"***Certainly the game is rigged. Don't let that stop you; if you don't bet you can't win."*** – *Robert A. Heinlein*

This past week was Fed Pubs' La Jolla Government Contracting Week, in which one of the most popular seminar-providers scheduled multiple courses in multiple areas of government contracting—all held in one hotel. Lots of people attended; it's kind a big deal and there's even a sponsored reception for students from the various classes to meet, mingle, and network. We know most of the instructors and they are, for the most part, top-notch. We have had no problem recommending these courses. That said, we were eager to get some feedback from course attendees.

One thing we heard was that some instructors were recommending use of Advance Agreements in order to proactively establish defenses against adverse DCAA audit findings. Obviously we weren't there, but the logic seemed to be that DCAA auditors were going to have findings—often findings that were obviously meritless—but the cognizant Contracting Officer was going to be hesitant about flatly overruling those findings because of the DCMA bureaucratic rules that govern the process.

Gone are the days when a warranted Contracting Officer had the authority to use independent business judgement to adjudicate and negotiate and resolve disputes without litigation. In today's Federal contracting environment, it's a rare CO who wants to risk their career in order to support a contractor's rebuttal of an adverse audit finding.

The theory, then, is that it is better to negotiate and work out a deal *before* things get adversarial. The contractor and CO should come to an understanding, memorialize it, and sign it. Then when DCAA shows up with problematic findings, it's not about an auditor being wrong; instead, it's about a pre-existing agreement that needs to be upheld by the US Government.

It's a good theory and we have no problem seconding the recommendation. Advance Agreements are great things when you've got them (and have retained them to support future

audits). Our only problem is that they are damn hard to get these days.

Let's talk about Advance Agreements.

FAR Rules

Advance Agreement are discussed in FAR 31.109. FAR 31.109(a) states that "To avoid possible subsequent disallowance or dispute based on unreasonableness, unallocability or unallowability under the specific cost principles at Subparts 31.2, 31.3, 31.6, and 31.7, contracting officers and contractors should seek advance agreement on the treatment of special or unusual costs and on statistical sampling methodologies at 31.205-6(c)." So there's the rationale for having them: they are intended to avoid cost disallowances or disputes in areas where it is "difficult to determine" cost allowability. Importantly, the FAR is clear that Advance Agreements should be negotiated "before incurrence of the costs involved" – *i.e.*, in advance. (Duh.) According to FAR 31.109(b): "The agreements must be in writing, executed by both contracting parties, and incorporated into applicable current and future contracts. An advance agreement shall contain a statement of its applicability and duration." In addition, "Advance agreements may be negotiated with a particular contractor for a single contract, a group of contracts, or all the contracts of a contracting office, an agency, or several agencies." Other than that, the parties are relatively free to draft their Advance Agreement in any manner they may choose.

FAR 31.109 lists areas in which Advance Agreements may be of particular value in avoiding disputes. These areas include:

1.

Compensation for personal services, including but not limited to allowances for off-site pay, incentive pay, location allowances, hardship pay, cost of living differential, and termination of defined benefit pension plans

2.

Use charges for fully depreciated assets

3.

Deferred maintenance costs

4.

Precontract costs

5.

Independent research and development and bid and proposal costs

6.

Royalties and other costs for use of patents

7.

Selling and distribution costs

8.

Travel and relocation costs, as related to special or mass personnel movements, as related to travel via contractor-owned, -leased, or -chartered aircraft; or as related to maximum per diem rates

9.

Costs of idle facilities and idle capacity

10.

Severance pay to employees on support service contracts

11.

Plant reconversion

12.

Professional services (e.g., legal, accounting, and engineering)

13.

General and administrative costs (e.g., corporate, division, or branch allocations) attributable to the general management, supervision, and conduct of the contractor's business as a whole. These costs are particularly significant in construction, job-site, architect-engineer, facilities, and Government-owned contractor operated (GOCO) plant contracts

14.

Costs of construction plant and equipment

15.

Costs of public relations and advertising

16.

Statistical sampling methods

In addition to the foregoing, the FAR emphasizes that construction and architect-engineer contracts are especially good candidates for use of Advance Agreements. The FAR states (at 31.105) "Because of widely varying factors such as the nature, size, duration, and location of the construction project, advance agreements … for such items as home office overhead, partners' compensation, employment of consultants, and equipment usage costs, are particularly important in construction and architect-engineer contracts."

The DFARS adds (at 231.205-70(d)(viii)) that the Contracting Officer should negotiate an Advance Agreement when a contractor is engaging in external restructuring (think Lockheed and Martin Marietta merging). That external restructuring Advance Agreement must set forth "at a minimum, a cumulative cost ceiling for restructuring projects and, when necessary, a cost amortization schedule."

Finally, you need to know that Contracting Officers cannot sign an Advance Agreement that makes an unallowable cost allowable. (See 31.109(c).) Some costs are made unallowable by statute, and no CO has the authority to contravene a public law.

Sounds pretty straightforward, right? So what's the problem?

DCMA Boards of Review

The first problem—as we alluded to earlier—is that DCMA doesn't give its Contracting Officers much independent discretion these days. For example, depending on the scope and/or estimated value of the contracts covered by a proposed Advance Agreement, that agreement may have to be reviewed by two separate Boards of Review (one at the Division level and one at the DCMA HQ level). If annual costs on contracts covered by the agreement are estimated to be less than $25 million, then the CO can execute it. But if annual costs on covered contracts are greater than $25 million then a Division-level Board of Review must be convened. And if annual costs on covered contracts are greater than $50 million, or if more than one contractor segment is affected, or if the Advance Agreement covers pension and/or insurance costs, then an HQ-level Board of Review must be convened.

DCMA has a Policy Instruction ("134—Boards of Review") but it's not available to the public. Consequently we can't tell you with certainty how they work. But we do know this: Each time a DCMA Board of Review is convened, the CO must prepare a review package. The package takes a lot of work and its quality (or lack thereof) is a direct reflection back on the CO who prepared it. Obviously, many Contracting Officers will be reluctant to invest the necessary time and effort to prepare a package that they won't mind being reviewed by their peers, superiors and/or the brass at Ft. Lee. You are going to have a lot of convincing to do.

Even if the CO decides to submit a review package in order to obtain approval to enter into an Advance Agreement, there is no guarantee that the Board (or Boards) of Review will go along with the plan. It's not unheard of for a CO to hear a resounding NO back from the Board (or Boards) of Review. What happens then? Well, the CO can resubmit the package and hope for a different answer—knowing that may upset some people, who may be under the impression that the CO is dense because they didn't get the message the first time. Or the CO can simply tell the contractor "sorry" and then get back to business.

Even if the Board (or Boards) of Review reach a favorable consensus and endorse the proposed Advance Agreement, that process is not going to happen overnight. It's going to take weeks or months. It's going to take time to prepare the review package and it's going to take time to convene the Board (or Boards) of review, and it's going to take time for the Board (or Boards) to deliberate and get back to the CO. Meanwhile, the contractor is not supposed to incur any costs covered by the proposed Advance Agreement until it's been executed.

Good luck with that.

DCAA's Role

At noted above, the objective of having an Advance Agreement is to proactively agree on the treatment of certain costs so that they do not become subsequently disallowed or become the subject of a dispute between contractor and customer. DCAA believes it has a role in the process of negotiating and executing an Advance Agreement, at least in certain areas. One of those areas is compliance with the unique requirements of contractor executive compensation. Without going into too much detail, DCMA and the contractor may enter into an Advance Agreement regarding use of "blended rates" to comply with the myriad statutory limits on executive compensation. DCMA and DCAA seem to have agreed that "prior to signing an advance agreement or accepting a methodology" (with respect to blended rates) "the ACO … must invite DCAA to review the computation of the compensation cap, and participate in prenegotiation discussions and/or subsequent negotiations." (See MRD 16-PSP-005, dated 2/19/2016.) Thus, if a contractor is proposing an Advance Agreement to address use of blended rates to comply with the executive compensation ceilings, not only will all of the DCMA process steps discussed above need to be followed, but your friendly local DCAA auditor will be part of the process as well.

As somewhat of a side note, we were piqued by the notion that DCAA would be participating in prenegotiation discussions and/or subsequent negotiations, as if DCAA somehow had co-equal authority as the warranted Contracting Officer. That seems … odd—and would seem to defeat at least a part of the objective for having an Advance Agreement in the first place. But what do we know?

More generally, the DCAA Contract Audit Manual (at 6-710) clearly states that "The auditor

shall abide by properly executed advance agreements that are in effect for the fiscal year when determining final rates." However, the CAM notes that "Should the auditor find that an advance agreement is not in the best interest of the Government, he/she will follow established procedures for recommending to the contracting officer, in writing, that the advance agreement be rescinded." We have some experience with rescinded Advance Agreements and, let us tell you, the rescission leaves a very bad taste in the contractor's mouth. Rescission of an Advance Agreement—after a cost has been incurred—is very much akin to breach of contract, in our view.

Where does this leave us with respect to the advice offered by the Fed Pubs instructors?

Well, we agree with it. It's good advice.

In theory.

But in the real world of today's somewhat adversarial defense acquisition environment, we believe that it's going to be a difficult challenge to get an executed Advance Agreement prior to incurrence of the costs at issue. Is it impossible? No. Not at all. But it is a challenge and it will take a long time, and the odds are stacked against a favorable outcome.

But don't let that stop you. If you don't bet you can't win.