Long-time blog reader “Black Hawk Dawn” asked us to comment on a recent DCAA assertion that an executed Certificate of Current Cost or Pricing Data (CCCPD) was required “of each separate entity from the same parent.” In essence, DCAA was asserting that work performed by an affiliated entity was effectively a subcontract with that entity. We wish that were the case, because it would solve so many difficulties … but unfortunately it is not. The DCAA auditor was wrong.

A cost transfers between affiliated entities under common control is not a matter of subcontracting. Instead, such transfers are commonly known as Inter-Organizational Transfers (IOTs). Yes, there are many names for such transfers—including Inter-Divisional Transfers, Inter-Entity Transfers, or even (our favorite) Inter-Divisional Work Authorization and Delegations (iWADs). But they are *not* subcontract costs. Subcontract costs are a separate cost element, related to, *but not the same as*, IOTs.

The proper cost accounting (and pricing) for IOTs is established by the FAR Cost Principle found at 31.205-26(e), which states—

(e) Allowance for all materials, supplies and services that are sold or transferred between any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control ***shal l be on the basis of cost incurred in accordance with this subpart***
. However, allowance may be at price when—
(1) It is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary or affiliate of the contractor under a common control; and

(2) The item being transferred qualifies for an exception under (b) and the contracting officer has not determined the price to be unreasonable. (f) When a commercial item under paragraph (e) of this subsection is transferred at a price based on a catalog or market price, the contractor—
(1) Should adjust the price to reflect the quantities being acquired; and

(2) May adjust the price to reflect the actual cost of any modifications necessary because of contract requirements.

[Emphasis added.]

That seems fairly straightforward, does it not? IOTs must be priced, and costed, on the basis

of actual cost incurred in accordance with the various cost accounting rules of FAR 31.2. (Unless the stated exception applies, which it may only in very rare circumstances.) In other words, the performing entity must transfer only allowable, allocable, costs. And it must transfer all costs actually incurred; it cannot agree to a fixed-price or lump-sum budget value, and then simply bill that agreed-upon amount.

It seems fairly straightforward, but compliant cost accounting is more difficult than it seems, as Bell Textron **learned** to its chagrin. In addition, we also **told readers about** similar problems faced by U.S. Foodservice for allegedly creating shell companies (called "value-added service providers") that were used to inflate the cost of goods and services provided to the DOD and the Department of Veterans Affairs.

So, no, getting the cost accounting and pricing right for IOTs is more difficult than it might seem. And penalties for being caught getting it wrong can be painful.

Getting back to the original question, DCAA should not be requesting separate CCCPDs from each affiliated organization whose costs were included in the proposal, since all IOT efforts are considered to be parts of the same overall effort to be performed by the parent organization. How do we know that?

Well, because the FAR tells us so.

Let's start by disposing of the very rare circumstance when the IOT is transferred at price (including profit), because the contractor met all the requirements of 31.205-26(e) and (f), and 15.403-1(b)—and the Contracting Officer has not determined that the transfer price was unreasonable. If the basis of the 15.403-1(b) exception is that the contractor is transferring a "commercial item" (as that term is defined in FAR 15.403-1(c)(3) and FAR 2.101), then the DCAA auditor might have a slight scintilla of a point. In that circumstance—and *in no other*—the IOT
would
be considered to be a subcontract. (See the definition of "subcontract" found at 15.401. As we **told you before**
, the FAR has many definitions of "subcontract" and you need to know which one applies to your situation. In this case—and in this particular case
only
—the IOT should properly be treated as a subcontract for purposes of determining compliance

with FAR Part 15 requirements.)

But while that transfer of a commercial item at commercial prices would be considered to be a subcontract for purposes of determining compliance with FAR Part 15 requirements, that commercial item "subcontract" would not need a separate CCPD. So the DCAA auditor is still wrong.

We know this because we read FAR 15.403-1(b), which references 15.403-1(c)(3). And 15.403-1(c)(3) states—

(3) Commercial items.

(i) Any acquisition of an item that the contracting officer determines meets the commercial item definition in 2.101 … is exempt from the requirement for certified cost or pricing data. …

There's quite a bit more verbiage under that section, worth reading if one is thinking about trying to justify commercial item inter-organizational transfer pricing, but it's not particularly germane to the main topic. The point is, if one takes advantage of the exception to the default rule that IOTs must be costed and priced on the basis of actual, allowable, incurred costs—and the basis of that exception is that the item in question is a commercial item being transferred at commercial prices—then one is dealing with a subcontract. But it's also a subcontract that is *exempt* from the requirement to submit certified cost or pricing data; and hence it's also exempt from the requirement to submit a separate CCCPD. So that's the story on that.

We're going to move on from this rare situation, because it's very hard to jump over the regulatory bar imposed by the FAR. It's far more likely—perhaps almost certain—that your organization will be forced to price and cost (and bill) its IOTs on the basis of actual, allowable, incurred costs.

If that's the case, then you most definitely do *not* have a subcontract. This is made manifestly clear at FAR 15.407-2 ("Make-or-Buy Programs"). For those who may not know, a make-or-buy decision is simply that: it's a decision (made by the Prime Contractor or higher-tier subcontractor) as to whether or not it will perform the work itself (in-house) or if it will outsource the work to another, lower-tier, contractor. A "make" item is one that is made in-house, while a "buy" item is one that will be acquired from an external source. FAR 15.407-2(b) states—

(b) *Definition.* 'Make item,' as used in this subsection, means an item or work effort to be produced or performed by the prime contractor or its affiliates, subsidiaries, or divisions.

So an IOT is not an acquisition from an external source. It is clearly a "make" item, and not a subcontract.

But there's more support for the notion that your basic, average, IOT is not a subcontract—and that support comes from DCAA itself.

We **told readers** that DCAA has developed a checklist to ensure the adequacy of proposals it is auditing. DCAA reasons that, after all, why should it waste its scarce resources auditing proposals that are inadequate for audit? While we respectfully disagree with DCAA's notion that it is the sole arbiter of cost proposal adequacy, we don't mind using its "Criteria for Adequate Contract Pricing Proposals" (issued January 2012) to support our position.

Criteria Number 25 addresses IOTs. (You can find it at the bottom of Page 6 of 8 of the adequacy checklist.) It says (in part)—

NOTE: Interorganizational work is considered to be part of the cost or pricing data submission of the prime. As such, the prime contractor's responsibility for conducting subcontract cost/price analyses does not apply to interorganizational transfers. Prior to the submission of the proposal, the prime contractor shall (a) ensure that all statement of work tasks are addressed without duplication and are consistent with the overall program performance schedule and, (b) ensure ground rules and assumptions are consistent with the prime's proposal.

So there you go. The IOT is not a separate subcontract; it is an inherent part of the cost or pricing data of the organization submitting the proposal. As such, it is subject to the Truth-in-Negotiations Act (TINA) requirements of the organization as a whole—but it is not subject to any separate TINA requirements. In particular, it need not submit a separate CCCPD; the organization's single CCCPD covers all IOTs subject to certified cost or pricing data submission requirements.

So there you have it.

Our thanks to “Black Hawk Dawn” for submitting this issue for us to think about. If you have a similar conundrum of your own, please feel free to do the same.