
GCA REPORT

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NEW DEVELOPMENTS

New Compensation Cap Takes Effect June 24 Causing Confusion

The allowable cost limit for reimbursable compensation for contractor and subcontractor employees drops to \$487,999 for contracts awarded and costs incurred after June 24, 2014. The new limit was set by the Bipartisan Budget Act (BBA). The new cap adheres to section 702 of the BBA that revised the compensation cap to apply 180 days after enactment of the Act. The cap will apply to compensation of all employees not just senior executives where an exception can be allowed for highly skilled employees such as engineers and scientists to “ensure the agency has continued access to needed skills.” The BBA \$487,000 cap is a significant reduction over the \$952,308 set by the Office of Procurement Policy established in 2012. The BBA was approved by the Senate on Dec 18, a day after the National Defense Authorization Act which called for a \$650,000 cap where the President signed both on Dec 26th but signed the BBA last making the lower cap apply. The BBA cap will be adjusted annually to conform to Bureau of Labor Statistics inflation index.

Though the cap takes effect June 24, 2014 some commentators have stated they have no idea what the cap is for 2013 while others state the 2012 cap of \$952,308 will apply in 2013 unless it is changed. The OFPP has been “erratic” in establishing its mandated compensation caps where it waited until December 2013 to establish the \$952,308 cap for calendar year 2012. The confusion has been increased by other changes such as application of the cap to all employees of contractors and subcontractors with DOD, NASA and Coast Guard awards. This means that companies doing business with these agencies as well as civilian agencies has to adjust their accounting methods to deal with different caps – one for the top five executives and one for all employees. At the end of 2014 contractors may find themselves computing one general and administrative rate for civilian agency contracts awarded by June 24, 2014, another for DOD contracts awarded before that

date and yet another for all contracts awarded after June 24, 2014. It has been “a little bit of a mess” since it was not clear at the time the President signed the two bills on Dec 26th which cap would take precedence. Be aware that these caps apply to larger companies (usually \$50 million or more in revenue) so the government will apply lower caps to smaller companies during their compensation reviews.

New Contract-Related Interest Rate Set for Second Half of 2014

The Treasury Secretary has set a rate of 2.0% for the period July through December 2014. The new rate is a slight decrease from the 2.125% rate applicable to the first six months of 2014. The Secretary of the Treasury semiannually establishes an interest rate that is then applied for several government contract-related purposes. Among other things, the rates apply to (1) what a contractor must pay the government under the “Interest” clause at FAR 52.232-17 and (2) what the government must pay a contractor on either a claim decided in its favor under the Contract Disputes Act or payment delays under the Prompt Payment Act. The rate also applies to cost of money calculations under Cost Accounting Standards 414 and 417 as well as FAR 31.205-10 and when a discount factor is used to calculate the present value of future payments (e.g. deferred compensation).

DCAA Issues New Significant Guidance

- **New Guidance on Treatment of Delinquent Final Rate Proposals**

DCAA has issued guidance to its auditors addressing late incurred cost submittals (ICEs). The guidance instructs audit teams to discontinue sending late notices except for the 30 day overdue notification letter. Audit teams will continue to (1) educate contractors about their contractual obligations under final indirect rate proposals as part of its ongoing relationship with the contractor (2) support the contracting officer, as necessary, to obtain adequate ICEs by meeting with contractors and (3) support the CO to calculate a unilateral contract

cost decrement factor to apply when the CO cannot obtain a proposal. Audit teams will monitor the timely receipt of the ICE. When it is 30 days late without a valid extension, DCAA will continue to immediately prepare a 30-day overdue notice that will be sent to the contractor with a copy to the CO. However, audit teams will no longer be responsible for sending other reminder letters prior to the end of the fiscal year, three month overdue notice to the CO, five month overdue notice to the contractor and unilateral notice to the CO when relevant history does not exist.

When support to the CO is needed to establish a unilateral final indirect cost rate and contract costs DCAA will provide the CO historical data such as billing history and previous rate negotiation history if it exists. When relevant contract cost history does not exist DCAA will suggest a “total contract cost decrement” factor of 16.2 percent, down from a previous factor of 20 percent. If the decrement factor is used for any fiscal year the 16.2 decrement factor will be applied to the total costs (both direct and indirect) of each flexibly priced contract.

- **Changes to Cost Accounting Standards Audits**

DCAA used to conduct two audits of the CAS Disclosure Statement (D/S), one for whether it was adequate and two if it was compliant with CAS. In order to “allow for efficient use of DCAA resources”, now the adequacy assessment will be made by auditors before a D/S audit is conducted where the compliance audit will occur only after adequacy is determined. The adequacy review will include a determination whether the D/S was current (consistent with current practices), accurate (consistent with policies and procedures provided during a walk through of the submission) and complete (all items on the form are prepared in accordance with regulatory instructions). Once it is determined the D/S is current, accurate and complete a memo to the CFAO (cognizant federal agency official) will be issued summarizing the final assessment. The audit may begin before the memo is received and final determination of adequacy has been made but a final report must await such a determination. For audits of revised D/S practices, DCAA will establish one assignment for the audit but before accepting the engagement, it will document its assessment of adequacy of the practice changes and resolve with the CFAO any inadequacies in the D/S (*14-PAS-0100(R)*).

- **Labor Qualifications on T&M Contracts**

The audit guidance alludes to earlier guidance that discussed the fact that auditors should question costs

on time and material contracts related to labor hours for employees who do not meet the labor qualifications set forth in the contract. The guidance alludes to FAR 52.232.-7(a)(3) that states labor hours incurred to perform tasks for which labor qualifications were specified in the contract will not be paid to the extent the employees performing the work did not meet the qualifications specified in the contract unless specifically authorized by the Contracting Officer. The new guidance clarifies that contracting officers have the authority to approve use of non-qualifying labor both before and after the labor is provided and directs auditors to coordinate with COs before issuing audit findings in this area. Even in circumstances where the CO’s approval has not and will not be granted the guidance states the CO is not going to withhold payment of all labor costs when an employee does not meet the labor qualifications if the work delivered adequately completed the contract scope of work. In these cases, the guidance states the CO needs to modify the contract for a new rate or a contract line item to reimburse the costs. Auditors will assist the CO in arriving at a rate that “is more appropriate than the rate charged by the contractor (e.g. a rate based on the fully burdened rate of pay for the unqualified employee or the labor category where that employee truly fits).” Some comments we have seen state DCAA is not technically qualified to make an employee qualification determination.

The guidance goes further and directs the auditor to consider whether contractors’ failure to meet contract requirements constitutes weak internal controls and hence represents an inadequate accounting system where adequacy would include assurances that the contractor received CO authorization. Comments on this vulnerability to an assertion of significant deficiencies in its accounting systems have been very critical calling such prescriptions “simplistic” without considering whether the failure is material or systemic where contractors are urged to resist such auditor assertions as inconsistent with the definition of “significant deficiency” in the Business System rules (*MRD 14 PPD-008(R)*).

- **Cancelling the Handbook on Fraud Indicators.**

The new guidance withdraws the DCAA handbook on fraud indicators because of the handbook’s age and the fact that scenarios set forth in the handbook are “outdated.” In place of the handbook the guidance directs auditors to “use examples of Indicators of Fraud Risk in the GAGAS Appendix Section A.10,” relevant risk factors identified in earlier DCAA guidance (dated July 31, 2013) and the DODIG Contract Audit Fraud

Scenarios and Resources website (*MRD. No 14-PAS-003(R)*).

OMB and DRAP Extend Accelerated Payments to Small Business Subcontractors

The Office of Management and Budget and the Office of Defense Procurement and Acquisition have extended for two and a half years a temporary program to provide accelerated payments to small business subcontractors. The governmentwide initiative directs civilian and defense agencies to the full extent permitted by law to temporarily accelerate payments to all prime contractors – ideally within 15 days of receipt of proper invoices. It is hoped this will allow more prime contractors to pay their small business subcontractors faster. The original one year policy was implemented July 2011 and extended for a second year in July 2013. The FAR councils in Nov 2013 finalized a new contract clause requiring prime contractors that receive accelerated payments from the government to make similarly accelerated payments to their small business subcontractors where receipt of proper invoices triggers the clause requirements for fast-paced payments. The clause has been inserted in all solicitations issued after the rule's Dec 26, 2013 effective date, including solicitations and contracts for commercial items. No new rights are provided in the Prompt Payment Act and does not affect that law's late payment provisions.

Proposed DFARS Business Systems Rule Imposes Burden on Contractors to Self-Assess and Self-Report

On July 15 the Defense Department issued a proposed rule that would revise the DFARS Business Systems rule to require contractors to self-assess and report on compliance with the accounting, estimating and material management and accounting (MMAS) business systems. The proposed rule will impose a significant obligation on contractors to (1) adequately and accurately self-assess and report on business system compliance and (2) obtain an independent (CPA) review of system compliance. A contractor's failure to comply with the applicable reporting and audit requirements would result in system disapproval where the consequences can include payment withholds, negative past performance evaluations, cost disallowances, inability to receive new work and even potential False Claims Act actions.

Contractors would need to report on compliance with relevant system criteria for the three systems. The

report is to include (1) a statement the contractor has evaluated each system's compliance with relevant criteria (2) the contractor's self-assessment of each system's compliance including a statement as to whether the system complies in all material aspects as well as disclosure of any significant deficiencies as defined in the rule (3) status of any disclosed deficiencies including a corrective action plan with milestones for any deficiencies not yet corrected at the time of the report and (4) a signature from an employee at a level no lower than a vice president or CFO.

For accounting and estimating systems, this report will be made annually while for MMAS reporting it would be required when the government requests an MMAS review, which is usually required every three years. A contractor's accounting and estimating system would be subject to an audit every three years by an independent CPA where contractors will be required to ensure the CPA is objective and qualified to conduct the audit. The MMAS CPA audit will be required when the government requests it. Contractors are required to make available to the government documentation to provide reasonable support for the contractor's assessment as well as information related to the selection of the CPA and workpapers supporting the audit. Contractors with over \$100 million in qualifying sales during a fiscal year or that receive a government request will also be required to disclose their CPA's audit strategy, risk assessment and audit plan to the government. This requirement would require CPA firms to provide internal documentation they usually are reluctant to do so large firms may shun this audit work leaving it to smaller CPAs and CPA firms to perform.

The purpose of the proposed rule is to relieve DDAA of business system audit responsibilities because (1) they are unable to gather the resources to timely meet DOD needs and (2) they tend to find deficiencies in all systems they audit which negatively impacts the procurement process. At this time, there are no such reporting requirements for the other three business systems covered by DFARS – purchasing, earned value management and property management business systems (*Fed. Reg. 41174*).

Annual Protest Report Shows Best Grounds for Successful Protest

The General Accounting Office issued its annual report for 2013 showing an increase in number of protests being filed. For the first time, the report includes a "summary of the most prevalent grounds for sustaining

protests.” The most prevalent grounds, not necessarily in descending order, include (1) failure to follow solicitation criteria (2) inadequate documentation by source selection people (3) unequal treatment and (4) unreasonable cost/price evaluation. Commentary indicates an agency’s evaluation procedures are the most successful grounds for winning a protest while challenges to an agency’s technical evaluation does not make it to the top four, which is not surprising given the GAO tendency not to overturn agencies’ judgments on comparative merit and risk of proposals. The GAO report also reveals it is receiving more task order protests than ever before while it also saw a significant drop-off in the number of full hearings where protests were resolved by corrective actions before a fully developed hearing occurred. (*Go to gao.gov/assets/650/659993.pdf for a copy of the report.*)

SBA Increases Revenue-Based Size Standards for Five Years of Inflation

As of July 14, 2014 the Small Business Administration is adjusting all of its size standards that are based on revenue to account for five years of inflation since the last adjustment. There are 476 industries affected by the change. The SBA is using the Gross Domestic Product price index to obtain the best measure of inflation where it determined the amount of inflation from the first quarter of 2008 to the last quarter of 2013 was 8.73%. The SBA calculated the new size standards by multiplying the current size standards by 1.0873 and then rounded the total to the nearest \$500,000 resulting in new standards between \$5.5 million and \$38.5 million. The SBA is now required to review its size standards every five years following passage of the Small Business Jobs Act of 2010 (*Fed. Reg. 33647*).

DOD Report States Fixed Price Contracts are Not Necessarily Better than Cost Type in Lowering Costs

In a move away from assertions that award of cost type contracts costs the taxpayer too much, a recently released June 13 DOD report states in its annual Performance of the Defense Acquisition System that fixed price contracting does not necessarily control costs better than cost type contracts. In a report that draws various conclusions about contract types, it states fixed price contracts are normally associated with lower costs because DOD uses them for lower risk contracts. The report stated “objectively determined incentives were the factors that controlled costs not selecting cost plus or fixed-price contracts.” It stated though firm fixed

priced contracts do provide a powerful incentive to control costs the federal government does not share the cost savings that contractors earn unless the negotiated price accounts for actual prior costs. The report found that cost-plus-incentive fee and fixed-price incentive fee contracts control costs, price and schedules better than other types of contracts.

CASES/DECISIONS

“Would Have Cost” Rule should be used to Quantify Deductive Changes

(Editor’s Note. The following case is particularly timely since it addresses how to cost deductive changes that we see proliferating in response to budget cuts. Comments on this case all state the proper method of computing contract price adjustment for deductive work is the “would have cost” method described below and the importance of having an adequate accounting system even when most contract work is fixed price.)

EJB held a firm fixed price, indefinite quantity contract where the Navy deleted certain contract requirements such as receiving, storing and delivering Navy property. EJB argued the Navy was required to calculate the price reduction using the “would have cost” rule (what it would have cost to complete the deducted work as measured by the actual historical cost of performance) where the reduction would have cost \$565,000. The Navy argued it was entitled to use EJB’s original contract price resulting in about \$1.8 million due. The Navy argued first that a prior case – *Control Line, ASBCA No. 50235* – provided an exception for the would have cost rule where the Board disagreed saying in that case, there were unit prices not based on estimates of costs where here EJB had estimated the costs at the time of the deductive change. Next, the Board rejected the Navy’s assertion that the original proposal price was “a sufficient measure of the downward adjustment” stating deductive changes are usually the result of contractors’ current estimates or “would have cost” projections. The Navy also contended EJB’s accounting system was inadequate because it “failed to segregate the actual costs of the change.” To this argument the Board stated there was no duty to segregate the costs where if it was desired it should have been part of the contract. Further, the Board noted that DCAA had found its accounting system to be adequate for accumulating contract costs (*EJB Facilities Services, ASBCA No. 57547*)

Contractors Continue to Triumph in Statute of Limitation Case

(Editor's Note. The appeals board has continued the recent trend of protecting contractors because government tardiness has exceeded the six year Contract Disputes Act's Statute of Limitations.)

The government sought to disallow \$3.8 million in Laguna's subcontracts in Iraq asserting these subcontracts were awarded without proper competition and Laguna had failed to document the reasonableness of the subcontract prices. On Dec 6, 2005 the Iraq office of DCAA issued an audit report to the Salt Lake City Branch Office concluding Laguna's subcontract management system and related internal control policies were inadequate and could not be relied upon. On Feb 9, 2006 the Salt Lake City Branch Office forwarded these findings to the ACO in a separate audit report where the government inexplicitly failed to issue a final report on the \$3.8 million claim until Dec 2012. The Board sided with Laguna's assertion the claim was barred by the CDA because more than six years had passed from the date the claim accrued. Because the government was "fully aware of" Laguna's alleged failure to document the reasonableness of the subcontract prices in both the Dec 2005 and Feb 2006 audit reports it held the government claim accrued no later than Feb 9, 2006 making the Dec. 2012 final decision more than six years (*Laguna Constr. Co., ASBCA No. 58569*).

Contractor Has the Burden of Proof That Incurred Costs are Reasonable

(Editor's Note. The following case should alert contractors that despite showing that costs were incurred it is not sufficient to be reimbursed where the incurrence of the costs must also pass reasonableness tests.)

BAE submitted a claim of \$285,101 for an equitable adjustment. The claim was based on accounting records showing incurred costs for labor, hours, material, G&A and profit where DCAA conducted an audit, traced each element of claimed costs to the accounting system and source documents such as timesheets and vendor invoices and concluded all costs were verified as incurred and hence questioned none. The CO rejected DCAA's conclusions reasoning though the costs may have been incurred and successfully traced to accounting records, they were nonetheless unallowable in accordance with FAR 31.201-2, determining allowability and reasonableness provisions of 31.201-3. It cited examples of some costs being unreasonable such as

some of the direct costs charged to the modification were incurred after performance was complete, or some of the supervisory costs that were direct charged were also needed for other performed work or there was no authorization for the overtime hours. The Court disagreed that recorded costs, even confirmed by DCAA, should be the measure of an equitable adjustment absent proof from the contractor of reasonableness of the costs claimed (*BAE Systems, ASBCA 58809*).

Navy Discussions Were Proper

(Editor's Note. Several cases have been decided lately on the evolving issue of what constitutes proper discussions. Here is one.)

The Navy issued a RFP for boatyard products and services where all offerors invited to participate in discussions were to be advised of deficiencies and allowed to resolve them. Following discussions with Lyon the Navy said it should carefully review its price proposal which was significantly higher than the Navy's estimate. Lyon did not change its price and the award went to Marine Hydraulics because its technical and past performance ratings were the same as Lyon but its price was lower. Lyon filed a protest asserting the Navy violated FAR 15.306(d) by failing to conduct meaningful discussions about its price proposal where once the Navy determined its price was "excessive" and "more difficult to justify as reasonable" the Navy was required to reopen discussions. The Court disagreed with Lyon asserting the Navy is not required to discuss every weakness in a price proposal but is obligated to discuss an offeror's price only if it would preclude award. The Court ruled the FAR section referenced by Lyon does not require a CO to discuss a proposed price that is not considered to be a significant weakness where here there was no requirement to reopen discussions since Lyon's price was "arguably reasonable." The Court stated Lyon made a business decision not to adjust its price and it should not complain if the decision backfired. The Court added that reopening discussions is not required where a proposal weakness not addressed during discussions subsequently becomes a determining factor between two closely ranked proposals (*Lyon Shipyard Inc. v US, Fed. Cl. No. 13-508(C)*).

Not Considering Affiliates Past Performance Unduly Restricted Competition

The RFP to design, build and repair various utility corridor systems for the Army Corp. of Engineers stated offerors must demonstrate relevant experience on similar

projects and past performance only by the submitting firm where the requirements would not be met by the experience of offerors' parents, affiliates or separate divisions. Iyabak protested arguing the RFP's experience and past performance limitations were unduly restrictive of competition and information about affiliates should be allowed if they made a firm commitment to meaningfully participate in contract performance. The Corp argued that historically when agencies had allowed for affiliate history more concerns were raised where, for example, affiliates would give general statements about how resources could be moved from the affiliate with no concrete plan to do or proposals would rely on experience and past performance for affiliates no longer in existence. The Comp. Gen. ruled that the RFP was unduly restrictive of competition where it distinguished the Corp's concerns with those of Iyabak because the examples put forth did not address the contractor's argument that it is unreasonable to refuse consideration where there are firm commitments for meaningful affiliate participation with the Corps (*Isabak Constr., Comp. Gen. B-409196*).

Contractor Relied on Inaccurate Cost Data to its Detriment

IAP received a firm fixed price contract for basic services including facility operations and service calls and repairs at six facilities. Prior to award the agency provided offerors information it said was to be used to determine material and equipment costs required to support the service calls. IAP found during performance it was spending more time per service call than had been noted in the information provided by the agency where, for example, the actual costs of providing the calls at the Philadelphia site were \$480,000 more than its proposed costs. IAP filed a claim after the CO denied its request for an equitable adjustment. Citing an *Admiral Elevator case (CBCA 470, 07-2)* the board ruled that when an agency directs offerors to base their contract prices on significant, incorrect representations and the contractor does to its detriment the agency is responsible for the losses a contractor subsequently suffers. In this case the same principle applies where IAP relied on agency-provided data that was faulty and the board ruled the resulting additional work constituted a constructive change for which the agency was responsible (*IAP World Services Inc. v Dept of Treasury, CBCA No. 2709*).

SMALL/NEW CONTRACTORS

Basic Record Keeping Requirements

(Editor's Note. We have addressed adequate accounting systems several times in the past – what is an adequate system, what you can expect from DCAA and how you can evaluate your own system. Whereas several types of audits have been transferred to the Defense Contract Management Agency (e.g. large forward pricing proposals, purchasing systems reviews) and others have been reduced (e.g. low dollar incurred cost proposals) those remaining audit areas are getting more intensive scrutiny by DCAA. Since DCAA is tasked with determining whether contractors' accounting systems are adequate, we have found many changes in their approach so we thought it would be a good time to identify what now constitutes an adequate accounting system and what we see DCAA focusing on these days.)

When the term “accounting system” is used it does not necessarily refer to the accounting software or lack of it a contractor chooses to use. A contractor is free to use whatever software program they choose (even manual “shoe box” systems can be approved) and they can use actual or standard costing methods. Rather it is considered to be a combination of records, internal controls and written policies and procedures that together form the basis of estimating, accumulating and reporting financial data. Though an adequate accounting system is important for all companies, it is especially important for government contractors where they must establish an accounting system not only consistent with generally accepted accounting principles (GAAP) but also a variety of unique government accounting requirements.

Though some auditors may forget this lesson, the size of the firm and the extent of government contracts should dictate the depth and breadth of the accounting system. Small companies with relatively few contracts can probably generate all the necessary cost data using manual or spreadsheet systems. Large contractors with several segments or complex manufacturing will require much more. Accounting software that does not accommodate government accounting requirements (e.g. job costing) can be supplemented by spreadsheets as long as they are reconcilable with official books and records. If a contractor wishes to obtain government contracts over a relatively long period we recommend it obtain government-compliant accounting software that will interface with its corporate accounting transactions.

The software obtained should emphasize government cost accounting and reporting of government projects, timekeeping, labor distribution, revenue recognition and contract management capabilities. The system should also have billing capability to invoice costs, pre-established labor billing rates for T&M contracts, unit pricing, indirect costs and fees billed on top of appropriate costs (e.g. overhead billing on direct labor, general and administrative billed on total costs, fees on top of all or certain costs).

Basic Record Keeping

The types of books and records used in an accounting system vary widely where they need to be suitable for individual companies. For government contract purposes, the main requirement is that record keeping must provide sufficiently detailed contract costs so that they can be identified at interim levels for purposes of repricing contract work, negotiating revised targets, billings, and determination of when contract costs have hit 75% or 85% of approved funding levels. The record keeping system must include, at a minimum, a general ledger, a job cost ledger that tracks all direct costs, labor distribution records (e.g. hours and costs attributed to specific contracts), time records, subsidiary journals, a chart of accounts and financial statements such as Profit and Loss and Balance Sheet.

Several functions are considered essential to the adequacy of any basic record keeping system for government contractors:

1. Segregate direct costs by contract or job and then identify direct costs by cost element such as labor, material, subcontracts, travel, other direct costs. Government accounting jargon for contracts or jobs goes by the term final cost objectives (FCOs) and may differ widely. Sometimes FCOs may be a contract or subcontract, task or delivery order, CLIN, out-of-scope work in anticipation of a request for equitable adjustment, terminated and non-terminated portion of a contract, etc. In addition, significant IR&D and bid and proposal projects will need to be considered a FCO.
2. Segregate indirect costs by account and title depending on the indirect cost rates that will be applied for pricing and costing purposes. Common indirect costs include fringe benefits, labor-oriented overhead, material/subcontract related handling costs, G&A costs and service centers so these costs need to be readily identifiable. Also, be able to demonstrate that actual annualized indirect cost rates are monitored during the year.

3. Accumulate costs on both a current and cumulative basis such as year-to-date and cumulative-cost-to-date.
4. Establish the accounting period and reconcile time sheets to labor costs identified in job cost ledgers and ensure these costs are identifiable in the company's general ledger.
5. Enter costs to the books of account on a current basis e.g. at least monthly.
6. Separately identify unallowable costs in either the books of accounts (i.e. separate unallowable cost accounts) or less formal cost accounting techniques may be acceptable. For example, a contractor may elect to review all or a sample of accounts in certain risky accounts and identify a percentage of costs in that account that are unallowable. Though such after the fact screening methods were considered acceptable in the past some auditors are challenging such approaches asserting determinations of allowability should be made when the costs are either incurred or entered into the books of account and not later.

Special Emphasis on Treating Labor Costs

Verification of labor costs, because they are usually the highest cost element, attract indirect cost dollars and are vulnerable to inaccuracies because there is no third party verification (e.g. vendor invoices), is of paramount importance to the government. The key document in accounting for labor is the timesheet or timecard. Since timesheets can be easily altered by others, government contract employees must be made aware of their responsibility and the importance of accurate timesheet preparation. The government relies on the accuracy of timesheets and related internal controls to ensure the accuracy of labor costs presented for payment, contract costing and estimating. It is essential that the internal controls over labor reporting be clearly established and that they be reviewed by management periodically. Adequate timesheets must include the following information: employee name, employee identification number, time period, employee and supervisor signature, daily entries, project name, project number, daily totals, project totals and room to insert comments on changes or other matters. Electronic systems are acceptable provided they have such internal controls as only the employee may make entries or make changes or changes made after initial entry are visible to provide an audit trail. (*Editor's Note. For more detail see past articles on proper timekeeping and floorchecks – use our keyword function at our website to access these articles.*)

QUESTIONS & ANSWERS

Q. We are a subcontractor on most of our business. Due to sequestration and other cutbacks, our volume fell dramatically. The silver lining in this is that as of January 1, we are a small business again. Our plan is to leverage that and hopefully win some prime contracts. If we do, and we use subcontractors, what cost can we add to the subcontractor's cost. We do not plan to apply G&A. Should we establish a subcontractor management cost adder and then apply the cost plus fee? How common is it to have this subcontract handling fee?

A. Going forward, yes you can establish a subcontract management cost rate where the pool would be indirect costs associated with supporting subcontract costs (e.g. QA, purchasing, subcontract management) and the base would be direct subcontract costs. Based on the latest Grant Thornton Survey we report on each year, 24 percent of the surveyed professional services firms use a subcontract handling fee which usually ranges between 3-5%.

Q. Many of our contracts are in the \$500-800K range where we are starting to receive contracting officer decisions to impose penalties on questioned costs in prior years. When is a contract or subcontract too small to be subject to penalties?

A. Penalty thresholds have changed over the years. The schedule is:

Before Jan 9, 2005, the threshold was \$500,000
 From Jan 9, 2005 to Sep 28, 2006: \$550,000
 From Sep 28, 2005 to Sep 30, 2010: \$650,000
 After Oct 1, 2010: \$700,000

By the way, the FAR penalty provisions apply only to prime contracts, not subcontracts.

Q. We are working on a proposal that is a MUST WIN for us. Unfortunately our G&A rate is not very competitive due to the high incidence of R&D costs for FY 2014 which started on Nov 1. In my soon-to-be issued forward pricing rate request, I will submit a G&A Rate of 25% but I may want to "cap" the rate at a significantly lower rate. May I do so without violating the Certification of costs and pricing data norm?

A. Yes, you can offer a lower G&A rate for any specific proposal or even for all proposals than you are expected to incur. There are several mechanisms available to do so. For example, you can show all of your estimated G&A pool and base costs and then insert a "management concession" which would represent a voluntary reduction of pool costs where the effect is to lower the G&A rate by lowering the pool. Alternatively, you can simply propose it the normal way (e.g. estimated G&A pool and base costs) and then offer a reduced G&A rate for the one must win proposal. That reduced rate can be used on a fixed price contract or you can offer to cap your indirect cost rates if the contract is cost reimbursable (a cap often provides more points on rating your proposal). Or you could increase the base costs (denominator) by estimating on the high side those costs (e.g. project a highly optimistic estimate of work to be performed).

Q. Our scientists frequently go on experiments which require them to be outdoors (sometimes at sea) for several hours at a time. These employees receive meal reimbursements at GSA per diem rates. In addition to this reimbursement, we typically allow them to purchase water bottles and Gatorade to drink on the boat to prevent dehydration. Sometimes they purchase snacks as well which we do not deduct from the per diem. My question is – can we charge a cost-type contract for the cost of these drinks and snacks, since we are also charging the contract for full meal per diem amounts.

A. You should be able to consider these purchases as "supplies" or some comparable term in addition to the per diem. Of course, that should not prevent some auditor from taking an erroneous position.

Q. We are reluctant to provide a breakdown of costs on our subcontract invoices since it will divulge our rate structure and amounts to our prime who we may compete against in the future. What can we do?

A. If you are likely to compete with your prime, that's a good argument not to divulge a breakdown of costs on your invoices. However, if the government is requiring it of all cost type subcontracts its hard to fight that. Perhaps you can submit an invoice to the prime identifying the total of burdened costs and a separate one to the government identifying a cost breakdown. It is dependent on what you can negotiate.

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