
THE CONTRACT ADMINISTRATION SERVICES (CAS) SURCHARGE

By

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The purpose of this article is to examine the Contract Administration Services (CAS) surcharge, its legislative basis and developmental history, the functions included in contract administration, and how the surcharge is applied by the Security Assistance Accounting Center (SAAC). The objective is to provide case and financial managers and other interested readers with information with which to increase their management skills and awareness.

Section 22 of the Arms Export Control Act (AECA) ("Procurement for Cash Sales") authorizes foreign sales whereby the U.S. government purchases defense articles or services from a private firm for sale to a foreign government. This section requires the foreign government to agree to pay the full amount of the contract, thus insuring the U.S. government against any loss on the contract. Section 21(e)(1), which applies to sales under both Sections 21 and 22, requires the inclusion of appropriate charges for administrative services, among other things. The legislative intent of these two provisions is that, in the absence of special waivers authorized by law, both direct and indirect costs of sales be borne by foreign governments so that defense appropriations do not subsidize the Foreign Military Sales (FMS) program.

That the Department of Defense (DOD) had a responsibility to recover costs related to contract administration was recognized as long ago as 1970. Initially, implementing agencies (IAs) accumulated actual hours of contract administration effort in support of FMS and billed the costs to an FMS case. A major problem existed with this procedure. IAs were including only their own contract administration costs in the Letter of Offer and Acceptance, and did not issue reimbursable orders to other DOD components, and refused to pay billings from other DOD components, resulting in approximately \$20 million in billings in float. When this problem was surfaced to the OSD level, DOD components were directed not to perform contract administration of FMS contracts unless a reimbursable order had been received. It soon became apparent, however, that it was difficult to stop the CAS effort just because a reimbursable order had not been received, and the problem of the old bills remained unsolved. For this reason, a surcharge and a clearing account were established for CAS in 1980 which allowed old bills to be paid and set up a way to process future CAS billings.

Thus, for pre-1980 cases, CAS charges may have been a combination of actual hours and surcharges applied on a percentage basis to certain Delivery Source Codes by SAAC. In attempting to close such cases, care must be taken to ensure that the proper amount of CAS charges are applied to the case. Overbillings are common since frequently the CAS surcharge was applied to the total amount of contract effort on the case even though some of the costs of CAS effort were recovered through direct charges to the case.

It was not until DOD 7290.3-M, "Foreign Military Sales Financial Management Manual," was published in 1981 that a comprehensive policy became available to DOD components. However, a Defense Audit Service (DAS) report dated April 27, 1983 identified several areas of concern. The DAS concluded that while the use of a surcharge system to charge contract administration costs was an appropriate method of collecting funds from customers, the methods used by DOD components resulted in significant net overbillings to the CAS clearing account. According to the DAS, DOD components billed the CAS account for the costs of functions that should have been funded through the FMS administrative budget, excluded military personnel costs from billings, billed for costs of supervisory and clerical personnel that were also included as overhead in the hourly rate, and billed excess charges by applying an inflated hourly rate. Corrective action was recommended by the DAS.

Another area of concern identified by the Defense Audit Service was the way in which FMS workload was computed. DOD 7290.3-M originally specified that DOD components were to submit billings to SAAC for actual contract administration costs, based on hours of effort, in support of the FMS program. Again, according to DAS, DOD components used cost accumulation methods that did not accurately identify costs incurred. Change 1 to DOD 7290.3-M clarified this issue by specifying allocation methods for quality assurance, contract management, and contract audit for the various organizations authorized to bill for contract administration services.

One further area of concern involved countries or programs for which CAS charges had been waived, either under a statutory provision or as part of an international agreement. Total agreement has not been reached about how the cost of performing contract administration services should have been funded under both types of waivers. As a result, many billings related to waived costs were submitted to and paid by SAAC which more properly may have been funded by DOD appropriations. Further, even when it was agreed that billings may have been erroneous, it was not agreed that refunds were an appropriate corrective action.

As the result of preliminary reporting during the DAS review, SAAC was directed in June 1982 to unblock its computer program to assess the CAS surcharge on all cases (other than the EPG F-16, FMSO, and waived cases) regardless of implementation date, beginning with the June 1982 performance cycle.

In February 1981, SAAC began computing CAS on FMS cases with an offer date of 1 January 1979 or later, given certain Delivery Source Codes and given that a CAS percentage was present in SAAC's automated case master file. As a result of the June 1982 direction, SAAC "force loaded" CAS for pre-1979 cases. CAS charges for pre-1979 cases were processed for the lesser of the value of: 1) progress payments reported since June 1982, or 2) current disbursed/undelivered progress payments. Thus, pre-1979 cases should have CAS charges applied by SAAC only if progress payments were reported after June 1982, or if there were outstanding progress payments as of June 1982. A pre-1979 case which was "supply complete" or "delivered" prior to June 1982 should not have any CAS charges which were computed by SAAC. It is possible, however, that some recovery of CAS was done on a

case line. DD Form 1513-2 modifications were required for those cases where costs exceeded 110 percent of case value as a result of the CAS loading.

Current guidance related to recovery of contract administration costs is contained in DOD 7290.3-M, "Foreign Military Sales Financial Management Manual," which is mandatory for use by all DOD components. Paragraph 70305 of DOD 7290.3-M requires that:

. . . the cost of contract administration, as identified in paragraph I-406 of the DAR [Defense Acquisition Regulation], and contract audit shall be recovered through the application by the SAAC of a percentage surcharge to all RCS DD-COMP 1517 report disbursements to contractors for FMS new procurements on which applicable contract administration services have not been waived. . . .

Paragraph I-406 of the DAR equates to paragraph 42.302 of the Federal Acquisition Regulation (FAR)--the DAR's successor.

The FAR and its defense supplement identify approximately seventy contract administration functions that are performed by Contract Administration Offices (CAOs) to the extent that they apply, unless specifically withheld by the contracting office. Examples of these functions, selected to show the variety performed, are:

- Perform pre-award surveys.
- Conduct post-award orientation conferences.
- Consent to the placement of sub-contracts.
- Review and approve or disapprove the contractor's requests for progress payments and make payments on assigned contracts, when prescribed in regulations.
- Manage government-furnished property.
- Perform production support, surveillance, and status reporting, including timely reporting of potential and actual slippages in contract delivery schedules.
- Ensure contractor compliance with contractual quality assurance requirements.
- Cause release of shipments from contractor's plants according to shipping instructions.
- Establish final indirect cost rates and billing rates for contractors meeting certain criteria.

In accordance with DOD 7290.3-M, the prescribed surcharges are:

Quality Assurance and Inspection	0.5%
Other Contract Administration	0.5%
Contract Audit	<u>0.5%</u>
TOTAL	1.5%

In the past, it has been possible to waive the quality assurance and inspection and contract audit surcharges under Section 21(h), resulting in the application of the remaining 0.5% for "other contract administration" by SAAC. It was not possible to waive the surcharge for "other contract administration" under Section 21(h). With the passage of P.L. 99-83, effective 1 October 1985, it is possible to waive the entire 1.5% surcharge under Section 21(h). Also, other legislation waived the 1.5% CAS surcharge for the NATO E-3A program. The basis for the waiver of contract administration charges under Section 21(h) is a reciprocal agreement with a NATO member whereby that government provides such services on a reciprocal basis without charge to the U.S. government, or reciprocal agreements related to the NATO Infrastructure Program. In any event, the waived contract administration costs for FMS cases included on the list shall be funded by DOD appropriations.

SAAC maintains a cost clearing account for contract administration service (CAS) costs and applies the prescribed surcharge to billings submitted by the military departments, charges customers the amount derived by applying the surcharge, and pays DOD components for CAS costs based on SF 1080 submissions by those organizations authorized to bill for CAS.

Financial managers must clearly understand the workings of the CAS funding to avoid a misapplication of funds. First, a DD Form 1513 which involves procurement lines, either for major systems, services, or stock items, will have an amount included for CAS, unless waived. Prior to 1983, SAAC reserved obligational authority (OA) for CAS--it was not issued to Implementing Agencies (IAs). The maximum OA available to IAs was 110% of net case value minus CAS. Procedures changed during 1983 so that IAs were to request OA for CAS as part of the direct cite program for a FMS case. However, the IA has no way to commit CAS and, if applied directly to contract effort associated with the line, will ultimately result in an overcommitment by the amount of CAS for the following reasons. The only activities that can obligate CAS and subsequently liquidate those obligations are listed in paragraph 70305B3 of DOD 7290.3-M. According to section 205 of 7290.3-M, these activities must submit a letter to the DSAA Comptroller and to SAAC prior to the start of each fiscal year specifying the amount of anticipated reimbursements for services to be performed during the new fiscal year. This same section also stipulates that before actual contract administration and audit costs may be incurred, the components must establish a reimbursable order in the financing appropriation which will initially fund the actual cost of such services. Those components are the ones referred to above in chapter seven of DOD 7290.3-M. At case closure, it is the responsibility of the IA to identify to SAAC the amount of contract effort earning CAS; SAAC then determines the correct aggregate amount applied to the cost clearing account. The commitment obligation and liquidation of CAS clearing account dollars is thus a separate cycle in itself and does not enter the equation at case closure. The important point from a financial management perspective is to ensure that the correct cost is applied, and that the percentage is sufficient to cover the on-going effort so that the cost clearing account has sufficient resources to pay the bills as they are submitted by the performing components. The implementing activities must be careful not to obligate that portion of the OA they receive which is CAS. If they do, they must be prepared to adjust their case values, should that obligation drive the case cost over authorized thresholds.

In April 1984, SAAC undertook a conversion of CAS computation procedures. IAs were being issued OA for CAS, but SAAC still was doing the computation of CAS on reports of physical deliveries and progress payments. Some feedback was necessary to assure that SAAC and IA records were in agreement on CAS charges. The conversion involved an extraction of data from SAAC's records and another forced loading of CAS amounts. This forced reload once again caused some FMS cases to become out of balance. Also, as part of the 1984 conversion, the method of applying the CAS surcharge changed.

The method of applying the surcharge to military department billings (DD 1517 reports) is especially complicated and deserves further treatment since it has an impact on the management of FMS cases. In accordance with DOD 7290.3-M, SAAC applies the prescribed surcharge to certain military department performance reports received on or after 1 October 1980. Normally the surcharge is 1.5%, but if a waiver has been granted, the percentage may be less. In any case, the percentage to be applied is loaded into the case master file by SAAC, and is reflected in the field labeled "CAS-PCT" in the case summary data portion of either the Case Financial Management Worksheet or DIFS II printout. Note that there is no way of having different CAS percentages for different lines on a case. Soon after case implementation, case managers should verify that the percentage loaded by SAAC is appropriate for that case.

Three different types of CAS may be computed by SAAC.

Progress Payment CAS. Progress payment CAS is the amount computed on disbursements to contractors for work in process. The following logic applies:

1. The Price Code (Column 7 of the DD 1517 report) must be "N," indicating an incremental billing.
2. The Articles/Services/Progress Payment Indicator from SAAC's Table 27 must be a "P," indicating a progress payment or work in process report (as opposed to a physical delivery or performance of services).
3. The CAS Add-On Indicator (again from Table 27) must equal a "Y," indicating CAS may be applied.
4. A CAS percentage must be present at case level.

Conditions 2 and 3 limit the computation of Progress Payment CAS to Delivery Source Codes "DE" (progress payment to contractor) and "DK" (government-furnished material shipped from another contractor). Both represent disbursements to contractors. The latter, while it is a payment for an item which has been shipped, is not a delivery since the shipment is not to the FMS purchaser, but rather is to the prime contractor for systems integration.

Transactions meeting all the above conditions will be summed at record serial number (RSN) (line or sub-case) level and then CAS will be computed. A DD 1517 report will be computer generated by SAAC, the extended value of which will be the computed CAS. The calculated progress payment CAS costs

will be reflected in the monthly "FK" feedback report to the implementing agencies (IAs) for posting to case records. These transactions will be identified with transaction code "NU," NSN "CONTRACT ADMIN," delivery source code (DSC) "DE," and reimbursable code "W."

Liquidating Delivery CAS. "Liquidating delivery CAS" is the amount of CAS that is computed on reports of physical deliveries which liquidate previously reported progress payments, i.e., delivery reports with reimbursable code "N." The Navy does not use reimbursable code "N." Rather, as physical deliveries occur, the Navy reduces the value of unliquidated progress payments with credit progress payment transactions. Thus, since the Navy should have no liquidating deliveries, there should be no liquidating delivery CAS on Navy cases.

In contrast, the Air Force's current practice causes all physical deliveries to be reported as liquidating deliveries, even those from stock. In effect, the Air Force considers the cash transaction to be a progress payment (more precisely, work in process). The corresponding logistical delivery liquidates the cash transaction. Thus, for Air Force cases, the following logic applies:

1. Implementing Agency Code is "D."
2. Reimbursable Code is "N."
3. Articles/Services/Progress Payment Indicator is either "A" or "S", and the CAS add-on indicator is "Y."
4. A CAS percentage is present at case level, and CAS was computed on progress payments.

Condition 3 prevents CAS from being computed on deliveries from stock by limiting computation of liquidating delivery CAS to Delivery Source Codes "DA" (contractor services), "DB" (stock fund item from contractor), "DC" (secondary item from contractor), "DD" (principal or major item from contractor), "ED" (publications from contractor) and "EG" (other federal agency shipment from contractor). Condition 4 ensures that liquidating delivery CAS does not exceed progress payment CAS (this prevents overliquidations being caused by CAS).

For Army cases, the logic is slightly different:

1. Reimbursable Code is "N."
2. Articles/Services/Progress Payment Indicator is either "A" or "S."
3. A CAS percentage is present at case level and CAS was computed on progress payments.

If all of the above conditions are met for either the Air Force or Army, SAAC will sum such transactions at RSN level and a DD 1517 will be computer generated as for progress payment CAS. FK feedback to the implementing agency will be identified with transaction code "NC," NSN "CONTRACT

ADMIN," delivery source code "BD" (other DOD Services), and reimbursable code "X" (for Section 22) or "Y" (for Section 21).

Non-Liquidating Delivery CAS. "Non-liquidating delivery CAS" is the amount of CAS computed on performance reports which do not liquidate previously reported progress payments, i.e., those with a reimbursable code other than "N." Air Force deliveries, in effect, are eliminated from this delivery status since, as previously mentioned, all Air Force deliveries are reported as liquidating deliveries.

The following sets of logic apply to non-liquidating delivery CAS:

1. Price Code is "N."
2. Articles/Services/Progress Payment Indicator is "A" or "S", and the CAS add-on indicator is "Y."
3. Reimbursable Code is not "N."
4. A CAS percentage is present at case level.

Alternatively, with any price code:

1. Delivery Source Code is "DB" (stock fund item from contractor) or "DC" (secondary item from contractor).
2. Reimbursable Code is "I."
3. A CAS percentage is present at case level.

For Navy (Implementing Agency Code is "P"):

1. Price Code is "A," "R," or "N."
2. CAS Add-On Indicator is "Y."
3. A CAS percentage is present at case level.

As with progress payment CAS and liquidating delivery CAS, transactions which meet any of the above three sets of criteria will be summed at RSN level and a DD 1517 will be computer generated. The resulting CAS computation will be identified by transaction code "NC," NSN "CONTRACT ADMIN," delivery source code "BD," and reimbursable code "Z."

Some generalizations may now be pieced together:

First, the logic required to compute CAS seems unnecessarily tortuous. However, such extreme complexity is in fact necessary if CAS is to be properly charged since the military departments have three completely different ways of reporting performance on FMS cases, each with its anomalies and peculiarities. Most of the intricacies in SAAC's CAS computation result from eccentricities in the reporting systems used by the services. It would probably be ill advised, however, to require that the services modify their systems in order to conform to SAAC's processing system since the service

reporting systems are the larger systems and were developed to meet service requirements, and then modified to accommodate FMS transactions. Each of the services is genuinely trying to provide accurate, timely reporting to SAAC, but for organizational, philosophical, or evolutionary reasons, different methods to that goal have been developed.

Second, the price code "N" may be considered to be a CAS-computing code. If CAS is to be computed on progress payments to contractors, the progress payment must be reported with a "DE" or "DK" delivery source code and price code "N." When no progress payments are involved for contractor effort, such as might be the case on small contracts, the IA should use a delivery source code "DA" through "DD," and, if CAS is to be computed, use an "N" price code. In some instances, however, CAS may be computed with other price codes; normally, the CAS add-on indicator from SAAC's Table 27 drives CAS computation in such a case.

Third, an "N" price code reported in any transaction with an "N" reimbursable code will cause the transaction to be rejected by SAAC.

Fourth, there is what may seem to be an impossibility in the liquidating CAS logic. How could CAS be computed on a Section 21 delivery? Army uses delivery source code "BD" (other DOD services) to report various types of transactions, and will sometimes liquidate cash advances or disbursements with this delivery source code. In this regard, extreme care should be taken when using delivery source code "BD" to make sure it will do what is desired. "BD" bypasses all "below the line" surcharge computations. It will only compute CAS if it is a liquidating delivery (reimbursable code is "N"), and then only if progress payments had previously been reported on which CAS had been computed.

Fifth, the importance of the coding on a delivery report cannot be overemphasized. A delivery source code by itself triggers the computation of most add-on costs by the SAAC. The combination of delivery source code and reimbursable code places a delivered cost into a specific section (21 or 22) and status (non-liquidating or liquidating). If transportation is to be properly charged on a delivery, use of the transportation bill code is necessary. If CAS is to be applied to either a delivery or progress payment, the price code must be considered as well as delivery source code and reimbursable code.

Finally, attempts to reverse erroneously-submitted delivery reports can induce other errors even while perhaps correcting the original problem. Close attention should be paid to all the coding in, for example, a credit transaction, to make sure that inadvertent errors are avoided.

Application of CAS as it is now being done modifies a fundamental principle of FMS pricing, that of a "single selling price." Any SAAC-generated DD 1517 card which results from the above logic will appear on the FMS customer's Detail Delivery Listing as a separate transaction. The customer, if he desires to compute the "single selling price" of delivered articles, must follow the above logic to determine if CAS applies to the delivery. Even then, the extended value of the delivery may well reflect costs not subject to the CAS surcharge (e.g., nonrecurring cost recoupment/asset use charges) so that "backing into" the value of delivered CAS may prove to be impossible.

In the aggregate, single selling prices are shown on the DD Form 645 Billing Statement in the sense that delivered costs shown in columns 8 and 9 represent rolled-up amounts of all deliveries reported. However, it is not readily possible to always match logistical information with the financial information on the DD Form 645. With delivery CAS reported separately on the Detail Delivery Listing, this matching task is all the more difficult. Hopefully, an understanding of the computer logic and controls involved will make attempts at such tedious manual matches unnecessary. Rather, such understanding promotes a confidence in the system as opposed to confidence in a stubby pencil manual recomputation.

It is hoped that an increased understanding of the Contract Administration Services surcharge will help case and financial managers be more effective and that, as a result, better control of FMS funds will be realized. CAS, as it has evolved, has changed several, times both in its coverage and its accounting. Each of those changes had the potential to cause FMS cases to become "financially troubled" or to be driven into an adverse financial condition. Military department records must be analyzed to be sure that the proper amount of CAS is applied to contract efforts. If all else fails, SAAC's technicians have shown themselves to be extraordinarily responsive to requests for help in reconciling cases.

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