GCA REPORT

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NEW DEVELOPMENTS

OMB Increases Executive Compensation Ceiling

The Office of Management and Budget April 21 set the maximum "benchmark" compensation allowable for contractor executives in Fiscal Year 2010 at $693,951 for all applicable contracts no matter when awarded. The benchmark will apply to contract costs incurred after January 1, 2010 and should be used on all applicable contracts and subcontracts for FY 2010 and beyond until revised by OMB.

The new cap represents a 1.4 percent increase over the FY 2009 amount of $684,181. Contractors can, of course, pay their executives more than $684,181 but the additional compensation will not be allowable under their federal contracts. The cap covered compensation includes the total amounts of salary, bonuses, deferred compensation and employer contributions to defined contribution pension plans. The cap covered compensation does not apply to fringe benefits like health benefits and 401(k) employer contributions where if they are reasonable they are allowed irrespective of the cap. The cap covers the five senior managers of a company as well as subsidiary business segments directly reporting to the corporate headquarters. The benchmark compensation amount reflects the median amount of compensation for senior executives of all surveyed corporations for the most recent year data is available. Since the benchmarked companies represent large publicly traded companies with revenue exceeding $50 million, it should be stressed that significantly lower caps will apply to smaller companies (*Fed Reg 19661*).

Proposed DOD Rule Governing Contractor Business Systems Generates Widespread Criticism

Stemming from the DOD Task Force on Wartime Contracting report stating, in part, that contractor "business systems" are often deficient and the DOD is not using its payment withhold provisions to get contractors to improve, the DOD published a proposed rule in the Federal Registrar, No. 2457 in January, that defines contractor business systems and calls for COs to withhold payment if contractors' business systems contain deficiencies. The proposed rule defines "business systems" as accounting, estimating, purchasing, earned value management and material management systems. The new rule will add or amend a DFARS clause listing the characteristics of an acceptable system and requiring contractors to maintain such systems. If deficiencies are found, the rules will require ACOs to withhold payment when business systems are found to be deficient. The ACO will request and review a response from the contractor and implement a 10 percent withhold on the contractors' payments after determining a deficiency exists. A separate 10 percent withhold is available for each deficiency found where the proposal caps the withhold at 50 percent but under special circumstances the ACO may withhold 100 percent.

As expected, the proposal is generating considerable criticism. The American Bar Association's Section of Public Contract Law states the proposal fails to adequately define acceptable business systems or provide sufficient guidance for when an ACO should approve a system for which deficiencies are found. The Section states the rule goes "beyond protecting the government's interest and imposes a punitive withholding system" of up to 100 percent of payment without considering the large amount of defenses already available to prevent unallowable or unreasonable costs. The rule incorrectly assumes any deficiency automatically will cause the government to be overcharged which justifies payment withholds. The rule's definition of "deficiency" as merely a failure to maintain an adequate system and then listing only certain elements of such a system invites a great deal of controversy on what constitutes an inadequate system. It further states the rule is vulnerable to legal challenge since it treats nearly all alleged business deficiencies the same and fails to recognize every deficiency presents a unique risk.

The Professional Services Council is equally critical saying the proposed rule would deny payment to contractors "for even minor flaws" and states the rule sets no thresholds for either the size of a contract or a firm and provides no time lines for audit agencies to

confirm the identified deficiencies are fixed to allow resumption of payments. The rule would impose significant burdens on small and mid-sized firms. The rule also inappropriately takes away the discretion of the contracting officer to make judgments on the impact of the deficiencies.

FAR Council Proposes Increased Dollar Thresholds

Several acquisition related dollar thresholds in the FAR would be adjusted for inflation in a recently proposed rule. The most "heavily used" thresholds addressed by the proposed rule are:

- $100,000 simplified acquisition threshold at FAR 2.101 increased to $150,000
- $5.5 million ceiling for commercial item test program at FAR 13.500 increased to $6.5 million
- $650,000 cost and pricing data threshold at FAR 15.403-4 (covering Truth and Negotiations Act) would go to $700,000
- the $550,000 floor for prime contractor subcontractor plans would increase to $650,000 under FAR 19.702 (from $1.0 million to $1.5 million for construction subcontracting plans)

The $3,000 micropurchase threshold at FAR 2.101 and the FedBizOpps pre-award and post-award notices in FAR Part 5 would stay the same at $25,000.

DCAA Issues Guidance on Auditing Proposed Intercompany Transfer Prices

DCAA has issued guidance to its auditors on interorganizational transfers (IOT). In accordance with FAR 15.408, Table 15-2 IIA, Materials and Services, prime contractors should support its IOTs as if they are the prime's cost or pricing data. Auditors are reminded the requirements for the prime to conduct cost or pricing analyses are not applicable to IOTs. The scope of audit depends on whether the proposed IOT price is price or cost based.

If the proposed price is based on price then FAR 31.205-26(e) requirements must be met. If the item being proposed is price-based there must be an established practice by the affiliate to price its IOTs at other than cost. The items qualifying for an exemption to cost or pricing requirements must follow FAR 15.403-1(b). If the price is based on adequate competition, then there must be supporting competitive bids and market analysis to ensure the amount proposed is fair and reasonable. If the price is not based on competition (e.g. sole source) then the auditor is told to review the sales data to ensure the price is fair and reasonable. Only sales data to unrelated organizations that are not sold to local, state or federal government apply.

If the price is based on cost then there must be a breakdown of cost elements in accordance with FAR 15.408, Table 15.2. The auditor should request an assist audit if the affiliate is at another location based on its documented risk assessment.

The guidance also states that the IOT must be considered as a special consideration of the prime's make or buy decisions in accordance with the DCAM 9-405.2. The auditor is to evaluate the prime's practices regarding IOTs and make sure the decision to make the item (the IOT) was made in accordance with the policy and the result is a fair and reasonable price versus another vendor's price. The guidance alludes to FAR 15.407-2(f) that states the CO must establish the make/buy decision was proper before contract award. Finally, the auditor is told that any failure to meet Table 15.2 or cost principle requirements or any other estimating practices should be reported as an estimating system deficiency.

DCAA Guidance on 35% Indirect Cost Limit for Basic Research

The Defense Contract Audit Agency issued guidance stating the 2008 and 2009 DOD Appropriations Acts limit payments of indirect costs to 35% of total cost of a DOD contract, grant or cooperative agreement for certain work. The guidance instructs auditors to request recipients of "basic research" awards demonstrate their compliance with this limitation. The guidance includes an Oct 2008 memo and Dec 2007 memo written by the Department's acquisition chief John Young which we discussed in the Jan-Feb 2008 GCA REPORT. The memo issued to the military services notes that Section 8115 of the Act prohibits DOD from paying indirect costs in excess of 35 percent of the total cost of any contract, grant or cooperative agreement for basic research. Basic research means funds in programs within Budget Activity 1 of the Research, Development, Test and Evaluation (RDT&D) appropriation. The 35% limit applies on payment of indirect costs to awards at the prime level only and does not flow down to subordinate instruments. The term "total cost" has the meaning given in the government-wide cost principles while indirect costs are "all costs of a prime award that are Facilities and Administration costs." The Young memo points out that the restriction applies only to new awards made on or after Nov. 13, 2007 using FY 2008 funds or after Sep. 30, 2008 using FY 2009 basic research funds.

The guidance addresses the meaning of the 35% cap. 35% cap is not an indirect cost wrap rate but translates into a 53.8% wrap applied to direct costs. It is derived by considering an award of $100,000 where $35,000 in indirect costs is the maximum allowed ($100,000 X 35%). If $35,000 is indirect then $65,000 is direct so the resulting ratio is $35,000/$65,000 or 53.86%.

ABA Chimes in on Interim Pass Through Rule

The American Bar Association Section of Public Contract Law has come out against an interim rule passed last year seeking a limit to "excessive" pass through charges by subcontractors or tiers of subcontractors when they add "little to no value." The Section said the following points should be considered when drafting the final rule:

1. To ensure the rule is properly implemented rather than "merely employed to reprice contracts" the FAR should create guidance to COs.

2. The DOD should take risk into account when determining the degree of assessment needed when considering the value added. Such risk factors would include consideration of (1) whether the contract was completed (2) contract type – fixed price or cost reimbursable and (3) urgent requirements.

3. Ensure as much consistency as possible between evaluated proposals and actual performance rather than serving as a basis for disallowing costs after the fact.

4. The requirement for COs to review contractor's subcontract when 70 percent of the work is subcontracted can result in decisions to retain work in-house to avoid the 70 percent trigger despite the fact that contract work can more efficiently be performed by subcontractors.

5. The 70 percent trigger can also hamper the ability to build a "strong team" to best meet government needs if the amount of subcontracting is limited to an arbitrary share of total work effort.

6. The rule may conflict with the requirements of the cost accounting standards where CAS requires that all indirect costs be fully absorbed and allocated to final cost objectives while under the FAR interim rule the CO will determine how much value certain allocable indirect costs add to the contract. For example, G&A costs by their nature are residual and do not permit the assignment of a clear beneficial or causal relationship between the cost incurred and a benefit to any particular final cost objective so there is the potential that the G&A applied to all subcontracts in accordance with a contractor's disclosed practices can nonetheless be deemed excessive and hence unallowable.

End of Mandatory 10 Percent Withhold on A&E Vouchers

The FAR Council has issued a final rule on withholding of payment requirements under FAR 52.232-10, Payment under Fixed Price Architect-Engineer Contracts. Under current rules, COs are required to withhold 10 percent of the amount due on each voucher where the government retains the withheld amount until the CO determines the work is satisfactorily completed. However, payment can be made in full during any month the CO determines performance is satisfactory. Now, effective April 19 the clause will permit COs to use their judgment about the amount of payment withheld to apply under fixed price A&E contracts so that the withheld amount will be applied at the level needed to protect the government's interests (*Fed Reg 13422*).

New FAR Rule Clarifies Allowable Airfare Costs

The FAR Council has issued a final rule intending to clarify what is meant by the FAR 31.205-46(b) provision that limits allowable contractor airfare costs to the "lowest customary standard, coach, or equivalent airfare offered during normal business hours." The limitation has caused confusion as to whether the lowest airfare available to the contractor or to the general public should be applied where now the general public benchmark no longer applies because it is not a "feasible option in practice." Also the term "standard" has been dropped because it does not describe actual classes of airline service where "customary coach or equivalent" does (*Fed. Reg. 65612*).

Required Information to Evaluate Price Reasonableness for Commercial Services

An interim rule amends the FAR to provide that purchases of commercial services that are not offered and sold commercially in substantial quantities in the commercial marketplace may only be considered commercial items if the contracting officer determines in writing that there is enough information to evaluate the reasonableness of the price of the services. The rule says such services must be "of a type" offered and sold competitively in substantial quantities in the commercial marketplace.

To evaluate reasonableness of the prices, the CO may request the offeror to submit prices paid for the same or similar commercial items under comparable terms and conditions by both government and commercial customers. If needed, the CO may request "other relevant information regarding the basis for price or cost, including information on labor costs, material costs and overhead rates" (*Fed. Reg. 52852*).

Update Mileage Allowances

The Federal Travel Regulation was updated in January to amend mileage reimbursement rates for privately owned autos, motorcycles and airplanes used for official travel. The new per mile rates are .50 cents for autos, .47 cents for motorcycles and $1.29 for airplanes *(Fed Reg 790*).

CASES/DECISIONS

Variation in Quantity Clause Provides for Adjustment in Contract Amount

(*Editor's Note. The following case illustrates the importance of taking advantage of the Variation in Quantity clause.*)

Brinks' contract to provide guard services included a Variation in Quantity clause that provided Brinks would be entitled to an adjustment if services varied by more than 25 percent of estimated hours. During the base year, the services were only three percent of the estimated hours where there was a 9 percent markup for overhead and other indirect cost and it submitted a request for additional compensation to recover its increase in costs resulting from the 97 percent shortfall. In its rejection, the government said that (1) there was no guarantee of any hours in the contract and (2) Brinks would receive a windfall for work it did not have to perform. The Board agreed that the contract did not guarantee any hours but sided with Brinks for additional compensation explaining that when the government failed to offer the minimum amount of hours expected, the fixed indirect costs originally allocated to the hours the government failed to order were incurred nonetheless but not compensated for. It stated the Variation in Quantity clause provided for an adjustment in the hourly rate in situations where the stated range of estimated hours was exceeded or not met so as to cause the contractor to reap a windfall or incur a loss (*Brinks/Hermes Joint Venture V State Dept., CBCA, No 1188*).

GAO Rules JV Partners May Use Their Own Indirect Rates When Accounting for Joint Ventures

(Editor's Note. The following case addresses some of the important accounting issues for joint ventures.)

The Department of Transportation (FTA) issued a solicitation for oversight services to monitor and support capital projects and rejected a proposal from MD-JV, a joint venture of two firms asserting (a) there was no assurance it would follow generally accepted accounting standards as required by the FAR (b) MD-JV did not show it was an independent entity that required employees be committed from each company (c) it did not require there be an indirect rate structure unique to the JV and (d) MD-JV did not prepare budgetary forecasts for the entire proposed period. FTA subsequently abandoned many of its arguments for why it believed MD-JV's accounting system was inadequate and pressed one reason – the JV lacked a unique rate which violated CAS 401, requiring estimating costs of a proposal be consistent with its cost accounting practices. Though it was proper for FTA to investigate whether an adequate accounting system exists, the GAO ruled it did not provide a reasonable explanation why MD-JV's practice of using the individual overhead rates of its two partners was not proper. The GAO concluded neither FTA nor DCAA provided any analysis or legal authority as to why the dual overhead rate structure that MD-JV proposed would lead to an inconsistency in the application of cost accounting practices (*McKissack+Delcan JV II, B-401973*).

Release of Contract Line Item Pricing Violates FOIA Exemption

After losing the award to Fidelity, Essex submitted a Freedom of Information Act (FOIA) request for the award document along with the contract line item pricing. Fidelity objected to the release of the unit pricing information claiming it was proprietary and its release would reveal its business strategy and cost structure. The Army told Essex that the unit prices were properly withheld under Exemption 4 of FOIA and Essex filed a lawsuit. The Court sided with the Army's refusal to release the unit prices stating that Exemption 4 protects "trade secrets and commercial or financial information obtained from a person and privileged or confidential" explaining information is confidential if its disclosure is likely to impair the government's ability to obtain necessary information in the future or is likely to harm the competitive position of the person. The Court added harm need not be

demonstrated only evidence supporting the existence of potential competitive injury or economic harm needs to shown. The Court rejected Essex assertions that harm was highly speculative and that FAR 15.506 mandates disclosure, finding the disclosure would reveal Fidelity's business strategy and cost structure and the FAR citation contains an exception that debriefing shall not reveal any information exempt from release under FOIA (*Essex Electro Engrs, Inc. v US, Sec of Army, DDC, NO. 09-372*).

Court Decision Fuels Controversy Over HUBZone Set-Aside Preferences

(*Editor's Note. The following decision addresses the on-going controversy over whether HUBZone status receives priority consideration for small business contract set-asides over other status like 8(a), women or veteran owned, etc. Two previous court cases ruled HUBZone firms should be given priority while the Department of Justice recently issued rules no such priority should be given, stating there should be parity.*)

After the Army awarded an IT contract to Copper River, a Alaska Native 8(a) company, the incumbent MCS, who is both an 8(a) and qualified HUBZone small business, filed a protest. The Army decided to give the sole source contract to Cooper River while MCS asserted the Army should have competed the contract among HUBZone companies. The Army said that due to an opinion issued by the Justice Department saying HUBZone companies do not quality for priority setaside status, the Court stated the issue here is whether statutory language provides for the prioritization of the HUBZone program over others like 8(a) or whether they provide parity between the programs. The Court ruled that the plain meaning of the HUBZone statute – "shall be awarded" – requires that the contract be set aside for qualified HUBZone concerns if the "rule of two" (two qualified competitors) is met. This language contrasts with the 8(a) statute (as well as other programs) which affords discretion to the SBA in deciding whether to place a contract in the 8(a) program. The Court concluded the statutory language of the HUBZone program required the contract be awarded on the basis of competition between qualified HUBZone small business concerns (*Mission Critical Solutions vs US, Fed. Cl. No 09-864*).

Court Denies Petition to Hear Tecom Case

The US Court of Appeals for the Federal Circuit denied the petition to rehear the *Geren V Tecon Inc. case 566 F.ed 1037*. The Tecon case created what commentators have called the "untenable test" where costs incurred in the defense of an employment discrimination suit settled before trial are unallowable unless the contractor can prove the allegations against it had "very little likelihood of success on the merits." As we reported earlier the case extends the provisions that only settlements of false claims, false statements, fraud or other misconduct against the US would be subject to this test. Commentators say now the Tecom case penalizes a contractor that has made a prudent business decision to avoid costly litigation to settle private lawsuits where now the allowability of such costs will be made against the "little likelihood of success" test to be made by contracting officers who have little experience in determining such merits. Now government contractors will be effectively forced to take the expensive and uncertain litigation route in hopes of obtaining a successful result to recover its legal costs.

NEW/SMALL CONTRACTORS

The ICQ

As we have been reporting for over a year now, auditors are increasingly examining contractors' internal controls where negative findings on these controls are resulting in opinions of inadequacies on a variety of contractor systems e.g. accounting, billing, purchasing, estimating and planning or budgeting. Whereas internal control reviews used to be focused mainly on major contractors, we now see audit scrutiny of these controls at small contractors, even with less than $1 million worth of federal work. A key checklist DCAA uses with great frequency these days to identify sufficient internal controls is the "Survey of Contractor's Organization, Accounting System and System of Internal Controls (ICQ) Contractors with CCFY Dollars Between $15 Million and $90 Million" which is referred to as the ICQ. We urge contractors become familiar with this document because (1) they will likely be required to fill one out and (2) it provides a good roadmap of what policies and procedures should be prepared to show the government that good internal controls exists.

Basics

The ICQ is in the form of a questionnaire that is normally provided to the contractor who then must fill it in. The purpose of the ICQ is to provide the auditor a basis for documenting their understanding of the contractor's internal control components which is then supposed to be used to plan the audit. The ICQ specifies five components of internal controls applicable to all

contractors (which we will discuss below): Control Environment, Contractor's Risk Assessment, Information and Communications, Monitoring and Accounting System Control Objectives and Activities. The ICQ questionnaire is designed to apply to non-major contractors with auditable dollar value (flexible type contracts) between $15-$90 Million but, in practice, we see the ICQ distributed to virtually all non-major contractors no matter what their ADV is. The ICQ is supposed to be completed or updated as part of the auditor's periodic visits to non-major contractors where a new ICQ should be completed every year if a field visit is required. Also the ICQ consists of four parts A thought D. Part A is specific information about the contractors' business whereas Part B though D are of primary interest here.

The primary justification cited for the ICQ and focus on internal controls in general is the Generally Accepted Government Auditing Standards (GAGAS) Chapt. 6 that states "Auditors should obtain a sufficient understanding of the internal control that is material to the subject matter or assertion to plan the engagement and design procedures to achieve the objectives of the attestation engagement." A significant motivator for focusing on internal controls lies in DCAA quest to improve its productivity – good internal controls means to them less work required for audits (e.g. transaction testing)

The ICQ outlines steps needed to obtain an understanding of the contractor's internal controls. Knowledge is gained ordinarily through previous experience with the contractor, though an understanding of written procedures and observations of contractors operations as well as inspections of contractors' documents and records. In other words, you may expect both a reading of written policies for adequacy and then reviews of actual practices to ensure they are consistent with the policies.

The questionnaire consists of a Yes-No format where though a few desirable answers are "No" most are either "Yes" or "NA" where other answers would be significant red flags to form the basis of negative opinions.

Part A – Basic Organization

This section provides basic information about the contractor – location(s), corporate structure, breakdown of business, officers and their salary and information about contracts and subcontracts.

Part B – Control Environment and Overall Accounting System

This section comes close to reflecting the elements of a pre-award survey most contractors who have cost type work must go through. However, it goes further by asking whether a written policy exists that describes such government accounting requirements as assignment of responsibilities and authority, the general accounting system, screening unallowable costs, direct and indirect charging practices, allocation of indirect costs, approval and documentation of journal entries, establishing account and contract charge numbers and allocating income, rebates, etc. It further asks whether the cost accounting records are reconciled with the general ledger, whether costs are identified by final cost objectives in a job cost ledger and whether external negative CPA management letters are promptly addressed. Whereas the last item may be NA, there should be a "Yes" marked for each item.

Part C - Contractor's Risk Assessment, Information and Communications and Monitoring.

Each of the three areas identified in the title are separately identified. The Risk Assessment section asks whether significant accounting changes have occurred in the last two years, does the contractor have a "risk assessment process" for identifying problems in its required submissions and has any previous audits identified failure to properly assess risk.

The Information and Communications section addresses written policies covering the IT system, whether it be manual or computerized. This section has been updated in recognition that there may have been insufficient attention put on the IT system at non-major contractors. The written policies and procedures should cover the processes of how transactions and journal entries are made, how totals are put into the general ledger, how recurring or non-recurring adjustments are made if not by journal entry and how hard-copy documents are converted electronically. In addition, the policies should address the role and responsibilities of people, whether the policies are distributed to relevant employees and whether there has been any reported deficiencies in the past.

The Monitoring section asks whether the contractor has "ongoing monitoring procedures" and/or separate internal control reviews to ensure its internal controls are operating properly. It also asks about prior deficiencies reported here.

Part D – Accounting System Control, Objectives and Activities

This part is broken down into seven sections:

1. *Labor System*. Is there training for timekeeping with proper written timekeeping policies and procedures (PPs). Also does the contractor have written PPs covering other labor charging issues such as "labor document/work descriptions" identifying work to be performed, are the labor charges tracked to final cost objectives and are they direct or indirect or allowable or unallowable.

2. *Materials/Purchasing Systems*. Are there PPs and do they describe major manual and automated systems material management and accounting systems. The material portion of the requirement is oriented primarily to manufacturing firms but note the purchasing system PP applies to controls over purchasing subcontractor services and other high dollar purchases.

3. *Estimating*. This section states PPs need to address, at a minimum, employee training, assignment and authority of responsibilities, cost estimate development and estimating processes, activities and functions. We are seeing increased scrutiny over how subcontracting costs are identified and reviewed as well as how the contractor assures the subcontractor's systems are proper.

4. *Billing*. Are appropriate PPs disseminated to employees and do the PPs address employee training, contract briefing to identify special billing provisions and limitations and management review of billings.

5. *Planning/Budgeting*. Again, do PPs exist for how the company plans and budgets that must include a description of the system and assignment of duties and responsibilities. We used to recommend including the process of developing forward pricing rates as well as proposals in the estimating PPs but since there is a section addressing planning and budgeting it may be better to identify methods of estimating future costs and developing forward pricing rates here. The method of monitoring rates during the year is generally best identified in the accounting system policy, close to where indirect costs are described.

6. *Compensation*. Written PPs are required here that must include salary structure and administration, a description of fringe benefits that are provided to employees and a system for determining pay increases, bonuses and promotions. More and more, auditors want to see that contractors use bona fide compensation surveys to ensure their compensation levels are reasonable where there is often an independent audit conducted by the special Philadelphia based compensation team.

7. *Overall Accounting System Control Objective and Activities*. This section seeks to ensure that not only do written PPs exist but whether actual practices are consistent with the PPs. It asks whether any previous audit assignments identified failures to properly implement any of the internal controls which will be used to focus audit scrutiny on those areas.

QUESTIONS AND ANSWERS

Q. When is it necessary to complete the scrub of proposed costs for purposes of complying with the Truth in Negotiations Act? I heard it was after contract award.

A. You heard wrong. The scrubbing of costs needs to be effective after price agreement but before contract award (sometimes a short period before award).

Q. I currently have an issue with a DCAA audit. In 2006 we were going to lease a vehicle for a cost type contract. The lease cost was $19K for the remaining 24 months of the contract. We decided to purchase the vehicle for an additional $15K for a total cost of $34K. The $19K was charged, in agreement with the CO, as an up-front direct expense in 2006, because funds were available. The $15K was then depreciated with over three years where the depreciated amounts were included in G&A. The auditor says we cannot charge direct and indirect for the same vehicle. My position is that only the appropriate amounts were charged. What do you think?

A. DCAA is apparently making the point that like costs incurred under like circumstances must be treated consistently as either direct (no matter whether the contract pays for it) or indirect in accordance with CAS 402 or equivalent in FAR. You need to demonstrate why these are either unlike costs (not true) or unlike circumstances (likely true). You can demonstrate this by first indicating in your disclosed practices that auto or auto lease costs are sometimes direct and sometimes indirect where conditions are specified. Short of that, you need to demonstrate that though such costs are usually indirect the lease costs were charged direct in this case because they were needed only for that one contract and there was an agreement to treat them

direct. Your best bet is to show there was some documentation about there being an agreement. Check out the example of security guards in CAS 402 where though normally charged indirect guards hired to protect one building dedicated to one contract can be charged direct.

Q. I seem to remember an article stating the paid state income taxes our principles paid for their Subchapter S allocation of profits are unallowable costs. Our company paid the state income taxes on the profit of the company where I know the FAR allows for state income taxes. Could you explain the differences?

A. A fairly recent case (*Information Sys. & Networks Corp. vs US, 437 F.3d 1173*) reversed an earlier decision allowing the portion of profit distribution made to a single owner of a Subchapter S representing state income taxes. However, state income taxes paid by the corporation is not considered income of the owner(s) but allowable expenses of the corporation.

Q. Our auditor disallowed in-house meals because we had not documented the attendees at the meal and purpose of the meeting. What do you think?

A. Though those documentation requirements are imposed on expense reports documenting travel away from the office, I am unaware of any requirements for documenting those facts for meals associated with in-house business meetings. Though it is not unreasonable for the auditor to inquire into the nature of the meetings, the documentation requirements for them to be allowable is a bit excessive. I would ask the auditor to provide the basis for the assertion that such documentation is required.

Q. I proposed two days of ship storage time on a proposal. If it turned out I needed less, do I need to credit the contract.

A. No. Unless you knew of some facts at the time you proposed the costs that would indicate the two hours were not needed, just because you spent less than you reasonably estimated it would cost is not grounds for a credit. After all, if it was higher than you estimated, you would normally not be entitled to additional reimbursement.

Q. Can a CEO charge both overhead and G&A.

A Yes. What charges go to overhead and G&A are usually left to the contractor to define and if the basis is reasonable and consistently applied, it should be accepted. So, for example, if you decide that overhead expenses relate to support of projects that are not identifiable as direct charges while G&A are costs in support of the company as a whole then the activities of the CEO can be allocated to both pools depending on the nature of the activities. If you want to charge CEO or other indirect labor to both pools, then I would advise keeping track of those activities by use of a timesheet. Arbitrary or estimated times are often not accepted.

Q. As an incentive to encourage our employee to relocate from Nevada to open a Washington DC office we provided an employee, who is paid $200,000 per year, a one-time $100,000 incentive bonus. DCAA is now asking for documentation of relocation expenses to support the bonus which we cannot find. What can we do?

A. It appears as if DCAA is confusing relocation costs with a relocation incentive bonus. Reimbursement of relocation costs are covered by the relocation cost principle of FAR 31.205-35 that identifies specific types of costs that are allowable or not. The relocation incentive bonus, being a one time charge, should be evaluated for reasonableness, and compared to industry practices. We conducted a Google search on the topic and discovered that the federal government allows payment of relocation incentive bonuses up to 100% of a government employee's salary, which is far below what you paid your employee. It should not matter what the employee did with the funds – it is irrelevant whether they used the bonus for relocation costs, school tuitions or purchase of a Ferrari (used).

Q. Are lodging taxes for travel expenses included in the maximum lodging limits of the per diem rates?

A. The Federal Travel Regulation, which in this case should apply to contractor employees, was changed in August of 2008 to have taxes for domestic lodging be considered a miscellaneous expense not subject to per diem caps. For international travel, the taxes are included in the per diem limits.

GCA REPORT · P.O. Box 1235 · Alamo, CA 94507 · (tel) 925-362-0712 · (fax) 925-362-0806 · Email: gcaconsult@earthlink.net
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