GCA REPORT
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NEW DEVELOPMENTS

New Contract-Related Interest Rate Set for First Half of 2005

The Treasury Secretary has set a rate of 4.25% for the period January 1 through June 30, 2005. The new rate is a decrease from the 4.50% rate applicable in the last six months of 2004. 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) (Fed. Reg. 38,952).

New Survey on Government Services Contractors

The accounting firm of Grant Thorton released its 2004 survey Nov. 22 of services contractors with some interesting statistics. 120 companies responded to the survey indicating that 79 percent of their revenue comes from the federal government (46 percent from DOD, 33% from other federal agencies). Some interesting results were:

1. Mergers and acquisitions among federal contractors is continuing at a rapid rate, citing 42 percent of the surveyed firms indicating they have been approached in the last year to sell their company. Of the acquiring companies, 79 percent said the acquisition met or exceeded their expectations while 21 percent said it failed to do so.

2. The government's increasing reliance on General Services Administration schedule contracting has helped boost profit margins. The survey found 45 percent of respondents said their margins have improved in part because selling off the schedules means less competition.

3. Respondents were profitable across all revenue ranges. The pre-tax income figures increased, indicating that the respondents were "absorbing growth in their companies without diminishing profits."

4. Staffing shortages are a significant problem where around 40% of respondents said staffing shortages have adversely affected pursuit of new business, 6% of their technical positions remain unfilled, 48% had increased their recruiting budget, the average wage increase was 5.1% and 41 percent of direct charging employees worked at a client's facility (down from 50% last year).

5. Only 10% of respondents filed claims under their contracts. 21% of the companies said they consider their procedures for identifying claims related to out-of-scope work "very" effective while 79% believe their procedures are only "somewhat" effective. The survey concluded that it appears that many companies are not fully compensated for the work they perform.

6. 24% of the companies said their executive compensation exceeded the statutory ceiling for reimbursement under federal contracts and 37% of the companies reported clashing with federal auditors over executive compensation (up from 24% last year). At companies where executive compensation has been an issue with government auditors, 59% considered the auditor's methodology for challenging the reasonableness of compensation – usually based on an average determined from several different compensation surveys – to be invalid and offered their own compensation surveys in response. 46% said their positions on compensation were sustained while 32% said the dispute was resolved by reasonable compromise. 22% said the dispute was still pending or the government prevailed.

7. 70% of the respondents are authorized to submit invoices directly to the paying office without review by COs or auditor. 88% are very satisfied or somewhat satisfied with the timeliness of government payment while 40% reported that when the government is late

in paying its invoices, it automatically pays prompt payment interest.

New GSA Report Cites Significant Deficiencies of Contract Compliance

After finding "significant deficiencies" at three regional Client Support Centers (CSCs) the General Services Administration's Office of Inspector General issued a report after expanding its audit to eight CSCs. The report has generated considerable Congressional comments and can be expected to attract a great deal of attention. Deficiencies found include:

- Of the 204 task orders reviewed, 118 (58%) were awarded without adequate competition
- Numerous task orders for services exceeded the maximum order threshold at which point regulations direct the government to seek quotes from additional contractors
- For some of the task orders, the majority of work was performed by a different contractor than the awardee (called a "pass-through"). Some of the pass through work had fees of 10% or more applied where there was insufficient documentation demonstrating the awardee's contribution
- Contractors were asked to perform work or provide equipment that were not within the scope of their contract vehicles
- The small business 8(a) sole source authority was not appropriately used
- Unjustified extensions of task order performance periods were observed
- There were several problems with time and material task orders including (a) no justification for using time-and-material task orders (b) many task orders did not specify maximum amount of funds (ceilings) to be expended on the project and (c) there were incorrect and often higher billing rates used
- Numerous instances of inappropriate payments for work that was substandard, incomplete or never delivered, including unsubstantiated costs and equipment substitutions with substantial mark-up costs.

DOD Issues Interim Rule Lifting Contract Cap to 10 Years

The Defense Department has wasted little time in issuing an interim rule raising the cap on new task order/delivery order contracts, raising the limit to 10 years from five after recent passage of the FY 2005 DOD Authorization Act. Last March, DOD published an interim rule capping all new TO/DO contracts at five years, including extension options. Contractors strongly opposed the five-year cap as too short but certain members of Congress expressed concerns that extending options periods are used to extend TO/DO contracts resulting in lack of competition so the 10-year cap is seen as a compromise solution (Fed. Reg. 74992).

DOD Sends Out Pay Surveys to 10,000 Contractors

The Labor Department's Office of Federal Contract Compliance Programs (OFCCP) has proceeded with its plan to mail mandatory pay surveys to 10,000 randomly selected federal contractors, despite an upcoming evaluation by a private consulting firm that is expected to result in the demise of the survey. The survey was developed in 1999 and requires contractors to submit detailed information on the compensation, personnel activity and tenure of full time employees by race and gender. Members of employer groups have attacked the usefulness of the survey, complaining about the burden of completing it, while employee advocacy groups have maintained it is useful in detecting discrimination. OFCCP retained Abt Associates in 2002 to assess its usefulness and was hoping to avoid mailing in 2004 but since the study would not be complete until February, it sent out the surveys as required by law. During the last two years, respondents have been given a 90-day deadline to file the survey so that timeframe may give contractors reason to delay submitting their responses, in anticipation of additional action by OFCCP once the Abt report is reviewed.

DCAA Guidance on Using Sarbanes-Oxley Audit Effort

The Defense Contract Audit Agency Nov. 8 issued guidance reminding its auditors to discuss with contractors at their annual planning meeting the audit work performed by the contractor in support of Sarbanes-Oxley Act requirements. Auditors are told to identify opportunities for "relying on the contractor's efforts." Section 404 of the Act – on Management Assessment and Internal Controls – requires companies registered with the SEC to certify financial and other information contained in their quarterly and annual reports filed with the SEC. Also they must include in their annual filing a management report on the company's internal controls over financial reporting as well as an independent auditor's attestation report on management's assessment of internal controls. Accordingly, DCAA auditors should determine the potential for opportunities for (1) relying on the work

performed by the contractor so DCAA effort may be reduced during their internal control audits and (2) performing coordinated audits with the internal and external auditors to avoid duplication and reduce overall costs of audits to the company and the government.

Omnibus Bill Allows Use of Revised OMB A-76 Guidelines

The House and Senate conferees on the 2005 Omnibus Appropriations bill deleted language that would have banned use of the Bush Administration's revised guidance on private versus public competitions. The Omnibus bill, totaling $388 billion in discretionary spending for many federal agencies, runs counter to the 2005 defense spending bill that makes it harder to contract out to the private sector for DOD work. Public versus private competitions are governed by guidance from the Office of Management and Budget (OMB) Circular A-76 where the Bush Administration last year revised the circular to streamline procedures intended to increase outsourcing of non-core government functions. Unlike the DOD Act, the Omnibus Act now allows use of streamlined procedures for competitions of 11-65 full-time equivalents, bars the need for a most efficient organization (MEO) – that is an in-house best offer – where the private sector must beat the MEO by a 10 percent or $10 million margin (whichever is less) and bars the requirement that the contractor cannot receive an advantage for a proposal that would reduce costs through differences in health plans. The Democrats largely oppose use of the streamlined procedures while Republicans basically are for them.

SBA Attempts to Restructure Size Standards Again

Five months after scrapping its initial attempt to revamp small business size standards the Small Business Administration is now taking another stab at revising those criteria which are used to determine whether a business is small. It is seeking comments from industry and the government and will be holding public meetings across the country to address such areas as approaches to size standards, whether employment size or revenue should decide and whether there should be separate size standards for federal procurements. Much to the relief of contractors the SBA withdrew its controversial restructuring of size standards last July where the proposed rule sought to reduce the current 37 size standards based on either employee size or revenue to 10 size standards most of which would be employee-based.

SDB Price Evaluation Adjustment Ends at Civilian Agencies

The authority to use the price evaluation adjustment for Small Disadvantaged Businesses (SDBs) is no longer in effect for civilian agencies according to a Civilian Agency Acquisition Council letter 2004-04. FAR Subpart 19.11 authorizes civilian agencies to apply a price evaluation adjustment to competitive acquisitions in the authorized NAICS industry subsector to benefit certain SDBs at the prime contract level. The letter follows notification from the Small Business Administration that the program lapsed, effective Dec. 9. The authority remains in effect for the Defense Department, NASA and the Coast Guard and the statutory government-wide goal of 5 percent contracting with SDBs still remains.

SBA Requires Recertification of Small Business Contracts After a Merger or Acquisition

All novated or change-of-name agreements executed under FAR 42.12 after December 21, 2004 must recertify their small business status after a merger or acquisition. The new policy, intended to more accurately monitor contract awards when a small business is purchased or merged with a large business, recognizes that a business can be legitimately small when it is awarded the contract but becomes a large business after the merger. In the past, companies did not need to recertify if they transferred a contract to an acquiring business.

In the novation process, once a small business has been acquired by means of a purchase or merger, the contract is rewritten to reflect the transfer of ownership and the small business owner must reaffirm its small business status by submitting a written self-certification statement to the CO. Once the small business status has been established by the new owner, the CO can count the contract toward the agency's small business contracting goals. When the small business becomes part of a large business then federal contracts transferred to a large acquiring business need to be properly accounted for as a contract now held by a large business.

FAR Council Issues FAC 2001-26 and 27

The FAR Council issued amendments to the FAR under Federal Acquisition Circular 2001-26 published Dec. 20 and 2001-27, published Dec. 28. Significant changes include:

Penalties on Unallowable Costs. FAR 42.209(b) and FAR 42.709-6 have been modified to increase the threshold of contracts subject to imposition of penalties on expressly unallowable costs in a claim for reimbursement from $500,000 to $550,000. The threshold increase is intended to reflect inflation.

Electronic Updates of Reps and Certs. Starting Jan. 1, federal contractors must submit all of their required representations and certifications online to a central location and update them on at least an annual basis. The changes implement the "On-line Representation and Certifications Application" (ORCA) where a new contract clause will be included in solicitations – other than those for commercial items – requiring vendors to attest at the time of their offer submissions that their reps and certs are current, accurate and complete. Once implemented, ORCA will be considered the authoritative source for vendor-completed reps and certs for the entire federal government. The reps and certs will be provided electronically via the Business Partner Network (BPN) at website http://orca.bpn.gov.

Special Emergency Procurement Authority. The rule allows COs to expand use of Simplified Acquisitions and Commercial Item procedures when acquiring supplies or services that are to be used in support of contingency operations or to facilitate defense against or recovery from nuclear, biological, chemical or radiological attack. This change coincides with a memorandum issued by Deirdre Lee, the director of defense procurement and acquisition policy that announced the micro-purchase threshold for acquisitions outside the U.S. for the above-described conditions will be raised to $25,000 (currently $2,500) and the simplified acquisition threshold increased to $1 million (currently $100,000).

Notification of Employee Rights Concerning Payment of Union Dues. FAR Parts 2, 22 and 52 are amended to implement Executive Order 13201 and related Labor Department rules. The rule requires government contractors and subcontractors to post notices informing their employees that under federal law they cannot be required to join a union or maintain membership in a union to retain their jobs and also advices employees who are union members that they can object to use of their union dues for certain purposes.

DOD Proposes to Revise EVM Policy

The Defense Department is proposing to change policy on use of Earned Value Management (EVM) systems. EVM is "an integrating project management tool that facilitates improved planning and control of cost, schedule and work scope" that integrates work scope, schedule and cost information to create a picture of performance. EVM is not new to DOD but the new policy will increase the current $6.3 threshold to use EVM on cost type contracts, subcontracts and other agreements to $20 million. For contracts of $50 million and more, DOD's policy would require the Defense Contract Management Agency to validate contractor EVM plans. EVM would be optional on fixed price contracts. The new policy also seeks to standardize the EVM format by requiring use of the American National Standards Institute/Electronic Industries Alliance Standard 748 (ANSI/EIA-748). DOD has published new DOD contract clauses to incorporate the changes that can be found at http://pmcop.dau.mil/simplify/ev_php.

DOD and OPM Consolidate Security Investigations

The Defense Department announced November 22 that it was moving some 1,850 Defense Security Service employees to become employees of the Office of Personnel Management as of February 20, 2005. The stated purpose of the move is to create a uniform and more efficient process to handle the government's personnel security investigations.

DECISIONS/CASES

Level-of-Effort Offer Shifts Risk and Prejudices Other Offerors

An RFQ for an environmental assessment contract called for six tasks to be provided on a firm fixed price basis for completing all six tasks. Mangi's price was $7,000 less than the awardee but was rejected as "unacceptable" because its fixed price was based on a level-of-effort approach. In its protest, Mangi asserted it was entitled to the contract and that its level-of-effort contract constituted a form of fixed price contract and hence its quote was acceptable. The GAO rejected its protest. It agreed with Mangi that a fixed price, level-of-effort contract is a form of fixed price but the RFQ did not provide for award on a level of effort basis and Mangi quoting on this basis provided a benefit not available to vendors that quoted a fixed price. It stated that LOE contracts shift the risk and responsibility from the contractor to the government because the contractor agrees only to exert a certain level of effort, not the effort required to complete the underlying tasks. It concluded "an agency may not solicit quotes on one basis and then make awards on a materially different

basis when other vendors would be prejudiced by such an award" (*The Mangi Environmental Group, Inc. GAO, B-294587*).

Can Now Litigate Past Performance Evaluation

(Editor's Note. It was inevitable that contractors would be able to litigate bad evaluations they receive. Unlike the Armed Services Board of Contract Appeals that asserts past performance evaluations are really administrative matters, the U.S. Court of Federal Claims asserts that disagreements are really claims that can be decided by the Court.)

Record Steel received a "marginal" rating on several items at the end of its contract so along with its claim for an equitable price adjustment it included a requrest the Army's evaluation be corrected based on information it had given the Army. After the CO refused both requests Record Steel appealed to the Court (the other forum used to hear claims under the Contract Disputes Act). The Government asked the court to throw out the past performance issue saying the court had no authority to resolve that kind of issue. To the contractor, the matter was clearly a claim that is considered "a written demand…seeking as a matter of right…relief arising from or relating" to its contract with the Army. The Court agreed with the contractor, concluding it could review the performance evaluation. Here the agency did a performance evaluation and sent it to the contractor where in its response, the contractor disagreed and asked for some changes. The government refused to make the changes and its denial "meant the agency had issued its final agency action" allowing the court to review these evaluations as a claim. The Court rejected the ASBCA's position that evaluations are merely "administrative matters" but are a claim (*Record Steel and Construction Inc. v United States, United States Court of Federal Claims No.O3-2274C).*

Contractor Loses Patent Rights Because It Did Not Use Correct Form

(Editor's Note. The following case demonstrates in this era of uncertainty over intellectual property rights, the government and courts will not allow any failure to adhere to strict notice and disclosure requirements. Contractors will be well served to appoint a specific person on each contract to be responsible for ensuring compliance with all contract requirements related to intellectual property since the slightest slip-up can compromise rights in data or intellectual property.)

The Bayh-Dole Act permits a small business to retain title to inventions it develops under a government contract. To protect the government's interests, however, the act mandates that a contractor disclose each invention to the government within a reasonable period of time after which it becomes known to contractor personnel responsible for patent matters. Otherwise, the government may obtain title to the invention to preserve the government's rights. FAR 52.227-11 interprets the "reasonable period" as two months and adds the disclosure be in "the form of a written report," identifying the contract and technical details of the invention. This clause was contained in a cost-type contract to Campbell where there was an additional clause requiring the form of disclosure be a DD Form 82, found in the DFARS 253.303-882. The form requires a contractor to elect whether it will file a patent application in the U.S. or abroad and the court has held that taken together, these clauses give the government the opportunity to take title to the inventions if the contractor fails to disclose on a DD Form 882.

While Campbell admits it did not disclose its invention on the form it argued it had continually disclosed all features of the invention throughout the contract. The Court ruled Campbell's form of disclosure was not satisfactory stating the requirement of a single, easily identified form is sound and needs to be strictly enforced. If they ruled Campbell's style of disclosure was sufficient, the government "never would be sure which piece of paper, or oral statement might be part of its overall invention disclosure" (*Campbell Plastics Engineering & Manufacturing, Inc. v. Brownlee, 389 F.3d 1243 (Fed. Cir. 2004*).

Significant Increase of Award Value Violates Competition Rules

The Air Force awarded the best value contract to Navalas whose lower priced, technically acceptable proposal represented the best value. After the award, the Air Force modified the contract by adding and deleting work resulting in an increase of the contract's cost by almost 80 percent. About a year after award, Cardinal filed a protest alleging the modifications changed the contract to such an extent it violated the competitive requirements of the Competition in Contracting Act (CICA). Finding for the protester, the Court explained that CICA requires the government to use full and open competition to buy its goods and services and if a contract is awarded and then materially changed the government effectively contracts for work without competition. CICA does not provide for a test that distinguishes proper changes from improper ones so to fill this gap it must rely, by analogy, on the cardinal change doctrine, which prohibits the government from

forcing a contractor to perform work beyond the scope of the original contract. Under this doctrine, modifications differing materially from the original contract must comply with CICA. The Court accepted Cardinal's assertion the cost increased by 80 adding that even if it increased by only 40 percent the changes would have still violated CICA An injunction to the performance of the contract was approved (Cardinal Maintenance Serv. Inc. v. U.S., 63 Fed. Cl. 98).

Improper Award to Bidder Offering Non-FSS Labor Categories

The Defense Department awarded a Blank Purchase Agreement (BPA) where the RFQ required each vendor to identify labor categories on its Federal Supply Service (FSS) contract that "most closely matched" the labor categories required under the BPA. AMC protested asserting that ManTech's quote improperly contained items that were not in its FSS contract. In its ruling the Comp. Gen. explained that the FSS program gives agencies a simplified process for purchasing commonly used supplies and services and that FSS procedures satisfy the requirement for full and open competition, but only for FSS contract items while competitive procedures are mandatory for purchases of non-FSS contract items. The Comp Gen ruled that some of the services purchased from ManTech were outside the scope of its FSS contract (for example, the "task manager" labor category identified on ManTech's FSS contract did not match the BPA's "support manager" position) and hence it was improper to use FAR Part 8 procedures to award the BPA (*American Sys. Consulting, Inc. Comp. Gen. Dec. B-294644*).

Agency Was Right to Can RFP After Estimates Increase

The original request to maintain 2,557 computers and 3,148 printers in Guam was amended to increase the printer estimate another 2,439, and the agency decided to cancel the award under a small business set-aside rather than make the award to the next offeror. The next offeror protested saying it was next in line for the award but the GAO disagreed stating it was proper to amend the RFP since the quantity had increased about 77 percent and more than 40 percent for total equipment. The GAO stated that quantity estimates in a solicitation establishes a general framework for the government's anticipated purchases under the contract and a basis for offerors to determine their pricing. When an agency knows there is a serious discrepancy between the initial estimates and actually anticipated needs it should not make the award on the basis of stated estimates but should revise the solicitation to provide offerors with the most accurate information (*Digital Technologies Inc. GAO, B-291657*).

NEW/SMALL CONTRACTORS

What to Expect From and How to Manage a Floor Check

From time to time we have reported on what to expect during a floor check by government auditors. Recent critical reports by the GAO and DOD Inspector General offices on the lack of sufficient audit scrutiny over timekeeping practices has made the floorcheck audit a priority of most audit agencies. An extensively revised DCAA audit program in October 2004 has focused the need to update what to expect from an unannounced floorcheck. We have used the revised audit program and have added some lessons learned during our experience working with contractors.

The stated purpose of labor floor checks is to determine the contractor's compliance with its timekeeping controls and procedures and the reliability of employees' time records. Auditors are asked to verify whether employees are actually at work, they are performing in assigned job classifications and time is properly charged to the appropriate cost objective (i.e. contract, subcontract, task order). Auditors are told to consider "audit risk" of each contractor to determine the scope of the review but we have found the scope of review is less dependent on perceived risk assessment and more on the thoroughness of the individual auditors conducting the floorcheck.

An audit team (usually two) will show up without prior notification. Procedures should be in place for such an event that, at least, includes (1) assurance that an entrance conference is held where the scope of audit is discussed (e.g. auditors should be reminded to focus on employees engaged in government work) (2) requirement that the auditors are accompanied by a trained point of contact who is well versed in the company's timekeeping procedures and can be alert to employee comments that may be misinterpreted (3) instructions to a receptionist on where to seat auditors and who to notify and ensure they are not free to wander around the facilities and (4) an exit conference is held (discussed below).

Auditors are instructed to obtain an understanding of the contractor's timekeeping procedures and will be evaluating the adequacy of such areas as (1) how employee attendance is controlled by clock cards, timecards, etc (2) identifying the process for time keeping of manual or electronic records (3) procedures in place for notifying employees of assigned job numbers and whether there are procedures in place that all changes are properly initialed by employee and supervisor (4) determine whether hours shown on timecards or input electronically are periodically reconciled with hours identified on attendance and payroll records (5) whether there is a division of responsibility between personnel responsible for preparing and approving time records and those responsible for preparing payroll (6) whether there is a division of responsibility between those personnel preparing and/or approving time records and those responsible for operating within budgets and (7) procedures in place for coding and recording idle time

Auditors will usually pre-select a list of employees. Alternative employees will also be identified and auditors have recently been urged to follow-up on unavailable employees by attempting a follow-up interview or if not practical, at least verify employee's existence by observing their work area, examining personnel files or a follow-up telephone interview. Each selected employee will be asked to provide some form of identification and auditors will ask for their timesheets or time cards to review. The auditor will seek to determine whether the timesheets are (1) in the employee's possession (2) completed in ink (3) completed through the previous day's date (4) signed by the employee or supervisor and (5) are free of alterations or if altered, made in accordance with proper procedures (e.g. crossed out and initialed by employee and supervisor).

We have found the following list to be typical of questions asked and what is being evaluated:

1. Employee name, ID number, current job title and position description? - existence of employee and charging proper labor categories
2. When does employee receive timesheets and from whom? – adequate control over access and distribution of timesheets
3. How do they know what projects to identify? – proper procedures over establishing project numbers and ensuring appropriate projects are charged.
4. Does employee prepare their own timesheets? – tight control over who charges jobs.
5. Does employee always sign timesheets and when? – validate hours charged
6. Who approves them? – ensure a supervisor signs off
7. How are errors corrected? – proper treatment of corrections
8. Does anyone else make changes – alert for improper changes by someone else
9. What happens when overtime is worked? – determine whether total time worked is tracked
10. Will employees working on one project ever charge another – alert auditor for potential "gaming" the system (e.g. not charging overrun contracts).
11. What training did the employee receive – gauge "internal controls" over timekeeping
12. When working multiple projects, how does employee determine how much to charge – accuracy of time charged

Supervisors will often be asked additional questions such as: what project numbers were authorized, how errors are corrected and does the supervisor initial changes.

Since auditors want to verify that hours recorded on timesheets tie into the books of account they will ask for additional documentation (sometimes at a later period) such as copies of payroll records for period reviewed, labor distribution reports, cost ledgers and/or general ledger postings.

Sometimes the auditors will take the time to compile their findings while at the site and present deficiencies noted at an exit conference. Other times they may leave and later present a draft report of their findings. Both circumstances as well as pointed questions during the floor check that reveal suspected irregularities should be taken as opportunities to learn of perceived deficiencies, correct mistaken interpretations and provide additional documentation and information. The contractor should make a strong point of requesting to see a draft report before it is sent to the CO and incorporate their responses in any final report. If there is additional information that is not incorporated into the auditors' conclusions, particularly if there are many errors identified, a meeting with the auditor and their supervisor should be requested. An adverse report can have significant consequences down the road such as a judgment the contractor's labor charging system is inadequate.

Lastly, some contractors may question the auditors' right to access. These questions have been heavily litigated and the conclusion is that auditors have the right of access under the audit clauses of their cost and

GCA REPORT
P.O. Box 1235
Alamo, CA 94507

firm fixed price contracts. Denial of access, with the risk of disapproval of costs, rejection of invoices and strained relations with the customer must be carefully considered.

QUESTIONS AND ANSWERS

Q. We are expecting to bid on a large government contract (for us) where we intend to open another office to conduct the work if we win. We are considering either using our existing overhead rate to bid the job or establishing a new overhead rate for the new office. What do the accounting rules require?

A. Government accounting rules do not prescribe the number of overhead rates your company must use. If you want to use the existing overhead rate, you should adjust it (presumably downward) to take into account the new proposed work. This requirement can be waived if the new work represents an immaterial part of your total cost base of the old rate and hence would not materially affect the rate. You may also establish a new overhead rate. Actual practices vary widely. Some companies prefer using one overhead rate across multiple offices, some develop separate rates for each office while some use both a company-wide G&A rate and unique overhead rates for each office. There are also numerous variations.

We believe the best decision should be based upon your pricing objectives. If, for example, you need to bid a significantly lower "multiplier" over base labor costs to win the job, you may want to develop a separate overhead rate at the new office where you can provide, for example, lower fringe benefits and facility costs while applying a company-wide G&A rate to recoup those costs associated with running the company as a whole. Government auditors used to object to the one overhead rate approach (they believed one rate obscured varied costs through different geographic areas) but their objections were overturned by several case decisions in the mid to late 90's.

Q. We are working on an IR&D project this year where we intend to create another business segment next year that would produce products related to the IR&D project. Two questions: (1) Will DCAA disallow the IR&D costs this year asserting they should be charged to the new business unit, which would, in effect, not allow us to recover the IR&D costs (2) will royalty income anticipated in future years need to be credited to our G&A pool?

A. Though DCAA may take a "creative" approach, we do not see why the G&A costs incurred this year would be allocable to a business segment that does not yet exist. Like your other IR&D costs, you are incurring costs for your current business segment to expand the cost and sales base and hence it is properly allocable to the current business segment this year, not to some other one that does not yet exist. After all, CAS 402 and related FAR cost principles require consistent treatment of like costs incurred under like circumstances so why would the IR&D costs in question be different than other IR&D costs incurred this year? As for crediting future G&A costs for royalty payments, we see no need to credit the G&A pool for income in future years for costs incurred in the current year. The only time you might credit the royalty income (really the costs associated with the royalty income) is if the IR&D costs were in the G&A pool in the year you received the royalty income.

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