

Allowability of Supplier Conferences and Other Incentives

Written by Nick Sanders
Thursday, 27 April 2017 00:00

We received some positive feedback on [our article](#) that discussed the allowability of conferences and seminars. [Another](#) [article](#) on

entertainment versus employee morale gatherings was similarly well received. In that latter article we touched on supplier conferences. We said such conferences, when convened for purposes of communication and performance improvement, may well be allowable—but we noted some special issues with such conferences and promised a future article, to be devoted specifically to the topic of supplier conferences.

This is that promised article.

We are going to assume you read the prior articles on employee gatherings (or that you refreshed your knowledge through following the links in the first paragraph). Thus, we are not going to rehash the 31.205-13 versus 31.205-14 details, nor are we going to repeat our admonition to support the reasonableness of claimed costs. We're going to start moving forward from those points, so if you didn't read those articles, why don't you just go follow those links right now, because otherwise you may miss something.

The first thing we want to acknowledge is that there is no cost principle that squarely addresses the topic. There is no cost principle entitled "supplier conferences" or even "supplier incentives" so we don't have a lot of actual regulatory support for our positions. What we are about to assert is based primarily on experience, not a reading of the regulations.

Supplier conferences are typically convened by the larger prime contractors. The more that program execution has been pushed outside the prime's factory walls and into the supply chain, the more the (perceived) need for such conferences. In general, there are two business drivers cited for the conferences: (1) communicate business needs, recognize high performance, and otherwise incentivize the existing suppliers, and (2) show substantive efforts to attract and retain small businesses in the appropriate socioeconomic categories¹

A single conference may address both needs, but typically that is not the case. Instead, there is one conference devoted to the existing supplier base and another conference devoted to attracting new suppliers.² The second type of conference must be held, because of the requirements of contractors' small business plans, which require good faith outreach efforts. So

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while we don't think much of them (based on experience) we don't have too much to say from a cost allowability concern. We're going to focus, then, on the first type of conference—the Supplier Conference to Honor High-Performing Suppliers (or whatever you call it).

The first type of conference is typically a relatively lavish affair, held at a local hotel's ballroom, with nice lunches or dinners served at cloth-covered tables. Alcohol is not served, nor is drinking alcohol encouraged; however, often there are post-conference parties—billed as “networking events”—where alcohol is available. So what's the problem?

Well, the first problem (or “concern” really) is the ostensible business need. What purpose does such a conference fulfill? We hear you now, yelling at your screens, telling us that they fulfill the purpose(s) listed above—to communicate business needs, to educate the suppliers. The conferences are held to recognize high performers, and by providing public recognition thus to incentivize the supplier base towards better performance.

Yeah, we've heard that before. We ain't buyin' it.

Let's take the first ostensible business objective: education of suppliers. Yes, certainly there are several contract clauses that mandate supplier education. If you have actually read those clauses and are focusing your messaging at those specific areas, then we doff our hat at you to signify respect, because you would be the first in our experience actually to do so. More often—much more often—we see that supplier “education” is about informing the supplier base about how great the prime contractor is, about how programs are doing and about year-over-year growth statistics. The real message being conveyed is “how great it is to be a supplier of [INSERT COMPANY NAME HERE].” If that's the real message then you risk having the business purpose declared to be unallowable pursuant to the cost principle at 31.205-1.

With respect to the second ostensible business objective (performance improvement) we fail to see how public recognition of high performing suppliers stimulates better performance. We fail to see how the giving of a plaque and a taking of a photograph creates any real incentive—either for the supplier being honored or for the other suppliers in the audience. DoD has tried a similar tactic (called the “Superior Supplier Incentive Program” or [SSIP](#)) as part of Better Buying Power 2.1 “to incentivize contractor performance by recognizing the contractors that provide the greatest value to the DoD through superior performance and by informing those who perform below average.” Which is nice but, as we noted at the time, *there is no actual incentive for making the list*

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. Originally, BBP 2.1 stated that “SSS-level” contractors were to “receive more favorable terms and conditions in contracts” but anybody with experience in government contracting knew right away that wasn’t going to happen. Instead, in July, 2014, when the Navy announced its “Superior Suppliers,” Frank Kendall said that “DCAA has agreed to coordinate the results of the low-risk sampling initiative as a potential incentive element of DoD plans to implement a SSIP. DCAA has agreed to work with the Navy to incorporate low-risk sampling into the SSIP and will provide a recommendation on incorporating low-risk sampling into the DoD SSIP incentives for presentation to the BSIG [Business Senior Integration Group] by October 1, 2013.” We don’t know what DCAA did nor did not report to the BSIG, but we are fairly sure that no adjustments were made to DCAA’s audit program as a result. For that matter, how could DCAA do so and still maintain the façade that their audits were objective, independent, and GAGAS-compliant?

The point of the foregoing is that public recognition may be a strong incentive for individuals, but it’s not at all a good incentive for companies. Companies are motivated, generally, by profit. You give your high performing suppliers a bonus of 1 percent of their contract award values, that’s a real incentive right there. But you don’t do that. You don’t do that because it violates a number of contracting rules, not the least of which is contract type. If you award a FFP contract, you don’t get to give additional profit for on-time or on-spec performance. The supplier is already contracted to do that. If you award a CPFF contract, the fee is fixed so you can’t modify that. And if you have awarded some type of incentive contract, the monetary incentive is already baked-in to contract terms, so that won’t work. In point of fact, there is no extra-contractual incentive you can provide within the FAR rulebook³

Therefore, if upon close examination the business rationale for conducting supplier conference(s) seems very thin, are such conferences in fact an allowable activity? They may be. We are not saying they are unallowable; we’re saying that contractors who spend money holding them should be careful. Just because we are cynical doesn’t mean the government auditors will be equally cynical—especially if they’ve been blessing the costs consistently for several years (or decades).

But that’s not the only concern.

Other concerns include cost allocability, payment challenges, and timecharging issues. Let’s take them one-by-one.

1.

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Cost allocability. Where do the costs of these conferences get charged? Who pays for them? Typically they are charged to the same indirect cost pool where subcontract management/procurement charges, but is that really the right place? What if all the suppliers were associated with one and only one program? Would that make the cost of the conferences legitimate direct charges? Probably not, because you didn't bid the costs into your original cost proposal—but from a strict beneficial or causal relationship analysis, that's probably the right answer in that circumstance. In the other circumstances (i.e., general conferences not associated with one program), the answer is probably somebody's departmental overhead. Now all active contracts are paying for the conference through the normal indirect cost allocation methodology, which may be fine. But if you buy the notion that either the purpose of the conference is really general image enhancement (unallowable per 31.205-1) or that the "incentivization" of suppliers is really a bit of a sham, then you have to wonder whether the cost of the conference should be coming out of the prime's profit rather than being charged to customers as a cost. This is especially true if the prime is under some type of incentive contract (e.g., CPAF) where better supplier performance would be expected to lead to a higher contract profit. Hey, *we're just sayin'*.

1.

Payment challenges. This is a bit different from the allocability question. You are going to be dealing with a stream of payments, spread out over time. First, somebody is going to need to make a hotel deposit to hold the space. Maybe another deposit for catering. How are those transactions recorded in the accounting system? What General Ledger account or Cost Element will you be using? Probably they are going to be initiated by a check request. Who is going to review/approve that request? And that's not the end of it. Eventually the full cost will come in—the catered meals, the snacks and beverages, the waitstaff and their gratuities. How will that be handled? Who will review to assure that the costs are reasonable and for allowable things? Finally, employee expense reports should arrive, for things like local mileage and parking at the hotel. Who reviews those to provide some level of assurance that employees are being consistent—i.e., that the mileage from the office to the venue is correct and that everybody is paying the same amount for parking⁴ (And let's not forget that suppliers are incurring costs, as well. Are you going to let them bill you for attending your conference? How will you know if they do so? What subcontract term prohibits them from doing so? Think about it.)

1.

And speaking of consistency, let's talk about timekeeping. Your personnel will be attending the event. Are they doing so on their own time?⁵ So they will need a charge number—which, as noted above, is likely to be an indirect labor account number. Is that

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indirect labor charged to one single department/cost center, or do you let each employee charge their labor to their home department/cost center? You have an attendance list, of course. Good job. Now pull the time reports for every single employee on that list and compare how many hours they each charged for attending the supplier conference. That's right. They aren't going to be consistent. Mary and Joe charged 4 hours each, while Eric and Jane charged 3.5 hours and Marty and Michelle each charged 4.8 hours each. And what about Gary and Glen, who charged 8.0 hours each? Where they really there all day, or did they take off early to play golf? Arthur charged 4.0 hours for attendance, and he charged another 1.5 hours for "networking" at the hotel bar afterwards. Phoebe and Bernice each charged 8.0 hours a day for the entire week—because they were the planners and ran the registration table—you think. (

You hope!

) Everybody's labor charges are different. There's no consistency. The employee labor charges aren't consistent because (a) you didn't issue good labor charging direction before the event, and (b) everybody showed up at different times—and your attendance log doesn't show arrival/departure times because that seems to be overkill, even though now you wish you had required it, because you have no way to measure the accuracy of the labor charging. And if you didn't specify exactly where the labor should have been charged, and if you didn't figure out a way to capture it in your labor accounting system for subsequent review, then you will find, to your chagrin, that the labor is buried in general indirect labor accounts and there's absolutely no way to identify it to even start the comparison. And if you didn't issue good charging guidance, you will find that certain direct-charging employees charged their attendance to their programs as direct labor, even though other direct-charging employees charged their attendance to overhead, and now you have a CAS 402 concern because you weren't consistent between direct and indirect labor charges. Listen to us: this is the voice of experience talking.

Unless you plan for compliance, you will find that proving compliance is damn near impossible.

Hey! But don't let all that stop you. Go ahead and hold your supplier conferences, the same way you have been doing year after year. Ignore all the risks we've identified. Your auditors have never questioned anything and everybody has been very satisfied with the events. The Vice Presidents who make the speeches have come to expect the annual events, and the suppliers have as well. Everybody is happy with the *status quo*, except for those cranks at Apogee Consulting, Inc., who think these supplier conferences are rife with compliance challenges and risks—and who think companies would be far better off if they were never held.

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¹ We say “perceived need” because in our experience there is little, if any, evidence to show that supplier conferences actually accomplish either objective.

² We say “one conference” for simplicity, knowing full well that the larger primes may have multiple conferences held at different locations at various times in the year.

³ That doesn’t keep the military services from continuing to designate superior suppliers, and from continuing to proclaim that the rationale for doing so is to improve performance—even though the most recent Navy announcement (July 2016) admitted that the Superior Supplier rating will not, and cannot, be used in future award decisions.

⁴ You aren’t going to let your employees use valet parking, are you? If so, what’s your rationale for doing so? More importantly, how will you detect such charges?

⁵ *Ha!* Rhetorical question, of course. No, they’re not attending on their own time—*don’t be foolish*

With respect to hourly and/or non-exempt personnel, you can’t let them do so. With respect to exempt personnel, if you’re on total time accounting and you claim the expenses as bona-fide allowable business expenses, then the associated labor must also be bona fide allowable labor. If you’ve decided that the expenses are unallowable (or partially unallowable) then the labor may well be a directly associated unallowable cost. Think this one through.

You’ve got to be consistent between labor and expenses.