GCA REPORT
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NEW DEVELOPMENTS

Congress Approves $343B in FY 2002 Defense Authorization Bill

The House and Senate ratified the final version of the defense authorization bill that authorizes $62.5B for procurement, $46.5B for research, development, test and evaluation, $123B for operation and maintenance accounts and $8.3B for environmental cleanup including Dept. of Energy facilities. Contracting related measures include:

1. Responding to reports DOD pays more than it should from lack of competition under multiple award contracts, more competition will be targeted by requiring competition on individual task/purchase orders exceeding $100,000 by inclusion of a notice to as many contractors as practicable. It dictates that offers will be received from at least three qualified offerors or the CO must determine in writing they were unable to identify additional qualified offerors despite efforts to do so.

2. Extension of the mentor-protégé program another three years through 2005.

3. Permits DOD to enter into follow-on production contracts for a limited amount of items developed under Other Transaction procurements.

4. Agencies spending more than $500 million must develop recovery audit programs designed to recover erroneously made payments.

5. Provisions that facilitate speedy purchases of supplies and services necessary to respond to terrorist, chemical or biological attacks include (a) raising to $15,000 the micropurchase threshold (b) increasing the simplified acquisition threshold to $250,000 inside the US and $500,000 elsewhere (currently $200,000) and (c) purchase of biotechnology supplies and services as a commercial item.

6. Compromising on measures that bogged down negotiators for weeks, the final version authorizes a fifth round of base realignment and closures in 2005.

Changes to the DCAA Manual

The Defense Contract Audit Agency Contract Audit Manual (DCAM) is the two volume "bible" of DCAA and its auditors. Important changes to the July 2001 (the Government Printing Office is late) DCAM include:

Chapter 2 (Auditing Standards). Explicitly incorporates government auditing standards (the Yellow Book developed by the Comptroller General) which are also known as GAGAS and the American Institute of Certified Public Accountants' (AICPA) Attestation Standards that cover less complete "audit" assignments such as "examination", "review" and "agreed to procedures" (the latter generally covers the more common direct and indirect rate reviews we encounter).

Chapter 5 (Internal Controls). New guidance on contractors' internal controls including the need to test key internal controls every 2-4 years and how to assess control risks when conducting internal control audits at non-major contractors.

Chapter 6 (Incurred Cost Audits). Provides new guidance on (1) classifying cost proposals as high risk that requires audits each year (2) enumerates the procedures to be performed during a desk review of low risk incurred cost reviews (3) additional criteria for what constitutes an adequate billing system at major and non-major contractors (4) reviewing and approving interim public vouchers submitted to the auditor and (5) clarifies that a rate agreement must include Cumulative Allowance Cost Worksheets (CACWS) that reflect cumulative costs settled in earlier years to be used by the CO to close out contracts.

Chapter 7 (Selected Areas of Cost). New guidance covers (1) leases reclassified as capital leases that may result in depreciation and cost of money being greater than the leasing costs and if so, instructs auditors to determine if impact is material (2) detailed examination of split-dollar life insurance costs (sharing of premiums between employees and employers) and deferred compensation plans (3) special circumstances when up to 300 percent of per diem rates may be acceptable (e.g. must stay at a prearranged hotel for a conference,

travel to areas where subsistence has escalated for short periods) (4) accounting changes made in the method of measuring income for long term contracts as a result of tax changes should be considered a unilateral accounting change while other changes required by tax laws should be considered a desirable change (i.e. not detrimental to the government's interests) (5) if warranty costs are included as a separate contract line item the auditor is to verify this is consistent with the contractor's disclosed practices and is compliant with CAS 402 (6) the threshold for submitting a CAS Disclosure Statement has been increased where a contractor together with its segments receives net awards of CAS covered negotiated contracts totaling $50 million in its most recent cost accounting period and (7) alerting auditors that restructuring activities may result in cost accounting changes (e.g. change from a value added to total cost input base for G&A costs).

Chapter 8 (Cost Accounting Standards). Incorporates recent CAS Board, FAR and DFARS final rules that (1) increase the threshold for full CAS coverage from $25 million to $50 million with the addition of a $7.5 million "trigger" contract (2) adds and modifies exemptions to CAS (e.g. firm fixed price contracts based on competition without any cost or pricing data and fixed-price contract with economic price adjustments provided the adjustment is not based on costs incurred) (3) delegates CAS waiver authority to executive agencies under certain circumstances (4) provides more definitions of the types of accounting changes (5) exempts accounting practice changes resulting from an external restructuring activities from inclusion in the cost impact process and (6) adds new examples to illustrate the meaning of the cost accounting standards.

DOD Releases Handbook on Procuring Commercial Items

The Defense Department December 3 released a new handbook designed to help acquisition personnel to develop strategies for procuring commercial items. The guidebook appears to expand opportunities to use commercial items. It states the definition is broad, encompassing "items that have been offered for sale to the general public but not yet sold, items that have been sold but not in substantial quantities and items requiring modifications customary in the marketplace or minor modifications unique to the government." Only after careful review of the definition and the gathering of significant market research that the item is not commercial should the acquisition professional consider the item government-unique. Market research should be conducted in greater depth and if it indicates commercial items may not be available, the needs of the acquisition parties should consider restating its needs to permit use of commercial items. When the market research indicates no commercial items exist, the presolicitation synopsis should notify offerors that interested parties have 15 days to indicate their ability to satisfy the requirement with a commercial item. The handbook also emphasizes commercial item definition is not limited to prime contractors but also subcontracted items where the prime contractor is responsible for determining whether items supplied by the subcontractor are commercial.

Though many commentators have noted the handbook does little to expand opportunities to provide time and material and labor hour professional and technical services as a commercial item. However, the handbook does suggest some limited strategies such as (1) use of an ID/IQ contract with established fixed hourly rates that permit negotiating orders and (2) using a "sequential contract" that acquires requirements in "modular components" – for example, a preliminary cost type "diagnostic" effort allowing the contractor to understand the scope of work followed by a larger requirement on a firm-fixed price basis.

Current Status of Streamlining FAR Cost Principles

In a recent interview discussing current progress to date of a government review of ways to streamline the FAR Part 31, Ms. Deidre Lee, Director of DOD Procurement, stated that there are 17 specific areas of the FAR where individual proposals will be issued in the near future, 8 areas currently under consideration for change and 7 areas the committee has decided not to take action. In the areas where change will occur, the committee is formulating specific proposals but they will not be known until each one is issued separately. The areas where changes will be made include composition of total cost, determining allowability, direct costs, indirect costs, pension costs, deferred compensation, post-retirement benefits, cost of money, gains and losses on disposition of assets or impaired assets, insurance and indemnification, maintenance and repair, other business expenses, transportation and deferred IR&D. Areas being considered for change include accounting for unallowable costs, depreciation, economic planning costs, employee morale, health and welfare, IR&D/B&P, selling and travel costs. Areas where industry or government has recommended changes but the committee decided not to take action include:

1. Change the basis of allocation of cost in the FAR from "benefits" to the CAS concept of "causal/ beneficial" basis (FAR 31.201-4). In their effort to change the FAR, industry states the need to identify a "benefit" to allocate costs to a contract differs from the cost accounting standards requirement to identify a "causal/beneficial" connection. They point to a problem in two recent cases (*Boeing* and *Northrup*) where allocation and allowability were confused and the boards failed to realize that all costs are allocable to contracts including unallowable costs. The committee indicated the two cases involved legal defense costs where the government should not have paid and no change should occur based on what could happen in the future.

2. Eliminate the prohibition against accrual of severance pay (FAR 31.205-6(g), Severance pay). The committee said the change is inappropriate because the prohibition on accrual of mass severance does not result in the government paying less and if accruals were permitted, there would be many disputes regarding what is and is not a valid liability.

3. Remove the requirement to charge special tooling and special test equipment costs direct (FAR 31.205-40(b). The committee believes the current language is consistent with the CAS and FAR definitions of a direct costs and concepts of cost allocation.

4. Eliminate for non-CAS covered contractors FAR 31.205-52, assets valuations resulting from a business combination because non-CAS covered contracts do not represent significant risk to the government. The committee says the cost principle is needed to uphold the long-standing policy that the government should not be impacted by a change in business ownership.

In addition, the committee addressed efforts to (a) redefine "cost" (b) distinguishing between accounting for a credit and remitting it to the government and (c) define sale-leaseback and proper disposition of costs concluding current FAR, CAS and GAAP coverage is adequate.

The committee also rejected industry calls for a "blank slate" approach that would address broader questions such as why have a concept of "allowability" and the financial health of the defense industry and need to access cutting edge technology available in the non-government commercial sector. The committee stated the scope of such "big picture" issues would make it difficult to implement timely revisions at this time and that she was committed to getting things done now rather than waiting five years to pursue the broader approach.

FAC 2001-02 and 2001-03 Issued

Taking effect February 19, 2002, Federal Acquisition Circular 2001-02 issued nine new rules. Significant rule changes include:

1. Changing FAR 15.306(d), the new rule clarifies that while the government must discuss deficiencies and significant weaknesses in a proposal as well as certain adverse past performance information during discussions, the contracting officer need not discuss every area where a proposal could be improved.

2. The Prompt Payment coverage of FAR 32.908(c) and the clause in FAR 52.232-25(d) are amended to now require contractors to notify the CO if it becomes aware of an overpayment by the government. Also, contractor must now include an invoice number on its invoice and the rule clarifies that when the government erroneously rejects a proper invoice the interest clock starts on the date the original invoice was received.

3. The rule finalizes an earlier interim rule that added a new FAR 39.1 which prohibits the use of minimum experience or education requirements for contractor personnel in solicitations for IT services unless the CO first determines the needs of the agency cannot be met without such a requirement.

4. The rule finalizes an interim rule which amended the FAR to convert the size standards in the FAR that were based on the Standard Industrial Classification (SIC) system to the North American Industry Classification System (NAICS).

Also, the final rule restores the unique FAR Part 25 definitions of "component" and "end product" for acquisition of supplies for use in meeting Buy American Act and Balance of Payment Program requirements.

FAC 2001-03, issued December 27, revokes the much-maligned Clinton era rule setting increased responsibility on federal contractors. The revocation of the Contractor Responsibility rule – commonly called the "blacklisting" rule - makes permanent a stay issued earlier in the year by the Bush administration. The rule, dating back to 1997, attempted to link federal contract awards with compliance with federal labor, tax, employment, environmental, antitrust, and consumer protection laws.

BRIEFLY…

New Contract-Related Interest Rate Set for First Half of 2002

The Treasury Secretary has set a rate of 5.50% for the period January 1 through June 30, 2002. The new rate is a decrease over the 5.875% applicable in the last six months of 2001. 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).

FedBizOpps Becomes a Reality

Effective January 1, federal agencies must use the FedBizOpps website to provide public notice of procurement acquisitions valued at more than $25,000. Agencies are no longer required to publish solicitations in the Commerce Business Daily. The website address is: http://www.fedbizopps.gov.

FAIR Lists Released

The Office of Management and Budget, as required under the Federal Activities Inventory Reform (FAIR) Act, released its second and third lists of federal activities that are not considered "inherently governmental" and hence capable of being contracted out. The second set, released in November, covered 34 agencies (e.g. EPA, Interior, OPM) and the third, released in January, covers 17 agencies (GSA, NASA, Departments of Energy, Transportation and Veterans Affairs). The Department of Defense, by far the largest, has not yet released their list. FAIR requires federal agencies to complete by June of each year (they are late) lists of commercial type activities that can potentially be contracted out to the private sector. The legislation does not mandate private transfers but expansion of such transfers is expected under the Bush Administration's commitment to increase competitive sourcing. Though individual contractors are unlikely to ferret out potential outsourcing positions affecting them, industry groups will (or should) be focusing on those positions most likely affecting their members.

TRAVEL…

Alternatives to Flying are OK When Fearful of Flying

Following September 11, the General Services Administration (they administer travel regulations) has issued an advisory giving permission to agencies to approve, on a case-by-case basis, alternative modes of transportation for those travelers expressing genuine concerns about flying, even if flying is quicker and less expensive.

No Reimbursement for Alternative Transportation When Seat is Voluntarily Given Up

The civilian employee voluntarily gave up his seat on the last leg of his trip on an overbooked flight and instead of staying over and catching another flight, he rented a car and drove home. He turned in the unused portion of the ticket and sought reimbursement for the car rental. The appeals board ruled against the reimbursement stating though the Federal Travel Regulations permit employees to voluntarily vacate a seat if it does not interfere with their duties the employee must bear any additional expenses (GSBCA 15523-TRAV).

No Reimbursement for Dual Lodging Without Efforts To Minimize Costs

An employee stayed at a guesthouse for its temporary 4 month assignment during which time she was assigned to two trips and took annual leave. The agency reimbursed her for all lodging expenses except for the time away claiming it had reimbursed her for lodging during her two official trips and employees are not entitled to per diems during annual leave. The employee asserted she needed to keep the room since she would not have priority when she returned. The Board ruled against her stating she could have reserved the room when she returned and she would be entitled to the dual lodging only if she took steps to minimize the expenses in accordance with FTR Section 301-11.16. Unlike another case where the employee inquired about availability of quarters and was told if they checked out there would be no rooms available, in this case, no inquiries were made and hence she was not entitled to be reimbursed (GSBCA 15482-TRAV).

Can't Recover for Using Flight Coupons

Instead of purchasing his airfare, an employee redeemed flight vouchers he received for relinquishing his seat

on a previous flight for personal travel. When he presented the voucher to recover cost of airfare to his destination ($361) the agency refused payment explaining since he had not incurred the expense he was not entitled to it. The Board rejected his appeal stating their policy is redemption for frequent flyer miles or coupons acquired on personal travel may not be reimbursed at the supposed value of the tickets because of the difficulty of ascertaining their value and the problems associated with controlling reimbursement (GSBCA 15636-TRAV).

CASES/DECISIONS

Acceptable to Charge Certain Indirect Subcontract Costs Directly Under a Termination

The contractor received a contract that included subcontract costs for fabricating special tooling/special test equipment (STE) where the subcontractor would recover its costs indirectly through depreciation over three years of anticipated production. This did not occur because the contract was terminated. The prime and subcontractor negotiated an amount for the subcontracted STE costs and sought recovery under FAR 31.205-42(d) where the loss of useful value of STE costs would generally be an allowable cost on a contractor's termination settlement. The Army rejected the cost because (1) the contract did not provide for STE fabrication (2) to allow the cost could result in double recovery under FAR 31.205-42(d)(3) – the loss of useful life costs needs to be allocated to all contracts that use STE and (3) the termination proposal called for direct charging of an item that was previously charged indirect.

The Appeals Board sided with the contractor stating though the contract did not directly call for the fabrication it did not preclude it. The Board noted there was knowledge about the STE fabrication – e.g. the subcontract specifically contemplated STE acquisition or fabrication. The Board also rejected the double recovery argument because it applies only when other contracts can use the STE and here the value of the assets applied only to the terminated contract. Finally, the Board rejected the government's contention that the loss of useful value did not apply if the STE costs had been charged indirectly prior to termination because, as is common under a T for C, the termination resulted in the need to treat the STE costs differently than they normally would have been treated (General Dynamics Land Sys. Inc., ASBCA No. 52283).

Ambiguous Workpapers Justify Denial of Bid Correction

(Editor's Note. The following illustrates the need to keep proposal workpapers clear and in order)

Contractor submitted a $726,000 bid for a fixed price contract where the government estimated the job at $883,000 and the next bid was $969,000. When the agency requested confirmation of the bid, the contractor submitted a letter requesting an upward bid correction of $157,000 stating the clerical staff had made significant errors transcribing the owner's handwriting and calculating bid prices. To support the request, the contractor submitted original worksheets, a "contract cost proposal" and revised bid schedule showing the "alleged intended bid" along with subcontractor quotes. None of the documents were dated and no sworn affidavits from the vice president or clerical staff were submitted in support.

The GAO denied the request to correct the bid ruling the original bid had to stand or the contractor had to withdraw it. The GAO stated there must be "clear and convincing evidence that establishes the existence of a mistake" which must be supported by statements and supporting evidence that can include workpapers if they are in good order and indicate intended price. The workpapers presented were undated with no supporting documents showing when and how they were prepared. Also, there were too many ambiguities full of cross-outs and unclear handwriting making it impossible to determine what the intended bid price was (Si-Nor Inc. GAO, B-288990).

Agency Can't Eliminate Offer Without First Considering Price

A best value procurement was offered where evaluation factors, in descending order, were price, management, past performance and schedule. The protester was rated equal to awardee in management, inferior under past performance and scheduling but had the lowest price. The agency eliminated the protester from further consideration stating it would first eliminate the lower technical proposals and consider the prices of only the most highly rated offerors. The protester argued that the RFP stated price was the most important factor and the agency erred in not considering price at all until firms were eliminated. The GAO agreed with the protester stating price must always be included in any RFP as an evaluation factor and an agency cannot eliminate a technically acceptable proposal from consideration without taking into account the relative cost of that

proposal. To do otherwise is contrary to the agency's obligation to evaluate proposals under all stated criteria, including price. The GAO ordered the agency to perform a cost/technical tradeoff in accordance with the terms of the RFP (A&D Fire Protection Inc. GAO B-0288852).

Government is Not Unjustly Enriched by Unanticipated Currency Fluctuation

(Editor's Note. Be sure to provide a contingency or at least negotiate a price adjustment clause for currency fluctuations.)

The contractor was awarded a contract to be performed in Greece and bid in Greek drachmas. Though it had increased its bid 2% to hedge against a currency devaluation the drachma depreciated 15% against other currencies resulting in receiving less dollars for its fixed price contract. It submitted a claim for the loss asserting the US government was unjustly enriched because it was able to pay the drachma-priced contract with fewer dollars that it had intended concluding it was "unconscionable" for the government to obtain the unintended benefit at its expense. The Appeals Board rejected its claim stating the fixed price contract without price adjustments was a "conscious gamble with known risks" akin to an estimating error which under a fixed price contract is generally the contractor's responsibility (Elter S.A. ASBCA 52792).

No Eichleay Recovery For Termination that Preceded Performance

(Editor's Note. The following provides some insights into the limits of recovering unabsorbed overhead when little or no work is performed.)

The Army Corps of Engineers suspended a $1.4 million contract when a disappointed bidder filed a bid protest and instead of reactivating the contract, it was terminated nine months later. In its termination settlement proposal the contractor sought reimbursement of $187,000 for direct costs, associated overhead and profit as well as $388,000 for nine months of unabsorbed overhead where it claimed it was proper since it was forced to remain on standby (a condition for using the Eichleay method) for the period. The agency accepted the first part but rejected the unabsorbed overhead asserting no recovery was possible since the contractor could not establish actual days of contract performance and actual contract billings, both prerequisites for using the Eichleay formula. The contractor proposed it could be made whole by using a modified version of Eichleay where the original contract price could be the amount of "contract billing" and the anticipated period of performance could be the "actual days of performance."

Though the court expressed sympathy for the contractor who it recognized was forced to remain on standby for nine months it ruled no recovery under the Eichleay formula was possible because the contractor could not establish actual days of performance and actual billings. It stated the Eichleay formula was the exclusive formula for determining unabsorbed overhead and the application of that formula in this case yields a recovery of $0. It also stated it was not free to apply the alternative formula since a prior case (*Capital Elect. Co.*) rejected this alternative to the Eichleay formula (Nicon Inc. V. United States, Fed. Cl. No.990982C).

NEW/SMALL CONTRACTORS

Some Indirect Rates You May Want to Adopt

For a number of reasons our clients and readers have been more frequently asking us about adopting different indirect costing methods. Though the motivation may be the desire for more accurate accounting, more often the incentive is evenly divided between *increasing* recoveries on new contracts without affecting existing contracts and *lowering* indirect rate allocations to be more competitive. Using numerous texts (especially "Accounting for Government Contracts", edited by Lane Anderson) and our experiences we have identified common practices we have observed in industry that have proven useful to clients. In this first of two articles, we will focus on typical choices found in manufacturing environments which should also be of interest to service and professional firms since innovative changes in most environments come from manufacturing firms (e.g. material and subcontract handling, multiple department rates). In the second article we will focus on handling fringe benefits, support and service centers, G&A and home office costs for all firms with single and multiple locations. These two articles are not intended to cover all conceivable alternatives but touch on the most common. Analyzing the pros and cons of one method over another as well as how to get changes approved by the government will be covered in later articles.

Common Manufacturing Pools and Bases

Generally costs are not recoverable unless the indirect cost pools and bases are pre-established. For example,

costs of handling material cannot be proposed or recovered unless they are separately identified and established in a material handling pool. Manufacturing firms can be considered labor, material/subcontract or capital intensive and each often calls for using different types of indirect rates.

♦ **Labor intensive Firms**

Some firms may use a single manufacturing pool while for many more diverse and complex organizations additional cost pools may be appropriate. Separate pools are most commonly established by departments that may include fabrication, assembly, tooling, testing, quality assurance, inspection, machine shop, paint shop and welding. Though we rarely see indirect rates for each department, multiple rates are not unusual depending on their relative significance to others. Though multiple rates could be used, one or two can be decided upon, especially when there is no material differences between rates in multiple departments. On the other hand, more pools than necessary may be used even when there is little difference when companies, for example, want to track activity under different managers.

When a firm is labor intensive, the allocation base used for most cost pools are direct labor hours or direct labor dollars. Labor dollars have tended to be more favored because it is not affected by inflation – labor costs increase in proportion to the pool - while labor hours will tend to increase rates under inflationary conditions. The drawback to using labor dollars occurs when the labor base includes a wide range of wages and salaries resulting in increased allocation to higher paid labor activities. Generally, if the pool of expenses to be allocated are more closely related to the number of employees then a labor hour base is preferable; if the pool is more related to compensation then a labor dollar base should be used. Some cases (e.g. *Brown Engineering*) have ruled that premiums, bonuses and other pay differentials should be excluded from a direct labor dollar base.

In manufacturing companies where labor is decreasing as a percent of total cost firms may adopt activity based costing applications where labor bases give way to other allocation schemes. Common bases are machine set-ups, set-up hours, standard processing times, items inspected, engineering changes, drawings, routing, etc.

♦ **Material Intensive Firms**

When a firm is material intensive then material related cost pools should be considered. Material related costs might include material handling costs (e.g. unpacking, inspection, moving from and to storage) as well as purchasing and ordering. The government may object to allocating a significant amount of material related cost on a labor base asserting there is little correlation (i.e. casual/beneficial relationship). Using a labor base for material oriented costs may also be inconsistent with a company's goals – for example, for contracts with a relatively heavy material component and lighter labor cost, recovery would be less. Conversely, contracts containing a relatively high labor component may attract a disproportionately large amount of indirect costs which may or not be desirable. If material is used uniformly on all jobs then a separate pool is unnecessary. If labor costs are insignificant, then a material base may be appropriate for all indirect costs. Multiple material related pools may also be necessary - for example, when both material and customer-furnished material are significant and their proportionate use on contracts differ, then separate pools and bases may be needed.

A variation of a material related pool is a subcontract administration pool. A separate pool may be needed if subcontract related expenses are significant and are not incurred in the same ratio as material costs. We have seen a wide variety of costs included in subcontract handling pool from ordering and administering subcontracts to proportionate shares of engineering, marketing and research and development costs. Generally, direct subcontract costs are the allocation base.

When activity based costing is used, potential allocation bases for material costs may include the size of material, number of items, number of times material is moved within a facility, number of purchase orders, etc. We have seen numerous pools of material related costs divided by a variety of materials where the cost of one category was allocated to contracts based on number of purchase orders while the cost of another category was allocated to contracts on the number of items handled.

For *capital intensive* companies, other allocation pools and bases may be appropriate. Capital intensive manufacturing usually translates into equipment intensive so pools and bases are more oriented to equipment usage. For example, the costs related to a machine shop may constitute a separate pool using a machine hour base. DCAA has come up with guidance for allocating special facility costs where there is a preference, in descending order, for (1) use basis for allocation where predetermined rates are set for a year and the variance credited to overhead (2) allocation

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based on direct charging of specifically identifiable costs and allocating the rest to overhead accounts and (3) allocation to normal overhead cost pools.

♦ **Other Manufacturing Rates**

Spare Parts. To price spare parts more accurately, you may want to pool costs associated with handling, packaging, shipping and storing spare parts and allocating them on such bases as cost of spare parts or number of items shipped. In selecting a base, you need to consider circumstance – if number of items on an order can vary widely inequities can result if the allocation base is number of shipped items.

Field Service Pools. When field or customer services at off-site locations are significant and especially when such activity for different products or projects are unequal then one or more field service cost pools may be necessary including training of customer personnel, warranty repairs, liaison with operating personnel as well as fully burdened labor costs including allocations of fringe benefits, facilities costs, etc. The allocation base is commonly direct labor dollars or hours.

Process Cost Pools. Sometimes costs are accumulated by the various processes a product goes through before completion rather than on a job or contract basis. Indirect costs not identified with a process must still be allocated to output or equivalent units under the full-absorption concept of government accounting. Though a direct labor base is commonly used, rates can sometimes be quite high especially when the labor component is small. Alternative allocation bases might be machine hours, units of output or product cost.

QUESTIONS & ANSWERS

Q. We have several demonstration units we use for generating sales. Since we depreciate them, can we include them in our net asset base for computing cost of money?

A. I took a quick look at CAS 414 (Cost of money) CAS 404 (Capitalizing assets), CAS preambles, GAAP and FAR and could find nothing that would indicate you cannot apply cost of money. The units are consistent with the CAS definition of a capital asset as "having physical substance, more than minimum value and is expected to be held by an enterprise for continued use or possession beyond the current period for the services it yields." The demo units also are not included in the type of assets explicitly denied cost of money – e.g. land held for speculation, idle facilities, assets used for resale. The only thing I can see preventing cost of money is if the demo units are items held for resale which appears not to be the case.

Q. If an employee does not complete their timesheets (they are sometimes out of the office unable to complete their timesheets on time) before we submit payroll we are told we have to input time for them in order for them to be paid (it's a state law). However inputting time for employees would be a violation of government timekeeping policies. What should we do?

A. One solution that comes to mind is to create a "dummy" account where the hours are identified for payroll purposes and the costs are reflected as an overhead "job" account. When the employee can, he will credit the "dummy" hours from the timesheet and charge the appropriate hours. There, of course, must be an adequate audit trail to track these transactions.

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