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CONDUCT A "MOCK AUDIT" TO RECEIVE AN "ADEQUATE" OPINION ON YOUR ACCOUNTING SYSTEM

(Editor's Note. We addressed this issue about nine years ago in the GCA DIGEST where we thought it would be timely to revisit it now. The government is requiring auditors to review contractors' accounting systems more often, sometimes once a year in many cases. New requirements to focus on "business systems" of contractors and a new push by source selection officials to ensure awardees have adequate accounting practices have resulted in accounting system assessments being one of the biggest areas of audit scrutiny these days.

One of our most frequent consulting engagements involves conducting a "mock audit" of clients' accounting practices where we put on our "audit hat" and conduct a review of their accounting practices to identify weakness that can result in adverse findings during an actual audit. Our audit usually entails most of the steps identified below where the result ends in our presenting a report on strengths and weakness of the system along with recommendations for improvements, provision of workpapers that detail the basis of our findings, a recommendation addressing possible changes of accounting for and charging indirect costs and normally either improving or preparing written policies and procedures government auditors deem essential. We thought it would be a good idea to present some of the essential steps of conducting such a review so companies can conduct their own "mock audit." The advantages of contractors conducting their own audits or asking other independents are substantial: (1) identifies weaknesses beforehand so there is ample time to take corrective action and (2) supports the perception that you maintain strong internal controls since a key element of such controls includes independent monitoring of the system. (In the past, if the system was deemed acceptable we would allow the auditor to examine our report and workpapers which often resulted in reduced transaction testing since we are CPAs and former DCAA auditors/supervisors. This approach also worked somewhat when companies would do their own internal assessments but with increased emphasis on strict adherence to government audit standards these days, auditors have significantly lessened that opportunity but it is still considered an essential internal control.)

Adequate Accounting system

When auditors discuss an adequate accounting system they usually do not mean the accounting software you choose but rather your ability to identify, segregate and report on costs of distinct final cost objectives. "Final cost objective" (FCO) may mean a contract or subcontract but it may also mean contract line items or individual task or delivery orders within contracts depending on what are the specific requirements of the contract. Basically, you need to demonstrate your accounting system (no matter what type it is – packaged software, customized software, spreadsheets or manual) is an adequate project accounting system capable of identifying and reporting full costs on a project basis, particularly for government contracts.

Auditors used to issue one of three opinions – "adequate", "inadequate in part" or "inadequate" but lately the "inadequate in part" opinion has been eliminated. This development is unfortunate because the majority of opinions used to be "inadequate in part" where relatively minor fixes could be implemented and a return visit by auditors normally resulted in a happy ending. Now, only two opinions are possible – adequate and inadequate – where there is little guidance for auditors on how to distinguish between the two so not only have "inadequate" opinions proliferated but one auditor's opinion may differ widely from another's. The critical objective is still to avoid an "inadequate" opinion since a variety of undesirable consequences can occur such as failure to be awarded a contract based on cost and pricing data, suspension of payments on existing contracts, generation of additional audits (e.g. invoice), withdrawal of direct billing privileges, the need to demonstrate adequacy at a later date, etc.

Elements of Adequate Accounting Practices

At a minimum, contractors need to demonstrate they could pass a pre-award accounting survey that is commonly conducted by the Defense Contract Audit Agency. The criteria identified in this survey applies not only to new contractors who are likely to undergo such a survey before being awarded a contract but the same criteria is used to evaluate veteran

contractors during subsequent accounting system reviews. More detailed reviews are required for many larger contractors but this survey is required of all when the government wants to be assured a contractor can account for specific project costs. The criteria which is identified in Standard Form 1408 includes:

1. Direct costs are properly segregated from indirect costs.

2. Direct costs are identified and accumulated by final cost objective (e.g. grant, contract, subcontract, contract line item and task or delivery order).

3. Logical and consistent method of allocating indirect costs to contracts. Allocation of costs need not necessarily be part of the financial accounting system but, for example, is accomplished on spreadsheets for those contracts needing adequate costs (e.g. cost type contracts, fixed price contracts where there are progress billings or will be used to price follow-on work, etc.).

4. Identification of contract costs in general ledger. That is, the costs that are separately identified in a cost ledger are reconcilable (i.e. visible) in accounts included in the general ledger.

5. Timekeeping system is capable of identifying employees' labor by FCO.

6. Interim (monthly) determination of contract costs through posting to books of account.

7. Exclusion of unallowable costs.

8. Must demonstrate cost-type contracts can meet limitation of cost and payment clauses e.g. visibility of year-to-date and inception-to-date costs so the 85% notification can be provided. Also, whether fixed price contracts can meet progress billing requirements. Even if fixed price government work is the norm, contractors expecting to use cost data for pricing follow-on work or if requests for equitable adjustments or terminations occur, you will also need to demonstrate adequate accounting practices for pricing those items.

Conducting the Mock Audit

1. *Request all written policies and procedures related to the government accounting system*. This does not include normal, often voluminous material on the accounting software nor detailed employee instructions but higher level policies addressing the criteria above. Demonstration that contractors have adequate internal controls are critical to demonstrating the accounting system is acceptable and written policies and procedures are often the most critical element of internal controls in the eyes of government auditors. The absence of most critical written policies and procedures will rarely result in an "adequate" opinion these days. The critical policies and procedures you should be able to provide include basic accounting (e.g. distinguishing direct versus indirect costs, charging final cost objectives, accumulating and allocating indirect costs and monitoring those costs throughout the year), screening unallowable costs, timekeeping, expense reporting and billing (that address requirements for adjusting billing rates and ensuring subcontractors' practices are adequate). In addition to these five essential policies, be aware that some auditors may have their own personal favorites that they consider essential where the most common ones include estimating, purchasing and treating standard costs.

2. *Conduct interviews*. The "mock auditor" should sit down with the key government accounting person(s) and conduct a detailed interview on how the system works from the time a source document is received (e.g. vendor invoice, employee timesheet) through the accounting system to job cost reports and billings to the government. Examples of relevant reports (e.g. labor distribution, other direct costs by project, etc.) should be requested and examined. The results of this should be written up, either as a narrative or as a flowchart. In addition other topics where proper written policies do not exist should be covered in the interview and notes written up covering such topics as (a) how direct versus indirect costs are distinguished (b) how indirect costs are computed and allocated to cost objectives (c) how actual indirect costs are monitored during the year and the process for changing provisional rates (d) timekeeping practices (e) expense reporting (d) practices and training on screening unallowable costs and (f) how limitation of funding requirements (e.g. notification when 85% of authorized contract value is expended) are met. Additional topics should be determined beforehand corresponding to the type of industry the contractor is in and requirements of key contracts either awarded or being bid on.

3. *Trace a sample of recent invoices through the system*. Select, at least, one or two invoices on high dollar cost type work or job cost records from other high dollar government work and trace reported costs back through the system.

a. Trace the invoice to a job cost report identifying costs. If invoice and job cost records don't match, provide reconciliation.

b. Trace job cost report to intermediate reports like labor distribution and AP reports. DCAA is particularly interested in reconciling job cost labor expenses to labor distribution reports that, in turn, tie to labor hours identified in timesheets.

c. Reconcile direct job costs to general ledger accounts. If G/L accounts separately identify direct and indirect costs that's great; otherwise the direct costs identified in job costs should be included in specific accounts in the general ledger.

d. Trace a sample of direct costs to source documents. For labor, trace hours to timesheets and hourly rates to payroll records. For a sample of high dollar ODCs, trace to source documents such as vendor invoices and expense reports. Select at least a couple of expense reports and two vendor invoices. Reconcile any discrepancies.

e. Examine selected timesheets and expense reports to ensure they are consistent with written policies. If there are no written policies, ensure they are adequate according to required prescriptions set forth in the DCAA Contract Audit Manual. Though this mock audit is not intended to evaluate labor charging practices, gross inadequacies should be identified and brought to the attention of the contractor.

Many companies undergo an accounting system audit when they receive or are about to receive their first cost type or even a time-and-material contract even though they may have a long history of fixed price or commercial item government contracts. Be aware that auditors will not express a favorable opinion on potential adequacy – they want to see actual contract cost data when they come. When they do come, they will ask to see the types of records discussed above on an actual contract so be prepared to show at least three months of actual data. We usually recommend "pretending" one of you government contracts is a cost reimbursable contract and generate at least a quarter's worth of direct cost data for that contract ensuring the reports discussed above are available. If not easily accomplished with your normal accounting system, generating off-line spreadsheets is normally accepted as long as the data is reconcilable with your accounting system data.

4. *Prepare workpapers.* Compile workpapers where, at least, an evaluation of each major element of an accounting survey is identified. Ensure each significant observation is identified and each conclusion is logically tied to adequate documentation. If the contractor's system is likely to be considered adequate, either as it is now or after certain specific items are fixed, then be sure the workpapers are in logical and proper order so that an auditor may review them.

5. *Write a report.* Prepare a report that includes an executive summary and details of each major section. We prefer to use an observation-evaluation-recommendation format but other formats are fine. Both positive and negative evaluations should be clearly spelled out and corrective action needed to receive an "adequate" opinion highlighted.

Both the workpapers and report can be provided to a government auditor if the accounting practices are adequate or will be adequate by the time accounting practices are audited. If not adequate, you need not alert the auditor to the report. The process of preparing a "mock audit" plan, drafting a request for data, conducting the review, preparation of workpapers and a report usually takes about 10 days (probably more your first time). We find that contractors unanimously consider the benefits of the "mock audit" to be worth the effort.

APPEALS BOARD AGAIN REJECTS DCAA'S EXECUTIVE COMPENSATION APPROACH IN METRON CASE

(Editor's Note. For the second time this year, the Board has issued a stunning opinion challenging DCAA's approach to conducting executive compensation reviews of less than major government contractors. In the Q112 issue of the GCA DIGEST we described the J.F Taylor case that found DCAA's normal approach to evaluating executive compensation "fatally statistically flawed." Several challenges included faulting DCAA's approach to automatically applying a 10% range of reasonableness factor to their survey findings when the dispersion of data called for a much larger factor, treating widely different surveys equally, using a "default" 50 percentile, failing to consider non-financial factors when selecting

a percentile to use and benchmarking incorrect executive positions. The following case, briefly described in the last GCA REPORT, finds additional faults with DCAA's approach. Despite these exceptional findings, we see no new guidance nor change at this time in DCAA's approach to conducting their exec comp audits where most auditors are even unaware of these highly publicized findings.)

Background

Metron is a professional services firm that develops solutions to command and control problems applying mathematics, physics, statistical analysis and computer science approaches where the Department of Defense uses its technology to track a variety of items such as submarines and surface ships, missile defense and terrorist activities. Metron was a flat organization with few or no levels of intervening management where its executives have technical, business development and administrative responsibilities. The CEO, CFO and COO comprise the top level, where the next level down is the group level led by a Group manager consisting of two or more divisions and the third level is the divisional level where each division is led by a Division Manager who has P&L responsibility who is supported by one or more "Senior Engineers" (now called Senior Managers) who are, in turn, responsible for running "business units" within divisions that are made up of a customer or "problems" in technical areas. The Senior Engineers manage multiple projects, recruit and develop business in their areas.

The two senior executives hold PhDs in Physics. The company seeks to hire analysts with advanced degrees in math, science or computer where around 60% of its staff hold advanced degrees. In addition, its executives and technical staff are required to hold security clearance where over 60% held Top Secret or higher security clearances and most of the rest held Secret clearance.

Metron initiated an executive compensation plan in 1995 where it used the median Radford Executive Survey to set base salary and then used incentive bonuses to reward superior performance that were based on Radford statistics and company profits. Metron used the Radford results of the "under $50 million revenue range" for its 2004 and 2005 compensation where its revenue was $16.5 and $18.3 million, respectively. It selected the Radford survey after comparing the companies its employees had worked for or received offers from with those in the Radford survey concluding 42% of those companies were included in the Radford survey. It also found the industry and geographic companies to be "proportionally indistinguishable" from those in the Radford survey.

DCAA Audit

In its audit of Metron's 2004 and 2005 ICE proposals DCAA questioned $585,777 and $725,233, respectively, of compensation as unreasonable. The analysis conducted by its Philadelphia compensation team was fairly typical. It selected four surveys – the Radford Survey, Watson Wyatt, ERI and WTPF. DCAA selected the positions from the four surveys, it used the median survey position as a starting point and then adjusted that point for financial performance in each year to arrive at a "market price total cash compensation" (TCC) amount (salary plus bonus) for each survey then computed an average to arrive at a TCC for the position. It considered other elements of compensation by using other surveys to arrive at reasonable amounts (e.g. pension cost) and added those amounts to the TCC. Finally, 10 percent of the TCC plus pension cost was added to compute a range of reasonableness (ROR) in accordance with DCAA policy. The difference between the results for each position and amount paid was questioned as unreasonable compensation.

In its use of the Radford survey, DCAA used the 66 percentile for the CEO, COO and CFO positions to compensate for the lower revenue of the company compared to a $50 million level and it used a 41 percentile for the senior division positions it analyzed to match the even lower revenue figures generated at the division levels. DCAA did not use the Radford survey for the Senior Engineers stating the Radford survey did not identify executive positions that were appropriate for these job titles, reasoning they were not at the VP level or higher but were rather mid-management program or project managers.

Issues Raised and Board Decisions

Several approaches made by DCAA were rejected.

1. *Use of multiple surveys.* The first issue raised was what survey or surveys would have been appropriate to use. Both the company (Christopher McGee) and government (Bruce Overton) experts agreed that use of the Radford Survey was appropriate, where McGee said the analysis used to select it was "the most comprehensive" it had seen while Overton said it is a "very, very good survey" because it was representative of the industry.

Board Ruling. The Board ruled the Radford survey was "the best information for comparison with salaries paid by Metron" where the additional surveys "were not sufficiently comprehensive, reliable, relevant to Metron industry" or the job matches were not sufficiently similar to warrant "reduction of the results obtained from use of the Radford Survey data alone." The Board considered DCAA's normal approach of using multiple surveys to obtain an "average" and nonetheless ruled that contractors are not necessarily required to use more than one survey. Here, based on the facts, the Radford Survey data alone is sufficient. (*Editor's Note. We find this decision harkens back to the approach DCAA used to take – it would evaluate the basis on which a contractor determined compensation levels and then asked for a separate compensation review only if it decided the basis was inadequate (which was relatively rare). Now, DCAA automatically asks for a compensation review if it suspects compensation levels may be high regardless of the approach a contractor takes.*)

2. *Lowering bonus averages to account for a low number of bonuses reported.* DCAA noted in the Radford Survey that only a fraction of the participants reported receiving bonuses. For example, only 25% of CFOs reported bonuses in the survey stating that the amount of bonuses reported for the 25% (average of $48K) should be reduced by 75% (to $12K) to account for the low level of bonuses paid. Both experts disagreed with such an approach, asserting a survey reader cannot know the reason a company does not report bonus data stating there could be lots of possibilities for reporting only one element of compensation (e.g. turnover, compensation structure like granting stock, performance).

Board Ruling. The Board rejected DCAA's approach, agreeing with the experts.

3. *Lowering compensation within the "below $50 million bin."* DCAA, which was confirmed by their expert, used "regression analysis" and "best fit trend lines" to reduce the findings of the Radford Survey results that benchmarked employees in a "bin of below $50 million companies" to account for the lower revenues of $14.5 million and $18.3 million generated in 2004 and 2005. The CEO persuasively demonstrated though there may be some dependence of compensation across revenue bins there is little to no such dependence within a revenue bin. Mr. McGee argued the Radford Survey creates revenue bins because they believe there is statistical significance between different bins but not within a bin so no regression analysis is appropriate.

Board Ruling. The Board ruled that the government's adjustments to Radford Survey results were "deficient." It stated using "best fit trend lines" or "regression analysis" within a revenue bin was inappropriate where there is no evidence to support the contention that within each revenue bin (in this case under $50 million bin) there is a direct relationship between increasing revenue and increased compensation.

4. *Senior engineers are executives.* DCAA opined that senior engineers should be benchmarked to mid-level managers pointing to the fact there was no VP in their title, they were not "in charge of units" or responsible for "distinct product lines" or services and "probably had no sales responsibilities" where no interviews were held. After reviewing the Radford descriptions of strategic business unit executives both experts stated the senior engineers met those descriptions despite the fact they did not have the VP designation in their title. Similarly, DCAA insisted on benchmarking Dr. Corwin's part time consulting effort to an senior analyst position rather than a Chief Technical Officer since Dr. Corwin had an official title of Senior Analyst. After reviewing his functions and responsibilities, both experts agreed his compensation should be pegged to the CTO position.

Board Ruling. Metron's senior engineers/managers were properly considered to be executives where their positions should be matched to comparable Radford Survey executive positions. The evidence showed they had greater responsibilities than the government asserted, pointing in particular to their roles in business development. The Board also agreed with the experts about Dr. Corwin being benchmarked to the CTO position. The Board stressed that the function rather than title should be considered.

5. *High education and security clearances deserve premiums of pay.* Mr. McGee argued that few executive positions in the survey require a PhD degree in math and physics like Metron does which entitles it to a premium in pay. Likewise, the high security clearances of its executives should also deserve premium pay. The government and their expert witness disagreed, asserting a premium for these two requirements was not deserved.

Board Ruling. The Board sided with Metron stating it is "speculative to make an assumption that fails to recognize" the potential significance of other non-revenue factors that may influence compensation such

as level of education and security clearances. The Board also challenged the singular importance attached to revenue levels when determining percentile's to use stating DCAA's assumption that the overriding importance of revenues is "factually unjustified." In the extreme case, promising high technology firms may have little to no revenue in the early growth stages where they must nonetheless pay high levels of compensation.

6. Financial comparisons with "peer group" is improper. Both DCAA and its expert based their percentile ratings in part on financial comparisons of Metron with what they considered "peer group" companies, concluding Metron should be placed in the 66th and 41st percentiles in 2004 and 2005 respectively. Metron showed that these alleged comparable companies were very large, publicly traded companies with different organizational and financial structures.

Board Ruling. The Board said such comparisons are "misleading, unreliable and unreasonable." The Board agreed with Metron, finding that the "peer group" analysis conducted by DCAA and their expert witness was based on "misleading comparisons with much larger companies with markedly differing organizational and financial structures."

7. Adjusting division managers percentile ranking for lower revenue is improper. To account for the lower revenue figures division managers were in charge of, DCAA decided to lower the percentile used to benchmark these managers to the 25th percentile. However, both experts agreed no data provided by Radford showed that revenue size can be ascertained at any percentile level.

Board Ruling. The Board found the government's attempt to divide total Metron revenue in an attempt to lower the scope of accountability of executives "unpersuasive." It stated such an approach again makes the "questionable assumption" that there is a relationship between revenue and compensation within a revenue bin

8. DCAA did not conduct its financial analysis properly. In evaluating Metron's financial performance to determine the percentile that should be used, DCAA failed to add a $950,000 profit contribution to its profit for the year, resulting in an assignment of a 41st percentile for the year in question. Though the profit contribution was not claimed as an allowable cost, both experts stated it should have been considered profit made in 2005 which would have demonstrated greater financial performance.

Board Ruling. The Board stated the government "misanalysed" the $950,000 voluntary contribution stating it was made for tax purposes and among other things shows Metron's financial strength rather than a below average financial performance its lower percentile would indicate.

In addition, the Board sided with both experts' opinion that it was appropriate to add pension costs to the Radford Survey's TCC. The Board noted that Metron pays short term bonuses as opposed to long term compensation (e.g. pension) offered by larger companies and therefore it was proper to increase the TCC by the pension amounts to make up for the absence of long term payments

RULES ON LATE PROPOSALS

(*Editor's Note. We all know about the craziness of making sure a proposal is delivered on time in spite of plans to avoid being late. If you reviewed cases like we do (I wouldn't recommend it for fun) you see a significant amount of cases revolve around decisions related to what constitutes late delivery of proposals and when are they acceptable. We have been hoping to find an article that summarizes some of these cases to have a clearer idea on what the case-based rules are and we finally found one written by Ray Fioravanti of General Dynamics and Ken Weckstein of Epstein, Becker & Green written in the Jan 17th issue of Federal Government Report.*)

The authors start their article with a typical case study. You have a multimillion proposal requiring delivery of three hardcopies at the CO's office in minutes when the messenger phones to tell you he is lost. He made it to the facility after much traffic and finds himself in a maze of buildings. What to do? You need to have it "under government control" before the deadline where you direct the messenger to find the nearest government employee, maybe a security guard and leave it at the employee's desk until the CO is dispatched to pick it up. You should also immediate send an electronic copy to the agency. If the deadline has passed, is it still worth making the delivery anyhow, anyway that same day even if its hours late - if the office is locked find one that's open, if the electronic portal is down send it by email, just get it delivered.

The following addresses late bid rules and exceptions to them as well as a few recent cases. The general rule is pretty straightforward – offerors are responsible for ensuring proposals reach the designated office by the "exact time" stated in the solicitation (or 4:30 if

no time is specified) where a late proposal will "not be considered" unless it falls under a recognized exception per FAR 15.208. There are six recognized exceptions to the late bid rule:

1. The proposal was at the installation and under government control prior to the deadline.

2. Government misdirection or improper action was the paramount cause of the delay.

3. An emergency or unanticipated event interrupted the normal government process so that proposals could not be received.

4. If allowed by the solicitation, an electronic submission was received by the government infrastructure by 5:00 PM the prior working day.

5. The submission in question is a more favorable revision to an otherwise successful proposal

6. Only one proposal is received.

A review of the following recent cases shows how these exceptions apply to various circumstances and what late bidders should do to maximize their chances of qualifying for one of the exceptions.

♦ Under Government Control

In the first case, the messenger arrived at the facility security office before the deadline but due to a long time to be processed and wrong directions, did not leave the guardhouse (surveillance cameras showed him leaving) or deliver the until after the deadline. The Army determined it was late where in its protest B&S argued the commercial courier was "under government control" because he was at the facility and under surveillance before the deadline. The GAO rejected this argument stating the proposal had to be in the government's custody where because the courier never gave up control it was properly rejected as late (*B&S Transport, B-404648*).

USAI's messenger called at 1:50 to say he was lost and could not meet the 2:00 deadline. The reason was he followed outdated maps and stated the airbase provided wrong directions that did not reflect new street configurations where USAI argued the "government mishandling or misdirection" exception applied. The GAO disagreed saying out of date maps were typical and the government's misdirection was not the "paramount cause of delay" but rather the messenger's failure to arrive earlier was the cause (*US Aerospace, Inc., B-403464*).

The authors state that if in these two cases the messenger had convinced the security officials or other employee to take possession or allowed it to stay in plain sight while the CO was dispatched to come it might have worked. They cite the *Haskell Company case (B-2927560*) that ruled the fact the proposal was placed on the attendant's desk minutes before the deadline made it timely where the implication is that in the B&S and USAI cases they might have been successful had the messenger relinquished control before the deadline or at least the government would have had a basis to consider the proposal rather than reject it.

♦ Emergency or Unanticipated Event

Hunter mailed its proposal "next day noon delivery" on Feb 10 to meet a Feb 12 deadline. A severe snow storm caused the post office to close on the 10th and 11th where the federal government was open under its "late arrival/unused leave" policy where the agency staffed its office to receive proposals. The proposal did not arrive until the 16th, the next day delivery, where the government rejected it as late and the GAO agreed stating though it was undoubtedly delayed by the snowstorm, it did not make it impossible for bids to be delivered on the 12th (*Hunter Contracting Co., B-402575*).

♦ Prior Electronic Submission

Under this exception it must be established that (1) electronic submission was permitted by the solicitation and (2) the submission hit the government's "infrastructure" by 5:00 PM on the preceding work day. If that occurs the proposal will be considered timely even if not received in the intended recipient's email in-box by the actual deadline (thus eliminating arguments about whether the government's even caused the delay).

Sea Box allowed hand-delivery and electronic means of delivery to meet its July15, 1:00 PM deadline. All seven of its emails were received by the Army before 1:00 PM on July 15th but did not reach the CO's emails until 1:33 where the Army rejected the proposal. In its protest Sea Box argued its bid was "under government control" because the emails had hit the government's server prior to the deadline and it could not have made any changes or gained any advantage. Nonetheless, the GAO denied the protest stating to allow it would be rewriting the rule that required electronic submissions be made by 5:00 the prior day if it ruled that an e-submission received before the deadline but sent after 5:00 was considered

to be "under government control." (Sea Box, Inc., B-291056).

The following case significantly expands the ability to justify late deliveries. The solicitation required proposals be received by 12 noon, allowing either hand or email delivery. Watteron sent its email proposal at 11:02 AM where the Army's server received it at 11:29 AM but it did not reach the CO's in-box until 12:04 – four minutes late and therefore rejected. In its protest Watterson argued that several hours prior to deadline a "mail storm" caused email delivery to "come to a crawl." It did not deny it could have delivered it by hand on time. Contrary to earlier cases that ruled an "event" in question must actually prevent timely delivery not just making it difficult, the judge ruled here the mail storm constituted an "emergency or unanticipated event" notwithstanding the fact other proposals were received on time. She also ruled that because the email contacted the government's servicer a half hour prior to the deadline it was "under government control" so that exception also applied.

The authors state that at least in the US Court of Federal Claims the Watterson case has widened the reach of the "government control" and "emergency or anticipated event" exceptions to the late bid rule. It now appears as if offerors who manage to transmit an email proposal prior to the deadline can successfully argue their proposals were "under government control." regardless of when they were actually received in the designated in-box. Further, if a "mail storm" now constitutes an "unanticipated event" or "emergency" then it may now apply to any number of problems that make it difficult if not impossible to deliver a proposal like a snow storm, power outage or other IT problems that made it more difficult, but not impossible, to deliver on time (*Watterson v. United States, US Court of Federal Claims*).

Government Mishandling or Misdirection

Stauback was diligent where the deadline of Feb 21 at 4:30 was met by it arranging for DHL same day delivery on Feb 20, a day earlier. Late that same afternoon Stauback telephoned the CO to ask whether the proposal was received and the CO said it had a large package from Stauback that had been delivered to her. On Feb 24 Stauback was notified its proposal was rejected because only one of the three required volumes had been received where Stauback later discovered the other two volumes were at the airport's lost and found. Stauback protested to the GAO arguing that the government's "misdirection" caused the lateness citing the fact the CO incorrectly confirmed receipt of the proposal rather than accurately stating she received an incomplete submission. The GAO refused to apply the "government misdirection" exception stating contractors may not rely on statements of agency officials in that manner and are ultimately responsible for submitting their proposal on time (*The Stauback Company, B-276486*).

The lesson of *Stauback* and a similar *Aquaterra* case leaves clear the lesson that an offeror bears responsibility for a late proposal unless it is submitted in plenty of time prior the deadline and all fault for later delivery rests with government officials.

In a rare example of a finding of "government mishandling", CT Construction sent its proposal by USPS Express Mail overnight delivery to the designated post office box. Delivery to the post office box was attempted hours earlier than the deadline but after the agency had already picked up mail from the box where the proposal was not delivered to the designated official until the following day and hence was ruled late. The agency asserted it was addressed to the wrong official even though the post office box was correct but the GAO rejected the agency's argument stating if only it had simply checked the box later that day the proposal would have been delivered on time, regardless of whether it was properly addressed. It found the proposal was delivered on time where the fault for later delivery rested entirely with agency officials who failed to simply check the mailbox in the hours prior to the deadline (*CT Construction, B405575*)

More Favorable Revision to an Otherwise Successful Proposal

This exception applies to Best and Final Offers where it is not really strictly an exception but rather a "revision" to something other than the proposal where there is some cooperation with the agency. In appealing a late delivery decision Omega argued its original proposal submitted weeks earlier was more advantageous than the awardee's and therefore its late BAFO was merely a revision. The GAO ruled against Omega stating there had been no determination that its earlier submission was "otherwise successful" (*Omega Systems, B-298767*).

Only One Proposal Received

This exception is there more for the agency than the late bidder where though the agency does not have to make an award it frees them up to do so rather than have to go through the process of a re-solicitation. No cases are alluded to.

Taken as a whole, recent cases described here can be used to provide possible arguments that late bidders may be able to use. The authors offer a few "best practices:"

1. Be familiar with the solicitation's stated delivery methods, page requirements, number of copies and file size limitations. Electronic submissions may have to be broken up into smaller ones.

2. Obtain advance clearance and approval for delivery personnel admittance to the facility.

3. Send e-submissions with confirmation requests by 5:00 PM the prior business day. Don't depend on more lenient decisions.

4. If time is running out, try to get the proposal into the hands of an agency employee, even if it means leaving it with an attendant until the designated official meets you there.

5. If necessary, make delivery by any means to meet the deadline, regardless of copies required or what the solicitation's prescribed method is.

6. Even if it's late make delivery anyhow to preserve the ability to make "emergency or unanticipated event" delay arguments later that would provide for an extended next day delivery deadline.

The authors recommend learning the late bid rules now for when the time comes you will actually need them there may not be time then.

ADDITIONAL WAYS TO CHARGE COSTS DIRECT

(*Editor's Note. Since direct costing allows for not only a dollar for dollar recovery of costs but additional markups for indirect costs and fees contractors are understandably looking for ways to charge more costs directly rather than including those costs in indirect cost pools. Though the ability to charge specific costs directly may be limited to what a contract spells out, more often the contractor has flexibility in establishing its own practices on what costs it will charge directly. We have helped our clients establish ways to charge more costs directly so here are a few good ideas that we have found in multiple texts and our own practices.*)

Actual direct costs are usually associated with "touch" labor and material costs but several other categories of costs, even small dollar amounts that are not worth tracking on an individual basis may be charged direct. Some examples include:

1. Blanket Costs

Labor and material costs may be incurred for multiple products and services but are too small or too numerous to justify the record keeping needed to charge them directly to one final cost objective (FCO). These costs are generally "touch" labor or material which does not make them indirect costs yet it is usually too impractical or expensive to treat them as direct. Examples of these "blanket costs" are inspection or quality controls costs or in a manufacturing setting might include painting, tool room personnel, small tools and supplies or packing. Typical accounting treatment of these costs are to pool them as direct costs in an intermediate cost pool and them allocate them as direct costs to FCOs on a reasonable basis. They become an average or standard markup to existing direct costs. For example, small tools or supplies would be a markup to direct materials or small tool labor would be a percentage markup to direct fabrication labor. As long as the contractor specifies their practice in a written policy it will normally be accepted. Advantages of such blanket costs is they allow more costs to be charged directly to maximize cost recovery without having to track each cost and also, since they are not included in indirect cost pools, tend to lower those indirect cost rates which may help in a tough competition where the buyer is looking for lower overhead rates.

2. Average Costing

The regulations such as CAS 418 address average labor costing but most commentators say the same rules should apply to average material costing too. Direct labor costing can be based on average or pre-established direct labor rates set for a group of employees. The Cost Accounting Standards Board has established criteria for the group of employees to be (1) interchangeable with respect to functions to be performed (2) produce similar output or (3) form an integral team. So, for example, a group of employees may have diverse labor skills where an average rate for the group is computed and multiplied by the hours worked for each final cost objective. Or,

for example, an average group rate is computed where actual time spent by individuals within a group is identified and the average rate is applied to those hours. An ASBCA case (*Litton Systems, ASBCA 37131*) allowed computation of average rates across multiple facilities in several locations where there were overlapping manufacturing capabilities, where there were frequent changes on performance of specific operations and average labor rates were determined by a weekly averaging of actual rates within a grouping of job classifications.

3. Service Center Costs.

A service center is defined as an organizational unit that performs technical and/or administrative services. Most companies have numerous candidates for service center costs such as MIS, reproduction, warehouse, vehicles, engineering, repair and maintenance, etc. CAS 418 provides numerous examples of service centers and the basis in which the costs may be charged either directly to FCOs or to other indirect cost pools. (We have also discussed service centers in other contexts – use our key work search feature.) For cost reimbursable contracts, some contractors provide provisional service center rates where they then go through the often laborious process of "truing up" actual costs. We advise use of "fixed price" rates so as to avoid such a process where both auditors and ACOs will accept those even on cost reimbursable contracts if the rates can be justified.

4. Standard costs.

A variation of average costing is standard costing of materials and labor. Though too detailed to explore here, be aware that standard costing needs to conform to CAS 407 for labor and material costs which, in practice will apply to non-CAS covered contractors where standards updates and treatment of variances must be adhered to.

RECENT DECISIONS ON TRAVEL AND RELOCATION

(*Editor's Note. Though only three parts of the Federal Travel Regulation and Joint Travel Regulation provisions formally apply to government contractors – combined per diem rates, definitions of meals and incidentals and conditions justifying payment of up to 300% of per diem rates – many contractors choose to follow the FTR either because some contracts call for incorporation of it or auditors and contractors consider it to be the basis for determining "reasonableness." This feature is a continuation of our effort to present new changes or decisions likely to affect contractors' travel and relocation expenses.*)

Super Bowl Lodging Not Reimbursed Over 300 Percent of Max Lodging Rate

Donald was assigned temporary duty (TDY) to help participate in security operations related to the 2012 Super Bowl. Though he obtained lodging reservations well before the travel was to occur, the room rates spiked where the normal room rate of $91 increased to $329, a 361% increase. The agency limited reimbursement to $273 representing 300 percent of the maximum per diem rate plus taxes. In his appeal to receive the entire $329 rate the appeal board rule an agency has no leeway to reimburse actual expenses above 300 percent of the maximum per diem rate citing FTR 301.11.303 "The maximum amount that you may be reimbursed under actual expense is limited to 300 percent of the applicable maximum per diem rate" (*CBCA 2807-TRAV)*.

Could Notice of Lease Termination Been Given Earlier?

Linda was given a verbal job offer with the VA on March 23 that would include a transfer from Orlando, FL to Washington DC. The date the transfer took place was not known until she received a transfer order on April 13 providing a reporting date of April 25. On April 7, she gave her leasing office notice she would be leaving where a lease termination settlement of $350 was negotiated and she sought reimbursement. The VA said had she given notice on March 23rd there would not have been any lease termination costs and hence withheld reimbursement. The Board stated that lease termination fees made in connection with an authorized transfer is reimbursable except when there is a failure to give appropriate notice promptly after receiving definite knowledge of the transfer. The Board ruled Linda had given adequate notice because such notice is not required at the time of an informal job offer which did not occur until the April 13 written order (*CBCA 2703-RELO*).

Safety Concerns Justify Hotel Stay

Arriving home at 1:00 AM following a nine hour work day and a nine hour flight with a two hour drive home ahead, Michael who was too tired to drive home, secured lodging at the airport hotel. The Defense Department denied reimbursement for the hotel citing JTR C4552-C.1.a that states per diem cannot be paid within the permanent duty station limits or within the

vicinity of the residence the employee commutes from. In spite of the two-hour drive the Board did not dispute the agency's assertion the hotel was in the vicinity of Michael's residence but stated in previous cases employees were reimbursed for lodging within the vicinity of the residence when, for example, weather and safety concerns justified it where here, it ruled, an 18 hour day plus a two hour drive satisfied the safety concern criterion (*CBCA 2696 TRAV*).

Early Travel to Cancelled TDY Assignment is Allowed

In a related case, Kathryn received orders to attend training in Florida April 11-15 where she and her husband elected to spend a long weekend so she moved up her flight to April 8 and took a vacation day. Shortly after her arrival on April 8 she was notified the training was cancelled and the agency sought to avoid reimbursement for all of her expenses asserting it would be a violation of the JTR C4564-H that allows for reimbursement for cancelled trips during travel to the assignment but not if notified beforehand and concluded she should be responsible for her travel costs just as she would be for any personal vacation. The Board disagreed. It acknowledged that as a general rule when an employee travels away from their official duty station while on annual leave they must return home at their own expense. However, a prior case approved an exception in cases where cancellation of the TDY assignment is beyond the employee's control and it can be determined that the employee would have avoided the trip had it known about the cancellation. The Board concluded Kathryn would not have taken the trip had she known about the cancellation (*CBCA-2463-TRAV*).

Maximum Per Diem Limited to Assigned TDY Location

The TDY location was Newton, MA but the traveler decided to stay in Boston, 15 minutes away to see the holiday lights with his family. The agency refused to pay the Boston lodging, limiting reimbursement to that for Newton only. FTR 301-11.7 was cited which states the FDY location determines the maximum per diem rate allowed and the FDY location and not the lodging location should determine amount entitled to. The Board concluded if a traveler obtains lodging outside of the FDY location for personal preference or convenience the allowable per diem is limited to the FDY location (*GSBCA 13684-TRAV*).

Documentation From Online Hotel Reservation Services Are Acceptable

Two recent cases address the type of documentation required when lodging is booked online. Both Scott and Emily reserved lodging online and submitted itemized receipts from the online booking service. Both their requests for reimbursement were rejected where the agency cited JTR C4555.5-B.5 "Lodging reimbursement is not authorized for hotel lodging unless an itemized receipt from the hotel is provided." In both cases, the Board noted that the JTR was recently amended to state lodging reserved online is allowable when the traveler can provide an itemized receipt for room costs from the hotel or online agent showing the following charges: (a) daily hotel room costs (b) daily hotel taxes and (c) daily miscellaneous fees, if applicable. concluded that Hence the costs were reimbursable (*CBCA 2362-TRAV and CBCA 2511-TRAV*).

Board Allows Real Estate Fees Even Though They Went to Spouse

Phillip made a permanent change of duty station and paid out $24,850 in real estate fees associated with selling his old house. The government granted $9,720 in fees but rejected $12,960 paid to the listing agent Carnival, because the agent working for Carnival who received a percentage of the fee was his wife. The agency said this relationship constituted a conflict of interest stating when money exchanges between a husband and wife "no real expense is suffered" and therefore no expense should be granted. The Board sided with Phillip. It looked first to the relevant regulation in JTR C5756-A.1. that stated broker's fees are allowable as long as they are comparable rates paid in the locality. The Board found the payment met all the pertinent requirements for reimbursement of real estate fees where if a different listing agent was used they would have been reimbursed. As for the asserted conflict of interest, the government did not cite any rule asserting this position (*CBCA 2356-RELO*).

Entitled to Lodging Reimbursement When Residing in a Condo at TDY Assignment

In anticipation of frequent TDY assignments to Huntsville, Mark purchased a condominium for $63,900 taking out a mortgage of $60,700. Over a nine year period, Mark charged the government an amount it calculated for interest cost, utilities and taxes for the time he stayed in the condominium which

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represented a reduced rate of $33-35 per night over the maximum rate. Following an audit, the Defense Accounting and Finance Service (DFAS) asserted Mark owed the government the entire amount paid, $24,944. The Board said the full amount could not be collected from Mark since he was entitled to some lodging costs. In determining whether the amount paid was correct, the Board noted the regulations in place for the time allowed for lodging reimbursement under the "lodging plus" model – the actual amount paid by the traveler for lodging plus an allowance for meals and incidentals not to exceed the maximum per diem rate. The Board also examined case law when an employee purchases a condo in connection with TDY which establishes the traveler is entitled to a daily amount based on prorate monthly interest, property tax, utilities and maintenance costs. The Board concluded the agency should compute the total lodging entitled based on use of the lodging plus system for each day and if it exceeded the $24,944 no moneys were due but any amount less would be owed (*CBCA 2169-TRAV*).

How Much Freedom to Choose Hotels to Earn Travel Rewards

Though employees are not allowed to select airlines to earn miles on that airline we have been asked whether they can bypass company travel agents and company agreements at certain hotels to arrange hotel accommodations to earn points. FTR 301-53.4 states "you may not choose a travel provider to gain frequent traveler benefits for personal use" and FTR 301-11.11 states "when selecting commercial lodging facility, first consideration should be given to government lodging agreement programs." Of course if no travel agents or hotel agreements exist, I don't see why choice of lodging cannot be more flexible.

Government Not Obligated to Reimburse Stolen Advanced ATM Funds

The Employee withdrew ATM funds in advance of its TDY assignment where it was stolen at the TDY location and the government refused to reimburse Employee. The Board agreed with this decision asserting the advance is considered to be a personal loan to the traveler where he is responsible for the funds. Since he cannot show they were used for official travel the government is not obligated to repay the funds (*B-183489*).

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