

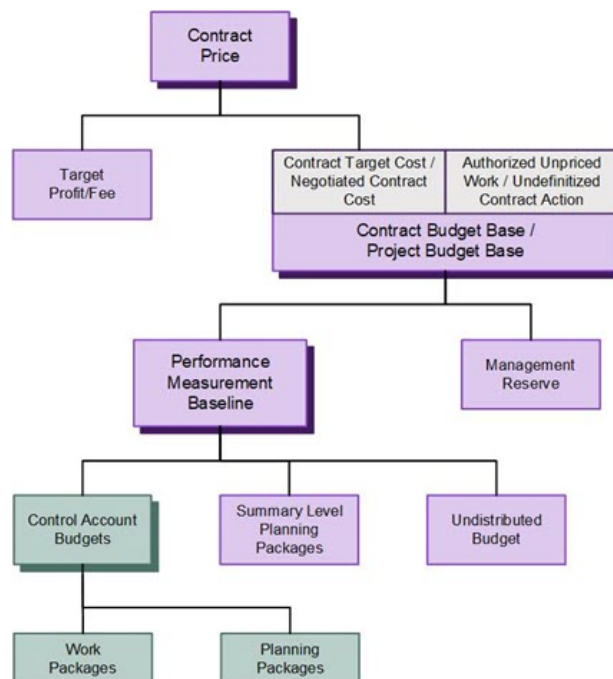
Handling Authorized Unpriced Work (AUW) in an Earned Value Management System

This article discusses the issues that commonly surface with authorized unpriced work (AUW). In some instances, contractors are not following the commonly used and recommended practices. In other instances, there is inconsistent interpretation by the various DCMA EVMS review teams that result in the review team writing a Corrective Action Request (CAR) for “improper implementation” of AUW when the contractors are actually implementing it properly.

Background

To set the stage for this discussion, it is useful to review a few EVM concepts.

The contract budget base (CBB) represents the base cost of contractually authorized work, including changes, from which the performance measurement baseline (PMB) is developed to measure future performance. The CBB (and subsequently the PMB) excludes any fee or profit. When all authorized work has been negotiated, the CBB equals the contract target cost (CTC). When there is authorized unpriced work (AUW), the CBB includes the contractor’s estimate to accomplish the work. The CTC is not changed until the effort is negotiated. The budget distribution flow down process is illustrated below.



It is also useful to review the EIA-748 guidelines, the related DCMA EVMS Cross Reference Checklist (March 2011 edition) as well as the NDIA PMSC EIA-748 Intent Guide, and the DCMA Earned Value Management Implementation Guide (EVMIG) (April 2005 edition) that deal with handling authorized unpriced work. These are listed below; key text is highlighted.

Guideline 8. Establish and maintain a time-phased budget baseline, at the control account level, against which program performance can be measured. Budget for far-term efforts may be held in higher level accounts until an appropriate time for allocation at the control account level. Initial budgets established for performance measurement will be based on either internal management goals or the external customer negotiated target cost including estimates for authorized but undefinitized work. On government contracts, if an over target baseline is used for performance measurement reporting purposes, prior notification must be provided to the customer.

Guideline 9. Establish budgets for authorized work with identification of significant cost elements (labor, material, etc.) as needed for internal management and for control of subcontractors.

DCMA Checklist, 9.a. Does the budgeting system contain-- (Provide exhibit.)

(1) The total budget for the contract (including estimates for authorized but unpriced work)?

Guideline 15. Provide that the program target cost goal is reconciled with the sum of all internal program budgets and management reserves.

DCMA Checklist, 15.b. Do the sum of the control account budgets for higher level WBS elements, undistributed budget, and management reserves reconcile with the contract target cost plus the estimated cost for authorized unpriced work? (Provide exhibit.)

Guideline 28. Incorporate authorized changes in a timely manner, recording the effects of such changes in budgets and schedules. In the directed effort prior to negotiation of a change, base such revisions on the amount estimated and budgeted to the program organizations.

NDIA PMSC Intent Guide, Guideline 28

Incorporate the work scope for authorized changes into the performance measurement baseline in a documented, disciplined, and timely manner. The timely and accurate incorporation of authorized and negotiated changes into the performance measurement baseline ensures that valid performance measurement information is generated for the new scope being executed. Adherence to this guideline helps to ensure that budget, schedule, and work remain coupled. For unpriced change orders, the contractor will develop its best estimate for planning and budgeting purposes for incorporation into the performance measurement baseline. Near term effort should be planned and have budget in control accounts. Far term effort that cannot be reasonably planned in the near term may be planned in summary level planning packages or maintained in Undistributed Budget (UB). Until contractual definitization, the near-term work is continually planned. After definitization, any budget remaining in undistributed budget will be planned and budgeted within control accounts, summary level planning package packages or management reserve as soon as practical. Incorporating changes must not arbitrarily eliminate existing cost and schedule variances. Rate changes and economic price adjustments may be made as appropriate.

DCMA Checklist, 28.c. Are internal budgets for authorized, but not priced changes based on the Contractor's resource plan for accomplishing the work?

DCMA Checklist, 28.d. *If current budgets for authorized changes do not sum to the negotiated cost for the changes, does the Contractor compensate for the differences by revising the undistributed budgets, management reserves, budgets established for work not yet started, or by a combination of these?*

EVMIG 3-3.a.3.¹ Authorized, Unpriced Effort. If a customer authorizes additional work and the value of the added work is still to be negotiated, the company may increase the program budget as needed for the newly authorized work. For authorized, unpriced work, the contractor should plan and budget near-term effort in CAs, and may leave the remaining effort and budget planned in SLPPs or maintained in UB during the period of negotiation. The budget applied may be adjusted when the authorized change is finalized. After definitization, the remaining effort will be planned and budgeted within CAs as soon as practical.

EVMIG 3-3.j.2.¹ Undistributed Budget. Budgets applicable to contract effort, which cannot be specifically identified to WBS or organizational elements in a timely manner, are referred to as UB. The establishment of UB may be necessary when project changes are authorized too late in an accounting month to be distributed in that month. The budget should be distributed to appropriate WBS or organizational elements and CAs as quickly as possible. For authorized work which has not been negotiated, the project may maintain budgets in the UB account until negotiations have been concluded, allocating budget only to that work which will start in the interim. After negotiations, the remaining budget should be allocated appropriately.

Applying the EIA EVMS Guidelines

The items highlighted above indicate that contractors are to budget for the AUW they receive from the customer by using their estimates for what it will take (the resources) to do the work. Items related to Guideline 28 discuss the post negotiation actions when the contractor must adjust the originally identified budgets down to the negotiated value of the contract change.

These excerpts from the EIA-748 and earlier government implementation guidance clearly demonstrate the basis for handling authorized unpriced work is through undistributed budget. In practice this means:

- Authorized unpriced work budget typically resides in undistributed budget (UB), with budget being incrementally issued to control accounts for near term work until the change is eventually negotiated (hopefully, within a relatively short period of time).
- Summary level planning packages (SLPPs, or other similar names) can also be used if the contractor's EVM System Description allows for them. SLPPs are mechanisms encouraged by the EIA-748 Guidelines and government implementation guidance that allow a contractor to move the budget from undistributed budget into the distributed budget at a higher level than the control account. This mechanism enables the contractor to distribute budget from UB in a timely manner (even though they should not have to for AUW), and it allows contractors to retain their flexibility in determining any management reserve (MR) following negotiation of the AUW.
- In those cases when negotiations take longer than expected, contractors sometimes end up distributing the entire budget from UB to control accounts (electing not to hold back

¹ The first version of the October 2006 EVMIG also included these references. The same text can be found in paragraphs 1.3.1.3 and 1.3.10.2. The later version of the October 2006 EVMIG removed these paragraphs along with other text in section 1.

MR budget thinking the customer will automatically take that budget back as “not needed” during negotiations – even though government language is clear that is not to happen).

- Once the A UW change is negotiated, the contractor then has to make the necessary adjustments to the budgets for the yet-to-be-distributed work residing in UB. This is also when a contractor determines a management reserve amount to withhold and distributes the remaining scope and budget to control accounts.
 - In those instances when negotiations take a long time, and all the budget has been distributed to control accounts, the contractor may have to adjust (reduce) control account budgets to accommodate the negotiation losses. This may include identifying management reserve budget as well.
 - Some contractors may elect to use existing MR (if any exists) to compensate for negotiation losses instead of taking back budget from the control accounts – this is at the Project Manager’s discretion. The customer cannot require the contractor to use MR from existing scope of work to cover new work (A UW) or to adjust budgets once A UW is negotiated.
 - If a contractor had used summary level planning packages, they could have used these accounts to make the final distributions to control accounts and to MR, instead of having to take budget back from control accounts.

Some customers may not have the knowledge or experience with A UW that one would hope they have, and they often incorrectly tell contractors how to incorporate A UW changes. A typical request is to tell a contractor to use their existing MR to do so. Guideline 28 makes it clear that UB is the correct place for these A UW activities to be transacted.

Some customers have also convinced contractors that they should only plan and budget to the not to exceed (NTE) that might be attached to an authorization to proceed (ATP) with authorized unpriced work. An NTE is typically a billing or spending limitation placed on A UW, and should not be confused with the total amount the contractor believes the undefinitized work will eventually cost.

For unpriced change orders, the contractor will need to develop its best estimate for planning and budgeting purposes for incorporation into the performance measurement baseline.

Under a “spending” NTE, the contractor is to report to the customer when their expenditures are nearing the NTE spending limitation, so the customer can either arrange to get additional funding and increase the NTE value or instruct the contractor to slow down or stop working along their performance measurement baseline planned for that work (usually resulting in a customer-driven impact to the schedule and cost forecast for that work).

In some cases, the customer comes into an A UW situation with a specific dollar value in mind about what the total cost for a particular change should be – calling this the “NTE”. If the contractor and the customer previously agreed that the change would not be higher than a certain amount, then this would probably be acceptable. If it is a unilaterally determined amount by the customer, and the customer does not allow a bid to be higher than the “NTE” amount, it can result in unrealistic project budgets if the contractor is forced to perform to an inadequately priced program.

Procedures Related to Authorized Unpriced Work

It is also useful to ensure EVM System Description discussion and any related processes and procedures are clear on how projects are to handle authorized unpriced work. This helps to ensure the preferred practices are followed.

We suggest verifying the following items are adequately addressed in an EVM System Description.

1. How and when undistributed budget is distributed to control accounts. This includes:
 - a. What controls are placed on the use and distribution of UB?
 - b. Is a specific period of time stipulated (e.g., 60 days, two accounting periods, etc.) that budget can be held in UB for fully negotiated work?
 - c. How and when UB is distributed to control accounts when its scope has not been definitized, i.e., the scope represents AUW.
 - d. During the definitization process, is there an interim budgeting procedure that allocates budgets from UB to the work package level for the near term (such as 3 to 6 months) effort? This interim budgeting procedure should be followed until the AUW scope of work held in UB is definitized and distributed to control accounts.
2. Are authorized changes incorporated in a timely manner? There are three parts to this.
 - a. What constitutes an authorized change? This needs to be described. An authorized change may be the result of: (1) a contractual change, initiated by the government (including both "priced" and "unpriced" changes, engineering change proposals, supplemental agreements, and no-cost change directions), (2) formal reprogramming, requiring mutual agreement of both contracting parties, and (3) internal replanning by the contractor within the scope of specific budgetary parameters specified by the government. Terms such as "re-plan", "reprogram", or "re-baseline" will need to be adequately defined so they are clear to anyone who uses the EVMS.
 - b. What deems these types of authorized changes have been incorporated? This needs to be described. Typically such changes are deemed "incorporated" when the planning (and its associated paperwork) is accomplished down to the control account level. This includes the incorporation of all such changes into the distributed portion of the performance measurement baseline (or, in the case of reprogramming, the over target baseline or OTB). This also requires that the necessary changes are made to work authorizations, budget assignments, schedule parameters, and applicable technical (scope of work) documents.
 - c. What constitutes a "timely" manner of incorporation? It is imperative that the length of time permissible for the full incorporation of all authorized changes be specifically stated. The government Contract Management Office (CMO) must be able to ensure that this "timely" incorporation is adhered to. As a rule of thumb, 30 to 60 days tends to be adequate for most contractual efforts. However, there can be a differential of difficulty involved in change incorporation between R&D and production projects. While 30 days may be sufficient in a production environment, it may be too stringent in an R&D environment. In either case, the length of time allotted for change incorporation must be identified.

Note that the EVMIG acknowledges a special dispensation in the case of unpriced change orders with respect to the enforcement of "timely" incorporation. In this situation, the contractor may maintain budgets in a UB account until negotiations have been concluded, allocating budget only to that work which will start in the interim. However, if the contractor intends to invoke this license, the system description must include adequate procedures for doing so. Once negotiations conclude, the "timely incorporation" timeline begins.

3. Are internal budgets for authorized but unpriced changes based on a resource plan for accomplishing the work? For example, are projects directed to have a detailed plan in place for the near term work using cost estimates and resource plans with appropriate direction to notify the customer when spending approaches any NTE spending limit specified? Can traceability through all steps of the process be demonstrated?

For authorized unpriced work prior to definitization, it is acceptable for the contractor to plan and budget near term effort in control accounts while the remaining effort and budget is planned at a higher level and/or in UB. Such situations necessitate that a budget be formulated for distribution purposes in spite of the fact that this budget amount has not been formally negotiated with the customer. In these situations, where work is authorized before negotiations, appropriate change order planning will need to be accomplished, and budgets will need to be established based on the contractor's cost estimate for the change. The contractor may allocate estimated budget for the immediate, near-term work requirement while maintaining the remainder of the budget estimate in a UB account (AUW is not subject to the same normal length of time UB may exist for a negotiated change).

The contractor should not be required to use existing MR to provide budget for authorized, but unpriced, change orders. The contractor may, if the documented management system permits, use MR to provide temporary budgets for such "unpriced" effort, but it must remain clear to both parties that the MR budget was derived from the funding previously negotiated for the contractual effort authorized prior to the change in process. After negotiation, the remaining effort will be planned and budgeted within control accounts as soon as practicable to ensure disciplined baseline planning, and any MR budget that may have been used will be replaced.

4. Are the effects of final negotiations fully addressed? For example, when negotiations are completed, is the remaining budget from UB distributed to the control accounts and MR if appropriate, ensuring that the sum of the changes equal the final negotiated amount?

When an unpriced change order is finally negotiated, the negotiated amount of that change must be reconciled with the amount that is currently authorized (the previously estimated budget). Adjustments must be made to resolve any differences between these two amounts. Such reconciliation is most easily done through the use of UB. UB is a temporary holding account used to account for budget changes until they can be planned in detail at the control account level. As authorized unpriced work is received, UB is credited by the amount estimated to perform that work, and only that effort to be performed in the near term is budgeted from the UB account to control accounts. When the change is negotiated, the differential adjustment can be made to the amount of budget remaining in UB.

The other two alternatives for making these differential adjustments are to use MR, if it is still available, or to make the change directly to the control account budgets. This may not be possible in some cases. For example, some government offices are taking three



and four years to negotiate AUW. The contractor may be done with the work, so work would have to be removed from work packages that have started (and possibly even finished). This ends up increasing the cost variance at completion because the BCWS and BCWP go down, but ACWP stays what it was.