you cannot terminate the contract until the 10-day period has been completed unless there is evidence of wrongful conduct or repudiation by the contractor.

Show Cause Issuance

FAR 49.607(b)

A ***show cause notice*** is used when there is insufficient time remaining in the delivery schedule for the contractor to cure or correct the delinquency. Less than 10 days is usually considered an insufficient time. However, you may use a show cause notice if you can document that the remaining time is insufficient, even if it is more than 10 days.

The notice must afford the contractor an opportunity to provide evidence the delinquency was beyond its control.

Format for a Cure Notice
FAR 49.607(a)

You are notified that the Government considers your _____ [specify the contractor's failure or failures] a condition that is endangering performance of the contract. Therefore, unless this condition is cured within ten days after receipt of this notice [or insert any longer time that the Contracting Officer may consider reasonably necessary], the Government may terminate for default under the terms and conditions of the _____ [insert clause title] clause of this contract.

Exhibit 15-6

Show Cause Notice Requirements

At a minimum, a show cause notice should:

- Inform the contractor of its liabilities in the event of default
- Request the contractor to "show cause" why the contract should not be terminated for default
- Inform the contractor that failure to explain the cause of the deficiency may be taken as admission that no valid explanation exists, and
- Invite the contractor to discuss the matter at a conference, when appropriate.

Format

The FAR format for a show cause notice is shown in Exhibit 15-7.

Distribution of Both Notices

Send both notices using a proof of delivery method.

Copies of either notice must also be sent to:

FAR 49.402-3(e)(4)

- When the contractor is a small business, the contracting office's small business specialist and the Small Business Administration Regional Office nearest the contractor

FAR 49.402-3(e)(3)

- When a payment and performance bond were required for contract performance, the contractor's surety.

Format for a Show Cause Notice
FAR 49.607(b)

Because you have failed to _____ [insert "perform Contract No. _____ within the time required by its terms" or "cure the conditions endangering performance under Contract No. _____ as described to you in the Government's letter of (date)"], the Government is considering terminating the contract under the provisions for default of this contract. Pending a final decision in this matter, it will be necessary to determine whether your failure to perform arose from causes beyond your control and without fault or negligence on your part. Accordingly, you are given the opportunity to present, in writing, any facts bearing on the question to _____ [insert the name and complete address of the contracting officer] within 10 days after receipt of this notice. Your failure to present any excuses within this time may be considered as an admission that none exist. Your attention is invited to the respective rights of the contractor and the Government and the liabilities that may be invoked if a decision is made to terminate for default.

Any assistance given to you on this contract or any acceptance by the Government of delinquent goods or services will be solely for the purpose of mitigating damages, and it is not the intention of the Government to condone any delinquency or to waive any rights the Government has under the contract.

Exhibit 15-7

Evaluation of Response

A contractor is not required to respond to a cure notice because the contractor is told to correct the problem before the contract becomes delinquent. However, unless the problem is actually corrected, the Government, has the option of issuing either a:

- Show cause notice, or
- Termination notice.

If you choose to issue a show cause notice (either with or without a prior cure notice), the contractor has 10 days to respond. Review typical responses in Exhibit 15-8.

Typical Contractor Responses to Delinquency Notices

- An offer to "cure" performance
- An offer to provide substantial consideration in exchange for relief from some terms or conditions in the contract
- Presentation of a case for an excusable delay or lack of progress
- Agreement with the facts of the notice, but no offered solution
- No response

Exhibit 15-8

Actions After Evaluation

Depending on the response you receive, you may:

- Defer termination action
- Modify the contract
- Begin default proceedings.

Defer Termination Action

Forbearance is the formal term used to describe deferring termination action. This strategy is appropriate when a contractor has provided a workable solution to a deficiency you formally brought to its attention.

Waiving Default Unintentionally

It is possible to unintentionally waive the Government's right to default, under certain conditions. This can happen when:

- The Government fails to terminate within a reasonable time after the conditions for the default occurs
- The contractor relies on the Government's failure to terminate and incurs additional expenses in its continuation of efforts to complete performance
- The Government has indicated a willingness for the contractor to continue performance.

Waiving Default Intentionally

You obviously must think there is a good chance for correction of deficiencies or prefer late delivery to default if you intentionally waive default action. When the Government indicates its concurrence with continued performance, such an indication must be clearly demonstrated to the contractor in order for that indication to constitute a waiver

of the right to terminate. Note that if the Government contracting office does not make such a clear indication, the contractor may choose to discontinue performance.

Protections To protect the Government's right to further action, you must:

1. Provide a notice to the contractor that includes all of the elements contained in Exhibit 15-9
2. Obtain a receipt for the notice, and
3. Continue with default proceedings immediately after the contractor's commitment for correcting performance is over and performance is not corrected.

By outlining the conditions of forbearance, you eliminate the contractor's defense of relying on the Government's inaction as evidence that contract performance is acceptable.

An example of a forbearance notice is shown in Exhibit 15-10.

Necessary Elements of a Forbearance Notice

To ensure preservation of the right to future remedial action for deficient performance, a notice of forbearance must:

- Acknowledge the contractor's stated method for, and commitment to, "cure" performance
- Inform the contractor that the Government is deferring its right to future corrective actions only if the contractor fulfills its commitment to remedy deficient performance
- Declare the Government's intention of pursuing corrective contractual remedies, including default, if the contractor fails to fulfill its commitment
- Document a finding of facts that forms the basis for requiring remedial actions

Exhibit 15-9

Sample Forbearance Notice

Dear Mr. Contractor:

SUBJECT: Contract No. XXX-9X-C-0891, Deficient Performance

This acknowledges your January 18, 199X response to the cure notice issued on January 11, 199X to ABC, Inc.

Your response outlined ABC's plan for making a delivery of the first run of 160 widgets that was due, according to the delivery schedule of this contract, by December 31, 199X, stating, in part, that:

1. The delinquency of the first run of widgets was due to employee absenteeism and overall lack of production during end-of-year holiday season and the late delivery on January 4, 199X, by a material supplier of chemical compound X3-NY that is necessary to complete the final stage of production.
2. Your company "projected" delivery of the first run of widgets by February 1, 199X, by adding a third production labor shift for the five-day work week beginning January 21, 199X.
3. You "projected" the second production run of widgets would be delivered on time on April 1.

In response to these statements, I find the following facts pertinent:

1. Because the holiday season was a well-established fact on June 28, 199X, the day you signed the proposal on which the Government contract award was based, any delay that may have been caused by it is not excusable under paragraph (b) of the Default clause in this contract.
2. Because you offer no explanation for the delinquent delivery of your material supplier, I am unable to determine if its late delivery is excusable under paragraph (b) of the Default clause. Absent evidence to the contrary, I must presume it is inexcusable.

Your use of the term "projected" does not convey to me a firm commitment on the part of the ABC, Inc., to meet the February 1 delivery date for the first run delivery or the contractually scheduled delivery dates for the second and third deliveries. It was only during a telephone conversation on January 15, 199X that you affirmed ABC's commitment to these delivery dates.

Based on this evidence, and in spite of the apparent inexcusability of the delayed shipment, the Government is prepared to temporarily defer default action. However, this forbearance is conditioned on the following events:

1. Delivery of the first run of widgets on February 1, 199X.
2. Delivery of the second and third production runs for the widgets as scheduled in the contract.

If delivery is not made as indicated above, the Government reserves its right to take all remedies available to it under the contract, including the right to terminate this contract for default, and under the general rights provided by Government contract law, based on all of the evidence it has accumulated to date in regard to the initial late delivery and any subsequent late deliveries.

If I may be of assistance in further explaining the Government's position in regard, please contact me.

Sincerely,

Exhibit 15-10

Regaining Government Default Rights

If the Government does waive its right to default, you can regain the right by:

- Unilaterally establishing a new reasonable date for delivery or satisfactory performance (the date must be reasonable considering the contractor's capabilities at the time that the new date is set), or
- Bilaterally establishing a new date for delivery.

Seek consideration from the contractor when establishing a new date. However, the date can be extended without consideration to clearly establish the contractor's obligation and protect the Government's rights to damages.

Seek Alternatives to Termination for Default

FAR 49.402-4

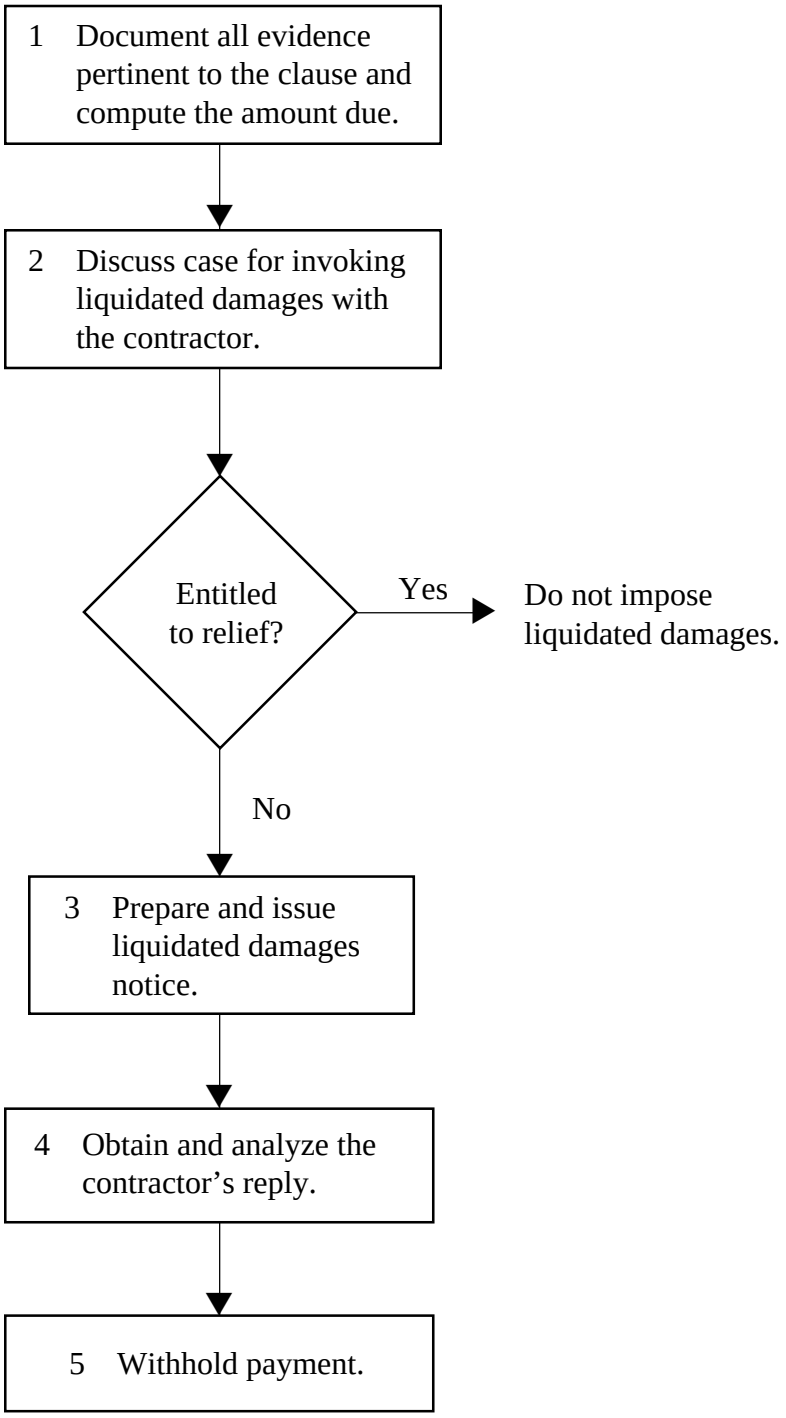
There are other alternatives to termination. You can:

- Establish a revised delivery schedule
- Permit the contractor to use a third party to continue performance
- Cancel the contract at no cost when a requirement is no longer needed.

For any of these alternatives, you tasks would be to:

- Establish the Government's position on any consideration, a new delivery schedule, and/or other terms and conditions
- Negotiate sufficient consideration for relief from terms and conditions that are not met
- Execute a supplemental agreement, and
- Document the file to support your actions.

STEPS IN IMPLEMENTING LIQUIDATED DAMAGES



15.4 ASSESS LIQUIDATED DAMAGES, IF APPROPRIATE

Liquidated damages are a predetermined rate of damages, payable to the Government by the contractor for the contractor's delay in performance or failure to comply.

Liquidated damages due to delay are predetermined when the need for timely delivery or performance is so crucial that:

- The Government would probably suffer damages if the delivery or performance is late, and
- The extent of the Government's actual damages would be difficult or impossible to prove.

Assessment of liquidated damages must be reasonable and considered in light of contract requirements, on a case-by-case basis. Any amount fixed without reference to probable actual damages might be interpreted as a penalty, thereby making them unenforceable.

Liquidated damages can only be assessed when an authorizing clause has been included in the contract. Standard liquidated damages clauses, applicable only to fixed-price contracts, are:

FAR 52.212-4

- FAR 52.212-4, *Liquidated Damages—Supplies, Services, or Research and Development*

FAR 52.212-5

- FAR 52.212-5, *Liquidated Damages—Construction.*

Liquidated damages clauses applicable to both fixed-price and cost-reimbursement contracts are:

FAR 52.219-16

- FAR 52.219-16, *Liquidated Damages—Small Business Subcontracting Plan*

FAR 52.222-4

- FAR 52.222-4, *Contract Work Hours and Safety Standard Act—Overtime Compensation.*

Document All Evidence

Document any evidence of the contractor's failure to deliver the supplies or perform the services within the time specified in the contract, or its failure to comply.

Focus this documentation on:

- The stage of completion
- The probable amount of damages sustained by the Government
- The reason and excusability for a delay or compliance failure
- The contractor's ability to complete the contract.

Compute the Amount Due

When assessment of liquidated damages is appropriate, the contracting officer withholds payment based on an accurate computation of the amount due.

The actual computation depends not only on the specific amount or specific formula in the contract, but also on actual events that occurred during the contract administration phase of the contract.

Identify all factors that control how you must compute these amounts to reflect an accurate maximum amount authorized under a specific liquidated damages clause.

Subtract amounts of time that may have constituted an excusable delay from the period for liquidated damages assessment. When you subtract out time for excusable delay, subtract out calendar days unless the performance is specifically described as "work" days. Holidays and weekends are not considered "work" days.

FAR 12.203(c)

The rate of assessment for liquidated damages may be in two or more increments, providing a declining rate of assessment as the delinquency continues.

Evaluate Calculated Damage Amount

FAR 32.111(c)(2)

Examine the contract for any restrictions. Generally, the contract will restrict the total amount withheld to the greatest amount that can be withheld under the authority of a single clause.

FAR 12.202(b)

To ensure that the total liquidated damages amount is reasonable and not a penalty, you may have special contract terms limiting the overall dollar amount or period of time, or both, for liquidated damages assessment. The courts and administrative boards will not uphold liquidated damages that are so excessive that they can be construed as a penalty.

Discuss the Assessment with the Contractor

After you determine the Government is entitled to assess liquidated damages, discuss the situation with the contractor. Explain your position and provide a chance for the contractor to present evidence to refute that position. Prior to the actual assessment of liquidated damages, advise the contractor of:

- The Government's intention to assess liquidated damages unless the contractor provides evidence to the Government by a specified date that such an assessment would be improper
- The basis or bases for the Government's assessment of these damages, and
- The amount of the planned liquidated damages assessment, detailing the reasons for any reduction in a specified amount stated in the contract.

Prepare and Issue Liquidated Damages Notice

A liquidated damages notice should indicate:

- The reason for assessing the damages provided in the clause
- The dollar amount of damages
- Any steps the contractor may be able to take to avoid further liquidated damages.

By issuing this notice, you are giving the contractor one last opportunity to provide evidence for not assessing these damages or assessing a lower amount.

Obtain and Analyze the Contractor's Reply

A contractor's response may:

- Document a case for an excusable delay
- Claim impossibility of performance, or
- Claim the work is substantially complete.

Liquidated damages are generally not appropriate after the work can be considered "substantially complete." Substantial completion occurs on the day the product is ready for use in the manner intended by the Government at the place required by the contract (for example, f.o.b. destination). The practical basis for this theory is that minor defects that do not affect use are not a reason to continue the liquidated damage period. However, this theory has limited application to supply and service contracts—applying mainly to equipment installation—and is based on boards of contract appeals and court rulings.

Withhold Payment

Based on the evidence you gather, you will either:

- Forego assessing liquidated damages
- Assess a reduced amount, or
- Assess the full amount of liquidated damages.

When you decide that it would be fair to forego a liquidated damages assessment, provide the contractor with a written explanation of the reason. Underscore that this case of nonassessment is not indicative of probable action in other similar circumstances.

Reduced amounts may be assessed when the total amount of liquidated damages is excessive in relation to:

- The total dollar amount of the contract, or
- The probable amount of damages sustained by the Government.

Before you actually make a deduction from any invoice, advise the contractor specifically of the amount the contracting officer has decided to deduct.

When the contractor has been authorized partial payments based on Government acceptance of some of the supplies or services, you may deduct liquidated damages that apply to accepted items or services from the invoice the contractor submits for payment of late partial shipments.

Do not deduct liquidated damages on invoices for progress payments. Liquidated damages deductions are not proper unless the supplies or services on the invoice have been ***accepted*** by the Government, even if acceptance results from a repurchase against the contractor's account. If payment is not due until final acceptance, deduct this amount on the final invoice.

On cost-reimbursement contracts, liquidated damages assessed for failure to pay overtime can be deducted from any subsequent invoices or even from payments due on other contracts held by the same contractor. Liquidated damages for willful noncompliance with a small business subcontracting plan usually are assessed against the final payment after the contractor has had an opportunity to demonstrate it acted in good faith.

15.5 REJECT NONCONFORMING WORK

FAR 46.407

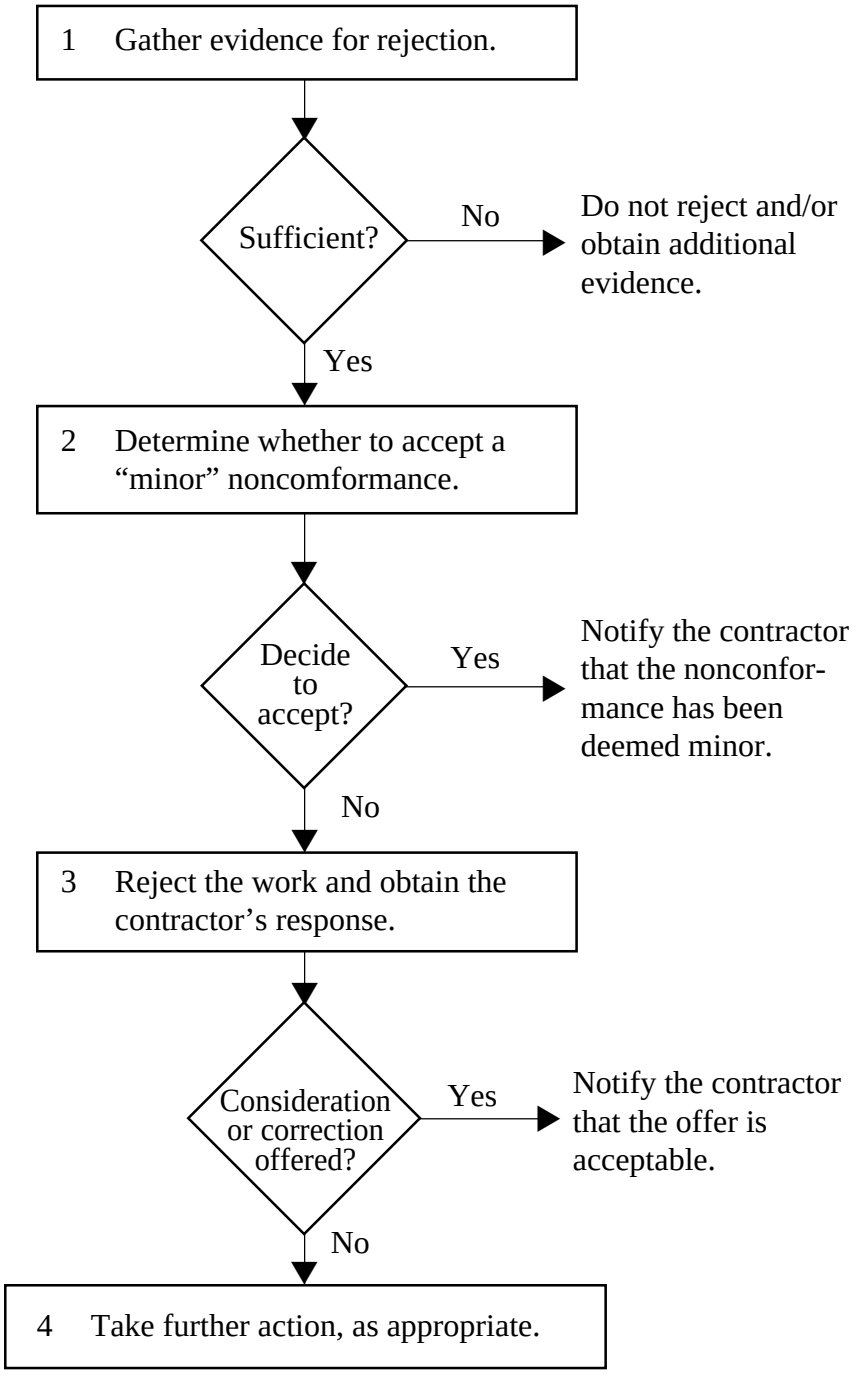
The regulations specifically tell contracting officers to reject supplies or services not conforming in all respects to contract requirements, except as otherwise authorized.

Gather Evidence for Rejection

When the supplies or services do not conform, investigate the circumstances to:

- Establish that acceptance has not already occurred
- Provide a basis for the rejection
- Determine the seriousness of the problem
- Determine if the contractor is at fault.

STEPS IN REJECTION OF NONCONFORMING SUPPLIES OR SERVICES



Previous Acceptance

Supplies or services that do not conform to the terms of the contract should be rejected before acceptance. On fixed-price contracts, you cannot later reject a product or service after it has been accepted—acceptance is final except for:

- Latent defects (not easily discoverable by a reasonable inspection)
- Fraud
- Gross mistakes.

You may not be able to avoid acceptance on fixed-price contracts. Determine if you have the right to reject nonconforming supplies or services by investigating whether:

- The work has already been explicitly accepted
- There is any evidence of implied acceptance by events such as
  - — Silence
  - — Late rejection
  - — Retention and use of delivered items
- The Government has accepted nonconforming work under a prior contract for the same requirement.

Basis for Rejection

The rejection notice must clearly demonstrate the reason for rejection. Supporting documentation must identify specific requirements that were not fulfilled. Inspection and acceptance clauses in the contract provide the basis for rejecting supplies and services as well as the contractor's obligation for correcting them. Defects detected during the inspection and acceptance process are termed ***patent*** defects. Exhibit 15-11 contains a summary of contractor responsibility for patent defects under the various standard FAR clauses.

Criticality of Nonconformance

One area to consider is the seriousness of the deficiency. Consider whether potential problems would be substantial or minor. You may not accept any supply or service when the nonconformance is substantial. Exhibit 15-12 summarizes the decisions that could result from your analysis.

Excusability

Another consideration is who is responsible. Verify that one of the other Government officials involved did not direct the contractor to make any changes.

Contractor's Obligation for Correcting Patent Defects	
Standard FAR Clause	**Time Frame for Correction of Patent Defects**
FAR 52.246-2, Inspection of Supplies—Fixed-Price	Until Government acceptance
FAR 52.246-3, Inspection of Supplies—Cost-Reimbursement	Six months following Government acceptance
FAR 52.246-4, Inspection of Services—Fixed-Price	Until Government acceptance
FAR 52.246-5, Inspection of Services—Cost-Reimbursement	Time frame for required reperformance is uncertain—courts and boards usually consider what is reasonable under specific contract circumstances
FAR 52.246-6, Inspection—Time-and-Materials and Labor-Hour	Six months following Government acceptance
FAR 52.246-7, Inspection of Research and Development—Fixed-Price	Until Government acceptance
FAR 52.246-8, Inspection of Research and Development—Cost-Reimbursement	Six months following Government acceptance
FAR 52.246-9, Inspection of Research and Development (Short Form)	Does not provide for the correction of defects

Exhibit 15-11

Minor Defects		
If. . .	**Then, remedies are. . .**	**Consideration you gain or should demand. . .**
Cost to correct would be less than the cost of modifying the contract	Accept as is or accept conditionally by: (1) Listing the conditions and providing them to the contractor, and (2) Withholding a retainer until conditions are met	Increased efficiency to the Government
Consideration would be greater than the cost of modifying the contract	Accept as is	Consideration comparable to the value of the loss sustained by the Government
Substantial Defects		
If. . .	**Then, remedies are. . .**	**Consideration to obtain for using these remedies. . .**
The contractor agrees to correct the deliverable or reperform the service within the delivery schedule	Withhold acceptance and payment until receipt of the corrected deliverable	Reduction in fee or fixed price for cost to reinspect or monitor service performance again
The contractor agrees to correct the deliverable or reperform the service, but needs a delivery extension	Withhold acceptance and payment until receipt of the corrected deliverable	Reduction in fee or fixed price for: • Cost to reinspect or retest • Appropriate consideration for the delay
Correction is specified under a specific warranty	Accept as is (only if warranty enforcement is ensured)	None
Acceptance: • Would not affect safety or performance, and • Is justified on the basis of economy or urgency	Accept as is	Consideration comparable to the value of the loss sustained by the Government
The contractor refuses to make corrections or provide appropriate consideration	Either: • Accept as is, or • Reject and terminate the contract	Reduce fixed price or fee by the cost of correction

Exhibit 15-12

For instance, a procurement for a firetruck may require the inclusion of 300 feet of hose. If the COR/COTR tells the contractor to provide only 250 feet of hose and in its place provide five fire extinguishers, a constructive change has occurred. The "missing 50 feet of hose" may cause a different inspector to recommend rejecting the truck.

Accept Minor Nonconformance

FAR 46.407(d)

You can accept a product or service when the basis for nonconformance is minor. Generally, a minor nonconformance does not adversely affect:

- Safety
- Health
- Reliability
- Durability
- Performance
- Interchangeability of parts or assemblies
- Weight (if a contract requirement)
- Appearance (if a contract requirement), or
- Any other basic objective of the contract.

FAR 46.407(f)

Minor defects may even be accepted as is without receiving compensation from the contractor. This is appropriate if any contractor savings realized by not conforming to exact requirements are less than Government costs for processing a formal modification.

Formalizing the Consideration

When the value of the deviation exceeds the cost of administrative processing, you must issue a formal contract modification specifying appropriate consideration for accepting the nonconforming deliverable. A downward price adjustment is the most typical form of compensation on fixed-price contracts. A reduction in fee is most typical on cost-reimbursement contracts.

Initiate the action by trying to negotiate a supplemental agreement with the contractor. If that fails, the contracting officer can issue a unilateral modification reducing the contract price or fee. The modification must incorporate a written determination by the contracting officer establishing the Government's claim against the contractor under the Disputes clause or other applicable clause in the contract.

You may not be in a position to determine the seriousness of the nonconformance. You may need to convene a joint contractor-contract administration review group to decide when a nonconformity is minor. Such a group would not have the authority to sanction a serious nonconformity.

Accepting a minor nonconformance on one contract or order does not provide relief for correcting similar defects on pending or future work. Let the contractor know that the Government expects correction of other similar defects before acceptance.

Reject and Notify the Contractor

FAR 46.407(g)

When the nonconformity seriously affects the requirement, you should ordinarily reject the item. It is acceptable to discuss the rejection with the contractor before issuing any written notification. The contractor may have additional information concerning the deliverable such as, for example, specific technical direction it obtained from authorized Government personnel.

The contractor must be notified by the person responsible. See Chapter 7 for details of the rejection notice.

Prompt Notices

The requirement for the Government to give "prompt" notice is measured within the context of the supplies or services that were rejected. The Government may not delay in issuing a rejection notice to the point that the contractor was prevented from reworking or repairing the defective item. In this case, the contractor would have good grounds for asserting that the notice was not prompt. Similarly, a notice is not prompt if the delay caused a contractor additional work or expense.

A rejection notice does not automatically extend the delivery period. The contractor is still required to provide supplies and services which conform to the contract within the delivery schedule.

Make the Final Decision on Acceptance

A contractor may respond to the notification by submitting:

- A proposal to correct the work
- A proposal to provide a downward price/fee adjustment for acceptance
- An offer to analyze and negotiate a revised delivery schedule for a conforming product with consideration
- No reply, or
- A refusal to repair the work or offer any consideration.

Rework

Ordinarily, a contractor is likely to propose correcting the problem through rework. Under a fixed-price contract, the rework would be entirely at the contractor's own expense. Under a cost-reimbursement contract, the Government assumes responsibility for the actual cost of the rework if it agrees to this option, but usually only if the contractor agrees to perform the work at no additional fee.

Take Other Action

If the contractor refuses to offer adequate consideration or correct the nonconformity, the delivery should be rejected and the appropriate additional action taken. This may be issuing a unilateral modification reducing the price or fee or initiating a Termination for Default by issuing a cure or show cause notice. Cite the failure to meet the delivery requirement as the reason.

15.6 PURSUE RIGHTS UNDER EXPRESS WARRANTIES

The Government typically specifies its requirements and validates that they have been met through the inspection and acceptance process. Written warranties limit the Government's risk when relying on the contractor's own inspection methods to ensure the quality of the requirement. A written warranty is an ***express warranty.*** It is:

FAR 46.701

> *"[A] promise or affirmation given by a contractor to the Government regarding the nature, usefulness, or conditions of the supplies or performance of services furnished under the contract."*

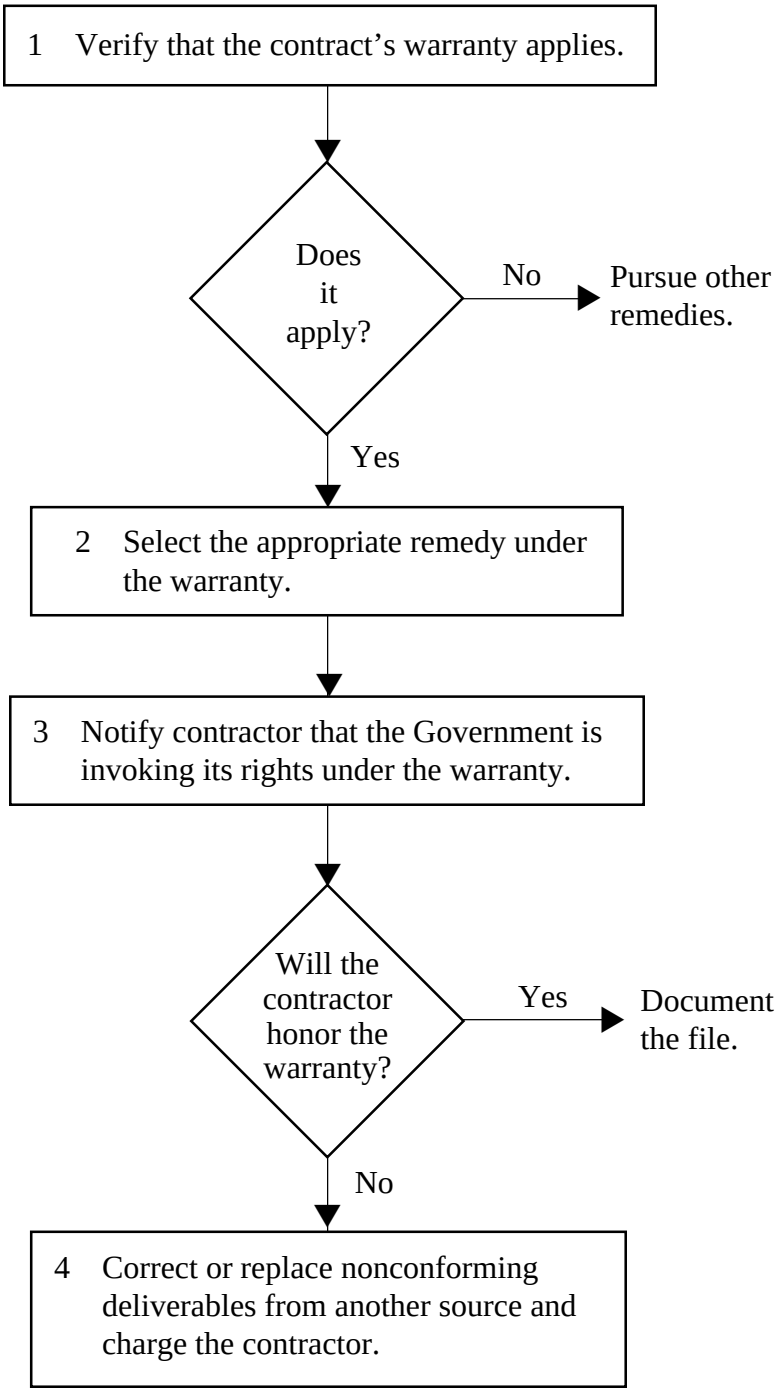
Warranty statements included in the contract define the rights and obligations of the contractor and the Government concerning defective items and services after acceptance. Written warranties extend the Government's right to correction of defects or replacement of the deliverable after acceptance.

Sometimes you will hear the word "guarantee" used interchangeably with "warranty." However, a guarantee is a promise of performance made by a third party, rather than the contractor itself. A surety, for example, provides a guarantee.

A written warranty is the contractor's way of assuring the Government that the product or service:

- Is free from defects in workmanship, and
- Conforms to the requirements of the contract.

STEPS IN IMPLEMENTING EXPRESS WARRANTIES



Forms of Written Warranties

Written warranties can take two forms:

1. Warranty terms in the Government contract, either in
   — Specification/statement of work terms, or
   — Standard or unique clauses that specifically address warranties
2. A contractor's standard commercial warranty incorporated by reference in the contract.

Specification/Statement of Work Language

The Government prefers to use standard clauses or clauses specifically approved by its lawyers to cover written warranties. Nevertheless, you may find other language in the technical requirement that constitutes a warranty. More often than not, however, you will find technical language that attempts to protect the Government from defects discovered after acceptance, but do not. An example of language typically used is:

An Inadequate Example

> *"The contractor's design shall ensure safe, efficient and economical operation under normal operating conditions."*

This example, like many others, is inadequate because it fails to:

- State the duration of the warranty, and
- Specify a period during which notice of any defect must be given to the contractor.

Other practical problems with this attempt at a warranty happen after the Government contends there is a defect. Unless a contract clause also covers warranty issues, it is unclear whether the contractor is expected to replace the item that is defective free of charge, replace it at a reduced rate based on usage to date, has the option of fixing it, and so forth.

You must recognize when attempts at a warranty are unenforceable as well as when enforcing language is legally acceptable. The standard FAR clauses addressing warranties provide tested legal language. These are listed in Exhibit 15-13.

These standard warranty clauses are used only with fixed-price contracts, and only when the use of the clause has been approved by agency procedures. They make explicit the requirement to correct or replace deliverables found defective after acceptance at the contractor's own expense.

Standard FAR Clauses Addressing Warranties	
Standard Warranty Clauses	**Variations**
FAR 52.246-17, Warranty of Supplies of a Noncomplex Nature	Fixed-Price Supply — Alternate I (Commercial Items) — Alternate II (Transportation Costs at Government Expense) — Alternate III (Contractor Only Source) — Alternate IV (Disassembly Required for Inspection or Replacement)
FAR 52.246-18, Warranty of Supplies of a Complex Nature	Fixed-Price Supply or R&D — Alternate I (Commercial Items) — Alternate II (Transportation Costs at Government Expense) — Alternate III (Fixed-Price Incentive Contract) — Alternate IV (Disassembly Required for Inspection or Replacement)
FAR 52.246-19, Warranty of Systems and Equipment under Performance Specifications or Design Criteria	Fixed-Price Supply, Services, or R&D when performance specifications or design are of major importance — Alternate I (Transportation Costs at Government expense) — Alternate II (Fixed-Price Incentive Contract) — Alternate III (Disassembly Required for Inspection or Replacement)
FAR 52.246-20, Warranty of Services	Fixed-Price Services (No variations)
FAR 52.236-23, Responsibility of the Architect-Engineer Contractor	Fixed-Price Architect-Engineer (No variations)

Exhibit 15-13

Types of Warranties

FAR 46.703

Government warranty clauses provide for various types of warranties in supply and service contracts, which generally fall into four basic categories:

1. **Failure-free or hardware warranty.** The contractor accepts the responsibility to correct any failure or defect that occurs during a specific or measured amount of use or operation. Refer to FAR 52.246-17, *Warranty of Supplies of a Noncomplex Nature,* for an example of this type of warranty.

2. **Correction of deficiencies warranty.** The contractor agrees to correct any deficiency in design, material, or workmanship that becomes apparent during the item's test or early operation and results in the item performing below the standard required by the contract. This type of warranty in a major systems contract usually also applies to spare parts and other supplies included in the contract. Refer to FAR 52.246-19, *Warranty of Systems and Equipment under Performance Specifications or Design Criteria,* for an example of this type of warranty.

3. **Supply warranty.** The contractor is obligated to replace or reperform work on contract items if defects in material or workmanship existed at the time of acceptance. This is very similar to a consumer warranty for commercial products. Refer to FAR 52.246-18, *Warranty of Supplies of a Complex Nature,* for an example of this type of warranty.

4. **Service warranty.** The contractor agrees to reperform defective services if defects in workmanship existed at the time of acceptance. This is similar to a repair warranty at a retail establishment. Refer to FAR 52.246-20, *Warranty of Services,* for an example of this type of warranty.

Enforcement

Because end users are the first to identify defects under a warranty, provide them with information such as:

- A summary of warranties that apply to a specific product or service
- Specific components to which the warranty applies, if all components are not included
- Who has Government responsibility to report warranty incidents and who has authority to implement warranty clauses
- Duration of the warranty
- Contact person in the Government procurement office

- Contractor's contact person, if direct contact is allowed
- Documentation and other warranty requirements, and
- Packaging and transportation requirements.

If the contractor's standard warranty applies, obtain a copy for your files and provide a copy to the end user.

Application

Verify that a warranty clause applies to the specific failure. The basic steps in determining applicability are to:

1. Confirm that the Government has officially accepted the items or services
2. Examine the written terms and conditions of the warranty to determine
    - Duration of the warranty
    - Coverage for specific defects
3. Determine if Government obligations under the warranty were met or ensure that they will be met
4. Confirm that the facts support invoking the warranty.

Select the Appropriate Remedy

You need to accurately determine the contractor's responsibilities and the Government's rights under the terms and conditions of the warranty. Warranties may provide alternate remedies such as:

- Repair the defect
- Replace the item
- Reperform the service
- Make an equitable adjustment
- Pay for repairs, replacements, or reperformance the Government has obtained from other sources.

Unless a specific clause states otherwise, the Government has the right to choose the remedy that is in its best interest.

FAR 46.706(b)(2)

The contractor's obligation to repair, replace, or agree to a price adjustment includes the labor and material costs necessary to:

- Reinspect items the Government reasonably expected to be defective
- Repair or replace the defective items, and
- Inspect, package, pack, and mark the repaired or replaced items.

Notify the Contractor

Contact the contractor if there is a warranty problem. Resolve any issue the contractor raises by:

1. Obtaining the contractor's position and its reasons for taking that position
2. Reaching agreement on how and when the warranty will be applied
3. Documenting the results.

There will be less room for argument if you notify the contractor *before* the warranty period expires. Warranties may be administered by other organizations besides the contracting office. A supply organization or the end user with this responsibility may issue the notification to the contractor. Make other Government organizations aware of the need for quick internal Government coordination to ensure that the Government's rights are not lost.

Correct or Replace Nonconforming Items or Services

You may arrange for repair or replacement by the Government or another source at the expense of the contractor, but take this action only as a last resort when other actions have failed.

15.7 PURSUE RIGHTS UNDER IMPLIED WARRANTIES

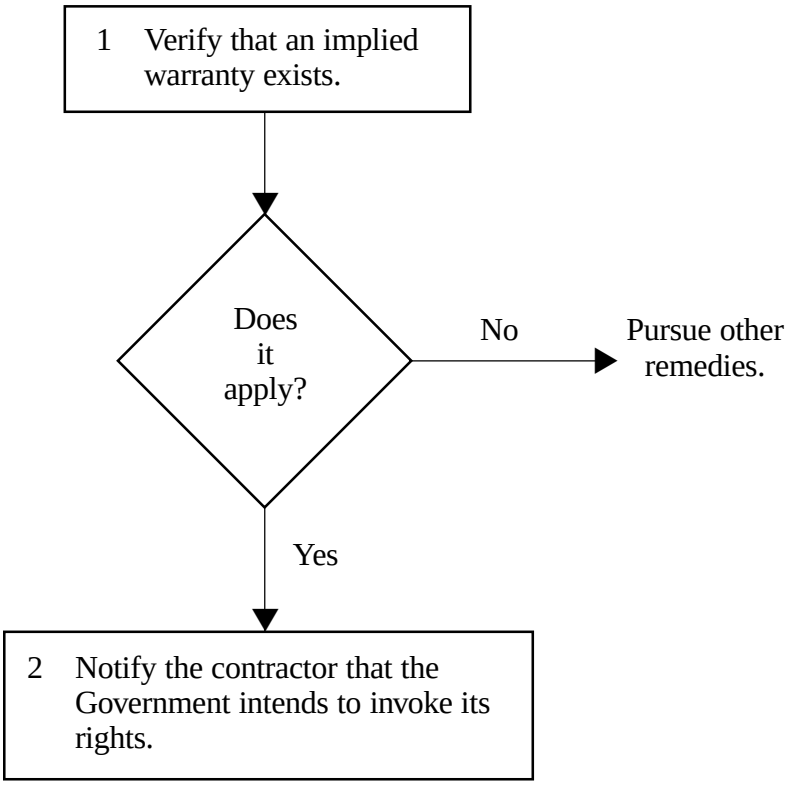
An ***implied warranty*** is one that exists through the operation of commercial law. The legal concept is one of fairness—a product or service should live up to the claims of the manufacturer or service provider. If it does not, the buyer is generally entitled to a legal remedy through the concept of an implied warranty.

Verify that an Implied Warranty Exists

There are two basic implied warranties that the Government, under very limited conditions, can use when a defect is not identified until after acceptance:

1. **Merchantability and usage of trade** (UCC 2-314). The goods must comply with the general description and average quality of other similar goods produced within the industry, and also comply with the description of the label affixed to them. The goods must be fit for the ordinary purposes for which such goods are generally used.
2. **Fitness for a specific purpose** (UCC 2-315). The goods must fit the particular purpose when the Government is relying on the contractor to furnish goods that will be suitable for that purpose.

STEPS IN IMPLEMENTING IMPLIED WARRANTIES



Limited Applicability However, these commercial law warranties only apply to Government contracts if the terms of a Government contract do not provide a specific remedy. Most situations you will encounter during contract administration are covered under the specific terms of the Government contract.

For example, most fixed-price clauses state that acceptance is final. Paragraph (k) of FAR 52.246-2, *Inspection of Supplies—Fixed-Price*, states:

> *"Acceptance shall be conclusive, except for latent defects, fraud, gross mistakes amounting to fraud, or otherwise provided in the contract."*

This language relieves the contractor of any obligation under the commercial concept of implied warranties after acceptance is made—except for the exclusions noted. Under cost-reimbursement contracts, responsibility under implied warranties for defects identified after acceptance is somewhat different—generally, except for fraud, corrective actions will be at Government expense.

Basis of Enforcement

When considering the applicability of implied warranties, remember that all of the standard FAR inspection and acceptance clauses *exclude* implied warranty obligations of the contractor by specifically addressing Government remedies for defects. Those that do not are:

- FAR 52.246-1, *Contractor Inspection Requirements,* and
- FAR 52.246-9, *Inspection of Research and Development (Short Form).*

Either of these clauses can be used with fixed-price or cost-reimbursement contracts. There are relatively few circumstances for which an implied warranty will have much significance under a cost-reimbursement contract, however.

Any kind of a warranty for simple R&D work would rarely, if ever, be an issue. This is because of the experimental nature of the work itself.

When the Government relies on the contractor's inspection system for ensuring the correction of defects, it is more likely that implied warranties might be an available and useful as a Government remedy. For example, the Government does not include an inspection and acceptance clause that addresses responsibility for defects for small purchase orders, but instead includes FAR 52.246-1, *Contractor Inspection Requirements,* that merely states the Government's intention to rely on the contractor for overall inspection and testing of the work. Thus, an implied warranty exists unless excluded by other terms of contract. For example, FAR 52.246-17, *Warranty of Supplies of a Noncomplex Nature,* specifically excludes them.

However, even when the Government has stated its intentions to rely on the contractor for inspection and testing, specific contract circumstances may invalidate the application of commercial law warranties. Therefore, do not seek remedies under implied warranties without the advice of a Government lawyer.

Contact the Contractor

When, with the advice of a Government lawyer, the contracting officer determines that a defect exists that is covered by an implied warranty, notify the contractor. Procedures are basically the same as those for contacting the contractor in regard to written warranties:

1. Obtain the contractor's position and its reasons for taking that position
2. Reach agreement on how and when the warranty will be applied
3. Document the results of this contact and include it in the contract file.

Invoke the Appropriate Remedy

The Government has the same rights under implied warranties as under written ones. The Government may choose to:

- Obtain a corrected product from the contractor
- Have the contractor reperform the service
- Make an equitable adjustment
- Have the product corrected or the service reperformed by other means at the expense of the contractor.

15.8 DETERMINE REMEDIES IF ACCEPTANCE WAS IN ERROR

Under standard fixed-price inspection and acceptance clauses, the Government's acceptance of contractor supplies and services is final unless:

- The defect is latent
- There is evidence of fraud, or
- There is evidence of a gross mistake amounting to fraud.

Verify Whether the Failure Was Due to a Latent Defect

For a defect to be ***latent*** it must be:

- Not susceptible to discovery using inspection methods that are reasonable under the circumstances, and
- In existence at the time of acceptance.

FAR 52.246-5(d)

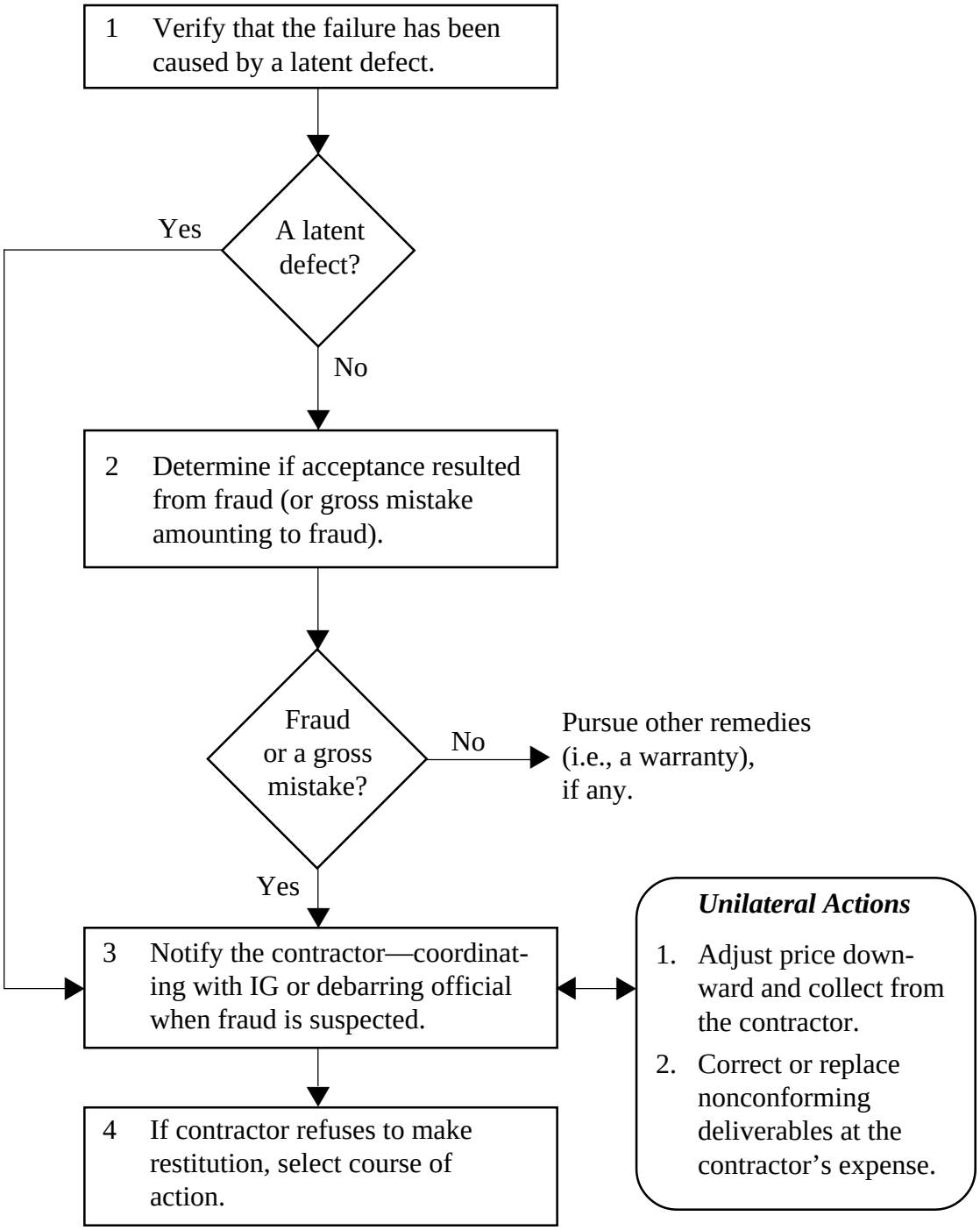
A latent defect can be in the design of a product rather than in the manufacture of it.

FAR 52.246-8(f)

An inspection method is reasonable if it would normally be performed as a custom of the trade.

Deciding what is "latent" is essentially deciding what is reasonable. Exhibit 15-14 summarizes the necessary evidence.

STEPS IN SEEKING REMEDIES FOR FRAUD, GROSS MISTAKE, OR LATENT DEFECTS



Steps in Verifying a Latent Defect

1. Identify the contractor's liability for the defect
2. Determine if the Government has fulfilled its obligations for inspection and acceptance
3. Identify what test could have revealed the defect at the time of acceptance
4. Identify whether such tests would have been reasonable under the circumstances

Exhibit 15-14

Although cost-reimbursement contractors, like fixed-price contractors, have an unlimited responsibility to correct defects concealed through fraud or gross mistakes, their responsibility for latent defects is quite different. Exhibit 15-15 contains a summary of contractor responsibility for latent defects under the various standard FAR clauses.

When there is no expiration to a contractor liability for a latent defect in a supply or equipment item, the extent of that liability is prorated over the useful life of that item.

Determine If Fraud or Gross Mistake Was a Factor

The only difference between ***fraud*** and a ***gross mistake*** is intent. To prove a gross mistake you need only prove that the mistake was truly irresponsible.

To prove fraud, you must show that the misrepresentation or concealment of fact was made with the intent to mislead. Assume gross mistake amounting to fraud when you are unable to establish intent to mislead, but all other factors apply.

Contractors Obligation for Correcting Latent Defects	
Standard FAR Clause	**Time Frame for Correcting of Latent Defects**
FAR 52.246-2, Inspection of Supplies—Fixed-Price	Indefinitely
FAR 52.246-3, Inspection of Supplies—Cost-Reimbursement	Six months following Government acceptance
FAR 52.246-4, Inspection of Services—Fixed-Price	Indefinitely
FAR 52.246-5, Inspection of Services—Cost-Reimbursement	Time frame for required reperformance is uncertain—courts and boards usually consider what is reasonable under specific contract circumstances
FAR 52.246-6, Inspection—Time-and-Materials and Labor-Hour	Six months following Government acceptance
FAR 52.246-7, Inspection of Research and Development—Fixed-Price	Indefinitely
FAR 52.246-8, Inspection of Research and Development—Cost-Reimbursement	Six months following Government acceptance
FAR 52.246-9, Inspection of Research and Development (Short Form)	Does not provide for the correction of defects

Exhibit 15-15

Prepare a Finding of Fact

Document evidence of fraud in a finding of facts. A summary of all the necessary elements for a finding of facts is contained in Exhibit 15-16.

For both fixed-price and cost-reimbursement contracts, the contractor can be forced to repair or replace the product or reperform the service at its own cost any time after acceptance when fraud is proven. The Government also can avail itself of all other remedies, including Termination for Default.

Necessary Elements of a Finding of Facts for Fraud

1. A misrepresentation of fact (actual or implied) or the concealment of a material fact
2. Contractor had knowledge that the fact was concealed or misrepresented
3. An intent to mislead the Government into relying on misrepresentations or concealment
4. Government suffered injury as a result of the concealment or misrepresentation

Exhibit 15-16

Report Evidence of Potential Fraud

Provide evidence of potential fraud to your agency's debarring official, Inspector General, and other officials who have a need to know.

Most agencies have "hot lines" for reporting instances of fraud to the agency's Inspector General.

Your agency's debarring official will probably be identified in your agency's supplementation to FAR Subpart 9.6, but use normal supervisory channels to report information for consideration of a suspension or debarment. Suspension and debarment procedures are outlined in Chapter 18.

Contact the Contractor

If you suspect fraud, notify the contractor only in coordination with your agency's Inspector General or debarring official. In less serious cases, where no intent to deceive is suspected, you are responsible for:

1. Obtaining the contractor's position on its responsibility and its reasons for taking that position
2. Requesting a proposal to repair or replace the deliverable or reperform the service and/or make a downward price adjustment
3. Preparing the Government position, using principles of cost and price analysis as you would on any other proposal
4. Negotiating a supplemental agreement with the contractor reflecting a new delivery schedule and/or consideration.

As with any other negotiation, document the results in the official contract file.

Take Unilateral Action

If the contractor refuses to make restitution, consider unilateral actions including:

- Determining the appropriate downward price or fee adjustment and collecting it from the contractor
- Correcting or replacing nonconforming deliverables from another source and charging the contractor for the costs incurred by the Government.

Issue a unilateral modification declaring the Government's claim against the contractor and citing the contract's inspection or other relevant clause.

NOTES

CHAPTER 16

CONTRACT TERMINATION

IT'S DEFAULT OF THE CONTRACTOR

Bea terminated the Tally-Up task order for convenience of the Government because there was no longer a need for auditing Down-Hill Industries after they filed for bankruptcy. Even if the estimated cost of completion of services under the task order had been less than $5,000, she would have argued that this situation was an exception to the general rule that you normally let a contract run to completion if those completion costs were less than $5,000.

Clearly continuing the audit would benefit no one and would probably aggravate Down-Hill personnel—if they would let the auditors in the door at all. Secondly, on a cost-reimbursement contract, it really would not be an additional administrative burden. Costs had to be verified whether they were contained on a settlement proposal or billed on a regularly scheduled voucher.

However, another potential termination action was more thought-provoking—the question of what to do about Troubles, Inc., the grounds maintenance contractor that still refused to acknowledge its negligence in performing preventive maintenance on the Government-furnished gang mowers.

Bea, Ernest, Johnnie I. Dotter, and Harry B. Labours, the property administrator, had discussed the evidence for negligence as the basis of a default action, but without reaching total agreement. However, at their second meeting, Ernest and Bea presented additional reasons to terminate for default.

"Troubles, Inc. has provided marginal performance from day one," Bea pointed out. "Yesterday was our first snowfall and I'm sure you all noticed that the sidewalks outside this building had a full 3-inch accumulation. If the sun hadn't melted some of it today, we'd still have 3 inches sitting there," Bea continued. "Ernest called them twice yesterday and once today. Their response is that they will get to it—that a snowfall this early in the year took them by surprise."

"How much of a warning do you need to get some laborers out there with shovels?" Ernest chimed in. "When snow is falling, the contract requires that the sidewalks be cleared at least every three hours between the hours of 6:00 a.m. and 6:00 p.m. on a work day. Here are pictures the COR took every hour on the hour yesterday. What more proof do we need?"

continued. . .

"None as far as I'm concerned—here's a Show Cause notice I prepared," Bea said sliding the preliminary action required for a default action across the table to Johnnie I. Dotter. "I'd like to send this out today."

Johnnie read Bea's signed notice and looked at the photographs. He then asked to look at the contract which he thumbed through for about 10 minutes. Ernest had paperclipped and highlighted pertinent sections that related to the proposed default action. "Everything looks in fine order to me," Johnnie pronounced. "We have a firm legal basis to proceed with this."

"Good," Ernest said. "We can cover the requirements through purchase orders until a new contract is in place."

"We may have more documentation for a default termination too," Bea told them. "The Department of Labor has asked us to verify minimum wage payments under the Service Contract Act clause in this contract. Apparently DOL is on to some potential violations, but I don't want to wait for that."

"I agree, but make sure you show me any response Troubles, Inc. may provide," Johnnie warned. "I want to make sure we didn't waive our rights somehow or that this company doesn't have an excusable reason for its lack of performance."

"Of course, Johnnie," Bea said sweetly. "Good old Johnnie was ever the alarmist," she thought. However, she knew it was true that he had kept them straight through a number of very sticky situations. As a matter of fact, when she was troubled about what action she should take in a particular situation, she invariably asked for his advice even if she wasn't required to seek it.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Determine whether to terminate a contract, and initiate termination actions for either a Termination for Convenience or a Termination for Default.

Individual:

PART A—In regard to initiating a termination:

16A.1 Determine appropriateness of discontinuing contract performance and consider alternatives.

16A.2 Select type of termination action.

PART B—In regard to a Termination for Convenience:

16B.1 Prepare and issue necessary notices.

16B.2 Meet with contractor and explain its obligations.

16B.3 Obtain contractor's settlement proposal.

16B.4 Agree to, negotiate, or determine elements of a settlement.

16B.5 Issue a modification and document the termination action.

PART C—In regard to a Termination for Default:

16C.1 Prepare and issue necessary notices.

16C.2 Meet with contractor and explain its obligations.

16C.3 Initiate reprocurement, if appropriate.

16C.4 Obtain contractor's settlement proposal.

16C.5 Agree to, negotiate, or determine elements of a settlement.

16C.6 Issue a modification and document the termination action.

INTRODUCTION TO CONTRACT TERMINATION

Definition of Termination

Termination is the administrative process that exercises the Government's contractual right to completely or partially discontinue performance under a funded contract.

Authority and Responsibility

The contracting officer has the authority to terminate a contract, and the responsibility to initiate a termination when it is in the best interest of the Government.

FAR 49.100

There are two types of terminations.

Types of Terminations

Termination for Convenience is initiated because the requirement no longer exists, because funds to continue performance are no longer available, or because of a radical change in the requirement that is beyond the scope of the contract or the contractor's expertise. For any contract, the Government has the right to a Termination for Convenience without cause.

Termination for Default is initiated because of a contractor's lack of performance, improper performance, or poor performance. A Termination for Default also can be used if it is anticipated that the contractor will fail to meet its contractual obligations. A Termination for Default cannot be used if the contractor's failure to perform was excusable—that is, for causes beyond its control and without its fault or negligence.

Each of these types of terminations have different consequences for both the Government and the contractor. The consequences of a termination also are different for fixed-price and cost-reimbursement contracts. Termination is the administrative process that exercises the Government's contractual right to completely or partially discontinue performance under a funded contract.

Termination Contracting Officer (TCO)

FAR 49.101(d)

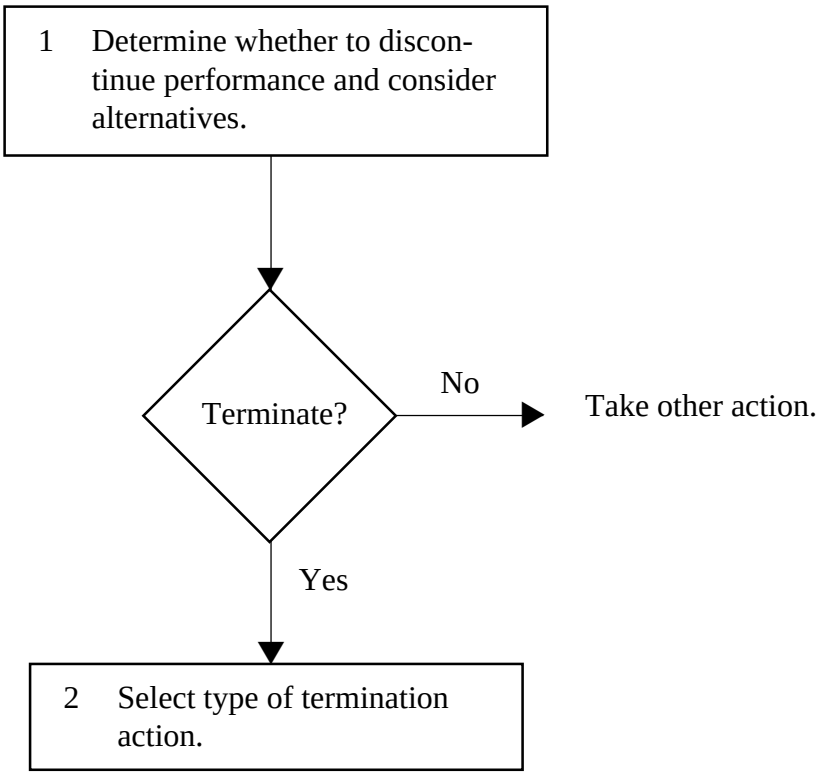
FAR 49.401-3(a)

In some agencies, termination procedures are delegated to a **termination contracting officer (TCO).** If you are responsible for these procedures yourself, you should always seek advice from legal advisors and other experts before initiating a termination. Many of the issues are complex and any misstep on your part could result in a less favorable outcome for the Government.

Steps in Performance

The steps in initiating a termination action are covered in Part A of this chapter. Part B considers the steps in implementing a Termination for Convenience. Part C considers the steps in implementing a Termination for Default. A flowchart at the beginning of each part outlines the procedure, and the steps are then discussed in detail.

STEPS IN INITIATING A TERMINATION



PART A—INITIATING A TERMINATION

16A.1 DETERMINE WHETHER TO DISCONTINUE PERFORMANCE AND CONSIDER ALTERNATIVES

After a contract has been awarded, changing circumstances or deficiencies in contractor performance may suggest the desirability of discontinuing contract performance. Some of these events will relate to changes in Government requirements or priorities. Others will relate to the quality, timeliness, or integrity of the contractor's performance.

Several reasons for you to consider discontinuing contract performance are listed in Exhibit 16A-1. They are divided to show reasons for considering a Termination for Convenience and for considering a Termination for Default.

Alternatives in Lieu of Termination

When you encounter a situation that could be the basis for terminating a contract, there are usually several possible courses of action. Although the contracting officer makes the final decision on what the Government action will be, it is important that the requiring activity have a strong voice in that decision because it must bear the operational impact.

Alternatives that you and the requiring activity should consider include:

- **Continuing contract performance** if the work is nearly over, if the need is urgent and cannot be filled by other sources, or if there is reason to believe the problems can be resolved satisfactorily
- **Issuing a no-cost cancellation** if certain conditions are met and the action is acceptable to the contractor
- **Issuing a deductive change order** that reduces the quantity of one or more of the products or services originally sought.

Continued Performance

FAR 49.101(c)

It may be in the best interest of the Government to continue performance even when the requirement no longer is valid. You may not terminate for convenience if the price of the undelivered balance of the contract is less than $5,000. If the contractor's performance has been unacceptable but you think it will improve, a contract remedy (see Chapter 15) may be more appropriate than terminating for default.

Depending on what went wrong, you also may want to consider allowing the contractor to continue with modified delivery dates or assistance in meeting acceptable standards. The contractor or its surety, if there is one, also may request the opportunity to subcontract to a more qualified firm rather than experience default.

Situations That May Evidence A Need to Terminate	
For Convenience	**For Default**
• There is no longer a need for the items or services under the contract • The extent of the work or quantity needed is reduced • Funds are not available for continued contract performance • There has been a radical change in the requirement that goes beyond the contractor's expertise • The items or services come under United States trade sanctions as outlined in FAR 25.1002	• Failure to make progress toward contract objectives or completion • Failure to make timely delivery • Repudiation of the contract by the contractor • Failure to comply with other contract terms, such as: — Violating contract labor requirements such as those required by: -- FAR 52.203-5, Covenant Against Contingent Fees -- FAR 52.203-7, Anti-Kickback Procedures -- FAR 52.222-20, Walsh-Healy Public Contracts Act -- FAR 52.222-26, Equal Opportunity -- FAR 52.222-41, Service Contract Act of 1965, as Amended — Failing to comply with contract quality standards when required by FAR 52.2236-5, Material and Workmanship, and similar clauses — Failure to obtain bonds or additional bond security when required by such clauses as FAR 523.228-2, Additional Bond Security — Failing to control abusive substances when required by such clauses as FAR 52.223-6, Drug-Free Workplace

Exhibit 16A-1

No-Cost Cancellations

FAR 49.109-4

No-cost cancellations are another possibility to consider. They are preferred over termination procedures, but you may only use this alternative if all of the prerequisites contained in Exhibit 16A-2 apply.

Prerequisites for a No-Cost Cancellation
FAR 49.101(b)

- The supply or service can readily be obtained elsewhere, if needed
- Government property was not furnished to the contractor
- There are no outstanding payments, or debts due the Government or other contractor obligations
- The contractor is willing to accept a no-cost settlement

Exhibit 16A-2

Deductive Change Orders

Deductive change orders can be used unilaterally by the contracting officer (see Chapter 14). Consider a deductive change order only as an alternative to a partial termination for convenience. Terminations for Convenience can be of one of two types:

- ***Partial,*** meaning that only a part of the unperformed work is terminated, or
- ***Complete,*** meaning that all of the unperformed remaining work is terminated.

There is a good deal of confusion over when a partial termination or a deductive change order is appropriate.

Generally, courts and boards have found that a major deletion should not be accomplished by using a change order.

The choice between a partial termination and a deductive change order not only has an effect on administrative costs, but also on the actual amount the Government will pay for the deleted work. Procedures under the standard Changes clauses focus on the cost of work deleted. Procedures under the convenience termination clauses focus on the cost of work actually completed.

FAR 52.243

Profit/fee is also treated differently. Under the procedures for a deductive change order, you generally reduce profit/fee only by amounts that apply to the projected cost of the work that is deleted.

FAR 49.202

Under convenience termination procedures, however, you allow the contractor to retain a "reasonable" profit/fee for the work actually performed.

Furthermore, deductive change order procedures do not allow recovery of expenses incurred by the contractor in preparing and presenting its equitable adjustment proposal to the contracting officer.

FAR 49.208

These settlement expenses can be allowable costs under convenience termination procedures.

In the end, the choice between Changes clause procedures and termination procedures is a contracting officer decision based on which approach is most fair to both parties.

Consulting with Requiring Activity

Before reaching a decision, you should consult with the requiring activity to:

- Obtain all of the facts and documents that will be needed to support the decision
- Explain the cost and other consequences of the type of termination contemplated, and
- Determine whether any alternatives to termination are acceptable.

Consulting with Legal Advisor

You also should consult with an agency legal advisor before taking action. You want to make sure your decision is defensible and that your procedure does not deviate from established requirements.

16A.2 SELECT A TYPE OF TERMINATION

If no other course of action seems appropriate, you may have to decide to terminate contract performance.

Termination for Convenience

The Government retains the right to terminate any contract for convenience—that is, on its own initiative and without cause. Some of the reasons for terminating a contract for convenience may include:

- The close of military campaigns and wars
- Changes in strategic planning or budget considerations
- Scientific innovations that make methods or items required under current contracts obsolete

- Need to resolve questions on the propriety of the original award
- A request by the General Accounting Office, a board of contract appeals, or a Federal Court.

A Termination for Convenience should not be used in place of a Termination for Default when the reason for the termination is a deficiency in the contractor's performance or conduct.

The most usual reason for a Termination for Convenience is a drastic change in the requiring activity's needs or priorities. The action will save money that otherwise would be spent on products or services that are no longer wanted.

Additional expenses may be incurred, however. The contractor has the right, under a fixed-price or cost-reimbursement contract, to recover its costs of performance to date, its profit/fee on work accomplished whether delivered or not, and the costs of preparing its settlement proposal. Some of these costs may be high. For example, the contractor may have invested considerable amounts in tooling and design work that would have to be reimbursed even if the contract was terminated prior to production of a single item. Payment for any anticipated profit or fee on work not performed is not allowed, however.

Partial Terminations

When appropriate, the contracting officer may terminate only part of a contract for convenience, rather than the entire contract. This action might be taken to reduce the quantity to be provided or to discontinue delivery of one of several products or services included within one contract. A partial termination rarely would be used in a default situation. An exception could be when one of the products or services called for by the contract was beyond the contractor's capability although its performance otherwise was satisfactory.

Termination for Default

Deciding to terminate for default rests on evidence that the contractor has failed or will fail to meet its obligations under the contract.

A Termination for Default has consequences that must be considered. For the contractor, a default termination is traumatic because it has a negative connotation on the contractor's management and its ability to perform future contracts. It also reduces or eliminates profit/fee on the defaulted contract. Additionally, fixed-price contractors may:

- Be unable to recover some costs already incurred, and
- Face possible liability for the Government's extra costs of having the contract completed by another contractor under a reprocurement.

A default termination also is an administrative burden on the contracting office handling the termination. It may not fully recover its administrative costs for managing any reprocurement contract or the cost of defending the Government's decisions.

If a bonding company has guaranteed performance, it must indemnify the Government up to the amount of the bond in the event of the contractor's default. However, the courts have ruled that the Government owes an obligation to a contractor's surety. The surety has the right to decide whether to:

- Complete the work under its own management
- Provide a subcontractor to complete the work, or
- Rely on the Government to complete the work inhouse or under a reprocurement contract.

If the Government does not comply with the bonding company's decision, it may be liable for any damages that the bonding company incurs.

Justification of a Default Termination

You must be able to justify a decision to terminate for default. Use Exhibit 16A-3 to help you decide if default is really the best course of action. The most crucial issue is how to best fulfill the requirement—not which party has the best legal case.

Contractor Defenses Against Default

A default action is initiated because the contractor has not, or is not expected to, live up to its obligations under the contract. This is called a ***breach.*** Even when a breach or anticipatory breach clearly exists, however, the contractor has the opportunity to offer two basic defenses in an effort to reinstate a contract after a default termination. It can argue that:

- The Government has waived its right to terminate, or
- Its action was excusable.

Excusable delays and situations that waive the Government's right to terminate for default were examined in Chapter 15.

The Government also can waive its rights to a default termination by neglecting to comply technically with default termination procedures. For instance, except for an anticipatory breach, the Government may not terminate for default on the basis of failure to deliver before the time for performance has expired. If it terminates for default even one day early, a Termination for Convenience applies in lieu of a Termination for Default.

Checklist for Deciding When to Terminate for Default
FAR 49.402-3

Section A — A "NO" answer to any questions in Section A indicates that default is not appropriate. Discontinue further default action.

	NO	YES	N/A
A-1. Can you specifically provide facts to support a finding that the contractor has breached the contract?			
A-2. Can you identify the specific clause or contract requirement that was breached?			
A-3. Is the breach substantial enough to warrant the severe default remedy?			
A-4. Has the Government met procedural requirements for proceeding with a default termination (issued all required notices, and so forth)?			
A-5. Does the contractor have a good case for being absolved of fault, based on such grounds as:			
– Impossibility of performance?			
– Excusable delay?			
– Breach by Government?			

Exhibit 16A-3 (page 1 of 2)

Checklist for Deciding When to Terminate for Default
FAR 49.402-3

Section B — A "NO" answer to questions B-1 through B-6 or a "NO" answer to both B-7 and B-8 indicates that a condition exists that is generally not favorable to a successful default termination. However, the contracting officer must use discretion and business judgement in analyzing each individual case.

	NO	YES	N/A
B-1. Will the technical requirement for a reprocurement be exactly the same as the one you are about to default? (Changes indicate that assessing excess costs is inappropriate, but may not necessarily mean that the default itself is inappropriate.)			
B-2. Does the contractor have a good case for contending that a default is arbitrary, capricious, or retaliatory?			
B-3. Has the decision to default been made solely on the facts in the case (carefully consider facts that do not seem to support a default termination)?			
B-4. Have default alternatives been considered?			
B-5. Is the requirement urgently needed?			
B-6. Is the requirement available from other sources for an expedited delivery?			
B-7. Is there a good potential for recovering Government costs from the contractor, such as unliquidated progress payments, excess reprocurement costs, and so forth?			
B-8. If there is not a good potential for recovering Government costs, are Government funds available to finance completion, if needed?			

Exhibit 16 A-3 (page 2 of 2)

Documenting a Termination

If you decide to pursue default action or an action in lieu of default such as a contract remedy (see Chapter 15), you must prepare a memorandum that documents the reasons for that action. Use the considerations listed in Exhibit 16A-3 as points for explaining why the decision was made.

After you, together with the requiring activity and agency legal advisors, have decided to terminate a contract, you can proceed with implementing the decision. Refer to Part B of this chapter if the action will be a Termination for Convenience. Refer to Part C if it will be a Termination for Default.

STEPS IN TERMINATION FOR CONVENIENCE

1. Prepare and issue necessary notices.
2. Meet with contractor and explain its obligations.
3. Obtain contractor's settlement proposal.
4. Agree to, negotiate, or determine elements of a final settlement.
5. Issue a modification and document the termination action.

PART B—TERMINATION FOR CONVENIENCE

16B.1 PREPARE AND ISSUE NECESSARY NOTICES

Written notices to the contractor are required to implement termination actions. Care must be taken in preparing these notices to make sure they contain all essential information.

Preliminary Notices

No preliminary notice is required prior to a Termination for Convenience. However, a stop work notice may have been issued while the Government was deciding whether to terminate the contract (see Chapter 15).

Notice of Termination for Convenience

When the Government decides to terminate a contract for convenience, an initial telegraphic notice may be used. It must be followed as soon as possible with a mailed or hand-delivered notice that incorporates all of the necessary content.

FAR 49.402-2

Content requirements for a Termination for Convenience notice are shown in Exhibit 16B-1. Note that these are minimum requirements. Additions may be appropriate—for example, to inform the contractor on actions to take concerning work in progress if an abrupt stop would damage equipment or result in a safety or environmental hazard. Exhibit 16B-2 provides additional guidelines regarding termination notices.

Minimum Requirements for a Termination for Convenience Notice FAR 49.102

The notice must:

- Cite the contract number and state that the contract is being terminated
- Provide the effective date of termination
- Outline the reason(s) for the termination
- Specify the extent of the termination (partial or complete)

Exhibit 16B-1

General Guidelines Regarding Termination Notices

- If the notice does not specify either a default or convenience termination, and the contractor believes it to be a Termination for Convenience and acts accordingly, the boards and courts have issued decisions that indicate such terminations are to be considered convenience terminations
- It is inappropriate to call a termination for default a termination for convenience to protect the contractor's reputation
- If there is a genuine uncertainly as to whether a termination for default or a termination for convenience is appropriate, the notice should cite a termination for convenience
- A termination for convenience cannot be converted to a termination for default

Exhibit 16B-2

Notice Formats

FAR 49.601

The FAR provides a suggested format for a telegraphic notice and a letter notice of termination. These should be tailored to reflect the circumstances applicable to a specific termination.

Distribution

FAR 49.102(a)

Copies of a convenience termination notice are distributed to the same distribution list as the original contract. as well as to the surety and any known assignee or guarantor of the contractor. When the notice is mailed to the contractor, it must be sent by certified mail, return receipt requested. If hand-delivered, a written acknowledgement of receipt must be obtained.

Documenting a Termination for Convenience Decision

Although a formal memorandum documenting the reasons for a for convenience termination is not required, a detailed record is advisable. A contractor may seek damages, for instance, if it is able to demonstrate that the termination was due to bad faith on the part of the Government. An example is if the Government knew at the time of award that requirements had changed and that a partial termination would be initiated.

16B.2 MEET WITH CONTRACTOR

As soon as possible following issuance of a Termination for Convenience notice, you should meet with the contractor to explain its obligations, issue any necessary instructions, and answer questions about the termination process. Achieving a settlement on a terminated contract is often an involved and lengthy process. Your aim following a Termination for Convenience is to minimize the costs to the Government while being fair to the contractor.

If responsibility for the termination has been assigned to a termination contracting officer (TCO), that person will meet with the contractor instead. You, however, should promptly inform the contractor as to who is designated as TCO.

Explain Contractor's Obligations

The contractor's obligations following receipt of a Termination for Convenience notice depends on the particular clause contained in the contract. Generally, however, the contractor must take the actions listed in Exhibit 16B-3.

Contractor Responsibilities Following a Termination for Convenience Notice
FAR 49.104

- Stop work immediately
- Provide termination notice to subcontractors and suppliers
- Settle subcontractor claims
- Prepare termination inventory schedules
- Protect Government property and other termination inventory, disposing of it as directed by the Government
- Submit its settlement proposal
- Provide immediate notification of any special circumstances precluding the stoppage of work
- Perform any work not terminated and prepare an equitable adjustment proposal for any increased costs of that work
- Provide notification of any subcontractor legal proceedings

Exhibit 16B-3

Provide Instructions to Contractor

FAR 31.205-42(b)

In your initial meeting with the contractor, you also should provide instructions that will minimize any unnecessary costs and speed the settlement process. Topics to be covered during this meeting may include, among others:

- Status of work upon termination
- Termination and settlement of subcontracts
- Delivery of materials required by the Government
- Disposition of inventories
- Submission of settlement proposal
- Timetable for settlement negotiations
- Activities taken to minimize impact on employees.

The contractor also may want answers to such questions as what costs are allowable following termination, how to dispose of inventory and Government-furnished property, and how to prepare a termination settlement proposal.

Work After the Date of Termination

FAR 31.205-42(b)

You also should advise the contractor that all work on the contract should stop on the effective date of the termination because costs incurred after termination may be disallowed. However, certain performance costs that are unavoidable after termination are allowable, so long as they are reasonable under the specific circumstances. Of course, if the termination is partial, the contractor remains obligated to complete the unterminated portion of the contract.

Amendments and Rescissions

FAR 49.102(c)

Based on what you may learn at the conference, you may find it necessary to amend the termination notice. Amendments are typically issued to correct nonsubstantive mistakes or add supplemental data or instructions. A recision would be necessary if the terminated items had been completed or shipped before the contractor's receipt of the termination notice.

FAR 49.102(d)

FAR 49.401(e)

Unless a board of contract appeals or a court orders a contract reinstatement, you may only issue an amendment to rescind a convenience termination notice and reinstate a contract if:

- The contractor agrees in writing to the reinstatement
- Terminated items or work are still needed by the Government
- Reinstatement is otherwise advantageous to the Government.

Deobligate Excess Funds

FAR 49.401(b)

As soon as practical, you also must deobligate any excess funds. You must make an initial estimate of the funds needed to settle the termination and recommend the release of excess funds within 30 days of the termination notice. The contracting officer then will deobligate the unneeded amount.

16B.3 OBTAIN CONTRACTOR'S SETTLEMENT PROPOSAL

Following a Termination for Convenience, the contractor is entitled to recover various costs incurred before and after the termination but not yet paid by the Government, as well as profit/fee on those costs. The contractor has up to one year following the notice of termination to prepare and submit its proposal for a settlement amount unless the Government authorizes a time extension.

Work Already Paid For

When a contract is terminated for convenience, portions of the work likely will have been paid for prior to the termination.

On a fixed-price contract, some deliverables may already have been accepted and for which the contractor has received payment.

On cost-reimbursement contracts, most of the contractor's expenses to the date of termination, plus a proportion of the fee, will have been reimbursed through the ordinary invoice process. These expenses are likely to include various preparation expenses such as the purchase of raw materials intended for manufacturing, design work, and subcontract costs to date.

Past payments to the contractor under either fixed-price or cost-reimbursement contracts generally do not enter into settlement calculations. However, unliquidated advance or progress payments are deducted from the final settlement amount.

Settlement with Subcontractors

FAR 49.108-1

The settlement process following a convenience termination usually begins with the prime contractor obtaining settlement proposals from any affected subcontractors, and negotiating a tentative settlement with them.

FAR 49.108-4

You must examine each tentative subcontractor settlement to determine whether the settlement was made necessary by the termination, whether it was arrived at in good faith, and whether the amount is reasonable. Approval of subcontract settlements generally is required.

You can the approve the subcontract settlement as a cost for which the contractor will be reimbursed. The contracting officer has the discretion to authorize the contractor to complete subcontractor settlements without approval if the amount is $100,000 or less.

FAR 49.108-1

The Government has no contractual relationship with subcontractors, and therefore is not a party to any dispute between them and the prime contractor. However, in unusual circumstances and with the consent of the prime contractor, the Government may intervene and assist the prime contractor in reaching a settlement with a subcontractor. In extreme cases, the Government may settle with a subcontractor directly.

Need for Audits

You must request an audit review of any proposed prime contract or subcontract settlement in excess of $100,000, and you may request audit assistance prior to approving settlements under this limit.

Settlement Proposal Forms

Standard forms must be used to calculate the amount claimed by the contractor following a contract termination. These forms must be accompanied by a parallel set of forms for calculating inventory on hand as of the date of termination. The forms for the settlement proposal are:

- SF 1435, *Settlement Proposal (Inventory Basis)*
- SF 1436, *Settlement Proposal (Total Cost Basis)*
- SF 1437, *Settlement Proposal for Cost-Reimbursement Type Contracts*
- SF 1438, *Settlement Proposal (Short Form).*

Fixed-Price Settlement Principles

FAR 49.206-2

The first two and fourth forms are used for fixed-price contracts. The distinction between them is that a settlement proposal using the *Inventory Basis* calculates the actual costs incurred for preparations and work begun but not yet completed, plus associated indirect costs, subcontract settlement costs, settlement proposal preparation expenses, and other proper charges.

FAR 49.105-1

The *Total Cost Basis* can be used only if authorized in advance. It is used when the Inventory Basis appears impractical in light of the contractor's accounting system. The contractor calculates the total amount spent and then subtracts the contract prices for work already delivered and paid for.

FAR 49.202

For both methods under a fixed-price contract, the contractor may include a profit allowance that reflects the status of work in progress. No profit is allowed on settlement expenses. Anticipated profits and consequential damages also are not allowed.

FAR 49.203

If it is apparent the contractor would suffer a loss were the contract to be completed, an adjustment is negotiated or determined by the contracting officer. The adjustment is applied to costs for preparation and work in progress but not for work completed or for settlement expenses.

FAR 49.203

The fourth form, Form 1438, also applies to fixed-price contract terminations. The contractor may use this form if the amount sought is less than $10,000.

Cost-Reimbursement Settlement Principles

The third form is used by the contractor to propose a settlement when a cost-reimbursement contract is terminated. This form is used only to claim an adjustment in the amount of fee due.

FAR 49.203

The contracting officer is responsible for deciding any adjustments in the fee to be paid. This fee generally is based on the percentage of work completed under the contract, but is then adjusted to consider the relative difficulty of work accomplished including:

- Planning and scheduling
- Technical study and engineering
- Production and supervision
- Placing and supervising subcontracts
- Stopping performance upon termination
- Settling terminated subcontracts
- Disposing of termination inventory.

The result may be greater or less than the amount of fee calculated using the ratio of costs incurred to the total estimated cost of contract performance.

FAR 49.302

In settlements on cost-reimbursement contracts, the contractor cannot receive any fee above amounts proportionate to actual expenses if any additional fee is paid to subcontractors with respect to their settlement proposals.

Allowable costs other than a fee adjustment following a Termination for Convenience under a cost-reimbursement contract are reimbursed by the Government on the basis of vouchers reporting these expenses, including indirect costs and the usual proportion of the fee. The contractor may continue submitting ordinary vouchers for up to six months following the termination.

Indirect Cost Rate

FAR 49.303-3

The final indirect cost rate applicable to expenses under a cost-reimbursement contract will be resolved in the same way as if the contract was still in force. The final rate will be determined following the end of the contractor's fiscal year. Alternatively, the contracting officer can negotiate agreed-upon rates if waiting for actual rates would unduly delay the settlement process. If the terminated contract was a sizable one, indirect cost rates may rise substantially due to unused plant and equipment and the smaller direct cost base.

16B.4 ARRIVE AT A FINAL SETTLEMENT

Following a Termination for Convenience, you should make every effort to negotiate a mutually acceptable final settlement with the contractor.

Audit Required

FAR 49.303-2

The contracting officer in most instances must obtain an audit of the contractor's settlement proposal and its accompanying documentation before agreeing on a final settlement amount. An exception is when the proposal only claims an adjustment of fee under a cost-reimbursement contract.

Fixed-Price Contracts

FAR 49.201

Government policy regarding settlements on fixed-price contracts is that they should compensate the contractor fairly for the work done and the preparations made, including a reasonable allowance for profit. If a total amount can be agreed upon, it is not necessary to reach agreement on individual elements of cost or profit.

Factors to be considered in arriving at a final settlement for a fixed-price contract include:

- Contractor's settlement with subcontractors
- Verification of any inventory claimed as attributable to the terminated contract
- Costs incurred by the contractor for the disposition of materials as directed by the Government
- Fair value of any inventory purchased by the contractor and not returned for credit or sold to others
- Allowance for profit beyond that appropriate for work completed before termination, such as for disposing of inventory and for work-in-process.

Partial Terminations

Following a partial termination, you will remain responsible for monitoring the continuing portion of the contract and for performing associated administrative responsibilities as required.

Following partial termination of a cost-reimbursement contract, a new ceiling on costs will be needed

Equitable Adjustment

Because of a partial termination, the contractor may be entitled to an equitable adjustment in the price of the continuing work under a fixed-price contract. Deletion of part of the work may have reduced efficiencies or the benefits of large purchases, for example.

Cost-Reimbursement Contracts

FAR 49.302

Generally, the only issue to be resolved in reaching a settlement following termination of a cost-reimbursement contract for convenience is the amount of fee due. All necessary costs following the termination, including costs for preparing the settlement proposal, are claimed on vouchers for six months following the termination. After that, termination-associated costs are to be included in the settlement proposal.

Partial Payments

FAR 49.112-1

During the settlement process, it may be appropriate to authorize partial payments to the contractor. These amounts will be paid only if the request for partial payments is proper and reasonable, and does not exceed certain percentage limits specified by the FAR.

16B.5 ISSUE MODIFICATION AND DOCUMENT THE TERMINATION

FAR 49.603

If an agreement on the settlement following a Termination for Convenience is reached with the contractor, prepare and issue a contract modification in the form of a supplemental agreement. The FAR provides specific guidance on the content of these contract modifications, which should be followed unless otherwise authorized by agency procedures.

Settlement Review

FAR 49.111

Agencies may require an administrative review of proposed termination settlements before a modification is issued.

FAR 49.604-9

If a complete settlement agreement cannot be reached, the contracting officer can, instead, prepare and issue a supplemental agreement that specifies areas or amounts that are mutually acceptable to the Government and the contractor, but explicitly excludes certain items from the settlement agreement.

Settlement by Determination

Furthermore, if no agreement at all can be reached, the contracting officer can proceed to a settlement by determination. This is accomplished by issuing a unilateral contract modification citing the contract's Termination clause as authorization.

FAR 49.109-7

Prior to issuing the unilateral modification, the contracting officer must provide notice to the contractor by certified mail. The notice must allow the contractor at least 15 days to submit written evidence substantiating the amount claimed in its settlement proposal.

Then, if the evidence fails to support the contractor's position, the contracting officer prepares and issues a final decision. If the contractor continues to disagree with the finding, it may pursue the matter under the Disputes clause.

Deobligate Any Remaining Funds

FAR 49.105-2

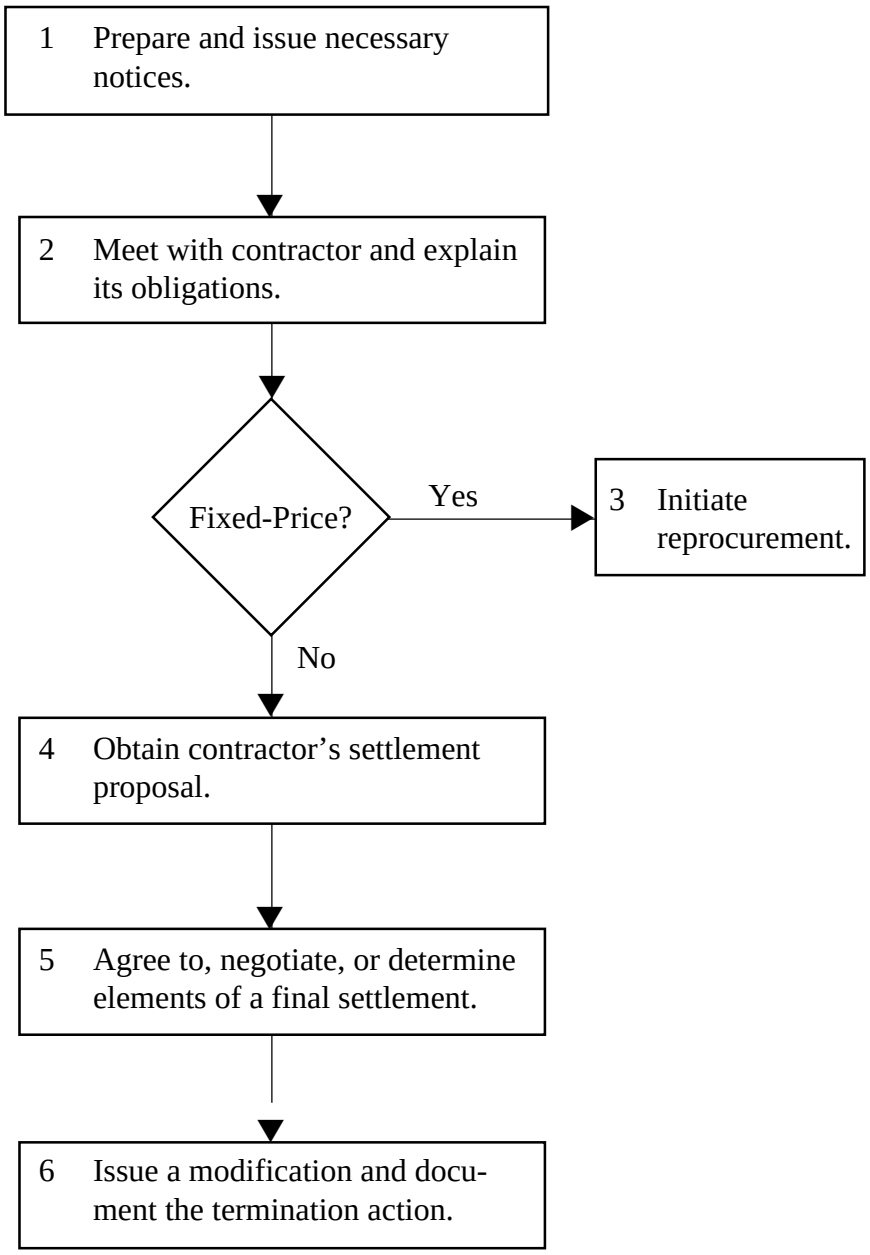
Payment can then be made to the contractor. If necessary because of funds released earlier, funds may be restored by the contracting officer to make up any shortage. Any funds remaining after a settlement has been completed should be deobligated.

Settlement Memorandum

FAR 49.110

At the conclusion of negotiations, the contracting officer must prepare a memorandum describing the elements of the settlement. If a lump-sum settlement was reached, only the basis for that amount needs to be described. However, if settlement was achieved based on negotiations over individual items, the memorandum must identify the factors considered for each item. Additional information should be included to the extent it would assist reviewing authorities in understanding the basis for the settlement.

STEPS IN TERMINATION FOR DEFAULT



PART C—TERMINATION FOR DEFAULT

16C.1 PREPARE AND ISSUE NECESSARY NOTICES

Written notices to the contractor are required to implement default termination actions. You must take care when preparing these notices to make sure they contain all essential information.

Preliminary Notices

FAR 49.402-3(d)

In most instances, a Termination for Default must be preceded by a cure notice or a show cause notice (see Chapter 15). A cure notice can be used if sufficient time remains under the contract for the contractor to correct the problem. The notice must provide the contractor with at least 10 days to remedy its performance. A show cause notice is used if insufficient time remains for the contractor to cure the deficiency. Either notice must be sent by proof of delivery method.

FAR 49.402-3(b)

An administrative contracting officer must obtain approval from the contracting office before issuing a cure or a show cause notice.

FAR 49.402-3(e)

If a Termination for Default appears imminent, the contracting officer also must provide written notice to the surety, if there is one.

FAR 49.402-3(c)

No preliminary notice to the contractor is required prior to a Termination for Default if the contractor has failed to complete delivery within the time specified by the contract. However, the Government must not have done anything that waived its right to timely delivery.

Notice of Termination for Default

FAR 49.402-2

Content requirements for default termination notices are shown in Exhibit 16C-1. Note that these are minimum requirements. Additions may be appropriate, for example, to notify the contractor that materials on hand at a contractor's plant, but not incorporated into a final product, are to become the property of the Government for use under a reprocurement contract. Exhibit 16C-2 provides additional guidance regarding termination notices.

FAR 49.102(a)

Copies of the termination notice must be distributed to the same distribution list as the original contract, as well as to the surety and any known assignee or guarantor of the contractor. When the notice is mailed to the contractor, it must be sent by certified mail, return receipt requested. If hand delivered, a written acknowledgement of receipt must be obtained.

Be careful to inform any surety of all actions. The surety has the right to intervene in order to correct deficiencies or complete performance, and must be afforded an opportunity to propose its solution.

Minimum Requirements for Termination for Default Notice FAR 49.402-3

The notice must:

- Cite the contract number and state that the contract is being terminated
- Provide the effective date of the termination
- Outline the reason(s) for the termination
- Notify the contractor of the Government's rights, including charging excess costs
- Outline the contractor's appeal rights
- Request that the Government be advised if the surety desires to enter into any arrangement for completion of the work

Exhibit 16C-1

General Guidelines Regarding Termination Notices

- If the notice does not specify either a default or convenience termination, and the contractor believes it to be a Termination for Convenience and acts accordingly, the boards and courts have issued decisions that indicate such terminations are to be considered convenience terminations
- It is inappropriate to call a termination for default a termination for convenience to protect the contractor's reputation
- If there is a genuine uncertainty as to whether a termination for default or a termination for convenience is appropriate, the notice should cite a termination for convenience
- A termination for convenience cannot be converted to a termination for default

Exhibit 16C-2

Notice to Disbursement Office

FAR 49.102(a)

Additionally, you must notify the contract disbursement office to withhold further payments on a contract terminated for default. Keep that office informed. You will need to work closely with the disbursement officer, particularly if a reprocurement is initiated.

Prepare a Memorandum

FAR 49.402-5

When a contract is terminated for default, or another action taken in lieu of a Termination for Default, the contracting officer must prepare a memorandum for the contract file. The memorandum should fully document the reasons for the action that was taken.

16C.2 MEET WITH CONTRACTOR

You or a termination contracting officer (TCO), if one is assigned, should meet with the contractor as promptly as possible after issuing the termination notice. By providing timely instructions and guidance, you will help the process move along more rapidly and more smoothly.

Excusable Failures to Perform

Because of the likely impact of a Termination for Default, the contractor may offer various reasons why it was not responsible for what happened. Ordinarily, this will occur following issuance of the preliminary notice, if one was required. However, the Government may not have had the time or all of the facts necessary to determine whether the contractor's failure to perform was excusable. Your meeting with the contractor may resolve any remaining questions.

FAR 52.249-8(c)(d)

FAR 52.249-14

The contractor is not to be considered in default if its failure to perform arose from causes beyond its control and without its fault or negligence. Examples include acts of God, actions by the Government, natural disasters, strikes, and because of a failure to perform by a subcontractor due to such reasons.

FAR 52.249-6(b)

FAR 52.249-8(g)

If the contracting officer determines that the failure to perform was excusable, the rights and obligations of both the contractor and the Government become what they would be under a Termination for Convenience.

Explain Contractor's Obligation

Following notice of a Termination for Default, the contractor nevertheless has continuing obligations under the contract. The contractor's obligations upon Termination for Default are listed in Exhibit 16C-3.

Work After the Date of Termination

You want to instruct the contractor what to do with respect to any raw materials purchased under the contract, work in progress, work completed but not yet shipped or inspected, plans and drawings, and so forth.

FAR 31.205-42(b)

You also should advise the contractor that all work on the contract should stop on the effective date of the termination because costs incurred after termination may be disallowed. However, certain performance costs that are unavoidable after termination are allowable, so long as they are reasonable under the specific circumstances.

Contractor Responsibilities Following a Termination for Default Notice FAR 49.104

- Stop work immediately
- Provide termination notice to subcontractors and suppliers
- Settle subcontractor claims
- Prepare termination inventory schedules
- Protect Government property and other termination inventory, disposing of it as directed by the Government
- Submit its settlement proposal

Exhibit 16C-3

Amendments and Rescissions

FAR 49.102(d)

FAR 490.401(e)

Based on what you may learn at the conference, you may find it necessary to amend the termination notice. Amendments are typically issued to correct nonsubstantive mistakes or add supplemental data or instructions. A recision would be necessary if the terminated items had been completed or shipped before the contractor's receipt of the termination notice, or the if default was excusable.

Unless a board of contract appeals or court orders a contract reinstatement, you may only issue an amendment to rescind a termination notice and reinstate a contract if:

- The contractor agrees in writing to the reinstatement
- Terminated items or work are still needed by the Government
- Reinstatement is otherwise advantageous to the Government.

16C.3 INITIATE REPROCUREMENT

If a fixed-price contract, but not a cost-reimbursement contract, is terminated for default, the contractor may be liable for any additional costs to the Government for reprocuring the as yet undelivered supplies or services.

FAR.49.402-6

Following a Termination for Default, the contracting officer determines whether the remaining supplies or services are still required. If they are, he or she is to proceed with a repurchase as soon as possible using a procurement approach that results in as reasonable a price as practical considering quality and delivery. After completion of the repurchase

contract, the Government will make a written demand of the defaulted fixed-price contractor for any increase in cost over the original contract price.

FAR 49.403

Under a cost-reimbursement contract, the contractor may instead be held liable for excess reprocurement costs if it failed to replace or correct defective supplies as required by FAR 52.246-3, *Inspection of Supplies—Cost Reimbursement.*

In order to successfully assess a defaulted fixed-price contractor for reprocurement costs, the Government must:

- Reprocure according to substantially the same terms and specifications
- Reprocure within a reasonable time
- Obtain a reasonable price
- Make reasonable efforts to mitigate the defaulted contractor's damages
- Provide evidence that the reprocurement contract was, in fact, performed and the reprocurement contractor was paid.

The Government, in addition, may make a demand of any liquidated damages due under the contract for delayed delivery or other reasons. Finally, it also may make a claim for other damages suffered, including added administrative costs such as those for accomplishing the reprocurement.

16C.4 OBTAIN CONTRACTOR'S SETTLEMENT PROPOSAL

Following a Termination for Default, the contractor is entitled to recover various costs incurred but not yet paid for by the Government. These recoverable costs are more limited than under a Termination for Convenience. The contractor has up to one year following the notice of termination to prepare and submit its proposal for a settlement amount unless the Government authorizes a time extension.

Work Already Paid For

When a contract is terminated for default, portions of the work likely will have been paid for prior to the termination. This includes deliverables already accepted and paid for under fixed-price contracts, and expenses and associated fee already reimbursed under cost-reimbursement contracts.

Past payments to the contractor under either fixed-price or cost-reimbursement contracts generally do not enter into settlement calculations. However, unliquidated advance or progress payments are deducted from the final settlement amount.

Settlement with Subcontractors

FAR 49.108

After a cost-reimbursement contract is terminated for default, the prime contractor is responsible for achieving settlements with any affected subcontractors. The same principles that apply to the prime contractor apply to settlements with its subcontractors—no payments are permitted for the loss of anticipated profits, for example.

Settlements with subcontractors are subject to ratification by the Government. To be approved, a settlement must be arrived in good faith, be reasonable in amount, and be allocable to the terminated portion of the contract. If necessary, the Government may intervene to achieve a settlement with a subcontractor on a cost-reimbursement contract.

FAR 49.108-4

The contracting officer may authorize the prime contractor to conclude settlements without verification if the amount is $100,000 or less.

Needs for Audits

FAR 49.107

An audit is required before a settlement with a subcontractor is approved, if the amount involved exceeds $100,000.

Following a Termination for Default under a fixed-price contract, it is the prime contractor's responsibility to settle with its subcontractors. The Government has no liability for compensating the prime contractor for the cost of subcontractor settlements.

Settlement Proposal Forms

FAR 49.602-1

The same standard forms used by a contractor to submit its settlement proposal following a convenience termination are used following a Termination of Default (see Part B).

Fixed-Price Settlement Principles

Following default, the Government is not obligated to pay a fixed-price contractor for inventory acquired to perform the work, work in progress, or work completed but not yet shipped unless it agrees to acquire that work.

FAR 52.249-8

The Government, however, is obligated to pay a fixed-price contractor for:

- Work completed and accepted but not yet paid for, at the contract price
- Any inventory and work in progress or undelivered work transferred to the Government, at a negotiated amount
- Preservation, protection, and shipping of inventory or work in progress acquired by the Government, at cost plus an agreed-upon profit if any.

No allowance is made in settlements of fixed-price contracts terminated for default for the contractor's cost of settling subcontracts or the preparation of the settlement proposal.

Cost-Reimbursement Settlement Principles

When a cost-reimbursement contract is terminated for default, the Government is obligated to pay the contractor for:

- Allowable costs incurred prior to the termination
- Allowable costs subsequent to the termination that were reasonably necessary or incurred at the direction of the Government
- Costs of approved settlements with subcontractors
- Fee in proportion to the supplies and services already delivered and accepted.

FAR 49.403

However, the contractor's costs for preparing its settlement proposal are not allowed. The Government may adjust the amount of fee paid to reflect the nature of work completed, the contractor's management of subcontractor settlements, and the reason for the termination.

Indirect Cost Rate

FAR 49-303-3

The final indirect cost rate applicable to expenses under a cost-reimbursement contract will be resolved in the same way as if the contract was still in force. The final rate will be determined following the end of the contractor's fiscal year. Alternatively, the contracting officer can negotiate agreed-upon rates if waiting for actual rates would unduly delay the settlement process. If the terminated contract was a sizable one, these indirect cost rates may rise substantially due to unused plant and equipment and the smaller direct cost base.

16C.5 ARRIVE AT A FINAL SETTLEMENT

Following a Termination for Default, you should make every effort to achieve a final settlement with the contractor as quickly as possible.

Very often, however, considerable time may be needed. For cost-reimbursement contracts, a final settlement depends on settlements with all subcontractors and determining or agreeing on applicable indirect rates. For fixed-price contracts, the final settlement must reflect the cost to the Government of reprocuring the required products or services.

Audit Required

FAR 49.303-2

In most cases, an audit of the contractor's settlement proposal is required prior to agreeing on a final settlement amount. An audit is not necessary under a cost-reimbursement contract if the contractor only claims an adjustment of fee.

Settlement by Determination

If agreement on a final settlement with the contractor cannot be achieved, the contracting officer can determine the amount of the settlement unilaterally. The contractor has the right to protest the determination under the Disputes clause.

FAR 49.109-7(b)

The contractor must be notified by certified mail in advance of a settlement by determination and be given at least 15 days to provide evidence that a greater amount is due.

16C.6 ISSUE MODIFICATION AND DOCUMENT THE TERMINATION

If the Government and the contractor mutually agree on the amount of the termination settlement, prepare and issue a supplemental agreement. The modification should follow the appropriate format for that type of contract and extent of termination as presented in FAR 49.603.

FAR 49.603-9

If only partial agreement on a settlement can be reached, prepare and issue a supplemental agreement that specifies the areas or amounts that are mutually acceptable to the Government and contractor, but explicitly excludes certain items from the settlement agreement. The contractor has the right to seek a more favorable settlement on excluded items under the Disputes clauses.

If a settlement agreement is not reached, prepare and issue a unilateral modification citing the contract's Termination clause as authorization.

Settlement Review

FAR 49.111

Some agencies require an administrative review of proposed termination settlements before a modification is issued.

Deobligate Any Remaining Funds

FAR 49.105.2

Any funds remaining after a settlement has been completed should be deobligated. If necessary because of funds released earlier, funds may be restored by the contracting officer to make up any shortage needed for the settlement.

Settlement Memorandum

FAR 49.110

At the conclusion of negotiations, the contracting officer must prepare a memorandum describing the elements of the settlement. If a lump-sum settlement was reached, only the basis for that amount needs to be described. However, if settlement was achieved based on negotiations over individual items, the memorandum must identify the factors considered for each item. Additional information should be included to the extent it would assist authorities in understanding the basis for the settlement.

CHAPTER 17

CLAIMS

'TIS A LAME CLAIM

The TRU project manager looked over the letter Jack B. Pickee had sent and rolled his eyes.

"Since when is compiling a table of contents considered a basic-level training requirement?" he asked no one in particular. The receptionist and one of his instructors were engaged in a playful argument over whose turn it was to make the coffee and ignored him.

He went back to his office to examine the contract. No mention of table of contents. On the other hand, what would the additional cost be? "Next to nil," he concluded. His instructors knew that stuff cold. The means to accomplish the compiling was included in the software. So there wasn't really a reason to pursue this fine point. He would comply—much simpler that way.

Bea would not have been surprised if she had received a claim on the table of contents compiling issue because she really wasn't sure how much of a headache it would be for the company to include it, but she was totally unprepared for a claim that Troubles, Inc. filed after their contract was terminated for default.

She had this claim in hand when she ran into Ernest in the hall. "Would you please get me the file on this troublesome Troubles, Inc. contract?" she asked. "Sure," he said reading the letter she gave him as he walked back to his office.

The letter contended that payment was a basic contract obligation of the Government toward the contractor and that the Government had failed to pay Troubles, Inc., in the amount of $85 for grass seed—an amount that it had invoiced five months ago under the cost reimbursable portion of its contract. The claim, signed by the President of the company, sought payment of the $85 and a recision of the default termination notice because the Government had breached the contract first and, therefore, it was under no obligation to proceed with performance.

"What do you suppose they've been sniffing?" Ernest asked incredulously as he and Bea went through the contract file together.

Bea smiled. "They're simply desperate—no one wants a defaulted contract on their record," she replied. "What's this $85 bill they're referring to?—I don't remember that."

continued . . .

"We never bothered you with it," Ernest said. "They're required to provide a bill of sale prior to reimbursement and they never did. Here's my letter telling them that they needed to include a receipt before we could pay for the grass seed. I even cited the paragraph number in the contract that requires the documentation!"

"So you did—good job," Bea said, reading his letter. "First, let's make sure that we really have to consider their letter a claim." They reviewed the factors summarized from Exhibit 17-1 in Bea's text and decided that it was technically a claim under the Contract Disputes Act.

"I'll call the President of Troubles and try to get him to withdraw the claim," Bea said. "Otherwise we're going to have to document our position, get Johnnie to review it, and I'll have to send it out as a final decision of the contracting officer under the Disputes clause in the contract."

Bea's agency required that any claim have legal concurrence before a final decision of the contracting officer was released to the contractor.

Bea got nowhere with the Troubles, Inc. President. So they issued the final decision after Johnnie I. Dotter concurred. Ernest had carefully review all the minimum content requirements for this notice—using the requirements summarized in Exhibit 17-5 from Bea's course, and Johnnie found the decision legally sufficient the first time around. Ernest hoped he had heard the last of that issue.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Analyze contractor claims and recommend/document appropriate settlement positions.

Individual:

17.1	Determine whether a contractor's demand constitutes a valid claim.
17.2	Ensure that contractor is aware of its obligation to continue performance.
17.3	Conduct factfinding and prepare the Government's position.
17.4	Attempt to resolve the claim informally through negotiation or ADR.
17.5	Prepare the contracting officer's decision and obtain required reviews.
17.6	Issue the decision and initiate payment in accordance with the decision.
17.7	If the contractor appeals, prepare a claims file and participate in appeal proceedings as requested.

INTRODUCTION TO CLAIMS

Definition of Dispute

A ***dispute*** refers to a postaward disagreement when it is first recognized that the Government and one of its contractors have conflicting points of view—in other words, before it officially becomes a "claim."

Definition of Claim

FAR 33.201

A ***claim*** is a dispute from the time that a written demand or assertion is made, as a matter of right, for the payment of a specific amount of money or other relief. The claim must be properly certified if required by law or regulation. A claim may include a written request for the adjustment of contract terms or for other relief arising under or relating to the contract. A claim may be originated by a contractor or by the Government.

A claim arising *under* a contract, unlike a claim *relating to* a contract, is a claim that can be resolved under a contract clause that provides for the relief sought by the claimant.

Contracting Officer's Role

FAR 33.210

Contracting officers are authorized to decide and settle all claims subject to the Contract Disputes Act except for:

- Claims for penalties or forfeitures prescribed by statute or regulation for which another Federal agency has been assigned responsibility
- Claims involving fraud.

Definition of Appeal

An ***appeal*** results from a claim that is denied, at least partially, by the contracting officer. The contractor then can file for consideration by a court or board of contract appeals.

Policy

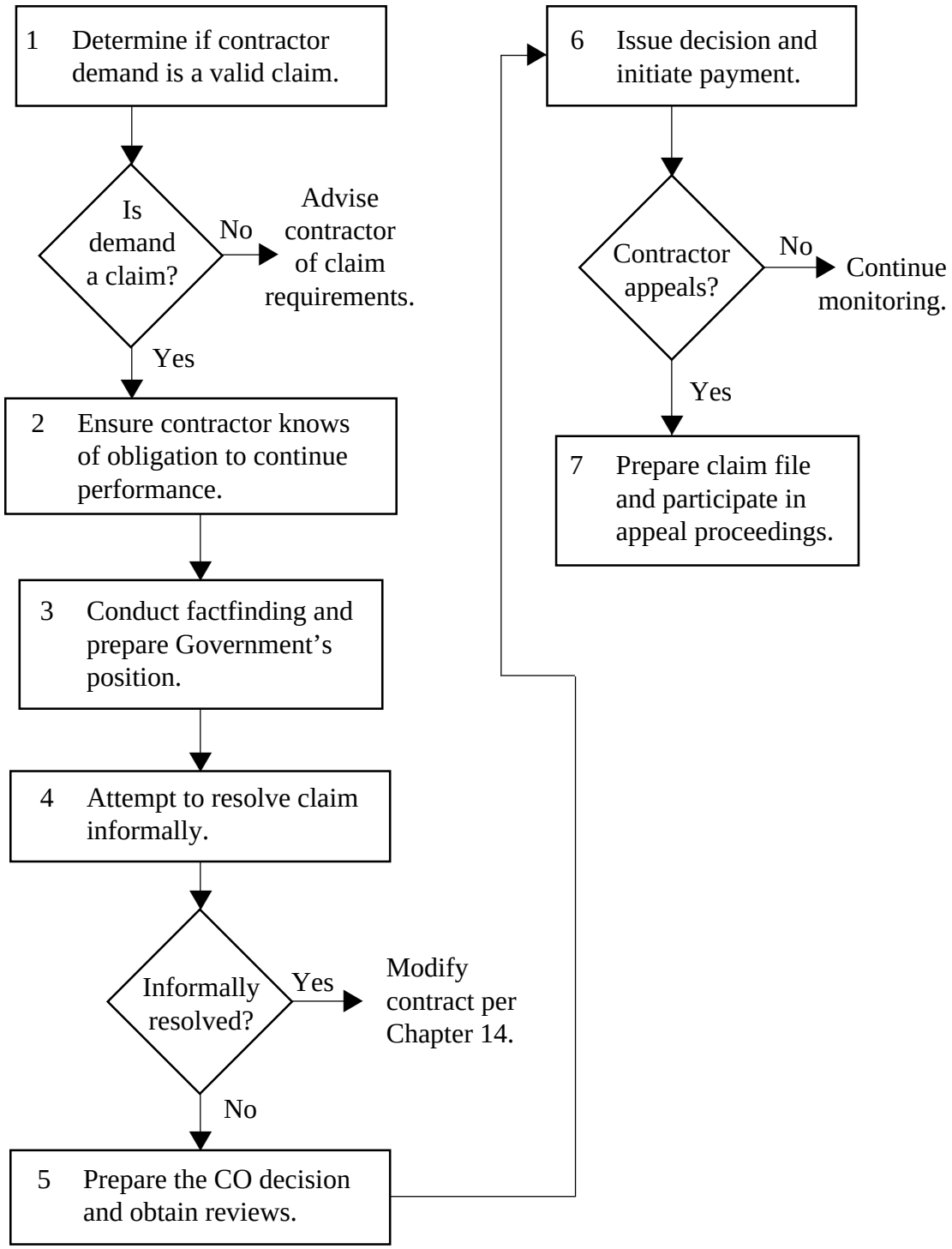
FAR 33.204

The Government's policy on claims is largely based in the Contract Disputes Act (CDA) of 1978, as amended. The emphasis in this policy is to try to resolve all contractual issues by mutual agreement at the contracting officer's level and without litigation.

Steps in Performance

The steps in resolving claims are charted on the next page. Following the flowchart, each step is discussed in turn.

STEPS IN RESOLVING CLAIMS



CLAIMS

17.1 DETERMINE IF A CONTRACTOR'S DEMAND IS A VALID CLAIM

There are several things you need to do before you can begin processing a claim in your contracting office.

- First make sure that the claim is one that your contracting office has the authority to process
- Then make sure that the claim, as submitted, meets all the prerequisites for processing under the Contract Disputes Act.

Types of Claims

There are two basic categories of claims involving Government contracts. They are:

1. **Disputes or Contract Disputes Act Claims.** Most contractor claims fall within this category and include:
    - Claims to correct or mitigate the effects of a mistake in, or reflected in, a contract
    - Claims for compensation as the result of a tort relating directly to a single contract.

    A ***tort*** is a wrong committed against the person or property of another. It is one of the two classes of civil actions, the other being contract actions. Although the Contract Disputes Act does not address tort claims, the Court of Federal Claims and the boards of contract appeals accept cases involving Government actions that can be characterized as torts, but which also constitute a ***breach,*** the failure to carry out a contractual obligation.

2. **Tort or Breach Claims Involving Issues Independent of a Single Contract.** If a tort or breach claim does not directly relate to obligations with respect to a single Government contract, it is outside the scope of the Disputes clause in that contract and, therefore, cannot be processed by the administrative boards of contract appeals or by the contracting officer for the procuring agency.

The Federal Tort Courts Act (FTCA) permits persons and entities injured by negligent conduct of the Government to sue for damages in U.S. district courts.

Contracting Officer Authority

FAR 33.210

Procuring agency contracting officers have the authority to settle all claims under the Contract Disputes Act except those that:

- Are the responsibility of a specific Federal agency because of a separate statute or regulation
- Involve fraud.

If contractors submit claims to your contracting office when it does not have the authority to decide on them, refer them to appropriate Federal agency that has sole responsibility for these claims. For example, a contractor might submit a claim to your office for the recovery of retroactive wages due to a Department of Labor reclassification ruling that affected its contract with your agency. You would have to refer that claim to the Department of Labor for resolution.

Fraudulent Claims

FAR 33.209

When you suspect that fraud is involved in a claim submitted to you, refer the matter to your agency's Inspector General.

Subcontractor Claims

FAR 44.203

Government subcontractors generally may not file a claim directly with the Government, but may file a claim through the prime contractor. The prime contractor sponsors the subcontractor's claim by filing a claim or an appeal of a claim on the subcontractor's behalf or by permitting the subcontractor to take such action under the prime contractor's name.

The most common exception to the need for prime contractor sponsorship of claims is Small Business Administration 8(a) subcontractors. They may file their claims directly rather than through the Small Business Administration that, technically, is the prime contractor.

Essential Elements of Contract Disputes Act Claims

After you establish that the claim is neither within the exclusive settlement authority of another agency or fraudulent, you must decide if it has all the essential elements required of Contract Disputes Act claims. Refer to Exhibit 17-1 to review these prerequisites.

Determination of Amount for Certification Requirements

To determine the dollar amount of a claim for purposes of certification requirements as indicated in the exhibit, you must aggregate the increased and decreased costs involved. For example, a contract requesting a net price increase of $10,000 for a change involving $40,000 of added work and $30,000 of deleted work would be required to provide a certification because the combination of the two amounts, $70,000, exceeds the $50,000 threshold.

Essential Elements of Contract Disputes Act Claims
FAR 33.207

- Must be in writing
- Must be addressed to the contracting officer
- Must specify a specific sum of money if a monetary compensation is a demand being made
- And, if the amount of the claim involves more than $50,000, a certification is included that:
  - — The claim is made in good faith
  - — Supporting data are accurate and complete to the best of the contractor's knowledge and belief
  - — The amount claimed actually reflects the contract adjustment for which the contractor believes the Government is liable, and
  - — The claim is signed by an individual who is duly authorized to bind the contractor with respect to the claim

Exhibit 17-1

Documentation of Receipt

If the claim includes all essential elements, you can begin processing it. Immediately document the file with evidence of a receipt date of the claim. The receipt date is important because the Disputes clause in the contract provides for the payment of interest from the date of the contracting officer's receipt of a claim that meets all the prerequisites outlined in Exhibit 17-1.

If the claim does not meet all of the required prerequisites, you must notify the contractor in writing immediately, stating the reasons why the claim is not being processed.

17.2 ENSURE PERFORMANCE CONTINUES, IF APPROPRIATE

It is essential that you immediately examine all relevant clauses that relate to the claim.

FAR 33.213

The first to consider is the Disputes clause. There are several versions and their requirements regarding the contractor's duty to continue performance are different. The basic Disputes clause at FAR 52.233-1 requires that the contractor continue performance when a claim arising *under* the contract is filed. In other words, under this basic clause, the contractor would be required to continue performance only if the subject of the claim is dealt with by specific terms of the contract. However, if Alternate I to the basic clause is used, the contractor also is required to continue to perform if the claim relates to the contract, even if its resolution is not outlined in specific contract terms.

Exceptions

Regardless of the Disputes clause language, the contractor does not have a duty to proceed when:

- Funding limits have been reached on cost-reimbursement contracts, or
- A stop work order is in effect.

17.3 CONDUCT FACTFINDING AND PREPARE THE GOVERNMENT'S POSITION

After the administrative prerequisites are confirmed, you then examine the material aspects of the claim itself to decide if it has merit. You first should make an initial review and then a detailed analysis. Steps for the initial review are covered in Exhibit 17-2.

Steps For Initial Claims Review

1. Read the contractor's letter and identify the issues involved
2. Review the contractor's documentation to develop a chronology of the facts as the contractor identifies them
3. Review the contract file and other contract documents to both verify the contractor's chronology and develop the chronology further
4. Review all pertinent contract clauses and identify the requirements associated with each one
5. Return to the contractor's letter and make a determination, based on the information that you investigated thus far, as to whether the claim may have merit

Exhibit 17-2

Exclusions Based on Initial Review

The initial review may exclude the claim, or part of it, from further consideration based on things such as:

- Lack of proper notice to the Government
- What can be requested as consideration
- Failure to follow procedures outlined under the terms of the contract.

Many events leading to a claim are covered by contract clauses that provide for the remedy sought. Cost-reimbursement contracts contain prescribed remedies in clauses such as:

- FAR 52.215-22, *Price Reduction for Defective Cost or Pricing Data*
- FAR 52.243-2, *Changes*
- FAR 52.245-5, *Government Property*
- FAR 52.246-5, *Inspection of Services*
- FAR 52.249-6, *Termination*

Some remedies prescribed are quite explicit. For example, FAR 52.222-43, *Fair Labor Standards and Service Contract Act—Price Adjustment (Multiple Year and Option Contracts),* specifies that any adjustment for labor increases is limited to increases or decreases in wages and fringe benefits. It specifically excludes any amounts for general and administrative costs, overhead, or profit.

Exclusions Based on a Thorough Review

If your initial review indicates that all or a part of the claim may have merit, study those areas of the claim in greater detail. Refer to Exhibit 17-3.

Technical Analysis

The technical analysis, including, if appropriate, the analysis of the engineering approach, should be accomplished by the person or persons who initially drafted the specifications or work statement. An analysis of the engineering approach establishes the reasonableness, from an engineering standpoint, of any additional time and labor hours claimed.

Prepare all of these facts in an organized form and preserve them in the contract file.

Develop Government's Position

If you have determined that all or part of the claim has merit, develop the Government's position in regard to the claim.

Steps for Analyzing a Claim in Detail

1. Based on the initial analysis of contractor documentation versus Government evidence, decide if the basic facts are true, not true, or partially true, and if the facts justify a claim
2. Make a technical analysis of the claim, thoroughly examining specifications or work statements (both as written and as changed)
3. Analyze the engineering approach documented by the contractor, if appropriate
4. Perform a price analysis and, if appropriate, a cost analysis
5. Obtain a legal analysis

Exhibit 17-3

Burden of Proof

In addition to the policy and procedure direction contained in contract clauses, remember that the contractor has the burden of establishing its right to the consideration it claims.

Additionally, it must prove that it has a right to the specific type of consideration it seeks, including the substantiation of any increases in money or time it may request. However, the courts and boards have ruled that the Government should not be relieved of a clear liability solely because the amount cannot be shown with mathematical certainty. On the other hand, you should not accept pure speculation even if it sounds logical. The contractor must show some reasonable basis for its estimates or projections of cost. Regardless of the basis used, the contractor must present the best evidence available and must demonstrate why better or more certain evidence is not possible.

FAR 31.201-2

Exclude all costs that do not comply with the FAR cost principles when you develop the Government's final position. Remember that the contractor must prove that its costs are allowable. This means that it must prove that its costs are reasonable, are allocable, comply with the cost accounting standards or generally-accepted accounting principles, and do not violate any of the contract's requirements.

17.4 ATTEMPT TO RESOLVE THE CLAIM INFORMALLY

FAR 33.204

The Government's policy is to try to resolve all contract disputes informally whenever possible. This includes arriving at a fair and reasonable settlement of contractual issues leading to claims. Once the Government's position on a claim is determined, you should initiate negotiations with the contractor in an effort to reach an agreement. Prolonged legal battles are time consuming and costly, and should be avoided.

Try to resolve differences over facts first. Once you and the contractor reach agreement on what happened, you can turn your attention to how best to compensate the contractor for any damages. Remedies may include an increase in funding, an increase in time, a decrease in quantities or other requirements, or some combination of these.

Alternative Disptues Resolution

FAR 33.214

If a negotiated settlement does not seem possible, suggest Alternative Dispute Resolution (ADR) procedures (See Chapter 10.) Agree on what issues you cannot resolve and the specifics, based on your agency's policies, under which ADR will proceed.

Government Claims

Informal resolution of the claim also is preferred when the Government has a claim against a contractor. Such claims may arise, for example, from inadvertent overpayments to the contractor, for the cost of reinspection following the rejection of nonconforming supplies, or for damage to Government property. Because the contractor can dispute the claim as erroneous, excessive, or unfair, any resulting litigation may not be in the best interests of the Government. A mutually acceptable outcome often is preferable.

You would only file a claim against a contractor when other remedies are inappropriate. Some guidelines for Government claims against contractors are included in Exhibit 17-4.

If a settlement can be reached at the contracting officer level, prepare and issue a supplemental agreement that modifies the terms of the contract (see Chapter 14).

Guidelines for Government Claims Against Contractors

- Take prompt action to determine the claim's dollar amount and other considerations
- Thoroughly research and review the claim before asserting it—have it reviewed by other agency officials such as engineering, accounting, and legal experts to ensure that it is accurate and appropriate
- Write the demand for payment as a concise claim statement. Where there is reason to believe that attempts at mutual agreement will be futile or there is reason to expedite collection, issue the demand in the form of a final decision
- Ensure any deferment is in agreement with agency policy
- Ensure that all Government claims are represented in bankruptcy proceedings
- Do not overlook the possibility of asserting common law damage claims to supplement an excess reprocurement cost claim or to compensate for delaying performance
- Prepare final decisions in the same manner as in addressing a contractor claim—include, at a minimum:
  - — A statement of the original contract requirements
  - — The conduct that gave rise to the liability
  - — The amount and nature of the price adjustment or damages claimed
  - — A statement that the decision is issued under the Disputes clause with advice on the appeals process

Exhibit 17-4

17.5 PREPARE CONTRACTING OFFICER'S DECISION AND OBTAIN REQUIRED REVIEWS

When mutual agreement is not reached, the contracting officer has the authority to settle the dispute unilaterally by issuing a final decision. The decision does not reflect complete acceptance of the claim because then there would be bilateral agreement as to the facts, the extent of damages, and the method of compensation. Therefore, the decision may reflect either:

- Complete rejection of the claim, or
- Partial acceptance and partial rejection of elements of the claim.

Prepare the contracting officer's final decision carefully because it is the focus of any further appeals that the contractor may make in regard to the claim. Therefore, the decision must be in writing and you must obtain a receipt from the contractor that it has been received. At a minimum, the decision must contain all of the elements listed in Exhibit 17-5.

Minimum Content Requirements for a Contracting Officer's Final Decision
FAR 33.211(a) and FAR 52.233-1

1. Appropriate references identifying the contract and issues involved, including:
   - Contract number
   - Summary of the claim that includes
     - — Succinct statement of its factual basis
     - — Contract excerpts the contractor used to support the claim
     - — Consideration sought
2. A finding of facts, including:
   - A summary of the decision reached
   - Reasons for the decision, including
     - — Statement of factual areas of agreement and disagreement
     - — Supporting rationale for the final decision
3. A closing statement that:
   - Identifies the document as the final decision of the contracting officer, and
   - Advises the contractor of its right to appeal the decision, providing brief information on how to file an appeal

Exhibit 17-5

Timely Response

The contracting officer has 60 days in which to issue a decision on claims of $50,000 or less. If the claim is larger than $50,000, and more than 60 days is needed to analyze and document it, the contracting officer may take longer to issue the final decision. However, the contractor must be notified in writing as to when the decision will ultimately be issued. If a response is not issued within these time frames, it is not considered timely.

The failure to issue a timely decision is viewed as a denial of the claim. This allows the contractor to file an appeal for consideration of the claim at higher levels.

Review Requirements

Most agencies have administrative review requirements for contracting officer's final decisions that may include legal reviews in addition to management reviews. Consult your agency's FAR supplement at Part 33 to locate your agency's review requirements.

17.6 ISSUE THE DECISION AND INITIATE PAYMENT, IF APPROPRIATE

Issue the final decision of the contracting officer as you would any other unilateral modification, as detailed in Chapter 14. The authority you would use for issuing this modification is the Disputes clause in the contract, either FAR 52.233-1 or FAR 52.233-1 (Alternate I).

FAR 33.211(h)

If the decision upholds part of the claim, process payment in the amount specified in the decision, plus interest.

Interest on Contractor Claims

The Government must pay interest on a successful contractor claim, computed from:

FAR 33.208

- The date the contracting officer receives a properly certified claim, or

FAR 52.233-1(h)

- The date payment otherwise would be due—if that date is later than the receipt of the claim—until the date of payment.

The interest rates are adjusted every six months by the Secretary of Treasury and vary considerably. The rates are published in the *Federal Register,* but may also be obtained from the accounting office in your agency. A claim that has gone from the "final decision" stage through the appeals process can span several periods of different interest rates, and the amount must be calculated on a daily basis.

FAR 33.211 (a)(4)

FAR 32.610 (a)

If the decision results in a finding that the contractor is indebted to the Government, include a demand for payment in the decision. Interest from the contractor will begin to accrue beginning in 30 days.

17.7 IF THE CONTRACTOR APPEALS, PREPARE A CLAIMS FILE AND PARTICIPATE IN THE PROCEEDINGS

The contractor has appeal rights following a contracting officer's decision. Generally, a contractor has an initial choice between:

- The procuring agency's board of contract appeals (BCA), where an appeal must be filed within 90 days, or
- The United States Court of Federal Claims, where an appeal must be filed within 12 months.

The contractor must initially choose one or the other. It may not seek a ruling from both.

Exceptions to the Appeals Process

There are some exceptions to this general appeals process for Contract Disputes Act claims.

1. **Maritime Vessel Contracts.** The forum for resolution is the United States district court having jurisdiction.
2. **Contracts Involving Fraud.** Although the Contract Disputes Act excludes administrative avenues of relief for disputes that involve fraudulent issues, a board may exercise its right to decide whether it has jurisdiction based on the merits of each case. Therefore, when there are overriding considerations of justice to claimants, a board may exercise its discretion and refuse to suspend proceedings.

Contractor Considerations

There are practical and legal considerations contractors weigh in deciding whether or not to appeal the contracting officer's final decision. These factors include:

- The chances of success
- The cost of litigation
- The impact on its business relationships
- Potential disruption to ongoing business
- The desire to create a precedent.

Exhibit 17-6 briefly outlines some factors that contractors would normally consider when choosing the initial forum for their appeal. The exhibit highlights the key differences, but this is not an exhaustive comparison.

A Brief Comparison: Boards vs. Courts		
Characteristic	***Boards of Contract Appeals***	***Court of Federal Claims***
Time limit on filing	90 days after the final decision of the contracting officer	One year after the contracting officer's final decision
Hearings (trials)	Optional—must be requested by any party preferring to present oral arguments rather than have a decision based solely on the written evidence Uses transcripts of hearings when hearings are held	Usually optional, but the judge may order the parties to present oral arguments Uses transcripts of hearings when hearings are held
Small claims procedures	Required to accelerate claims of $50,000 or less, with special expedited procedures for claims with a value of $10,000 or less	Does not have specific small claims procedures but generally tries to expedite smaller claims
Expense	Less formality, so generally less expense, but the process is becoming more formal over time	Procedures are more formal, so they generally are more time-consuming and, therefore, more expensive
The judges	The administrative judges have the reputation for deciding cases independently of agency pressures—nevertheless, contractors sometimes are suspicious of preferential treatment for the Government's case	Federal court judges are perceived as more independent and also more willing to make controversial decisions
The Government lawyer	The Government is represented by an attorney from the procuring agency	The Government is represented by the Department of Justice

Exhibit 17-6 (page 1 of 2)

A Brief Comparison: Boards vs. Courts		
Characteristic	***Boards of Contract Appeals***	***Court of Federal Claims***
Government contract expertise	Board members are usually required to have a minimum number of years of experience in public contract law	No specialized Government contracts experience is required
Use of precedent (basing decisions on rulings on previous similar cases)	More consistent in the application of precedent	Outcome of decision based on precedent is somewhat less likely
Forum for further appeals	Court of Appeals for the Federal Circuit	Court of Appeals for the Federal Circuit
Appeal restrictions	120 days from notice of an adverse board decision—must file a Notice of Appeal in the Court of Appeals for the Federal Circuit	Generally 60 days from the date of the adverse court judgment—must file with Clerk of the Court of Federal Claims
Judicial review standard	Upon appeal, board decisions are reviewed by the Federal Circuit Court to see if they lack support of "substantial evidence" or are based on an error of law	Upon appeal, Court of Federal Claims rulings are reviewed by the Federal Circuit Court to see if they are "clearly erroneous"—this review standard is generally regarded as stricter; therefore, a Court of Federal Claims ruling would be less prone to reversal than a board decision

Exhibit 17-6 (page 2 of 2)

Notice of Appeal Regardless of the initial forum chosen, the contractor must submit a copy of the notice of appeal to the contracting officer. To be legally effective, this notice must contain the six basic requirements listed in Exhibit 17-7.

Requirements for a Contractor's Notice of Appeal

- Be in writing
- Express discontent with the final decision
- State an intention to seek review of the decision by a higher authority
- Identify the contracting officer, the agency, or department location
- Contain the contract number and a description of contract requirements
- State the decision from which relief is being sought

Exhibit 17-7

Initial Actions After Notification

After you receive a contractor's notice of appeal, you should take two immediate actions:

1. Contact your agency's legal department to have a trial attorney assigned to the case, providing a copy of the notice of appeal with your request, and
2. Begin to assemble a claims file.

When a trial attorney is assigned, consult with this lawyer on the contents of the claims file, but begin to assemble it immediately because it is a time-consuming task. The boards and courts make judgements on claims filed with them based on evidence submitted by both parties. The claims file you submit to your lawyer will be the basis for the documents your lawyer will submit to the board or court that is to rule on the case. Typical contents of such files are outlined in Exhibit 17-8.

Participate in Appeals Proceedings

FAR 33.212

Your participation in ongoing litigation should be orchestrated by the Government lawyer. He or she will pass on any requests by the board or court for specific factual information to the contracting office. You also may be required to appear in person to provide evidence at a board or court hearing.

Contents of a Typical Claims File

- A full copy of the contract, including contract specifications and drawings and all changes made to them since contract award
- Correspondence that relates to the claim
- Inspection records that relate to the claim
- Memoranda of meetings, including postaward orientation conferences (often important in establishing expectations and understandings of both parties)
- Progress charts and information concerning progress, if progress is an issue
- Copies of pertinent administrative logs such as:
  - Daily inspection logs for construction or service work
  - Logs showing approval of contractor submissions
  - Change order logs
- Copies of photographs or videotapes that illustrate key points in the Government's case
- Copies of any interim or final performance evaluations that document key points in the Government's case

Exhibit 17-8

If the board or court eventually issues a decision that does not uphold the one originally made by the contracting officer, you will be required to modify the contract to enforce that court or board decision to the extent it alters existing terms of the contract. You would cite the board or court decision as your authority for this unilateral contract modification.

However, sometimes boards or courts will rule on entitlement and direct the parties to negotiate the terms of the settlement. In these cases, your contract modification would be a supplemental agreement acceptable to both parties.

CHAPTER 18

DEBARMENT AND SUSPENSION

GOTCHA!

Karl Kolumbo, an agency Inspector General (IG) auditor, went to the Troubles, Inc. office. He had investigated alleged Service Contract Act (SCA) violations before.

"Payments to laborers are made in cash," the Troubles, Inc. bookkeeper told him. Some of these people don't even have a checking account which makes it very difficult for them to cash checks." However, the bookkeeper produced a ledger that showed the amount paid to each laborer. Each laborer's signature appeared next to the amount paid to him. These amounts complied with SCA minimums.

However, Karl Kolumbo was still suspicious. "How come there are no addresses or phone numbers on these records?" Karl asked the bookkeeper.

"Many of these people are transient," she responded defensively. "It's a nightmare to keep up with current addresses and half of them don't have phones."

"Oh, yeah, I can just imagine. What a time you must have!" Kolumbo clucked sympathetically and turned to leave. Then he paused, apparently changing his mind, and came back towards her. "You know, there's something I still don't understand," he said. "How do you manage at the end of the year to track these people down to give them W-2 forms?"

"We tell them they have to pick their W-2s up here or send us an envelope with their current mailing address," she said quickly. She said she was not required to keep those addresses in the permanent record.

"Of course!" Kolumbo said, hitting his palm against his forehead. "I should have thought of that!" He left, thanking her profusely, and apologizing for any inconvenience he may have caused her.

There had been social security numbers on the company payroll ledger. Kolumbo had copied down several names and numbers. He'd run a check of these and see if he couldn't find anything else out that way.

Kolumbo's record search turned up some addresses and phone numbers. He contacted these employees. It was time well spent.

continued . . .

"Some of these folks were just too scared to talk to me, but a few others provided sworn statements that they were forced to sign the payroll records even though they were not paid as much as the records indicated," he informed Bea and Ernest while dropping off a copy of his report to them. "Furthermore, some of the social security numbers in the company records appear to be duds."

"Illegal foreigners?" Ernest asked.

"Wouldn't surprise me, but that's for another agency to worry about," Kolumbo said. "DOL wanted to know if these employees were paid the minimum wage—they're not. Furthermore, the company is engaging in fraudulent activity. The proof is in the report and the affidavits attached to it. The ball's out of my court now."

When he had left, Ernest asked Bea nervously, "Is the ball in our court now?"

She smiled, "No, Ernest—DOL is the enforcement agency for labor violations and because of the fraud indications, the Justice Department will get involved too.

DOL will undoubtedly declare Troubles, Inc. ineligible for Government contracts. Unless there are unusual circumstances for not declaring them ineligible, that action is mandatory for an SCA violation," Bea noted.

"You're talking about a debarment, right? I thought a debarring official had discretion on debarments!" Ernest exclaimed.

"Under our FAR guidelines, yes, our agency may always choose not to debar. However, under SCA regulations, the DOL official has no such discretion unless very unusual circumstances can be documented," Bea told him. "Also, for these types of statutory violations, the action is technically termed a declaration of ineligibility rather than a debarment—although the end result is the same."

"What are unusual circumstances?" Ernest wanted to know. "You mean something weird like the company going out of business and all of the principals dying? A debarment—or, excuse me, an ineligibility declaration—would be an exercise in futility in that case, wouldn't it?"

Bea laughed. "Yes, I think it would take something that extreme," she agreed.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Initiate debarment or suspension action by properly referring evidence of significant or persistent performance problems to responsible officials.

Individual:

18.1 Identify occurrences of significant or recurring performance problems.

18.2 Evaluate available evidence and take interim action, if appropriate.

18.3 Prepare reports to the suspending or debarring official and forward recommendations through appropriate channels.

18.4 Forward notices and participate in hearings, as appropriate.

18.5 After debarment, provide any additional data requested by the debarring official.

INTRODUCTION TO DEBARMENTAND SUSPENSION

Definition of Suspension

Suspension is the temporary disqualification of a contractor from receiving a contract or approved subcontract for a period of time. This action is taken when, based on evidence, a contractor is suspected of engaging in seriously improper conduct, nonperformance or significantly incompetent performance. Suspension actions typically are issued pending completion of an investigation that may lead to debarment.

Definition of Debarment

Debarment excludes a contractor from contracting and approved subcontracting for a reasonable, specified period of time. The period depends on the seriousness of the offense or extent of the failure or inadequacy of performance.

Suspension or debarment applies only to eligibility for future awards. Current contracts may continue, but not be extended without compelling reason. In addition, when appropriate, separate action can be taken to terminate contracts already in place.

Policy on Suspension and Debarment

FAR 9.402

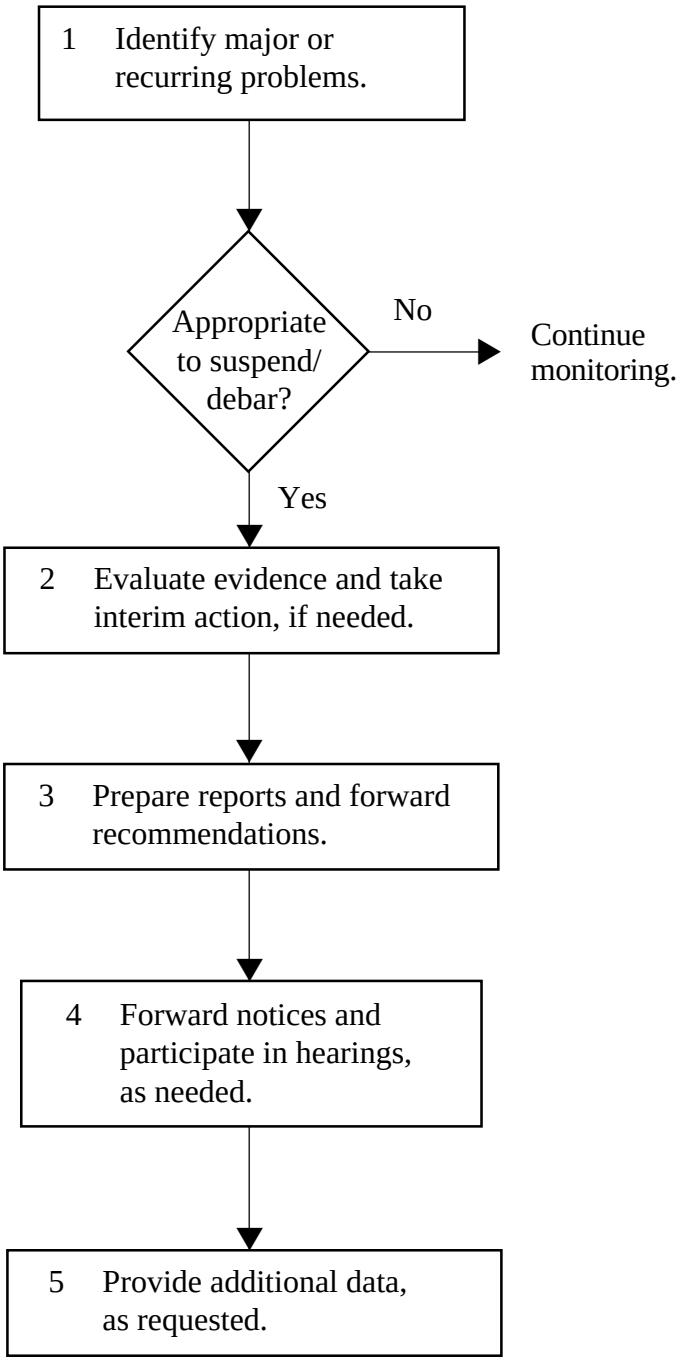
Agencies are required to solicit offers from, award contracts to, and consent to subcontracts only with responsible contractors. Debarment and suspension are discretionary actions that, when prescribed procedures are followed, are an appropriate means to meet that requirement.

However, the serious nature of suspension and debarment demands that these sanctions be taken only in the public interest for the Government's protection and not for the purposes of punishing a contractor or subcontractor.

Steps in Performance

The steps necessary to suspend or debar contractors are charted on the next page. Following the flowchart, each step is discussed in turn.

STEPS IN DEBARMENT AND SUSPENSION



DEBARMENT AND SUSPENSION

18.1 IDENTIFY MAJOR OR RECURRING PERFORMANCE PROBLEMS

Debarment essentially precludes a contracting officer from making an award to a debared company or individual. Debarment overrides any judgement by the contracting officer as to the acceptability of doing business with a contractor based on its bid, proposal, or other information about the company.

Suspension has the same effect as debarment, but is only an interim measure taken to protect the Government while debarment procedures are pursued.

Reasons to Suspend/ Debar

There are two basic reasons for initiating suspension or debarment procedures against a contractor:

1. The contractor generally poses a substantial business risk to the Government, or
2. The contractor has actually violated a provision of a statute, executive order, or regulation but the FAR contains no specific sanction for the offense.

General business risk debarments are imposed by following FAR procedures. Additionally, some specific statutory sanctions also are imposed through FAR procedures—for example, debarment proceedings for Drug Free Workplace Act violations.

Declarations of Ineligibility

FAR 9.400(b)

The second category of debarments are commonly termed *statutory* or *inducement* debarments and are initiated exclusively through the use of procedures not contained in the FAR. The FAR terms these debarments *declarations of ineligibility*. The most typical legal bases for declarations of ineligibility are the:

- Davis-Bacon Act
- Service Contract Act
- Equal Employment Opportunity Acts and Executive Order 11246
- Walsh-Healey Public Contracts Act
- Environmental Protection Acts.

Applicability of FAR Procedures

FAR 9.405(b)

Although FAR procedures for establishing who is and is not debarred do not apply to declarations of ineligibility, FAR procedures concerning treatment of debarred entities apply in the same way as other declarations of ineligibility.

Except for the FAR debarment procedures, the regulation governing debarment for Service Contract Act (SCA) violations is the most detailed. A comparison of these rules with FAR procedures identifies some substantial differences. Under Service Contract Act, there is a strong presumption in favor of debarment, contrasted with a strong concern for due process issues under FAR procedures. Refer to Exhibit 18-1.

FAR Guidelines	SCA Regulatory Guidelines
When a cause for debarment exists, debarment is not mandatory	When a violation of the Service Contract Act is found, debarment is mandatory, absent "unusual circumstances"
Debarment is prescribed for substantial or serious violations	Debarment is prescribed even when the violation is minor or inadvertent
The contractor is ineligible for both prime contracts and subcontracts	The contractor is ineligible for both prime contracts and subcontracts
Reduction in the period of debarment may be based on new evidence as well as mistake or legal error	Reduction in the period of debarment is considered only in cases of mistake or legal error
Usually, debarment has no effect on current contracts except that renewals or extensions are not issued	Violations often result in the cancellation of existing contracts

Exhibit 18-1

GSA Publication of Ineligible Parties

FAR 9.404

You normally find out about declarations of ineligibility by reviewing *Parties Excluded from Procurement Programs,* a publication issued by the General Services Administration. You need to know who they are for two reasons:

1. Agencies responsible for making declarations of ineligibility may request information about contracts you administer as part of an investigation they conduct prior to taking suspension or debarment action, and

2. You may need to cancel an existing contract or refrain from extending or renewing a current contract.

Your agency and other procuring agencies also are responsible for reporting suspensions and debarments they put in effect for reasons of general business risk.

Appropriate Initiation by Procuring Agencies

You initiate suspension and debarment proceedings when you become aware of serious or recurring performance problems. Your aim is to protect the Government against dishonest or negligent businesses entities and individuals.

It is appropriate to begin examining the need for suspension and debarment proceedings when you realize that a firm or individual cannot be trusted to perform important contract terms. For example, you may have evidence of:

- Continued unsatisfactory performance in regard to important technical requirements
- A general lack of integrity or failure to observe business ethics
- Actions that seem to indicate functioning as a front for other debarred or suspended individuals
- A contractor's criminal conviction or a civil judgement against it.

18.2 EVALUATE EVIDENCE AND TAKE ACTION, IF APPROPRIATE

The purpose of debarment is not to hurt the contractor—it is to help the Government by ensuring the prospective integrity of its suppliers. The harm to the contractor is simply a byproduct. It would be inconsistent with the double jeopardy principle of the Constitution to punish a contractor or subcontractor through the criminal justice system and then, additionally, through debarment proceedings.

Therefore, suspension and debarment proceedings in the FAR usually prescribe actions that *may* be taken, but rarely prescribe mandatory action.

You should recommend suspending or debarring contractors only if it clearly protects the Government from potential harm. The FAR provides examples of when debarring a contractor may be appropriate. Refer to Exhibit 18-2.

Typical Causes for a Contractor Suspension or Debarment
FAR 9.406-2, FAR 9.407-2 and FAR 23.506(d)

- Fraud or another criminal offense in connection with:
  - — Obtaining a public contract or subcontract
  - — Attempting to obtain a public contract or subcontract
  - — Performing a public contract or subcontract
- Violation of Federal or State antitrust statutes relating to the submission of offers
- Establishment of guilt for embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, or receiving stolen property
- Violation of Drug-Free Workplace Act requirements
- Using unfair trade practices, such as:
  - — Violations of section 337 of the Tariff Act of 1930
  - — Violations of bilateral or multilateral export control agreements
- Use of a "made in America" label on products not made in America
- Any other offense indicating a lack of business integrity that seriously and directly affects present ability to act responsibly

Exhibit 18-2

Note that any evidence of lack of business integrity may be the basis for a suspension or debarment. For example, the fact that a contractor cheats on its corporate income tax has no direct effect on a Government contract, but may nevertheless be indicative of a lack of business integrity justifying debarment. The theory behind this policy is that one who lacks integrity in one area probably lacks integrity in others, and that this lack of integrity poses a risk to the Government in its contracting relationship.

Mitigating Factors However, there may be mitigating factors to consider. The FAR provides examples of such factors, as summarized in Exhibit 18-3.

Mitigating Factors Against Suspension/Debarment
FAR 9.406-1

- Existing, effective contractor standards of conduct and internal control systems
- The contractor brought the activity cited as a cause for debarment to the Government's attention in a timely manner
- The contractor fully investigated the circumstances surrounding the cause for debarment and made the results of the investigation available to the Government
- The contractor cooperated fully with Government agencies during the investigation and any court or administrative action
- The contractor has paid or has agreed to pay all criminal, civil, and administrative liability for the improper activity, including any investigative or administrative costs incurred by the Government, and has made or agreed to make full restitution
- The contractor has taken appropriate disciplinary action against individuals responsible for the activity which constituted cause for debarment
- The contractor has implemented or agreed to implement remedial measures, including any identified by the Government
- The contractor has instituted or agreed to institute new or revised review and control procedures and ethics training programs
- The contractor has had adequate time to eliminate the circumstances within the its organization that led to the cause of debarment
- The contractor's management recognizes and understands the seriousness of the misconduct and has implemented programs to prevent recurrence

Exhibit 18-3

Current Contracts Suspension and debarment affect eligibility for future contract awards and extensions of ongoing contracts. These actions do not affect current contracts. However, termination or other measures may be appropriate if the contractor's continued performance represents a risk to the Government's interests. These additional actions are independent of suspension and debarment, and must follow procedures and policies applicable to the additional action.

18.3 PREPARE REPORTS AND FORWARD RECOMMENDATIONS

Suspension or debarment are among the few contracting actions that are beyond the authority of Government contracting officers.

Responsible Officials

FAR 9.403

Instead, a ***debarring official,*** either the agency head or an agency official specifically designated by the agency head, will be responsible for suspension or debarment actions. Your agency's supplement to the FAR should specify that official.

It is your responsibility to provide a report containing documentation and recommendations for suspension and debarment to that official. Your agency's FAR supplement may also contain parameters or formats for assembling that report.

Documentation for Debarment

FAR 9.406-3(d)(3)

FAR 9.403

In the absence of a conviction or civil judgment, your recommendation for debarment must establish that there is *a preponderance of the evidence* that indicates a serious business risk for the Government.

Preponderance of the evidence means information that, compared with information opposing it, leads to the conclusion that the fact at issue is more probably true than not.

Documentation for Suspension

A recommendation of suspension involves an examination of the evidence of wrongdoing, and then fact finding to achieve a standard of *adequate evidence.* This is a more lenient standard than the legal standard of preponderance of evidence. This is logical because the statutory definition of suspension states that its occurrence is appropriate when one is "suspected" of engaging in seriously improper conduct. The standard of adequate evidence has been compared to the legal definition of *probable cause.*

FAR 9.407-2

Criminal indictment for any of the causes for suspension listed in Exhibit 18-2 satisfies the burden of proof. In such cases, a grand jury already has examined the evidence and found it sufficient to issue an indictment. Therefore, the grand jury is assumed to have acted on *adequate evidence.* The only issues in such a suspension proceeding are whether the basis for the indictment is a reason for suspension and whether suspension is necessary to protect the Government's interests.

You must assume the burden of proof for suspension in the absence of an indictment. This means you must decide whether the information is sufficient to support a reasonable belief that a particular act or omission has occurred. The FAR provides criteria you should consider before deciding. Refer to Exhibit 18-4.

Criteria For Deciding Whether a Suspension is Appropriate
FAR 9.407-1(b)

- The extent of information available
- The credibility of the evidence given the circumstances
- Whether or not important allegations are corroborated
- What inferences can reasonably be drawn as a result of the evidence

Exhibit 18-4

FAR 9.407-1(b)(1)

With these criteria in mind, examine basic documents, such as:

- Contracts
- Inspection reports
- Correspondence.

Look for any proof you may need to support a suspension recommendation. However, it is not your responsibility to conduct an investigation. That will be carried out by the debarment official in collaboration with agency and other Federal authorities.

Individuals Versus Contractors

Companies do not commit debarable offenses—people do. Therefore, contractors often claim that misbehaving employees were acting on their own without the sanction or knowledge of company officials. The FAR provides specific guidelines for when such misbehavior may result in debarment of the employer. When the conduct occurs in connection with the individual's performance of duties for or on behalf of the contractor, the contractor is held responsible.

This means that even when an employee acts outside the scope of his or her employment, the employer's knowledge, approval, or acquiescence is sufficient to make it responsible for the employee's actions. Additionally, the contractor's acceptance of the benefits derived from the employee's actions is considered evidence of such knowledge, approval, or acquiescence—making contractor responsibility virtually unavoidable.

This transfer of legal responsibility from one party to another, associated party is termed *imputation.*

Imputation from company to employee is similar. Individuals may face debarment when they participated in, knew of, or had reason to know of the contractor's conduct that formed the basis for debarment. Generally speaking, to know of a crime is not to a crime itself, but the debarment regulations establish a tougher legal standard.

If an individual knows of wrongful conduct by an employer, or even if the individual only had reason to know of that conduct but didn't, he or she is responsible for that conduct under debarment regulations.

Despite this broad regulatory language, there is some evidence that you should also consider *intent* when you recommend a debarment. In a 1982 case, a board ruled that individuals could be debarred only as a result of their personal action or inaction (*Azzarelli Construction Co.,* HUD BCA No. 82-670-D11, 82-1 BCA ¶ 15,676).

In regard to suspension and debarment, the FAR's definition of the term *contractor* extends to individuals to a limited extent:

FAR 9.403

> *"Contractor," as used in this Subpart, means any individual or other legal entity that—*
>
> *(a) Directly or indirectly (e.g., through an affiliate) submits offers for or is awarded, or reasonably may be expected to submit offers for or be awarded, a Government contract . . . or a subcontract under a Government contract; or*
>
> *(b) Conducts business with the Government as an agent or representative of another contractor.*

So, when the sole proprietor of a small service company attempts to bribe a Government official, clearly the Government would consider it a risk to do business with that individual regardless of which company he or she becomes affiliated with in the future. Furthermore, it may be reasonable to presume that such an individual might start up another company to do business with the Government. It therefore would be appropriate to debar the individual as well as the company.

On the other hand, if a middle manager in a large aerospace company attempts to illegally influence a Government official, the Government may be able to protect itself if that the individual is removed from any position of responsibility with the aerospace contractor (assuming other company officials were not involved).

Debarment of that individual probably is unnecessary because that person may not be expected to submit offers for, or be awarded, a Government contract or subcontract.

Debarment of Affiliates

FAR 9.403

Affiliates are business concerns, organizations, or individuals that:

- Have the power to control each other, directly or indirectly, or
- Are both controlled by a third party.

Examples of such control are:

- Interlocking management or ownership
- Pooling of interests among family members
- Shared facilities and equipment
- Common use of employees.

FAR 9.406-1(b)

FAR 9.407-1(c)

You may recommend that an affiliate be suspended or debarred, but you must specifically identify it by name in your recommendation to the debarring official. That affiliate must then be given written notice of the proposed debarment and an opportunity to respond separately from the contractor with whom it is affiliated.

Some would argue that debarment of affiliates is proper to prevent the circumvention of sanctions by operating through multiple entities. Normally, however, as a matter of fairness, debarring officials will not debar an affiliate if it had no connection with the business circumstances surrounding the improper act.

A business entity newly organized following the debarment, suspension, or proposed debarment of a contractor which has the same or similar management, ownership, or principal employees as the contractor that was debarred, suspended, or proposed for debarment is considered an affiliate.

Successor Companies

FAR 9.406-4(c)(3)

You should be sensitive to the risk that a debarred contractor may try to do business with the Government under a new name. On the other hand, when a *bona fide* change in ownership or management takes place, as through the sale of the company's assets, it is appropriate to reconsider the decision to debar.

Guidelines for Affiliation Decisions

Affiliation is a concept in both the debarment regulations and the SBA's size standard regulations. If you must decide on whether or not to recommend suspending or debaring a company you suspect is an affiliate, consult the SBA size standard regulations for a detailed definition of affiliation. Also request assistance from you legal office before deciding on an appropriate recommendation regarding affiliates.

Recommendations for the Time Period

Time periods for suspensions or debarments are intended to reflect the seriousness of the reasons for initiating the action. Exhibit 18-5 provides the maximum time intervals prescribed by the FAR.

Maximum Suspension and Debarment Time Periods FAR 9.406-4 and FAR 9.407-4

Description of Suspension or Debarment	Maximum Time
Suspensions (in general)	12 months
Suspensions for which an Assistant Attorney General has requested an extension	18 months
Suspensions on which legal proceedings have been initiated within the original or appropriately extended suspension time frame	For the duration of the legal proceedings
Debarments (in general)	3 years
Drug-Free Workplace Act violations	5 years

Exhibit 18-5

Written Reports

After carefully considering the facts, prepare a report that contains, at a minimum, all of the information listed in Exhibit 18-6. Other information may be required by your agency's FAR supplement or internal instructions that have been issued by your agency's suspending/debarring official. Review these before assembling your report.

18.4 FORWARD NOTICES AND PARTICIPATE IN HEARINGS, AS APPROPRIATE

Suspending or debarring a firm is damaging, and may even be fatal, to a firm's reputation and business. For this reason, Government officials, under FAR procedures, must afford certain due process protections before taking these actions.

Due process refers to the Constitutional guarantee, found in the Fifth and Fourteenth Amendments, of fundamentally fair treatment by the Government. *Procedural* due process includes notice by the Government and an opportunity to be heard by the Government prior to the infringement of a liberty or property interest. As a result, in Government suspension and debarment proceedings, contractors must be given:

Minimum Content Requirements for Written Reports Submitted to Suspending or Debarring Officials

- Description of problem
- Discussion of mitigating factors, if any
- Indexed file of related documents
- Description of any known relationships between the contractor and other entities that have had similar problems
- Analysis of the impact that the contractor's performance problems may have on:
  - — Overall cost and delays in obtaining needed supplies and services
  - — Competition and withdrawal of more responsible suppliers from the Government market
  - — Mission accomplishment

Exhibit 18-6

- Notice of the intent to suspend or debar, including the grounds for the suspension or debarment action
- An opportunity to provide evidence in opposition to the action taken (in the case of a suspension) or to be taken (in the case of debarment)
- Notice of the suspending or debarring official's decision.

Notices of Intent

You will probably be the one to write the notice of a proposed debarment that the debaring official must sign. Be particularly careful to include all of the minimum content requirements. Inadvertent omission of any one of them could be the basis for challenging the correctness of the procedures and a reason for judicial reconsideration upon a contractor's appeal.

Response to Notices

The response to such notices may be in person, in writing, or through a representative—that is, an attorney.

Before submitting a response to the notice, contractors are likely to ask for a copy of the administrative record. Although Government-wide rules are silent on granting such requests, the debarring official customarily complies. This record includes your report and supporting documentation.

Minimum Content Requirements for Suspension and Debarment Notices FAR 9.406-3 and FAR 9.407-3

For suspension or debarment notices:

- A statement that debarment is being considered or that suspension action has been taken
- Reasons for the suspension or proposed debarment in terms sufficient to put the contractor on notice of the conduct or transaction(s) upon which it is based
- Description of the cause(s) that form the bases for the suspension or debarment (for suspension notices, descriptions should not so detailed as to disclose the Government's evidence)
- An invitation to submit, within 30 days after receipt of the notice, in person, in writing, or through a representative, opposing information, including such additional specific information that raises a genuine dispute over the material facts
- A statement of the agency's procedures governing suspension or debarment decisionmaking
- A statement of the effect of issuing the notice, and
- A statement of the potential effect of an actual debarment

Additionally, for suspension notices only:

- Notification that the suspension is based on an indictment or other adequate evidence that the contractor has committed irregularities:
  - — Of a serious nature in business dealings with the Government, or
  - — Seriously reflecting on the propriety of further Government dealings with the contractor
- Notification that the suspension is temporary pending the completion of an investigation and possible legal proceedings
- If any of the circumstances that entitle contractors to a hearing as part of due process exists (refer to Exhibit 18-8), a statement that additional proceedings to determine disputed material facts will be conducted

Exhibit 18-7

Hearings

FAR 9.400(a)(1)

Whenever a contractor is proposed for debarment under FAR procedures, the contractor is entitled to a hearing under the circumstances outlined in Exhibit 18-8. Otherwise, it only is invited to provide a written response to the allegations unless the suspending or debarring official optionally agrees to hold a hearing at the contractor's request.

Circumstances That Entitle Contractors to a Hearing As Part of Due Process

FAR 9.405 FAR 9.406 FAR 9.407

- When suspension or proposed debarment is not based upon a conviction or civil judgment
- When the contractor's submission in response to the Government notice raises a genuine issue of material fact
- In suspension cases, when substantial interests of the Government in pending or contemplated legal proceedings would not be prejudiced by a hearing

Exhibit 18-8

Timing of Hearing

A point of legal argument is whether due process requires notice and the opportunity to be heard before a suspension action is taken against a contractor. In most circumstances, the Federal courts have upheld the Government's right to suspend a contractor and thereby exclude it from new awards before holding a hearing, but only if:

FAR 9.407-4

- A suspension without a hearing lasts no more than 18 months

FAR 9.405-1(a)

- The suspension does not affect the performance of existing contracts, but only the award of new ones.

Hearing Transcriptions

FAR 9.406-3(b)(2)(ii)

FAR 9.407-3(b)(2)(ii)

Hearings, including optional hearings, must be on the record and transcribed unless the contractor and the agency, by mutual agreement, waive the requirement for a transcript. Unless waived, the transcript must be made available to the contractor at cost upon request.

Bases for Debarment

FAR 9.406-3(d)(2)

FAR 9.407-3(d)(2)

The debarring official bases his or her decision on:

- The report you submitted
- Facts that may be provided by other Government officials—for example, Government attorneys
- Any information and argument submitted by the contractor, and
- Any other information in the administrative record.

Timing of Decisions

FAR 9.406-3(d)(1)

If there is no hearing, a debarring official must make a decision within thirty working days of receipt of the contractor's submission of rebuttal evidence unless there is a good reason to extend that time frame.

FAR 9.406-3(e)

FAR 9.407-3(d)(2)iii

The FAR does not establish a time frame for suspension decisions or for debarment procedures that include a hearing, except to say that it must be prompt. If the decision is for debarment, the decision must specify the reasons for debarment and state the effective period.

Distribution of Decisions

The decision of the suspending or debarring official is transmitted by certified mail.

18.5 PROVIDE ADDITIONAL DATA AFTER DEBARMENT, AS REQUESTED

There may be any number of reasons for providing additional information after debarment, but most of them fall under the following categories:

- The Government is considering an extension of a suspension or debarment
- The Government must defend itself against charges of impropriety, or
- A debarred or suspended contractor or subcontractor has asked for reconsideration.

Extensions

FAR 9.406-4(b)

A debarment may not be extended solely on the basis of the same facts and circumstances upon which the initial debarment action was based. Procedures for extending debarment are essentially the same as those for the original debarment.

Procedural Challenges

FAR 9.402(b)

While due process challenges generally have failed, the courts have been sympathetic to challenges based on departures from established rules. The Administrative Procedures Act (5 U.S.C. 702) waives the Government's sovereign immunity against a complaint alleging that such regulations have been violated. Moreover, the debarment regulations themselves expressly state that their use is mandatory.

In the event of such challenges, you would be expected to assist your agency's suspending or debarring official in providing information attesting to the appropriateness of the procedures followed.

Request for Reconsideration

FAR 9.406-4(c)

The debarring official, under FAR rules, may reduce the period or extent of debarment upon the contractor's request. This request must be supported by documentation, citing reasons such as:

- Newly-discovered material evidence
- Reversal of a conviction or civil judgment upon which the debarment was based
- A true change in ownership or management
- Elimination of other causes for which the debarment was imposed, or
- Other reasons the debarring official deems appropriate.

You generally are required to provide additional input for such considerations.

Based on the evidence supplied, the debarring official may then reduce the period of suspension or debarment. However, the Davis-Bacon debarment time frames are an exception and cannot be reduced.

CHAPTER 19

FINAL PAYMENT AND CLOSEOUT

ALL's WELL THAT ENDS WELL

Ernest N. Deavors was staying late one night to clear up some of the paperwork. He was trying to close out two of the contracts he had been administering.

His agency never heard from Troubles, Inc. about an appeal against Bea Ware's final decision regarding the $85 grass seed bill and the default termination. "They must have other priorities with DOL and Justice down their backs," Ernest thought.

So Ernest went through his checklist—copied from Exhibit 19-1 in Bea's contract administration text—to see if he couldn't close out the file and send the contract to storage.

He ran into problems on the third checklist item. The DOL investigation on Troubles, Inc. was still active—so he couldn't close it out. No use going through the rest of the items. "Nuts, this contract will be taking up space in my drawer forever!" he thought.

He had better luck with the cost-plus-incentive-fee contract Bea had turned over to him when another contract specialist had relocated. The contractor had taken exception to several items in the draft report and the auditors had agreed to a recomputation that affected one of the company's overhead pools. Ernest had completed his rework of the incentive fee formula five weeks ago and now had evidence that final payment under that contract had been made.

Ernest thumbed through the pages of the final audit report as he affixed it securely to its place in the contract file record. He thought it odd that technically this type of final closeout audit was known as a transaction audit, even though it encompassed just about all of the transactions that had taken place during contract performance plus the verification of indirect costs. "Seems a bit of a misnomer," he mused.

He peered at his contract closeout checklist again and went down the list. All of his checkmarks were in the "Yes" or "N/A" columns until he came to item 16—the contractor's performance evaluation.

He didn't remember seeing an evaluation. He checked where the specialists usually filed these evaluations. No luck. Next, he thumbed through the papers in the miscellaneous section of the file. No. Then, he again went through the stack of duplicate copies he had pulled from the file. No—it hadn't gotten mixed in with them either.

continued . . .

"I'll just have to write one up," he said to himself. It wasn't a difficult task. The incentive fee formula put the contractor slightly better than average on the cost control aspect of contract performance. File documentation indicated no serious problems, but no real show-stopping stellar technical performances either. So a fully satisfactory performance rating was in order—nothing more, nothing less.

Ernest filled out the form his agency customarily used for contractor performance evaluations, flagged the approval line for Bea Ware's signature, and affixed it to the file in front of him. He checked off item 16 "Yes" and completed the checklist.

"I want you out of here and I want out of here too!" he said aloud to the file as he quickly attached a contract closeout statement and the checklist to the multiple file package that contained all the contractual paperwork on this cost-plus-incentive-fee contract. He then deposited the entire package on the table next to Bea Ware's desk. With that, he was out the door.

COURSE LEARNING OBJECTIVES

At the end of this course, you will be able to:

Overall: Close out Government contracts, adjust billing rates and establish final indirect cost rates for final payment of cost-reimbursement contracts, and provide "lessons learned" as a result of contract performance.

Individual:

19.1	Verify that the contract is physically complete.
19.2	Obtain all forms, reports, and clearances required for closeout, and verify that all contract terms are met.
19.3	Adjust billing rates and determine whether to apply quick closeout procedures on cost-reimbursement contracts.
19.4	Settle outstanding issues, such as obtaining and applying final indirect cost rates.
19.5	Verify that there are no outstanding claims or disputes.
19.6	Make final contract payment or collect overpayment.
19.7	Identify and recommend deobligation of excess funds.
19.8	Document lessons learned from contract performance, including an evaluation of contractor performance.
19.9	Prepare a contract completion statement and dispose of files.
19.10	Determine whether to invoke the Government's rights under the Continuity of Services clause.

INTRODUCTION TO FINAL PAYMENT AND CLOSEOUT

Definition of Contract Closeout

Contract ***closeout*** is the procedure for verifying that all administrative matters have been concluded on a contract that is otherwise physically complete; that is, the contractor has delivered the required supplies or performed the required services and the Government has inspected and accepted the supplies or services.

Policy on Contract Closeout

FAR 4.804-5

According to Government policy, the contracting officer administering the contract signs a contract completion statement confirming that all administrative actions have been performed.

Closeout Time Frames

FAR 4.804-5

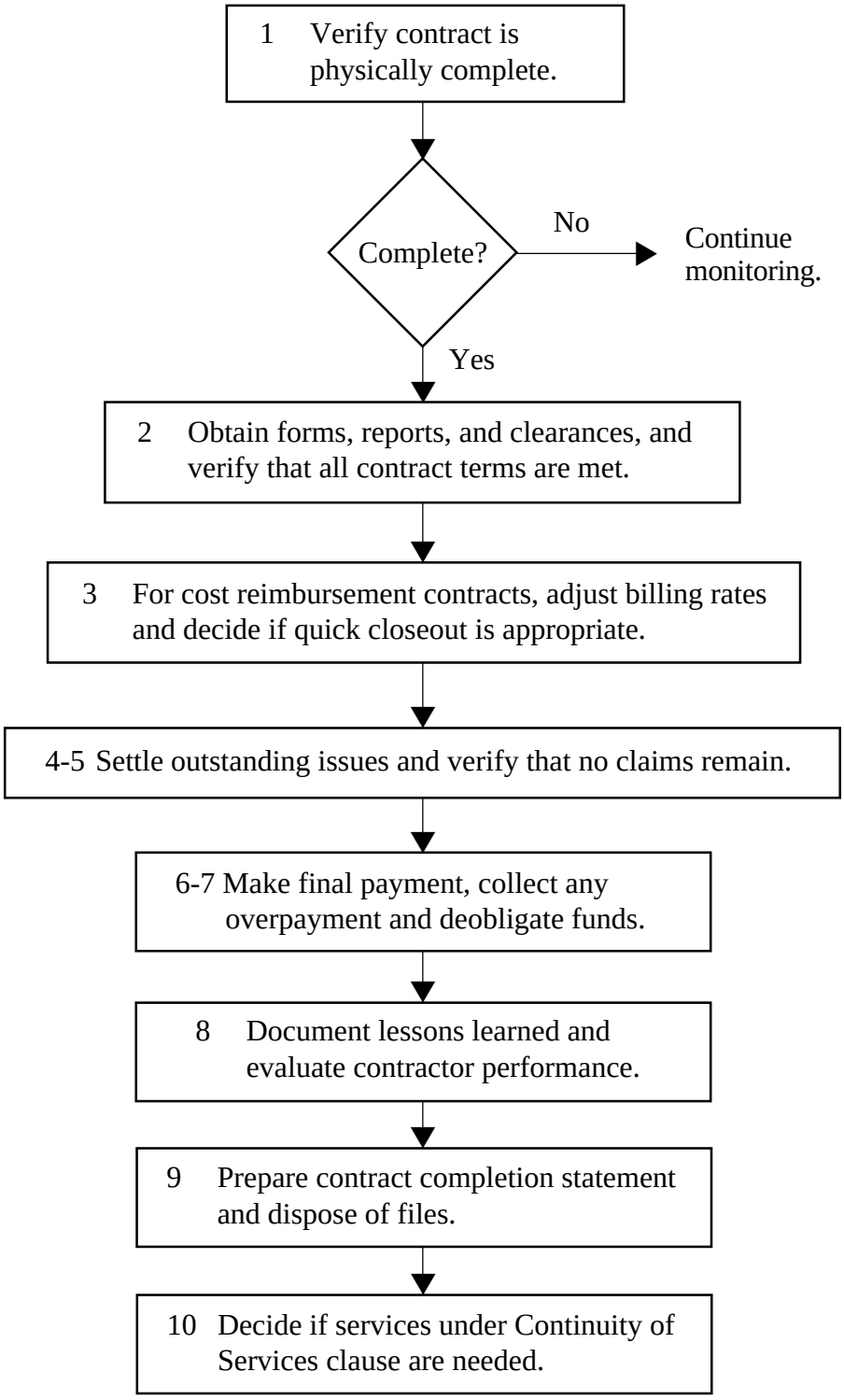
Standard times for closing out a contract vary depending on the contract type:

- Small purchases are considered closed with evidence of receipt of supplies or services, and final payment is made.
- Fixed-price contracts that are not small purchases should be closed out within six months after receipt of evidence of physical completion.
- Contracts requiring settlement of indirect cost rates should be closed out within 36 months after receipt of evidence of physical completion.
- Other contracts should be closed out within 20 months after receipt of evidence of physical completion.

Steps in Performance

The steps in final payment and closeout are charted on the next page. Following the flowchart, each step is discussed in turn.

STEPS IN FINAL PAYMENT AND CLOSEOUT



FINAL PAYMENT AND CLOSEOUT

19.1 VERIFY PHYSICAL COMPLETION

FAR 4.804-4

A contract is physically complete when one of two events has occurred:

- All required supplies or services have been delivered or performed, inspected, and accepted, and all existing options have been exercised or have expired
- A contract termination notice has been issued to the contractor, and a settlement has been completed.

After you verify that a contract is physically complete, you begin contract closeout procedures.

19.2 OBTAIN ALL FORMS, REPORTS, AND CLEARANCES, AND VERIFY TERMS ARE MET

The purpose of closeout is to ensure that there is no further administrative action necessary on the contract and that the Government and the contractor have fulfilled all of their responsibilities under the contract.

Completion of Paperwork

Part of the task is to make sure that all paperwork has been submitted. Most agencies use a checklist to ensure that all forms, reports, and clearances that may be outstanding after a contract is physically complete are obtained and included in contract files. Use of such a checklist is considered a “best practice” by the Office of Federal Procurement Policy. An example of a contract closeout checklist is shown in Exhibit 19-1.

Contract Closeout Checklist

A check in the "No" column for any item indicates that closing out the contract is inappropriate at this time. "N/A" means not applicable under this contract.

	Yes	N/A	No
1. Proper disposition has been made of all classified material.			
2. There is adequate documentation to show receipt and formal acceptance of all contract items. No "punchlist" discrepancies remain.			
3. There are no claims or investigations by GAO, Department of Labor, or an Inspector General pending on this contract.			
4. Value engineering change proposals have been either disapproved or physically complete and made a part of the contract.			
5. Any required plant clearances have been obtained.			
6. Any required property clearances have been obtained.			
7. All interim or disallowed cost issues (including refunds, rebates, and credits) are settled.			
8. All action related to contract price revisions and changes have been concluded.			
9. All outstanding subcontracting issues have been settled by the prime contractor.			

Exhibit 19-1 (page 1 of 2)

Contract Closeout Checklist *continued*

A check in the "No" column for any item indicates that closing out the contract is inappropriate at this time. "N/A" means not applicable under this contract.

	Yes	N/A	No
10. All prior year indirect cost rates have been settled.			
11. If a partial or complete termination was involved, the termination docket shows that all action is complete.			
12. Any required contract audit for cost-type contracts is now complete.			
13. Contractor's release of claims has been received, or closing statement has been investigated as to why the contractor will not provide one.			
14. The contractor's final invoice has been submitted and paid.			
15. A contract funds review has been accomplished, and deobligation of any excess funds has been recommended or overpayments have been collected from the contractor.			
16. The Government contract administration team has officially evaluated the contractor's performance.			
17. Final patent report has been obtained, if required.			
18. Final royalty report has been obtained, if required.			

Exhibit 19-1 (page 2 of 2)

Contract Terms Satisfied

Both the contractor and the Government are required, in addition to physical completion responsibilities, to fulfill the requirements of all terms in the contract. Some examples of end-of-contract requirements are:

- Contractor must return or otherwise properly dispose of Government furnished property
- Contractor must promptly remove its property from Government furnished facilities
- Contractor must deliver or otherwise properly dispose of surplus materials in inventory under cost-reimbursement contracts
- Government must promptly vacate facilities provided by the contractor
- Government must notify a surety issuing a performance bond that performance is complete.

You should review every clause in the contract carefully to make sure all obligations have been met. Do this as early in the closeout process as possible so any needed actions can be completed in a timely way.

19.3 ADJUST BILLING RATES AND DECIDE IF QUICK CLOSEOUT IS APPROPRIATE

Billing rates are estimated rates for indirect costs. Prior to establishing final indirect cost rates, billing rates are adjusted from time to time in order to prevent substantial overpayment or underpayment.

Responsibility for Rate Adjustment

FAR 42.703

Only one Federal agency at a time (known as the *cognizant agency*) may establish or adjust billing rates for a contractor business unit. This policy was established to provide uniformity of approach, economy in administration, and timely settlement. If your agency is not the cognizant agency, you must obtain billing rate adjustments from the agency that has that responsibility.

When to Make Adjustments

When your agency does have cognizance, you should make an interim billing rate adjustment when a contract is physically complete. This adjustment will be only an approximation of the final billing rate because final indirect cost rates are usually established only after the close of the contractor's fiscal year. Therefore, a time lag typically occurs between when the contract is physically complete and when final indirect cost rates can be established.

However, in the case of cost-reimbursement research and development contracts with educational institutions, final rates may already be established—indirect cost rates for these contracts may be predetermined for a future period on the basis of cost experience with similar contracts.

Exhibit 19-2 lists typical sources that can be used as a basis for adjusting billing rates prior to when a final rate is determined.

Typical Sources for Adjusting Billing Rates

- Information from budget tracking systems
- Unaudited actual costs
- The most recent audit reviews available
- Contractor's final indirect cost rate proposal

Exhibit 19-2

Methods for Establishing Final Indirect Cost Rates

Final indirect cost rates can be established by either:

- Negotiation between the contractor and the contracting officer, or
- Establishment of actual rates through a final contract audit by the contract auditor.

The distinction is who has ultimate responsibility for the final rate—the auditor or the contracting officer.

Generally, if there is a corporate ACO or a resident ACO assigned to the business unit, the auditor does not have responsibility for the final rate. For other business units, a contracting officer in the agency having the predominant interest (on the basis of unliquidated contract dollar amount) sets the indirect cost rates if agency procedures require contracting officer determination.

FAR 42.705-2(a)

Even when agency procedures generally require contracting officer determination, the auditor and contracting officer can agree to the auditor determining the indirect cost rates if special circumstances of a particular case make it more efficient to do so. However, if the auditor and contractor cannot agree on the rate, the cognizant contracting officer must settle the disagreement.

Quick Closeout Procedures

FAR 42.708

Quick closeout procedures simply mean that the contracting officer negotiates the settlement of indirect costs for a specific contract in advance of an advisory audit by a contract auditor. Quick closeout procedures can only be used if:

- The contract is physically complete
- The amount of unsettled indirect cost to be allocated to the contract is relatively insignificant, and
- Agreement can be reached on a reasonable estimate of allocable dollars.

Criteria for Cost Allocation Significance

A two-fold test is used to determine whether the amount of unsettled indirect cost to be allocated to the contract can be considered, "insignificant":

1. The total unsettled indirect cost applicable to any one contract does not exceed $500,000
2. Unless otherwise provided in agency procedures, the cumulative unsettled indirect costs to be allocated to one or more contracts in a single fiscal year do not exceed 15% of the estimated total unsettled indirect cost allocable to cost-type contracts for the fiscal year.

Generally, only the cognizant audit agency has access to the contractor's accounting records, and a review of these records is necessary to ensure that the 15%, or agency-established limitation, is not exceeded.

Additional Criteria Quick Closeout

From a good business management perspective, the contractor's history of incurred costs, billings, and performance are additional factors to consider when deciding whether quick closeout is appropriate.

Finality of Quick Closeout Rates

FAR 42.708(b)

The contracting officer's determination of rates under quick closeout procedures are final for the contract it covers. No compensating adjustments may be made to other contracts if that determination is later found to be over or under actual rates.

19.4 SETTLE OUTSTANDING ISSUES, SUCH AS INDIRECT COST RATES

There may be unsettled issues related to basic contract performance that have not yet been resolved. These kinds of unsettled issues include:

- The application of indirect cost rates
- Unresolved value engineering change proposals
- Disallowed costs
- The final total price of a fixed-price incentive contract
- The award amount under an award-fee contract
- The final fee for a cost-plus-incentive-fee contract
- Contractor settlement costs under terminated contracts.

Final Indirect Cost Rates

Because of the overload of auditing work in most agencies, the establishment and application of final indirect cost rates is likely to be the most time-consuming issue to settle if you do not use quick closeout procedures. Unless your agency is the single agency responsible for establishing indirect cost rates for a contractor business unit whose contract you will to close out, you must work through the contracting officer in another agency rather than in your own agency.

Settlement of Indirect Cost Rates by Contracting Officer

FAR 4.705-1(b)

When the cognizant contracting officer negotiates indirect cost rates, regardless of whether or not quick closeout procedures are used, the contractor must submit a proposal for final indirect cost rates that reflects actual cost experience during the covered period and includes supporting data for the requested rates.

Time Frame for Indirect Cost Rates Proposal Receipt

FAR 52.216-7

Such a proposal is due within 90 days after the expiration of the contractor's fiscal year.

Adequate Bases for Negotiation

Some general criteria for using specific contractor proposals as an adequate bases for conducting negotiations on final indirect cost rates are listed in Exhibit 19-3.

Government-Wide Criteria for Adequate Final Indirect Cost Rate Proposals
Source: Summary Report of the SWAT Team on Civilian Agency Contracting

- Proposal is based on recorded costs, financial statements, or other similar records
- All unallowable costs have been removed from the proposal
- Proposal identifies all cost-type Government prime contracts and subcontracts included in bases used to allocate indirect costs
- Proposal identifies to whom the proposal was submitted and to whom copies were provided

Exhibit 19-3

Agency-Required Certifications

A few agencies require contractors to certify that their indirect cost proposals contain no unallowable costs and provide penalties when false certifications are made. A false certification is not only subject to these penalties, including interest, but also to criminal penalties under appropriate fraud statutes.

Preliminary Procedures

Although the contracting officer in the cognizant agency is responsible, the negotiation is a team effort that includes the contract auditor as well as technical and functional Government officials in one or more agencies, as required.

Agency procedures will sometimes require the contractor to submit a copy of its indirect cost rate proposal to the contract auditor in addition to the cognizant contracting officer. The cognizant contracting officer makes a request for any specific information in a request for field pricing support, as outlined in Chapter 13. This request must include a copy of the contractor's proposal if it was not submitted directly to the auditor by the contractor.

FAR 15-805-5(e)

FAR 42.705-1(b)(2)

The auditor submits an advisory audit report identifying any relevant advance agreements or restrictive terms of specific contracts in addition to the standard information provided in advisory audit reports. Refer to Chapter 13.

Cognizant contracting officer responsibilities after receipt of this advisory report are contained in Exhibit 19-4.

Cognizant Contracting Officer Responsibilities For Establishing Indirect Cost Rates

- Establish a negotiation position based on the advisory audit report with advice from other Government officials
- Conduct negotiations
- Prepare a written indirect cost rate agreement conforming to the requirements of the contracts covered by the agreement
- Prepare, sign, and place in the contractor general file a negotiation memorandum that:
  - — Explains disposition of issues outlined in the advisory audit report
  - — Reconciles costs questioned
  - — Explains why recommendations of other Government officials were not followed
  - — Identifies cost or pricing data submitted during the negotiations that were relied upon in reaching settlement
- Distribute all resulting documents as outlined in Chapter 14

Exhibit 19-4

Settlement of Indirect Cost Rates by Contract Audit

FAR 42.705-2

When settlement is made by contract audit, the contract auditor is responsible for the settlement and the affected contracting offices, including the cognizant contracting office, need only implement the settlement as it applies to individual contract modifications.

19.5 VERIFY THAT THERE ARE NO CLAIMS OR DISPUTES OUTSTANDING

The contractor may not have raised all of the issues it intends to raise before you begin closeout. To avoid having to reopen a file that has been closed, some agencies make it a standard practice to request a release of claims from a contractor as a condition of final payment even if not required by a contract clause.

Releases Required for Cost-Reimbursement Contracts

FAR 52.216-7(h)(ii)

On cost-reimbursement contracts, the contractor is required by the Allowable Cost and Payment clause to submit a release within one year after completion of the work and before final payment of any remaining allowable costs or fees. The release required by the clause discharges the Government, its officers, agents, and employees from all liabilities, obligations, and claims arising out of or under the contract with the exception of the type of claims listed in Exhibit 19-5.

Types of Claims Exempt From a Required Release of Claims FAR 52.216-7

- Claims specified by the contractor and for which it provides either:
  - — An exact amount for the claim, or
  - — When the exact amount is not yet known, an estimated amount
- Claims—including reasonable incidental expenses—based on liabilities of the contractor to third parties arising out of contract performance, but **only if:**
  - — Such claims are unknown to the contractor on the date of the execution of the release, and
  - — The contractor gives notice of such claims in writing to the contracting officer within six years following the release date or notice of final payment date, whichever is earlier
- Claims for reimbursement of costs—including reasonable incidental expenses—incurred by the contractor under the patent clauses, excluding, however, expenses arising from the contractor's indemnification of the Government against patent liability

Exhibit 19-5

Format Example

Refer to Exhibit 19-6 for a sample format for obtaining a release of claims and other required information from a contractor prior to close-out.

Notification of Closeout Actions Format

(Contractor name and address)

Dear_____:

Reference_____(agency)_____Contract No._____for

_____(describe supplies or services)_____.

In order to expedite final payment and contract closeout, please forward the following items to my attention by_____(date)_____:

(List only items that apply, renumbering paragraphs after deleting an item.)

1. Any outstanding reports or data items such as technical manuals, or instruction manuals per (reference contract line item number or paragraph citation).
2. Government-furnished property.
3. Inventory schedules for Government property.
4. Contractor's release of claims (form enclosed).
5. Final voucher (cost-type contracts only).
6. Other (cite specific requirement).

(Use the following paragraph only if it applies:)

Under the terms of the contract, a warranty (describe) is still in effect. Final payment and contract closeout do not relieve you of your obligations to the Government under the warranty clause.

(signed)
_____
Contracting Officer

Exhibit 19-6

Effect of Release of Claims

The contractor is entitled to final payment no matter how many exceptions are listed in its release of claims. Normally, a general release of claims—without any exceptions listed—bars a contractor from future claims. However, if Government officials coerce a general release without exceptions from the contractor as a condition of final payment, then that coercion can be used by the contractor to regain its right to make additional claims.

Government Documentation for Conditional Releases

When a contractor provides a conditional release, document the file with as much information as you can gather on the issue that the contractor excepts from the general language of the release. If the contractor does pursue the issue later, you then will have documentation on the issue. Often, contract administration team members leave Government employment and are hard to track down, or you or they simply may not remember the details.

19.6 MAKE FINAL PAYMENT OR COLLECT OVERPAYMENT

Overpayments can result from a variety of reasons:

- Assessing excess costs of reprocurement on a defaulted contract
- Assessing liquidated damages that result in overpayment
- Adjustments after an audit on a cost-type contract
- Unliquidated progress payments
- Retroactive price reductions
- Advance payments authorized by law.

Setoff

FAR 32.611

Setoff is the Government's principal debt-collection device. A setoff refers to the reduction of contract payments properly due and invoiced to the Government by amounts the contractor owes the Government. The setoff need not be made on a contract on which the contractor debt originated. The Government may collect sums through invoice reduction on one contract even when the debt arose on another, unrelated contract.

Typical Setoff Examples

FAR 49.402-6

A typical example of when invoiced amounts are set off for unrelated debts is when a repurchase is made on a defaulted contract and there are not enough funds left on the contract to cover the additional expense.

For cost-reimbursement contracts, setoffs are typical when indirect cost billing rates used for part or all of the contract period are found to be overstated.

Overpayment Collection Steps

Steps for collecting overpayments are outlined in Exhibit 19-7. These procedures include making a written demand for payment prior to setoff. The content requirements for such demands are contained in Exhibit 19-8.

Contractor Requests for Deferment

A contractor may request a deferment if the debt cannot be paid off promptly. If the contractor has an appeal concerning the amount of the debt pending, the request for deferment need only explain the contractor's general financial condition.

FAR 32.613

If no appeal is pending, the request for deferment must include statements explaining the following:

- Contractor's financial condition
- Contractor's backlog
- Projected cash receipts and requirements
- The feasibility of immediate payment of the debt
- The probable effect on contractor operations if the debt were paid in full immediately.

Accrual of Interest

FAR 52.232-17

Unless paid within 30 days of a written demand for payment, interest is due on contractor debts to the Government in an amount established by interest rates published by the Department of the Treasury.

Exceptions

FAR 32.617

However, setoff amounts are exempt from interest accruals if they originate on:

- Small purchases
- Contracts with other Government agencies
- Contracts with foreign governments or instrumentalities
- Contracts with nonprofit organizations that do not include a profit or fee
- Contracts for paid advertisements
- Other exception that may be authorized under agency procedures.

General Steps for Collecting Overpayments From Contractors

1. Make a written demand for payment as soon as it is known that a refund is due (refer to Exhibit 19-8 for content requirements)
2. Consider withholding amounts otherwise due until 30 days after demand is made
3. If payment is not made within 30 days after written demand either:
   - Reduce payments otherwise due on contractor invoice(s) in the amount of the debt (plus interest accruing after the 30 day period)
   - Defer collection of the debt, but ***only if:***
     - The contractor requests a deferment in writing
     - A deferment agreement is signed by both parties that complies with all required FAR documentation (refer to Exhibit 19-9)
     - A reasonable balance between the need for Government security against loss and undue hardship on the contractor can be made (when appeals are not in process, the time frame for deferment must be as short as practicable)
4. Apply an equitable interest credit when:
   - The amount of debt initially determined is subsequently reduced through a successful contractor appeal
   - Collection procedures result in an overcollection of the debt due, or
   - Payments to the contractor are otherwise delayed during the same time that interest on contractor debt applies, but only if the Government has not already paid an interest penalty for the late payment

Exhibit 19-7

Content Requirements for Debt Collection Notices
FAR 32.610

- A description of the debt, including the debt amount
- When the amount of debt was established by negotiations, a proposed supplemental agreement that confirms the completed negotiations
- Notification that any amounts not paid within 30 days will bear interest from the date of the notice or from an earlier date if so specified in the contract (unless an exception applies)
- Unless exempt from accrual of interest, a statement that the interest rate is the rate established by the Secretary of the Treasury for the period or periods affected
- A statement that the contractor may submit a proposal for deferment of collection if immediate payment is not practicable or if the amount is disputed
- A statement identifying the responsible Government official designated for determining the amount of the debt and its collection

Exhibit 19-8

19.7 IDENTIFY AND RECOMMEND DEOBLIGATION OF EXCESS FUNDS

Identify the amount of any funds remaining on the contract and, if there is no known potential for their future use on this contract, recommend that they be deobligated. Because many agencies have taken cuts in some of their basic programs, this step is becoming increasingly important in order to use scarce funds for their maximum benefit.

19.8 DOCUMENT LESSONS LEARNED AND EVALUATE CONTRACTOR PERFORMANCE

At the end of a contract, it makes good business sense to leave a paper trail for those who may face similar contracting situations in the future. This is usually done by documenting:

- Lessons learned in contract administration, and
- Overall evaluation of the contractor's performance.

Content Requirements for Deferment Agreements on Contractor Debts FAR 32.613

General requirements:

- A description of the debt
- The date of first demand for payment
- Notice of an interest charge accrual (unless interest is excepted)
- Identification of the office to which the contractor is to send debt payments
- A requirement for the contractor to submit financial information requested by the Government and for reasonable access to the contractor's records and property by Government representatives
- A statement that the Government can terminate the deferment agreement and accelerate the maturity of the debt if the contractor defaults of if bankruptcy or insolvency proceedings are instituted by or against the contractor
- Any protective measures that may be advisable under individual contract circumstances—examples are:
  - Liens
  - Personal or corporate guarantees
  - Subordinations or standbys of indebtedness
  - Special bank accounts
  - Terms that limit further contractor indebtedness unless such indebtedness is entered into to pay the Government
- A payment plan or schedule (unless the contractor is appealing the debt determination)

Additional requirements if the contractor is appealing the debt determination:

- A requirement for the contractor to diligently prosecute the appeal
- A requirement for the contractor to pay the debt in full when the appeal is decided or when the parties otherwise reach agreement on the debt amount
- If desired by the contractor, a statement that prepayments before settlement of appeals are without prejudice for determining overpayments and interest credits

Exhibit 19-9

Experiences in contract administration may be useful for preaward contracting personnel as well as those engaged solely in contract administration activities. The character of these experiences determines how they can be best documented. There are a variety of possibilities.

Use of Broad Lessons Learned

When a learning experience relates to most agency contracts or to specific types of contracts, items may be added to the agency's in-house internal control review checklist to ensure that the same mistakes are not made again. For example, the wording of a unique contract clause may have proven troublesome in contract administration. An agency's Procurement Committee may be alerted to look out for similar language in future contracts.

General lessons learned also are typically included within in-house training programs.

Use of Specific Contractor Lessons Learned

FAR 4.801(c)(3)

When learning experiences relate specifically to one contractor, alerting other contracting personnel in the agency may be accomplished by adding notes on lessons learned to an official contractor performance evaluation that is required for a contractor general file.

Contractor Evaluations

General documentation of how a contractor performed on a particular contract is invaluable when that contractor is again being considered for a Government contract award.

To ensure fairness, agency procedures often require that two people sign standard contractor evaluation forms. An example of such a form is shown in Exhibit 19-10. Others, however, require only one agency official to sign the form—usually the contracting officer.

It is important to fully document evaluations that are either particularly laudatory or very negative.

Contractor Performance Evaluation

Name and Address of Contractor	
Contract No. and Award Date	Type and Amount of Contract
Contract Requirements	Location of Plant

O = Outstanding S = Satisfactory U=Unsatisfactory	**O**	**S**	**U**
1. Quality of End Products or Services			
2. Timeliness of Performance			
3. Compliance with General Contract Clauses*			
4. Cost Contract Management*			
5. General Business Conduct*			

Prepared by:	Concurrence by:
Name and Signature of COR	Name and Signature of Contracting Officer
Date	Date

* *Outstanding, Satisfactory, or Unsatisfactory Ratings.* If contractor is rated "outstanding" or "unsatisfactory," include reasons for such ratings beside each item or attach separate sheets. Support general statements or conclusions, such as "contractor was uncooperative" with details and/or examples.

* *Block 3.* Includes EEO and labor law compliance, small business subcontracting, etc.

* *Block 4.* Is applicable only to cost-reimbursement contracts. This item includes (i) adherence to budgetary allowances, (ii) appropriateness of charges, and (iii) management of Government property, etc.

* *Block 5.* Cooperation, integrity, etc.

Exhibit 19-10

19.9 PREPARE CONTRACT COMPLETION STATEMENT AND DISPOSE OF FILES

The contracting officer in charge of contract administration is required to sign a contract completion statement that contains all of the information listed in Exhibit 19-11.

Content Requirements of a Contract Completion Statement
FAR 4.804-5(b)

1. Contract administration office name and address (if different from the procuring contracting office)
2. Contracting office name and address
3. Contract number
4. The last modification number
5. Last call or order number
6. The contractor's name and address
7. Dollar amount of excess funds, if any
8. Voucher number and date of final payment, or
9. Invoice number and date, if the final approved invoice has been forwarded to the payment office of another agency or organization and you do not know the payment status
10. A statement that all required contract administration actions have been fully and satisfactorily accomplished
11. Name and signature of the contracting officer
12. Date

Exhibit 19-11

Distribution

Place the original document in the official contract file. When preaward and contract administration responsibilities are split between two offices, forward the original to the procuring contracting office for inclusion in their official contract file record, and place a copy in the contract administration file.

Handling and Storage

FAR 4.805

Individual agencies prescribe procedures for the handling, storage and disposal of contract files. Sometimes files are stored in a different building and occasionally in a different part of the city or even in another city. In these cases, retrieving files to settle unresolved issues can be quite time-consuming, making your thoroughness of closeout review particularly important. The contract administration activity normally keeps a log of closed out files containing such information as:

- The date the file was closed out
- The date the file was physically transferred to a storage center
- Where it was sent for storage
- A filing location provided by the storage facility.

Retention Requirements

FAR 4.805

Some information in your contract files must be kept for a specific number of years. These recordkeeping retention requirements are sometimes the result of a legal requirement and sometimes the result of administrative regulations.

19.10 DETERMINE WHETHER TO INVOKE THE GOVERNMENT'S RIGHTS UNDER THE CONTINUITY OF SERVICES CLAUSE

FAR 37.110(c)

When the Government anticipates difficulty in transitioning from an incumbent contractor to a possible follow-on contractor for essential services, it includes a Continuity of Services clause in the incumbent's contract. This clause specifies that the incumbent contractor will provide training services to the follow-on contractor for a period of 30 to 90 days, but only if the contracting officer provides notice that the Government will require these services.

FAR 52.237-3

The contractor is reimbursed at cost plus a fee or profit that does not exceed the fee or profit percentage of the basic contract for these services if it provides them.

You clearly do not need the services if the incumbent contractor receives the award for the follow-on contract. Additionally, you also may not need these services if:

- The follow-on contractor provided the service under another contract
- The follow-on contractor is hiring a substantial number of employees of the incumbent contractor for work under the follow-on contract.

Further, the extent to which the services are needed varies depending on the experience of the follow-on contractor with the specific service and with Government contracts.

You must provide notice to the incumbent contractor if there is a need for phase-in/phase-out service. In this notice, include all of the elements outlined in Exhibit 19-12.

Minimum Content Requirements For a Phase-In/Phase-Out Notice

1. Specify a time frame, by calendar date, during which the Government requires phase-in/phase-out services
2. Specify a date for the contractor to submit a training program for Government review
3. Outline specific areas that this training program should cover
4. Specify a date when the responsibility for contract performance will be transferred from the incumbent contractor to the follow-on contractor

Exhibit 19-12

After you have activated the requirement for phase-in/phase-out services, administer them as you would any other contract requirement.

1993

JANUARY

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FEBRUARY

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JANUARY

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FEBRUARY

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MARCH

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APRIL

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22	23	24	25	26	27	28
29	30	31				

JUNE

S	M	T	W	Th	F	S
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5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30		

JULY

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3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

AUGUST

S	M	T	W	Th	F	S
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7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

SEPTEMBER

S	M	T	W	Th	F	S
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4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	

OCTOBER

S	M	T	W	Th	F	S
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

NOVEMBER

S	M	T	W	Th	F	S
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30			

DECEMBER

S	M	T	W	Th	F	S
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4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

1995

JANUARY

S	M	T	W	Th	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

FEBRUARY

S	M	T	W	Th	F	S
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28				

MARCH

S	M	T	W	Th	F	S
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	

APRIL

S	M	T	W	Th	F	S
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2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
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MAY

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7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

JUNE

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4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	

JULY

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16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

AUGUST

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SEPTEMBER

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10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30

OCTOBER

S	M	T	W	Th	F	S
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8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

NOVEMBER

S	M	T	W	Th	F	S
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DECEMBER

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10	11	12	13	14	15	16
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24	25	26	27	28	29	30
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1996

JANUARY

S	M	T	W	Th	F	S
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7	8	9	10	11	12	13
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21	22	23	24	25	26	27
28	29	30	31			

FEBRUARY

S	M	T	W	Th	F	S
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4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29		

MARCH

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24	25	26	27	28	29	30
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APRIL

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MAY

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JUNE

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JULY

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AUGUST

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SEPTEMBER

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OCTOBER

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NOVEMBER

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DECEMBER

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1997

JANUARY

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FEBRUARY

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MARCH

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APRIL

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MAY

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JUNE

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JULY

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AUGUST

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SEPTEMBER

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OCTOBER

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NOVEMBER

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DECEMBER

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1998

JANUARY

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11	12	13	14	15	16	17
18	19	20	21	22	23	24
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FEBRUARY

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15	16	17	18	19	20	21
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MARCH

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APRIL

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MAY

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JUNE

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JULY

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AUGUST

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SEPTEMBER

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OCTOBER

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NOVEMBER

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DECEMBER

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