It's got a bland title, one that says "pay no attention to this technical change." But hidden inside is a huge problem for the majority of Government contractors.

On August 20, 2009 a proposed revision to the Federal Acquisition Regulation (FAR) was published with the innocuous title of "FAR Case 2008-020, Contract Closeout." Although some aspects of the proposed rule change did, in fact, address contract close-out activities, the majority of the language turned out to be a "wolf in sheep's clothing" that, if implemented as drafted, will significantly expand the powers of DCAA, and will force contractors to comply with arbitrary DCAA demands or risk monetary penalties.

The Good

Nearly five years ago (in 2005) the Federal government was concerned with the seeming inability of the contracting parties to close-out contracts after physical completion of the work. The administrative issues involved in the contract close-out process, including those related to finalization of indirect cost rates, seemed to defeat the best efforts of both contractor and Government employees. As a result, hundreds and even thousands of physically completed contracts were lingering on the Government's books like guests who wouldn't leave a party. Since the majority of those lingering contracts were "flexibly priced" types, that situation meant the Federal government didn't have a good handle on how much it might still owe its contractors--or whether those contractors owed it a refund based on their "final costs incurred." The financial situation was unclear and that prevented the agencies of the Executive Branch (DOD in particular) from generating accurate financial statements.

This was back in the day when the contracting parties still aimed for "partnering" with each other to overcome the mutual challenges of performing the contracted work. (In today's environment, such alignment is called an " independence violation " and " lack of oversight .") The Defense Acquisition Regulation (DAR)
Council
(aka DARC) asked contractors to meet with them and identify opportunities to better the contract close-out process so that more contracts could be closed-out faster. Input into that forum can be found
here
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The DAR Council and others in the DOD mulled over the input for two years and, in 2007, came up with some recommendations to improve the process. In the words of the FAR Council, "The assessment resulted in recommendations for revisions to policy, guidance, and training related to contract closeout responsibilities in both the FAR and DFARS. The DARC opened DFARS Case 2007-D015 and recommended changes to the DFARS text and PGI documents." Government rule-making being what it is, it took an additional two years to get to the point where, on August 20, 2009 a proposed rule was published for public comment.

The foregoing is the background to why the proposed rule has the title it does, and why it contains some language that will be helpful to contractors. Some of the helpful language includes:

Revises FAR Part 4 to require clearing of final patent reports within 60 days of receipt. If a required patent report is not received, permits the Contracting Officer to proceed with contract close-out actions "upon consultation with the agency legal counsel responsible for patent matters."

- Revises FAR 42.708 (Quick-closeout Procedure) to increase the dollar value limit of "unsettled indirect and direct costs" that qualify a contract action for quick close-out, from $1 million to $4 million.

- Provides more detailed guidance to Contracting Officers regarding the "risk assessment" to be performed when evaluating whether to utilize quick close-out procedures.

The above revisions are helpful but, in a seeming , *quid pro quo*, the FAR Council asks contractors to accept extremely unhelpful regulatory changes along with the helpful one.

The Bad

Currently, the FAR permits Contracting Officers to withhold some portion of the fixed fee owed a contractor, *"in an amount necessary to protect the Government's interest [but the amount] shall not exceed 15 percent of the total fixed fee or $100,000, whichever is less."* (See the clauses 52.216-8, 51.216-9, and 52.216-10.) Importantly the clauses directs the Contracting Officer to release
"75 percent of all fee withholds under this contract after receipt of the
certified
final indirect cost rate proposal covering the year of physical completion of this contract."

This new rule proposes to revise those three contract clauses so as to "encourage the timely submission of an adequate indirect cost rate proposal." The revised language does that, and more.

For example, the revised clause language at 52.216-8 (Fixed Fee) now reads (in part):

"The Contracting Officer shall release 75 percent of all fee withholds under this contract after receipt of an ***adequate*** *certified final indirect cost rate proposal covering the year of physical*

completion of this contract, provided the Contractor has satisfied all other contract terms and conditions, including the submission of the final patent and royalty reports, and is not delinquent in submitting final vouchers on prior years' settlements. The Contracting Officer may release up to 90 percent of the fee withholds under this contract based on the Contractor's past performance related to the submission and settlement of final indirect cost rate proposals."

Accordingly, if the proposed rule is finalized as drafted, contractors, fees will become hostage to the DCAA's determination that their final indirect cost proposals are, in the subjective judgment of the auditor, *"adequate"* for audit. What constitutes an *"adequate"* submission, one might wonder?

The Ugly

What constitutes an "adequate" final indirect cost proposal is discussed at FAR 42.705-1 .

The FAR says "The required content of the proposal and supporting data will vary depending on such factors as business type, size, and accounting system capabilities. The contractor, contracting officer, and auditor must work together to make the proposal, audit, and negotiation process as efficient as possible. ... A contractor shall support its proposal with adequate supporting data. For guidance on what generally constitutes an adequate final indirect cost rate proposal and supporting data, contractors should refer to the Model Incurred Cost Proposal in Chapter 6 of the Defense Contract Audit Agency Pamphlet No. 7641.90, Information for Contractors, available via the Internet at DCAA.

It is clear in the current FAR language that the DCAA "model incurred cost proposal" is "guidance" and absolute conformity is not mandatory for a determination of "adequacy." Indeed, the FAR acknowledges that "the required content ... will vary" by contractor.

The proposed rule will change all that, if finalized as drafted. The proposed rule defines an "adequate" proposal is great detail and, not coincidentally, the definition of adequacy is taken, word for word, directly from the DCAA's model incurred cost proposal. No more will contractors be able to adjust their proposals to match their business systems and cost accounting practices; they will be forced to comply in all respects with the DCAA's idea of an "adequate" submission, without regard to what makes sense for the contractor given its business type, size, and accounting system capabilities. This will undoubtedly impact many contractors and will disrupt their operations. To the extent that they will need to revise business systems and processes, or add resources, to meet these new requirements, it will increase the costs of doing business with the Federal government.

Although the Federal Register notice claims this proposed rule revision is "not a significant regulatory action," nothing could be further from the truth.

The other problem with this rule making effort is that it continues the recent trend of DCAA inserting itself into the procurement process, establishing a situation where DCAA's decisions

affect the ability of the contracting parties to comply with contract terms. Whereas a decision by the Contracting Officer is subject to appeal under the Contract Disputes Act, there is no such appeal from a DCAA auditor's decision. Regardless of how arbitrary or capricious the DCAA decision regarding "adequacy" may be, it cannot be reviewed by any judicial entity -- which upsets the careful system of checks and balances established by the three branches of Federal government through the Contract Disputes Act and similar statutes.

Find the proposed rule here.

Comment on the proposed rule at regulations.gov .

or via mail following the detailed instructions in the proposed rule.