Precontract costs are not preproduction costs. Let's get that out of the way first. The SF-1408 requires, as a condition of having an adequate accounting system, that a contractor must be able to segregate preproduction costs from production costs.

According to the DoD's Contract Pricing/Finance Guide (Volume 3, Chapter 8)—

Preproduction costs, also known as start-up or non-recurring costs, can be characterized as out of the ordinary costs associated with the initiation of production under a particular contract or program. Examples of preproduction costs include:

- Preproduction engineering;
- Special tooling;
- Special plant rearrangement;
- Training programs;
- Initial rework or spoilage; and
- Pilot production runs.

There is really no question but that the foregoing costs are allowable; the issue is that contractors have to be able to segregate those costs from their recurring production costs. (Exactly *why* that ability is so critically important to the government has never been explained to my satisfaction.) Interestingly, the Guide assumes that the costs will be proposed as Other Direct Costs (ODCs), not as the constituent cost elements that may comprise the efforts (e.g., labor, materials, subcontractor costs, etc.). The Guide also states that such costs may be deferred and recognized over the life of production, which is something to keep in mind for future competitive proposals—not to mention Boeing's EELV litigation.

But this article isn't about preproduction costs; it's about precontract costs, which are something else entirely.

The FAR cost principle at 31.205-32 is remarkably brief and to the point. It states—

Precontract costs means costs incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule. These costs are allowable to the extent that they would have been allowable if incurred after the date of the contract (see

31.109).

Right away, precontract costs are defined broadly, as *any* costs that were incurred by the contractor "before the effective date of the contract."
Period.
Labor, materials, subcontractor costs, preproduction costs—whatever. Any costs incurred before the effective date of the contract (which may be different from the date upon which the contract was executed) are precontract costs.

If those precontract costs were incurred by the contractor "directly pursuant" to the contract's negotiations *and* if those precontract costs were incurred by the contractor "in the anticipation of the contract award" *and* if those precontract costs were incurred by the contractor "when such incurrence [was] necessary to comply with the proposed contract delivery schedule," then the precontract costs are allowable.

But they are allowable only to the extent they would have been allowable if incurred after the date of the contract. In other words, an otherwise unallowable cost cannot be made allowable by virtue of it having been incurred before the effective date of the contract.

What does that reference to 31.109 mean? As we all know, FAR 31.109 refers to Advance Agreements, which is where the contractor and government enter into an agreement that establishes the treatment of certain costs. We discussed the topic of Advance Agreements in **this article**. If you mosey over to 31.109, you will see that use of Advance Agreements is recommended with respect to treatment of precontract costs; or, at least, precontract costa are one of the listed topics for which an Advance Agreement might be considered by the contracting parties.

We touched on Advance Agreements in the context of precontract costs in this **article**. But note that article was hardly a "deep dive" into the topic we are discussing today. It was more a discussion of the allowability of costs incurred either before, or after, the contract's official period of performance.

Getting back to this topic, we need to ask whether the allowability of precontract costs conditioned upon an executed Advance Agreement? *No.* Absolutely not. Whether an Advance

Agreement exists does not impact the allowability of precontract costs in the slightest. Having one may be helpful in terms of avoiding disputes (or audit findings), but it is not a requirement.

In summary, precontract costs are allowable if (1) the costs were incurred directly pursuant to negotiation of the contract and in anticipation of award, (2) the costs were necessarily incurred in order to comply with the proposed contract delivery schedule, and (3) the costs would have been allowable if incurred after the date of the contract.

Some court cases seem to indicate that allowability turns on whether or not the government has provided prior approval for the contractor to incur its precontract costs. That finding would seem to add a fourth requirement to the three listed above; a requirement not found in the FAR nor in the Radant Technologies line of cases at the ASBCA. Our layperson's understanding is that those contrary decisions are found at the Court of Federal Claims. Karen Manos has a 2013 article that discusses those other cases, and we suggest readers seek it out. In the meantime, if you have a dispute that involves precontract costs, you may have a better outcome at the ASBCA, if you can file there.

What does DCAA say about precontract costs? Not much, it seems.

The Selected Areas of Cost Guidebook, Chapter 57 ("Pre-contract Costs") is empty. All it says is "Refer to authoritative source." We are not suggesting that this article is that authoritative source!

The Contract Audit Manual (at 6.202) discusses audit procedures related to precontract costs. It states—

Precontract costs are defined in FAR 31.205-32. Such costs, which otherwise meet the tests of allowability, may be approved for reimbursement by the auditor. If the precontract costs are subject to an advance agreement, the auditor should determine whether the costs incurred meet the conditions of the agreement. However, if there is no advance agreement, the auditor should ascertain whether the precontract costs meet all the tests of FAR 31.205-32 and are allowable to the same extent they would have been allowable if incurred after the effective date of the contract. The auditor should obtain the assistance of the Plant Representative/ACO and, where appropriate, the PCO in reaching this decision whenever necessary to clarify the facts

and conditions for incurring precontract costs.

We are pleased to see that the DCAA audit guidance agrees with the decisions at the ASBCA.

Let’s wrap this up. If you are a contractor with a contract award pending, or in negotiations, you can incur precontract costs with an expectation of having them reimbursed or included in the contract price. You don’t need an Advance Agreement nor do you need express permission from the cognizant contracting officer. You need to meet the three tests we discussed in this article. However, if you have a dispute about the allowability of your precontract costs, and you want to litigate, best you take your appeal to the ASBCA.