

## DOD Bid And Proposal Guidance — Is It Right?

*Law360, New York (December 19, 2011, 12:41 PM ET)* -- Cost Accounting Standard 402 has long provided that bid and proposal (B&P) costs incurred pursuant to a specific requirement of an existing contract may be distinguished from B&P generally and treated as direct costs of the requiring contract. As CAS 402-61 states:

The circumstances are different because the costs of preparing proposals specifically required by the provisions of an existing contract relate only to that contract while other proposal costs relate to all work of the contractor.

Given this long-established prescription, the Nov. 10, 2011, memorandum issued by the Office of the Under Secretary of Defense entitled “Direct and Indirect Charging of Contractor Proposal Preparation and Negotiation Support Costs” is, in some ways at least, unremarkable. It hardly breaks new ground for the U.S. Department of Defense to state, for example, that:

Proposal and negotiation costs should only be charged directly to a contract when there is a specific contractual requirement for the contractor to submit a proposal.

Nor, given the emphasis in CAS 402 on the need for a “specific” contract requirement to support the direct costing proposal preparation costs, is it surprising that the Nov. 10 memorandum states that:

For the costs to be charged directly to a contract there must be a specific requirement in an existing contract to submit that particular proposal, not just an implied requirement.

Nonetheless, there are some new and troubling aspects to the DOD guidance.

First, the memorandum states that the “specific requirement” that supports direct charging “should manifest itself in the contract, such as in a funded line item.” The first half of that sentence is a truism, because if it does not manifest itself in the contract then the requirement is not “specific,” but implied, and outside the reach of the CAS 402-61 interpretation that supports direct charging of proposal costs.

But the second half of the sentence finds no expression or support in CAS 402 or Federal Acquisition Regulation 31.205-18 and represents an effort at unilateral rulemaking that is beyond the realm of the secretariat's authority. One can now envision squads of auditors disallowing proposal costs associated with specific contract requirements on the ostensible ground that there is no "funded line item" for the proposal.

It will be unfortunate if contractors now find themselves fighting for the recovery of the costs incurred under the specific requirements of the changes clause, the value engineering clause, or clauses requiring the submission of proposals to definitize unpriced contract actions because auditors or contracting officers believe that a "funded line item" is a condition precedent to direct charging of proposal preparation effort.

Second, to avoid paying the fair and reasonable costs of proposals specifically required by existing contracts, the memorandum suggests that contracting officers place cost controls on the proposal effort, in the form of firm fixed or not-to-exceed prices, using the "typical B&P costs" incurred by contractors and allocated as indirect costs.

The memorandum announces the imminence of a new Defense Federal Acquisition Regulation Supplement rule to gauge the adequacy of contractor proposals and we await with great interest the manner in which — if at all that DFARS rule addresses the definition of "typical B&P costs" and the "typical" requirements against which those B&P costs were generated.

Third, the memorandum's is simply wrong when it states that:

If there is a specific requirement in an existing contract to submit one or more proposals, cost of preparing those proposals are allocable only to the contract requiring the proposal submission.

This assertion misreads CAS 402-61. The standard allows proposal costs to be charged directly to a contract under certain circumstances. It does not compel that accounting treatment. CAS 402-61(d) specifically states that:

This interpretation does not preclude the allocation, as indirect costs, of costs incurred in preparing all proposals. The cost accounting practices used by the contractor, however, must be followed consistently and the method used to allocate such costs, of course, must provide an equitable distribution to all final cost objectives.

Few contractors, in our experience, adopt this alternative, but it is — here's that word — a "specific" and authorized alternative method of accounting for B&P. The OUSD does not get to repeal CAS 402-61(d) through the simple expedient of issuing a unilateral memorandum. Perhaps a revised memorandum will be forthcoming ... but I doubt it.

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