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Readers may remember **our article** on the DFARS Class Deviation issued to implement the statutory requirement found in Section 808 of the FY 2012 National Defense Authorization Act. While we took issue with the need to issue a DFARS Class Deviation when the statute only called for the issuance of "guidance," we also noted that there wasn't much to be done about it. We weren't overly concerned because the direction called for the establishment of contract negotiation objectives based on 2010 ceilings.

Objectives are simply goals; they are not necessarily mandated outcomes.

We weren't even unduly concerned by written **letters of protest**, aimed at Under Secretary of Defense Frank Kendall, **charging** that DOD is misinterpreting and misapplying the statutory requirements, to the detriment of defense contractors. Sure, there were some omissions in the DOD guidance. As the Professional Services Council wrote—

The guidance fails to provide allowable exemptions, such as for commercial items, firm-fixed price contracts, and contracts with priced options or instances where contractors have pre-negotiated forward pricing rate agreements. The guidance does not adequately clarify instances when it is acceptable to negotiate contractor labor or overhead rates that are higher than 2010 levels. Although the guidance states that negotiation objectives should seek to hold rates to 2010 levels, unless the rates are otherwise established by law, the guidance fails to provide meaningful examples that would clarify such instances. The Service Contract Act and the Davis-Bacon Act are two such examples where the government's actions dictate escalations in contractor's labor rates. In addition, recent Cost Accounting Standards changes,

particularly related to pension harmonization that were a result of the Pension Protection Act (P.L. 109-280), did not go into effect for most contractors until 2011. As a result of these changes, many contractors' overhead rates necessarily increased. The deviation issued on July 31 does not account for this dynamic and would effectively punish contractors for actions taken in response to government mandates.

We were not overly concerned because we thought (and still do) that this is more a matter of negotiation tactics than anything else. One side is going to point to the statutory requirements, and associated DOD policy guidance, as the basis for demanding lower prices. The other side is going to point out the exceptions and demand the right to charge higher prices. Ultimately, the side that's better at negotiating should prevail.

But now the DOD Contracting Officers will have the additional assistance of DCAA to help implement the statutory requirements. Recent DCAA audit guidance (MRD 12-PSP-022(R), dated August 24, 2012) was issued that emphasized how DCAA auditors should assist the COs. (As if the auditors didn't have anything *else* to do.)

DCAA auditors should assist COs by providing information, including such information as: "contractor Fiscal Year 2010 final rates, the contractor's proposed incurred cost rates (accompanied with historical decrements for unallowable, unallocable, and unreasonable expenses), or other information that is available in the files."

But there's more! The audit guidance also stated—

Auditors should be alert for accounting changes, subsequent to 2010, that may impact the use of 2010 actual rates. Auditors should explain these changes, and if practical, furnish calculations to make the rate information comparable. All non-audited rate information (i.e., factual information from the permanent files) should be provided by memorandum following the guidance at CAM 9-107. Contracting officers do not require audited 2010 incurred cost rates to establish a negotiation objective

Actually, we think the guidance is pretty good. Among other nice things, it said—

If the contracting officer requests a proposal audit and the scope includes rates, auditors should plan and perform the audit procedures as they would do on any proposal examination (i.e. independently determine if the proposed rates comply with FAR Parts 15 and 31, CAS, etc.). Auditors should not view the directive as a rate cap nor as audit criteria (i.e. should not be used as a basis to question proposed rates). Any unaudited rate information previously

furnished should not be included in the audit report.

However, we did notice one bit of ominous foreshowing, found at the end of the MRD. It stated—

It should be noted, that the DPAP memorandum does not impose requirements on the prime contractor's negotiation objectives with its subcontractors. However, pursuant to FAR 15.404-3, the contracting officer is responsible for the determination of a fair and reasonable price for the prime contract, including subcontract costs. Therefore, the contracting officer may request rate information related to significant subcontractors.

So contractors attempting to provide services to DOD will not only have to contend with Contracting Officers seeking to implement problematic guidance, they will also have to contend with DCAA requesting information in order to assist those Contracting Officers.

Fun times!