GCA REPORT
(A publication of Government Contract Associates)

January - February 2008 Vol 14, No. 1

NEW DEVELOPMENTS

New Contract-Related Interest Rate Set for First Half of 2008

The Treasury Secretary has set a rate of 4 3/4% for the period January through June 2008. The new rate is a decrease from the 5 3/4% rate applicable in the last six months of 2007. 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. 74408)*.

Proposed FAR Rule On Allowable Airfare Costs

A proposed government-wide rule to amend the FAR would limit allowable airfare costs for federal contractors to the lowest standard or coach fare available to the contractor rather than to the general public. The proposed rule change is intended to address inconsistent interpretations of the travel cost principle at FAR 31.205-46(b) which limits allowable airfare costs to the "lowest customary standard, coach or equivalent airfare offered during normal business hours." The limitation is confusing because of different interpretations where the lowest fare sometimes is the fare available to the contractor while sometimes it is interpreted to be the fare available to the general public. The FAR Council rejected the general public benchmark because it "is not a feasible option in practice" because it would essentially require continuously monitoring a fluctuating fare to determine what was the lowest available fare in any one day. Likewise, government auditors could not reasonably be expected to recreate the competitive fare market for each instance of contractor travel. Further, it is not "prudent" to consider the lowest fare available to the general public when many contractors are able to obtain lower fares as a result of direct negotiations. As a result the FAR writers opted instead to use the lowest fare available to the contractor as the measurement for determining allowability.

The FAR writers also proposed to omit reference to the term "standard" from the description of classes of allowable airfare because the term does not describe actual classes of airline services. Rather the term "customary coach or equivalent" more accurately describes the classes of services (*Fed. Reg. 72325*).

DOD Implements 35% Indirect Cost Limit for Basic Research

(*Editor's Note. One of our subscribers drew our attention to this new development. Take a look at the first question in the Q&A section for more clarification.*)

The Defense Department's acquisition chief John Young Dec. 1 issued internal guidance to implement a 35 percent limit on indirect cost rates under contracts, grants or cooperative agreements for basic research that is funded under the FY 2008 defense appropriations act. The memo issued to the military services notes that Section 8115 of the Act prohibits DOD from paying indirect costs in excess of 35 percent of the total cost of any contract, grant or cooperative agreement for basic research. Basic research means funds in programs within Budget Activity 1 of the Research, Development, Test and Evaluation (RDT&D) appropriation. The 35% limit applies on payment of indirect costs to awards at the prime level only and does not flow down to subordinate instruments. The term "total cost" has the meaning given in the government-wide cost principles while indirect costs are "all costs of a prime award that are Facilities and Administration costs." The Young memo points out that the restriction applies only to new awards made on or after Nov. 14 using basic research funds.

DOD 2008 Authorization Act Passes

(*Editor's Note. Since passage of the following Act represents what one Senator calls "the most far reaching acquisition reform measure approved by Congress in over a decade" we will provide*

a more detailed accounting of the Act in the next edition of the GCA DIGEST over the brief summary provided below.)

The Senate approved December 14 the conference report to the National Defense Authorization Act for Fiscal Year 2008. Most provisions call for rapid implementation where those most relevant to government contractors include: (1) establishing a $300 million fund to be used for recruiting, training and retaining DOD civilian acquisition related employees (2) increased oversight of service contracts (3) tighter rules on use of commercial procedures for commercial services that will authorize COs to require submission of information to support price reasonableness (*see the 4Q07 issue of the GCA DIGEST*) (4) categories of services that may be purchased using T&M contracts (5) prohibit new contracts for lead system integrators after 2010 and limit their use on existing contracts (e.g. multi-year contracts where there is a history of significant cost growth) (6) tighter reporting requirements for former DOD officials hired by defense contractors (7) compromise measures on use of specialty metals (8) new requirements for undefinitized contract actions (9) clarifications of rules for submitting cost or pricing data on noncommercial modifications of commercial items (10) restricting use of government-unique contract clauses on commercial contracts (11) extended use of simplified acquisition procedures for certain commercial items (12) extended use of "other transaction authority" for prototype projects (13) enhanced competition requirement for task and delivery order contracts (14) public disclosure requirements for use of noncompetitive contracts (15) ethics programs reporting and (16) establishing a green procurement policy.

New Government Web Site Provides Data on Federal Contracts

The Office of Management and Budget Dec 13 launched a new Web site that includes a searchable online database of all government contracts intended to offer the public a "Google" resource for federal spending. The new Web site at www.USASpending.gov allows users to track government contracts and grants with information including the name of the recipient, the amount of the contract, purpose of the contract and the congressional district of the entity receiving the contract. The new Web site is a result of the Federal Funding Accountability and Transparency Act of 2006 that required the government to establish a Web site reporting detailed information on all government transactions exceeding $25,000.

DOD Memo Calls for Limited Use of Awards Without Discussions

In a Jan 2 two page internal memo to the military services calling for more "open, ongoing dialogue with prospective offerors throughout the source selection process" Defense Procurement and Acquisition Policy Director Shay Assad directed the use of awards without discussion be limited. Stressing the need for government participants to be "fully engaged with industry at all stages" of procurement, awards of competitively sourced contracts without discussions should be made "only in limited circumstances." Candidates for such no discussion awards would be mature dual source production programs, routine procurements with well-defined requirements and a number of qualified vendors and procurements of spare parts.

FY 2008 Omnibus Spending Act

The catch-all omnibus spending act for fiscal year 2008 signed by President Bush December 26, 2007 contains some provisions of interest to contractors:

1. Several changes intended to slow the momentum of transferring government work to the private sector were enacted that include (a) prohibiting conversion of work if performed by more than 10 federal employees unless the conversion is based on a competition that includes a most efficient and cost effective (MEO) plan developed by the activity and that the performance of the activity must be less costly to the agency by an amount that equals or exceeds 10% of the MEO's personnel-related costs or $10 million, whichever is less (b) expanding Circular A-76 (rules for public-private competitions) to allow for evaluations of the benefits of converting work from the private to the public sector and (c) expanding appeals rights for federal employees who have lost A-76 competitions to contractors.

2. Exclusion of retirement benefits and health care costs from consideration in cost comparison studies to prevent a contractor from receiving an advantage for a proposal over the federal government that provides more expensive retirement or health benefits packages to federal employees.

3. Barring contract awards to foreign incorporated entities that are treated as foreign domestic corporations to avoid "rewarding tax scofflaws who establish offshore shell companies to avoid paying US taxes with lucrative contracts at taxpayer expense."

OFPP Proposes New Policy Letter on Acquiring "Green" Products and Services

The Office of Federal Procurement Policy Dec 28 proposed a new policy letter that would call on federal agencies to develop and implement "green purchasing policies and affirmative procurement programs" to be incorporated into all government contracts and procurement strategies. The letter would require agencies to give preference to green products and services including alternative fuels and alternative fuel vehicles, bio-based products, Energy Star and Federal Energy Management Program (FEMP)-designated products, electronics registered on the Electronic Product Environmental Assess, low or no toxic or hazardous chemicals or products, non-ozone depleting substances, renewable energy and water-efficient products. The policy letter calls for having environmental and energy experts participate in integrated procurement teams and having each agency develop and implement comprehensive purchasing plans that would at a minimum give preferences for acquiring green products and services at the prime and subcontract level (*see the proposed letter at Fed. Reg. 73904*).

Industry Calls for a CAS Waiver to Recognize Pension Act Funding Changes

Several industry groups Jan 8 are urging the Defense Department to ask the Cost Accounting Standards Board for a temporary waiver of the pension accounting standards at CAS 412 and 413 to allow contractors to include in their forward pricing rates a factor to account for the estimated impact of the Pension Protection Act of 2006. The combined letter by the Aerospace Industries Association and the National Defense Industries Association said that without such a waiver the negative impact on contractor cash flow resulting from the difference between "aggressive" PPA funding requirements and the current CAS standards would be "measured in the billions of dollars." The waiver would be temporary until the CAS "harmonization" required by the PPA can be accomplished.

The reason for the request stems from the fact that the PPA, designed to better ensure pension obligations are met, will result in sharply increased funding requirements for defined benefit plans. This is because the PPA mandated use of reduced interest rate assumptions and shortened amortization periods with a funding target of 100 percent of liabilities rather than the current 90%. DCAA has recognized that before the CAS-PPA harmonization is achieved, the increased funding required by the PPA is unlikely to be recognized under government contracts because the current CAS requires use of higher interest rate assumptions and longer amortization periods than those mandated by PPA. The letter includes a good summary of the conflicts between the PPA and CAS.

Industry Groups Oppose Mandated Reporting to IGs on Criminal Law Violations

A group of contractor associations Jan 11 came out against a proposed FAR rule that would require federal contractors to report to agency inspectors general and their contracting officers if they have reason to believe there has been a violation of federal criminal law in connection with one of their contracts or subcontracts valued at $5 million or more. The influential Council of Defense and Space Industry Associations said the changes were "unnecessary and unsound" stating it could not support provisions that would (1) require "timely" reporting to the IG and CO whenever the contractor "has reasonable grounds to believe a principal, employee, agency or subcontractor" has violated a criminal law in connection with award or performance of a contract and (2) establish as grounds for suspension and debarment the "knowing failure to disclose" overpayments or violations of criminal law.

Some of the comments put forth were that existing voluntary programs actually work and can be improved. The mandatory disclosure rule would effectively require contractors to waive the right to confidential attorney-client communication and work product protections because the proposed rule would require contractors to implement ethics programs mandating "full cooperation with government audits and investigations" without clarifying the meaning of "full cooperation." It is also unfair because it does not clarify what is required e.g. "reasonable grounds" or "criminal violation" invites arbitrary enforcement. In addition the proposal would delay efficient resolution of relatively minor cases, encourage over disclosure that would inundate investigators and discourage contractors from doing business with the government. It would also remove authority from the CO to be able to settle and compromise issues related to the disclosure.

DOD Proposes New Rule on Leased Government Equipment Costs

The Defense Department has proposed to amend the Defense Federal Acquisition Regulation Supplement (DFARS) to address limitations on the allowability of contractor costs associated with the leasing of government equipment for display and demonstrations. The proposed rule specifies that monies paid to the

government for leasing of government equipment are unallowable as either direct or indirect costs, except to the extent they are chargeable to contracts for foreign military sales contracts. The proposed rule would modify DFARS 231.205-1, Public relations and advertising costs to state unallowable public relations and advertizing costs would include "monies paid to the Government associated with the leasing of Government equipment, including lease payments and reimbursement for support services, except for foreign military sales contracts as provided at 225.7303-2" (*Fed. Reg. 69176*).

Government Seeks Greater Use of Performance Based Contracting

A new FAR rule, effective Jan 25, 2008, seeks to increase and improve use of performance-based payments (PBPs) as a method of financing government contracts. Under the new rule, COs may use PBPs for individual task orders and contracts when the CO and offeror agree on the PBP payment terms and the contract or task/delivery order is fixed price. PBPs are not allowed for cost-reimbursable line items and contracts awarded through sealed bid procedures nor for architect-engineer services, construction or shipbuilding and repair when contracts provide for progress billings based upon percentage or stage of completion. The new FAR rule also clarifies that PBPs are considered to be contract financing payments and hence are not subject to the interest penalties under the Prompt Payment Act.

The basis for payments under PBPs may either be specifically described events, such as milestones or some measurable criterion of performance. While the event need not be a critical event the government must be able to verify successful performance. Under the rule, COs are to establish a complete schedule of events or performance criteria and payment amounts when negotiating terms of the contract. The PBP amounts are also to be commensurate with the value of the performance event and are not expected to result in an unreasonably low or negative level of contract investment in the contract. PBPs are also not to exceed 90 percent of the contract price for contracts or 90 percent of the delivery item for task or delivery orders. The CO responsible for administering PBPs also should be responsible for reviewing, approving and transmitting the payment requests to the paying office. Both prepayment and post payment reviews and verifications are allowed and should be arranged based on the risk to the government (*Fed. Reg. 73219*).

In separate action, the Office of Federal Procurement Policy has issued guidelines asking federal agency to raise their goals from 45 percent to 50 percent for using performance–based acquisition (PBA) methods of acquiring services valued more than $25,000. The OFPP memo states that PBA is the "preferred approach for acquiring services" and if implemented properly will result in more competitive pricing, innovative solutions and quality services.

OFPP Urges Review of Incentive Fee Arrangements

The Office of Federal Procurement Policy Dec. 4 called on top federal acquisition officials to review their agencies' policies on incentive fees contracting to ensure the fees paid are linked to specific acquisition outcomes such as cost, schedule and performance results. The policy memo states the review should ensure incentive fees are not earned if the contractor's performance is judged to be below satisfactory or does not meet the basic requirements of the contract and it discourages use of giving contractors additional opportunities to obtain initially unearned fees knows as "rollover" fees.

Interim Rule Limits LSI Financial Interests

In an action to implement a provision of the 2007 DOD authorization act the Department of Defense January 10 issued an interim rule barring contractors that serve as lead system integrators (LSIs) for major defense acquisition systems from holding financial interests related to the development and construction of individual programs or systems that fall within the scope of their LSI responsibility. Exceptions can be made when the defense secretary certifies to congressional defense committees that (1) the competitive procedures were used in selecting the LSI contractor for development or construction of the system and (2) DOD took appropriate steps to avoid any organizational conflict of interest. Another exception would be if the entity was selected as a subcontractor to perform on a lower-tier subcontract provided the LSI "exercised no control" over the selection.

If a LSI contractor acquires or plans to acquire an interest in a company doing construction or development of an individual system or element of a system it must immediately notify the CO and provide all relevant information so that a determination can be made of whether an exception applies or whether the contractor will be allowed to continue performance. The new clause will state that if a direct financial interest cannot be avoided or mitigated to the CO's satisfaction or if there was a misrepresentation of

financial interests at the time of award, the contract may be terminated for default (*Fed. Reg. 1853*).

CASES/DECISIONS

Allocation of Sales Price to Land Resulting in Disposition Loss on Buildings is Proper

LMC sold six parcels of land where the buyers intended to demolish the existing buildings to build new office buildings in their place. In accounting for the sale, in accordance with the purchase agreement, LMC allocated the entire proceeds of the sale to land and treated the remaining net book value of the assets (e.g. buildings and improvements) as a loss on disposition. DCAA questioned the costs of the loss asserting that regardless of the purchase and sales agreement the buildings had to be assigned some value because they had value to LMC or alternatively, the sales should be treated as mass or extraordinary dispositions in accordance with FAR 31.205-16(e) and CAS 409.50-16(j)(3) which, respectively, calls for a "case-by-case" determination settled on "equitable" grounds. The Board sided with LMC stating it was clear the buyers of the parcels paid nothing for the buildings on the land and hence LMC properly allocated all proceeds to the land whether or not the sale was considered to be a mass or extraordinary sale. However, for two of the parcels that were temporarily leased back to LMC the board found that LMC may have received some additional consideration associated with its leasehold interests in the buildings (e.g. below market rent) so there should be some offset to the loss (*Lockheed Martin Corp. ASBCA 54169*).

Appeal Sent Via Commercial Service is Considered Filed Upon Receipt

In appealing the contracting officer's final decision on its termination proposal, KAMP sent a notice of appeal by Federal Express on the 90th day following receipt of the CO's final decision. The government contended the notice was untimely because it did not meet the 90 day time limit for appeals. The Board sided with the government stating that under preceding board decisions notices of appeal sent via commercial delivery services are deemed filed when received by the Board. The Board acknowledged that in computing the 90 day timeframe it has ruled in the past that the date of filing is the date of transfer to the US Postal Service – the postmarked date. The board noted the differences for commercial filing (deemed delivered when received by the board) and filing using the US postal service (deemed delivered on the post mark date) had an "uneven effect" and stated regulatory change is warranted but nonetheless, ruled KAMP's notice was late (*KAMP Systems Inc., ASBCA, No. 55317*).

Negligence Allegations Might Preclude Use of the Contractor Defense

In its contract with the Army Corps of Engineers in New Orleans to demolish, excavate and remove several structures the government asserted WGII caused the collapse of a flood wall during Hurricane Katrina. WGII claimed it had performed in accordance with the terms of the contract and hence was protected from liability by the contractor defense rule which holds federal contractors cannot be held liable for performing contracts in conformity with government specifications providing the contractors carried out such contracts with due care and absent negligence. The government alleged specific negligent acts were performed by WGII (e.g. should have know its work caused damage to levees, failed to follow proper procedures, failed to comply with appropriate regulations and standards, etc.) arguing the contractor defense is not applicable when there are allegations the contractor performed any negligent act or omission or any intentional act that was beyond the scope of the task required by the contract and that there were sufficient facts to state a plausible claim against WGII. The Court noted that for a contractor to invoke the contractor defense (1) the government must have approved reasonably precise specs. (2) the equipment must have conformed to these specs and (3) the contractor/supplier must have warned the government of any equipment dangers that were known to it but not the government. Here, the court stated the government's assertion that WGII did not comply with regulations and standards and it knew or should have known the damage its actions were causing but did not stop to inform the Corps were plausible and if proven, would preclude the contractor defense immunity. In addition, there were some issues whether the contract was a performance or a design specifications contract noting it "might not meet the specificity such that immunity should attach" (*In re Katrina Canal Breaches Consolidated Litigation, E.D. L., No. 05-4182*).

Company That Sold Assets Can't Pursue its Earlier Protest

Emerald successfully protested an award to supply fruits and vegetables to commissary stores where the government was to reevaluate and reselect the winning bidder after which Emerald continued to protest when the government awarded the contract to the original awardee. During this litigation Emerald sold its assets to another company and withdrew its request to prevent

performance of the contract and only sought bid preparation and attorney's costs. The government claimed the protest was no longer valid because Emerald had sold its assets while Emerald argued that the Purchase Agreement governing the sale of its assets exempted its accounts receivables from the sale and that the costs it sought to recover constituted accounts receivable. The Court disagreed with Emerald stating it had not provided any support that a lawsuit is an account receivable. It further stated that the only discussion of lawsuits in Generally Accepted Accounting Principles was in a Financial Accounting Standards chapter entitled "Accounting for Contingencies." In addressing whether a lawsuit is an account receivable the court quoted an accounting text that stated a receivable is "a current asset expected to be realized in one year" while a contingency involves "an occurrence that might arise in the future." The Court concluded a contingency is not an accounts receivable and hence the company did not have the right to pursue the protest (*Emerald Cost Finest Produce Co., v. US, Fed. Cl. No 06-742C*).

Government Contractor Awarded $23 M for Ex-Employees' Collusion With Competitor

Three employees of ITC formed their own company – AMTI - while still employed by ITC and used its proprietary information to obtain government contracts at the expense of ITC. The state court found the three workers had given the rival firm an unfair advantage in the marketplace – calling the employees "faithless servants" – and hoping to set an example, awarded ITC $23 million – including $17 million in punitive damages (*Innovative Techs Corp. v Kenton Trace Techs, OH Ct. CP, No 2003CV03674*).

Repriced Contract Using Changed Accounting Practice Is Not Included In Cost Impact Base

(*Editor's Note. When a contractor changes a costing practice, it must often show the impact of the change on its contracts by identifying how the change affects the costing of government contracts before and after the change. CAS covered contractors must formally do this while non-CAS covered contractors often are requested to do so by the government when it is informed that a change is either contemplated or has been made.)*

At the time it renegotiated its F-22 fighter aircraft contract the government persuaded Lockheed to change its cost accounting practices to reclassify certain indirect costs as direct where the changed practices were used to re-price the contract. DCAA took the position that the "rephrasing" of the F-22 contract was a modification and that Lockheed was required to include the F-22 contract in its cost analysis. It further asserted that because the change resulted in increased costs on its contracts, the changes should not be considered desirable as Lockheed requested (which would preclude the government from being reimbursed for increased costs). The appeals board disagreed with the government where it cited the definition of "affected CAS-covered contract or subcontract" in the 2005 changed FAR as "contracts for which the contractor used the changed practice to both estimate and accumulate costs are not 'affected contracts'…and would not be included within the cost impact proposal/ study required by FAR 30.602-3(b)." As for whether the change was desirable the ASBCA held that an increase in costs alone is not sufficient for determining whether a changed practice is desirable. The ASBCA concluded that in deciding whether a voluntary change is desirable and not detrimental to the government relevant factors to consider are not only increased costs but also the extent of government involvement and support for the changes, the degree to which the change increased the accuracy and precision of cost measurement, the degree to which the changed increased the "visibility, manageability and/or controllability of the costs in question" and any other short or long term benefits to the government (*Lockheed Martin Corp., ASBCA 53822*).

NEW/SMALL CONTRACTORS

Indicators of Irregular Activities

Whether it be recent financial scandals reported in the media, increased focus on defective pricing audits or recent attention being given to contractor requirements to establish ethics programs and report violations of law, we are seeing more and more concern on the part of the government on spotting potential contractor fraudulent practices. In searching for articles on what DCAA considers to be potential fraud indicators we were surprised to see we have not written an article on this issue so the following addresses what guidance auditors are told to be on the lookout for.

Chapters 4 and 14 in the DCAA Contract Audit Manual cover actions by contractors that may indicate violations of law or "irregularities." First, recurrent mention of "fraud" is not intended to cover all legal aspects of the term but is generally considered to be "willful or

conscious wrongdoing including but not limited to cheating or dishonesty which contribute to a loss or damage to the government." Numerous examples are identified such as falsifying time cards and purchase orders, charging personal expenses to government contracts, submitting false claims such as invoices for services not performed or supplies not delivered, intentional mischarging or misallocation of costs, bribery, violations of the Foreign Corrupt Practices Act, government employee seeking financial interest or employment with a contractor over whom it exercises oversight, kickbacks and unlawful or fraudulent acts resulting from accounting classification practices designed to conceal the true nature of the expenses e.g. classifying unallowable advertising or entertainment as office supplies or attempts or conspiracy to engage in the above acts.

Though the guidance stresses that auditors are not trained to conduct investigations they are urged to consider "risk factors", be mindful of potential irregularities during all audits and to follow up on indications of fraud until they are satisfied there are innocent explanations of irregularities. There are also detailed instructions on how to issue investigative referrals when fraud is indicated.

The guidance points to specific laws and regulations and what to look for to determine possible violations. Under the *Anti-kickback Act*, auditors are told to examine payments of commissions to prime contractor personnel, entertainment provided for prime contractor personnel, loans made to prime or higher-tier contractor personnel that may not be repaid and expensive gifts or preferential treatment to particular subcontractors. For suspected *anticompetitive procurement practices* auditors are referred to FAR 3.303(c) and are cautioned that such practices do not include bona fide sole-source procurement actions, buying-in practices or violations of the Competition in Contracting Act. To spot *illegal political contributions* auditors are told to look for bonus payments made to contractor personnel that are passed on as personal contributions (they usually include payments to cover taxes associated with the increased compensation), payments to outside consultants or other professional contacts where they may be too high for the service rendered or no services were provided at all or padding or falsifying expenses paid to employees. Auditors are also told to look for *improper gifts or gratuities* given to government personnel but the guidance refers auditors to more current exceptions to gift prohibitions such as gifts valued at less than $20 per occasion or $50 per calendar year or free participation at an event sponsored by contractors (e.g. conference, dinner, reception).

The DCAA guidance, in addition to extensive narrative, provides a handy appendix identifying several examples of characteristics and types of activities associated with illegal expenditures. These include:

1. Labor. Unexplained changes to time cards transferring hours from commercial firm fixed price contracts to government cost type, employee time charged differently than associated travel costs are or diverting direct labor from firm fixed price contracts by reclassifying employees as indirect.

2. Material. Significant requirements charged to government cost-type contracts where follow-up work shows the material was not needed, using inferior materials on government contracts that do not meet contract specs or false certifications of inspection test results.

3. Subcontracts. Intercompany profit claimed and billed for intercompany affiliates that the contractor represented as an unrelated subcontractor.

4. Indirect costs. Overrun contract costs charged to indirect expenses, expressly unallowable costs recorded in accounts that are generally allowable such as small tools, supplies, etc. and improper transfers of costs to indirect accounts or direct contract costs that are not allowed to be charged under the terms of the contract.

5. Defective pricing (see 14.121.2 of the DCAM). High incidences of defective pricing, repeated defective pricing involving similar patterns, continued failure to correct deficiencies, a consistent failure to update cost or pricing data with knowledge that past practices indicate prices have decreased, not disclosing knowledge of significant cost issues that reduce proposal costs (e.g. negotiation of lower subcontract costs or a union agreement), denying existence of historical records by knowledgeable employees that are later found, repeated use of nonqualified employees to develop cost or pricing data used in estimating costs, indications of falsifying or altering supporting data, distortion of overhead pool or base accounts, continued failure to make complete disclosure of data known by responsible contractor personnel, continued prolonged delay in releasing data to the government to prevent possible proposal reductions or employing people known to have previously committed fraud against the government.

6. All audit areas. Alterations of documents that would result in improper costs claimed for government contracts and evidence showing that payments were not actually made for amounts shown on documents.

GCA REPORT
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QUESTIONS & ANSWERS

Q. I have heard there is a 35% cap of indirect costs on certain basic research contracts. Is that true? Since we work on these contracts how can we be expected to recover our costs?

A. Your concern is very understandable. We called two contact people mentioned in the memo we discuss above to get some clarification. We were reminded that much of the research dollars flow to educational institutions and other non-profit organizations that have their own unique definitions of indirect costs and guidelines on how to compute them. However, the wording of the regulation does not exclude non-educational institutions and hence applies to other contractors covered by the FAR cost principles and hence the 35% limitation will apply to them also. The people we spoke to indicated the 35% limit on total costs translates into a 54% limitation of indirect cost rates on direct labor costs. Considerable care should be taken when negotiating price and terms on these basic research awards (e.g. what costs are defined as direct.)

Q. Is there someplace on your web site where one can submit questions to be answered in your publications? Are salaried employees (administration, engineers, scientists, senior management) required to fill out time cards and have those time cards approved? A recent DCAA floorcheck audit report claimed we must have all employees prepare time cards, have them signed and approved. Any answers or comments would be appreciated.

A. First, our normal method of receiving questions are through our email (gcaconsult@earthlink.net), website (govcontractassoc.com) or by phone at (925)362-0712. As for printing questions in our Q&A section in our newsletters, we can't print all the questions we receive but usually select 2-3 depending on space limitations and a judgment on what would be most relevant to the greatest number of subscribers. We have just launched a new website that includes a FORUM which we are hoping will become THE community for our subscribers to discuss contract, cost or pricing issues.

As for your other question, the general rule is that all employees who work directly on projects - whether they are normally direct or indirect employees - should complete time cards. However, when indirect employees do not work on projects, they often do not complete time cards and should not be required to do so. If an auditor is insisting they do, I would bring it up their supervisor. Timekeeping requirements are covered in Chapter 5.900 of the DCAA Contract Audit Manual, which is generally considered as the standard by both industry and other government auditors.

Q. We are a closely held company and a recent DCAA audit challenged costs associated with giving stock shares to executives because they are not publicly traded. I believe the auditor does not understand the nature of closely held companies, equity structure and their evaluation. Can you provide some general insight?

A. Though I am unaware of the specifics of your situation, securities costs, other than explicitly unallowable security items (e.g. stock options, phantom stock plans) are not necessarily unallowable. The basic criteria for the allowability of the types of securities costs you are discussing are whether they are considered to be an acceptable IRS deduction per FAR 31.205-6(a)6(i)(B)(iii). If so, they should be allowable for government contracts.

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