NEW DEVELOPMENTS

Poll Finds Most Contractors Saw Revenue Declines From Sequestration and Shutdown; Economy on the Mend

Nearly two thirds of contractors saw their revenues decline in 2013 as a result of sequestration and the government shutdown according to a poll released by Market Connections and Lohfeld Consulting Group. Thirty one percent said their revenue declined by at least 10 percent, another thirty percent suffered moderate declines of up to 10 percent, fifteen percent experienced modest to significant growth while sixteen percent said revenue remained flat. The contractors polled said they are trying to cope with the government market pressures in various ways including (1) expanding into adjacent markets (2) modifying their lines of business, emphasizing end of the procurement cycle to improve capture strategies (3) expanding into new federal agencies and (4) pursuing new opportunities in state and local government as well as international markets.

On a positive note, prior estimates of a slow growth in the economy have been significantly upgraded after original estimates of 2.8 percent growth in the third quarter were revised to 4.1 percent. The reasons cited for better projected GDP growth are higher consumer spending, non-residential investments, exports, private inventory investments and greater state and local spending.

President Obama Announces Minimum Wage Hike to $10.10

President Obama signed an executive order Feb 12, 2014 mandating that government contractors and subcontractors pay their employees a minimum of $10.10 per hour. President Obama said in his State of the Union speech that though he will continue to urge Congress to pass legislation that will boost the federal minimum wage to $10.10 for all workers, the executive order is seen as a faster approach that would impact wages for federal contract workers. The “fact sheet” posted online states the Order would cover workers performing services, construction and concession contracts that are getting paid less than $10.10.

Many commentators have criticized the action for singling out government contractors and state that despite the significant publicity surrounding the EO, there are four reasons to believe the action will have limited impact: (1) the mandate does not take effect until Jan 1, 2015 meaning there is no requirement to immediately raise wages (2) the order will take affect only after the Labor Department and FAR Council issue regulations implementing the Order after which existing contracts will need to be modified by COs and contractors will be entitled to equitable adjustments to their contract prices (3) the services and construction contracts being affected are already covered by the Service Contract Act and David Bacon Act, respectively, where the vast majority of labor categories already exceed the $10.10 wage and (4) there are almost certainly to be numerous legal challenges to the Order.

DOD Amends its Proposal Checklist Requirement

The Defense Department issued a final rule amending the Defense Federal Acquisition Regulation Supplement to remove a redundant item in the original rule. Effective Jan 29, the final rule removes and reserves Item 19 of the solicitation provision at DFARS 252.215-7009. The original rule that amended the DFARS in March 2013 (Federal Register 18865, March 28, 2013) requires all contractors submitting a cost proposal that contains cost or pricing data to self-certify and submit with their proposal a DFARS Proposal Adequacy Checklist. If it is not submitted, the proposal can be judged unacceptable and/or non-responsive to the solicitation. In a separate action, the National Aeronautical Space Administration is proposing a change to their acquisition supplement that will require an identical checklist.

DOE Issues Guidance on Legal Costs

The Department of Energy has issued guidance to its contracting officers about the allowability under cost reimbursable contracts of legal costs stemming from allegations of discrimination such as affirmative action and equal opportunity protections. According to this
guidance, DOE states the Appeals Court has ruled such costs are unallowable if a court rules against the contractor in favor of the employee. If the contractor settles a claim prior to a judgment, the costs of litigation and settlement are allowable only if the CO determines the contractor's claim had little chance of success on the merits. When considering the chance of success on the merits the CO is instructed to request the contractor submit information needed to make the decision including the rationale for determining there was little chance of success and the CO should consult with in-house counsel on the matter.

**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.)

**Prediction of 2014 DCAA Actions During Their Incurred Cost Audits**

Someone sent us an interesting blog by Darryl Walker discussing his hopes for better DCAA audits of incurred cost proposals (ICPs), frustrations they have not occurred and predictions for 2014. His thoughts are shared by many of our subscribers and clients and unfortunately mirror our experience as consultants. The author notes many of the changes initiated by DCAA and DCMA to lessen the chances of incurred cost proposals being audited will result in less ICP audits and increases in contracts being closed out more quickly. He was hoping to see a more educated and experienced DCAA audit staff who would demonstrate greater knowledge of the cost principles, less exhaustive transaction testing during audits and a greater appreciation of materiality considerations. He states these hopes are not being realized where he expects little change to how DCAA conducts its ICP audits. (Editor’s Note. We have a slightly different view on this. We believe the problem of poor audit results lie less with inexperienced auditors – there is a long history for this – and more in lack of adequate supervision of auditors, reluctance of DCAA management to challenge initial faulty audit positions and inaccessibility of DCAA managers to meet with contractors to resolve audit issues before reports go to ACOs.) Mr. Walker states the audits He will continue to take months to complete, extensive transaction testing will occur where there will continue to be requests for layers of documentation irrespective of retention rules where the only silver lining is the audits will not meet the six year statute of limitation threshold and hence they will then be abandoned.

In the light of these rather dismal assessments five predictions for 2014 are made in the blog: (1) continued and never ending transaction testing where requests for documentation (with unreasonable turnaround times) will accompany unnecessary justifications for costs (proof of actual payment and review of timesheets) (2) retroactive challenges to cost accounting practices because the auditor believes it has a “better” practice (3) continued questioning of executive compensation based on subjective criteria despite recent court cases finding their approach to be “fatally flawed” (4) questioning “easy pickings” – professional and consulting fees, travel expenses, advertising, certain legal costs, business conferences and meetings where recreation is combined with business and (5) “insufficient and garbled” explanations for questioned costs where there is insufficient time to respond to DCAA findings.

**DODIG Questions Use of Cost Reimbursable Contracts at Two Agencies**

The Department of Defense Inspector General Office reported that contracting personnel from the Missile Defense Agency and Defense Microelectronics activity are not following FAR revisions on the use of cost reimbursable contracts. The interim March 2012 FAR rules at Parts 7, 16 and 42 that implemented the 2009 National Defense Authorization Act require contracting officials to include approval, justification and transition areas in the acquisition planning documentation including (a) obtaining approval for cost-reimbursement contracts at least one level above the CO (b) justifying use of the cost-reimbursement contract (c) documenting the potential for such contracts to transition to firm-fixed-price contracts (d) ensuring adequate resources
are available to manage the cost type contract and (e) determining the adequacy of the contractors’ accounting system during the entire period of performance. The IG review of 88 cost reimbursable contracts worth $1.8 billion at MDA and DMEA was part of a DOD wide review of 971 such contracts worth $14 billion. According to the IG report, MDA and DMEA personnel did not obtain necessary approval for 50 contracts, did not document the possibility of transition to a firm fixed price contract for 50 contracts and did not verify the adequacy of the contractors’ accounting system for 27 of the contracts. MDA and DMEA have taken steps to fix the problem and DOD will be conducting more audits.

**Webinar Focuses on New HR Issues to be Careful About in 2014**

A Jan 9 webinar by the law firm of Crowell & Moring focused on several recent Human Resource developments that government contractors need to face. These include:

1. Recent new compensation caps. See our Q&A item below.

2. Congress has been very critical of the lack of use of suspension and debarment actions by the government for violations of the Service Contract Act and Davis Bacon Act and other violations. The webinar stated contractors can expect to see a significant “upick in suspension and debarment activity” in 2014.

3. More compliance audits by the Department of Labor on contractors’ reporting of affirmative action and equal opportunity obligations with respect to protected veterans and people with disabilities. They are recommending that contractors make sure their applicant tracking system and HR information systems are set up to collect and maintain information about veterans and disabled status.

**Issues Related to Commercial Items Becoming a Hot Topic**

To determine the extent which the Test Program for Certain Commercial Items was being used, the General Accounting Office issued a report stating its underutilization was resulting in “missed opportunities” for both contractors and the government. The report stated the test program reduced contracting lead time and administrative burdens and “generally did not incur additional risks above those for other federal acquisition efforts.” The test program is based on the premise that market forces ensure reasonable prices for commercial items where efficient access to commercial products and services may help agencies save costs in an era of budget cuts. In 1996, Congress authorized the use of simplified acquisition procedures for commercial items not exceeding $5 million under the Test Program. Though the program was initially intended for three years, it has been repeatedly extended where it is good until Jan 2015.

Despite the praise of using commercial items in some government circles, the influential Aerospace Industry Association has expressed concern that the Defense Department has become hesitant to consider products as commercial. As an example, DOD requested Congress to remove a provision of the FAR allowing items “of a type” similar to those available to the private section to be considered commercial which Congress rejected. DOD claims it issued the request to ensure prices paid for commercial items were fair and reasonable when there are no commercial sales or insufficient sales that are claimed to be commercial. Opponents of this position assert there is sufficient ability to ensure price reasonableness where, for example, FAR 15.404 gives authority to the government to request cost or pricing data that is not certified (called other than certified cost or pricing data).

**Filing of Qui Tam Whistleblower Actions Soar in 2013**

The US Department of Justice reported that it had recovered $3.8 billion in FY 2013 in settlements and judgment from civil cases brought under the federal False Claims Act (FCA), topped only by $4.9 billion in 2012 when 15% less whistleblower cases were brought. Commentaries on the report state the increases are largely due to (1) greater protections to whistleblowers passed by Congress (2) removal or weakened contractor defenses and barriers to bringing qui tam suits (e.g. narrowing the types of public disclosures that will bar qui tam suits) and (3) expanded scope of what is a “false” claim that justifies an action under the FCA (e.g. false statements during negotiations, failure to disclose relevant information, “false” cost estimates or Byrd Amendment violations such as using public funds for lobbying activities). The commentators recommend tightening up contractors’ business ethics awareness and compliance programs, internal controls systems where early reporting of suspected irregular activity is encouraged, vigilantly investigating allegations of improper or fraudulent activity and proceed cautiously when confronted by a whistleblower.
**CASES/DECISIONS**

**Navy Failed to Conduct Meaningful Discussions**

*(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 solicitation for a fixed price indefinite quantity base services contract where the RFP contemplated a best value award based on price and six non-price factors. The evaluators of the nine proposals found that West Sound’s proposal contained two significant weaknesses related to technical approach and number of full time equivalent employees. Following discussions it submitted revised price and technical proposals where the evaluators removed it from further consideration asserting West Sound had not made sufficient changes to remove the two weaknesses. West Sound protested on the grounds that the agency did not engage in meaningful discussions because its questioning did not address concerns in the two areas. The GAO sided with West Sound stating though the Navy had asked it to amplify its technical approach it did not mention concerns about its approach. As for the FTEs, the GAO found though the agency raised concerns during a post-discussion evaluation it failed to reopen discussions with West Sound to address them (*West Sound Systems, GAO No. B-406583*).

**Agency Failed to Consider Personnel Strengths**

*(Editor’s Note. The following makes clear that contractors must make sure they receive the maximum credit possible for proposal strengths based on stated evaluation criteria.)*

The RFP for a small business set-aside for logistical support services in the Middle East and other locations stated selection would be a best value award based on technical/management, past performance, security and cost/price factors. Evaluators noted Logistics received highly favorable past performance ratings and had a reputation for using highly skilled personnel with a solid work ethic but decided these advantages were outweighed by C4’s lower price and gave them the award. Logistics protested asserting the agency improperly abandoned the stated evaluation scheme when reviewing proposed personnel. Though offerors were to be evaluated based on the extent proposed personnel met solicitation requirements the agency decided not to give more credit for personnel with higher education and greater experience where the “outstanding” rating would be eliminated and the highest rating would be “good.” In siding with Logistics, the GAO ruled the agency’s approach deviated from the evaluation scheme which clearly advised offerors that technically superior proposals would be favored over those that merely met minimum solicitation requirements. The GAO said because the agency failed to consider possible differences between Logistics and C4 it had no basis to conclude whether such a review would have changed the agency’s view of the competition. The GAO also sustained the protest because there was no indication that the agency conducted a price realism analysis as required by the RFP to determine whether prices were unrealistically high or low (*Logistics 2020, GAO B-408543*).

**NASA Should Reevaluate Proposals**

NASA’s RFP to award two ID/IQ contracts for coaching and organizational development services was to be best value based on technical merit and price performance. The solicitation required all offerors but small business to submit a small business subcontracting plan. NASA evaluators identified significant weaknesses in the way SRA addressed organizational strategic planning, proposing inappropriate labor categories and failing to address the extent subcontractors would have enforceable agreements and concluded though SRA offered competitive prices they were offset by the technical deficiencies cited. In its protest, SRA argued NASA unreasonably assigned a weakness in its proposal for failing to specify the extent of its commitment to use small business subcontractors. Though SRA failed to submit a specific exhibit on this issue the GAO found it provided goals for subcontracting with various small business categories in another format concluding that since the agency received the information it was unreasonable to assign it a weakness. The GAO also found that SRA did furnish copies of enforceable agreements that did comply with RFP provisions. Finally, the GAO concluded that NASA assigned weaknesses in an unequal manner where NASA assigned a significant weakness for failing to adequately address organization planning requirements while not assigning significant weaknesses to other proposals with equally substantial shortcomings (*SRA Int’l Inc. GAO, B-408624*).

**Suspensions for Affiliates May Exceed 18 Months**

*(Editor’s Note. The following should alert multi-segment contractors that indictment of an affiliate can result in an indefinite suspension of other affiliates even if they have done nothing wrong.)*
Public Warehousing owned Agility Defense and Agility International. The Defense Logistics Agency suspended Public from contracting privileges in Nov 2009 after it was indicted on allegations of food fraud and suspended the two Agility affiliates based solely on their affiliate status. A lower court granted the two affiliates summary judgment after 31 months of the suspension ruling the DLA could not suspend them indefinitely even though they had the power to initially suspend them based solely on their affiliate status. Afterward the government appealed this decision where Warehouse argued it could not suspend its affiliates if they had not done anything wrong and a suspension longer than 18 months violated the Due Process Clause of the Fifth Amendment.

The Appeals Court sided with the government on both issues. The Court stated FAR 9.407 clearly provides that no showing of wrongdoing is required to suspend an affiliate. The suspension of an indicted company and its affiliate constitutes one suspension affecting both entities and rejected Warehousing’s assertion that they must be treated independently from the contractor because that is how the agency treats an affiliate when assessing responsibility to perform. As for the 18 month limit, the Court ruled FAR 9.407 does provide that a suspension may be extended if the affiliate is (a) specifically named (b) given written notice and (c) given an opportunity to respond where the FAR section does set an 18 month limit “unless legal proceedings” have been initiated within that period which is the case here (Agility Def & Govt Svcs v Dept of Defense, BL 358470, 11th Cir. No. 13—10157).

Statute of Limitations Bar CAS Noncompliance Claim for Payments Made Over Six Years Prior to ACO Final Decision

(Editor's Note. The following is the latest of disputes interpreting the Contract Disputes Act's Statute of Limitations where in full disclosure we provided expert witness consulting to Government attorneys on the disputed cost accounting standards issues.)

A final decision by the ACO dated Nov. 7, 2011 determined that Flour’s practice of including premium pay ("uplifts") such as hazard pay and foreign assignment pay in the allocation base of its corporate office burden and benefit (B&B) indirect cost pool was noncompliant with CAS 403-40(a)(1) and CAS 403-40(b)(4) and demanded payment of $63 million for the increased cost that Flour allegedly billed the government on its Iraq contracts as a result of the noncompliance. Flour appealed the final decision moving to dismiss the case for lack of jurisdiction on the grounds the government’s claim was barred by the CDA’s six year statute of limitations (SOL) which provides that a claim related to a contract must be submitted within six years after the accrual of the claim. FAR 33.201 defines “accrual of the claim” as the date “when all events that fix the alleged liability of either the Government or contractor and permits assertion of the claim, were known or should have been known.” Flour argued that the claim accrued on Jan 1, 2004 which is the date the noncompliance was alleged to have started where the government’s claim was untimely because the cost accounting practices at issue were disclosed so the government knew or should have known at the time. The government argued its claim was timely because it did not know and had no reason to know that Flour’s billings were noncompliant with CAS 403 until the summer of 2006 when DCAA began auditing its FY 2004 Incurred Cost Proposal where it became evident the Iraq contract costs significantly increased because the high level of uplift costs of those contracts caused a larger allocation of fringe benefit costs to them. At an evidentiary hearing, the Board found that the government knew in 2004 Flour was paying substantial amounts of premium pay to employees stationed in Iraq and knew or should have known no later than Feb 2005 that the allocation base did include the uplifts. Accordingly, the Board ruled that payments made before Nov. 11, 2005 (six years before the final decision) were subject to the SOL prohibitions and hence not payable as a claim. However, payments accruing after this date were within the six year SOL period and hence subject to the claim where the Board stated the government could not have known about these payments until they were “performed, billed and paid” (Flour Corp., ASBCA No. 57852).

Modification Requiring Invoicing on Hours Worked Did Not Change a Fixed Price Contract into a T&M Contract

At the end of its performance period on a fixed price task order under a GSA schedule contract, the parties entered into a modification of the TO providing for a two month extension. Though the mod specified a unit price for the two month extension it did include wording that invoicing under the mod would include documentation showing “the hours invoiced for during the previous monthly period” and it would be paid “based on the hours documented.” JMA performed the two month extension and was paid where two years later, a GSA Inspector General audit concluded JMA had billed for more hours than it had worked during the extension period where the CO issued a final decision demanding payment for the alleged overbilling. The Board ruled against the government stating notwithstanding the language in the mod requiring the invoice be based on
hours worked the task order nonetheless remained fixed price. Reasons cited for its decision was the mod must be “either a fixed price or cost type, not both” where looking at the requirements of fixed price and T&M contracts, the task order met none of the FAR Part 16.601 requirements for a T&M contract (Janet Mobley & Assocs, Inc. v GSA, GBCA 2878).

NEW/SMALL CONTRACTORS

FAR Versus Cost Principles Applicable to State and Local Contracts

(Editor’s Note. As a CPA firm, we have been auditing the incurred cost and forward pricing proposed rates of contractors doing business with state and local governments and we have also provided consulting services helping other clients establish compensation analyses required by these governments (you can’t both audit and consult for the same client). Federal budget cuts are motivating federal contractors to seek state and local business while these government entities are seeing an expansion of their awards financed by federal agencies (e.g. Department of Transportation has been augmented by Homeland Security, NASA, HHS and others) who are covered by different cost principles. We will identify significant differences between FAR and AASHTO cost principles below and also how, in practice, state auditors’ questioned costs differ from those of federal auditors.)

Prior to 2001, contractors holding state and local contracts that were funded by federal dollars (most often Dept. Of Transportation) were faced with audits where state and local auditors attempted to audit either incurred cost proposals or forward pricing rates using FAR cost principles as the criteria for allowability. Auditors were often not well trained in FAR based audits where it was not uncommon for them to take a very “creative” approach where contractors were facing questioned costs they never had heard of. This problem was somewhat curtailed in 2001 where the American Association of State Highway and Transportation Officials (AASHTO) issued its Uniform Audit and Accounting Guide that has been periodically updated since. Incurred costs proposals may still be audited by state or local auditors but these local agencies are required to accept the results of a third party CPA firm audit that is paid for by the contractor or DCAA audited results. Nonetheless, it is quite common for local auditors to review results and workpapers of the other auditors and also quite common for them to substitute their own judgment and conclusions for that of the other auditors.

The AASHTO guide presents detailed guidelines for auditors to follow when auditing “Indirect Rate Cost Schedules” as well as related accounting, job-costing and labor-charging systems that serve as the basis for the schedules. Though the most recent upgrade to the AASHTO guide in 2012 is explicitly oriented to A/E firms in practice it is used when auditing all professional service firms. The audit approach explicitly alludes to both the FAR and DCAA Contract Audit Manual (DCAM) sections as their criteria of acceptability and the individual cost principles in the Guide explicitly reference their corresponding sections of the FAR. Even though the Guide is intended not to “supersede” the FAR audit there are some differences in both the content of the material and some common interpretations of the cost principles by these local auditors that we highlight here.

5.4.2 – Uncompensated Overtime. Though the DCAM is cited as the basis for this section of the Guide, one of the three methods DCAA considers to be acceptable is not addressed in this section where state auditors usually reject the approach if a contractor uses it. The two accepted methods addressed and approved are the effective rate method and the salary variance method but the Prorated Method DCAA approves of (allocating actual salary paid based on percentage of hours charged) is not addressed.

5.4.G – Purchased Labor. Though all costing issues reflect those found in the DCAM, there is no discussion on when purchased labor may use billing labor rates found in T&M contracts. Though this is considered acceptable in the federal arena, we have seen state auditors question this approach under its contracts citing the absence of discussion of this topic in the Guide.

7. Executive Compensation. There are several areas of differences here.

7.7 - Use of Matrix. The Guidance states that if the contractor does not conduct an compensation analysis (discussed below) then the auditors must use one survey – the National Compensation Matrix (NCM) – to benchmark the contractors’ compensation. This differs from DCAAs’s use of several different surveys.

7.5 - Demonstration of Compensation Analysis in accordance with Techplan and Information Systems cases as well as DCAM 6-414 and 6-414. Unlike DCAA, that will always conduct its own survey analysis if it suspects compensation is too high, the Guide allows an alternative to using the NCM survey (which yields very low results) – contractors can demonstrate they
conduct their own compensation analysis that is based on DCAM and the two cases identified above. This prescribed analysis identifies detailed steps to be taken by the contractor to determine whether compensation levels are reasonable (e.g. use reputable surveys, average survey results, disallow differences between survey results and amounts paid after applying a 10% range of reasonableness factor). Interestingly, one offset that DCAA is supposed to apply is not identified in the Guide – when fringe benefits are comparatively low, those costs are supposed to offset disallowed compensation costs.

7.11 - Bonus and Profit Distribution Plans. Unlike the DCAM the Guide stresses the distinction between these two plans where the former is allowable while the latter is not. The DCAM is careful to alert its auditors that apparent unallowable distribution of profits in small companies may not be the case while the Guide does not address this problem so it is much more common for state auditors to question bonuses as profit distributions. Also the Guide identifies specific elements that the bonus policy must include for the cost to be allowable (e.g. eligibility criteria, period of bonus plan, performance criteria).

♦ Selected Costs

Some of these costs are more limited than the FAR while some are more generous. One theme that is identified in a couple of cost principles – a cost is unallowable if it does not benefit a government contract such as a commercial contract – is frequently cited as the basis for state auditors to question bonuses as profit distributions. Also the Guide identifies specific elements that the bonus policy must include for the cost to be allowable (e.g. eligibility criteria, period of bonus plan, performance criteria).

8.2 – Advertising. Advertising costs associated with recruiting employees with skills needed only on commercial contracts are unallowable.

8.3 – Trade Shows. Labor costs for employees who attend otherwise unallowable trade shows where the purpose is to train them are allowable.

8.5 – Contributions and Donation. Certain costs that would be considered contributions and donations are identified to be allowable such as blood drives, charity dinners and disaster assistance.

8.8 – Employee Welfare. Consistent with the DCAM, picnics are considered to be unallowable but unlike the DCAM holiday meals are not identified to be unallowable.

8.12 – Idle Facilities. Whereas the DCAM states the amount of time for a facility to be idle should be limited to one year, there is no such limitation stated here.

8.14 – Bid & Proposal costs. As we see in the sales and marketing section below, the Guidelines looks for ways to challenge these types of costs. In order for B&P costs to be allowable, contractors must have written policies and procedures in place that distinguish between B&P and sales and marketing costs. In addition, “market planning costs” are considered to be activities of marketing that are unallowable, contrary to the FAR.

8.20 - Patent Costs. Though the FAR does not make all indirect patent costs unallowable (e.g. general counseling costs) the Guide does make such costs unallowable if not required for a specific government contract.

8.22 - Relocation. Though the Guide mirrors the FAR, it lists conditions not found in the FAR for which the costs “might be unallowable” including costs “which do not benefit the employee” and where “the employer does not have a consistent relocation policy for all employees.”

8.24 - Selling. Though the section addressing allowability mirrors the FAR the section on allocability is often cited as reason to question selling costs where it instructs the auditor to question such costs when they are “considered unnecessary/ unallowable to government contracts.”

8.30 – Listing of Common Unallowable Costs. The last section lists 31 categories of costs that are “generally ineligible for reimbursement on government contracts as either direct or indirect costs.” The problem is this list is often used as the basis for questioning costs by inexperienced auditors where there are many categories of expenses on the list that are not always unallowable such as advertising, trade shows, employee gifts and recreation, organization/reorganization and travel costs in excess of FTR per diem rates.

QUESTIONS & ANSWERS

Q. Our 2011 and 2012 ICP’s were recently audited by DCAA for adequacy. The auditor questioned why our G&A base included all direct and indirect costs when
in fact we do not charge G&A on direct reimbursable travel costs. I was under the impression that using total cost input for the G&A base required us to include all costs whether or not we applied G&A to each cost item in the base. I have asked the auditor if I can make a correction to my G&A base methodology but both DCAA and DCMA have been nonresponsive. My question is since this seems to be an unintentional error in methodology and I do not know when I can expect an answer from them, can I unilaterally correct my methodology starting in 2013.

A. First, you are wrong about needing to include all costs in the G&A base and I believe your idea of including only those costs that you want to apply G&A to in the base is quite acceptable. Going forward, say 2014, you can change the way you calculate and apply G&A. You need not even inform the government about the change until you submit the 2014 ICP where you might want to apply the old method to contracts awarded before 2014 and apply the new method for contracts awarded after Jan 1, 2014. As for changing the methodology in 2013 that might involve complications because you proposed and billed one way but now you would be changing the method for ICP purposes. You would need to demonstrate there was no material impact. That’s why its cleaner just to change it, effective Jan 1, 2014.

Q. We were pleased to see OMB issue the compensation cap for 2012 finally at $952,308. In your recent newsletter, you mention that the NDAA resets the cap to $625,000, which conflicts with the BBA figure of $487,000. It is very confusing. What limits are contractors to use for 2014?

A. Yes it is confusing. As of this writing, it is still up to the Obama Administration to set the amount of the cap – the $487,000 or $625,000. In an attempt to avoid retroactive application problems experienced in 1998, both acts’ caps apply 180 days after the December 27, 2013 enactment date of the acts so they will not apply to contracts until June 2014. In the meantime, the $952,308 amount should apply to all contracts awarded before June 27th. This can mean there may be two indirect cost rates for 2014 for proposal and incurred cost purposes. Recommendations we have seen to avoid this two rate scenario is (1) do not apply the new limits in 2014 but attempt to obtain an agreement to apply new rates to all contracts beginning in 2015 or (2) use the lower limit to all contracts in 2014. Hopefully, new guidance will clarify things.

Q. How can I get out of having to prepare disclosure statements for all of our segments. It’s a real pain. Can I, for example, redefine what a segment is?

A. CAS 403 as well as the definition section of the FAR provides a definition of segments. The rules pretty clearly state that segments with over $750K of cost based federal contracts must submit a disclosure statement as long as the corporation as a whole meets the CAS thresholds ($50 million contract/subcontract or total of $50 million in the prior year). I can’t figure a way out of this unless (1) the corporation does not meet the fully CAS covered threshold (2) the “segments” do not meet the definition of a segment (e.g. maybe they are “profit centers” or “off-site locations” or (3) the $750K of cost based contracts don’t apply (e.g. they provided commercial items to the government or were awarded on a competitive price basis).