# GCA REPORT
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## NEW DEVELOPMENTS

### DOD to Recommend New Penalties for System Deficiencies

*(Editor's Note. We have been reporting for the last year and our featured article shows the government's increased audit focus on "systems" and "internal controls" which is resulting in increasingly negative opinions. The following proposal seems to be a move in the direction of formalizing this trend.)*

The Defense Department is proposing new penalties for contractors that fail to remedy deficiencies in their business systems and internal controls. The proposal is to improve oversight of contract business systems by DCMA and DCAA where there would be compliance enforcement mechanisms such as withhold of progress payments, performance based or interim payments under cost reimbursable, incentive type or T&M/Labor Hour contracts until system deficiencies are corrected.

The rule proposes to clarify the definition of contractor business systems to include:

- Accounting systems
- Estimating systems
- Purchasing systems
- Earned value management systems
- Material Management and accounting systems and property management systems.

The proposed rule states adequate internal controls and business systems are considered to be the "first line of defense against waste fraud and abuse" as well as the "increased risk of unallowable and unreasonable costs on government contracts." There will be a business system clause requiring contractors to respond to initial and final determinations of deficiencies. When decisions to withhold payments are made because of business systems problems, COs must notify a contractor of any deficiencies that need to be remedied and inform the contractor they need to be corrected after which the contractor must submit a corrective action plan within 45 days if the deficiencies have not been corrected within that time period.

### Final Rules Bars Compensation to DOD Officials Without Ethics Opinion

The Defense Department has issued a final rule for contractors who may pay former DOD executives and other personnel following their employment with the government. DOD officials who have been personally and substantially involved with acquisition programs exceeding $10 million must request and receive a written DOD ethics opinion before being paid by a defense contractor within two years of leaving the department. The rule covers both senior DOD officials (senior executive service or general or flag officers) as well as others who held "key acquisition positions" for a contract valued at more than $10 million. Those officials include program manager or deputy, procuring contracting officer, administrative contracting officer, source selection authority or member of the source selection board or chief of a financial or technical evaluation team. The rule prohibits defense contractors from providing compensation to a covered DOD official without first determining whether the official has received or requested the post employment ethics opinion where failure to do so can result in cancellation of a procurement, recession of a contract or suspension or debarment from government contracting (*Fed. Reg. 59913*).

### New FAR Rule Clarifies Allowable Airfare Costs

The FAR Council has issued a final rule intending to clarify what is meant by the FAR 31.205-46(b) provision that limits allowable contractor airfare costs to the "lowest customary standard, coach, or equivalent airfare offered during normal business hours." The limitation has caused confusion as to whether the lowest airfare available to the contractor or to the general public should be applied where now the general public benchmark no longer applies because it is not a "feasible option in practice." Also the term "standard" has been dropped because it does not describe actual classes of airline service where "customary coach or equivalent" does (*Fed. Reg. 65612*).

## Final Rule on PRBs Gives Contractors Options for Measuring Accrued PRB Costs

Contractors that use the accrual method to account for costs of post-retirement benefits (PRBs) now have a choice as to the criteria used to measure these costs – either in accordance with Internal Revenue Code No. 419 or criteria in FAS 106. FAR 31.205-6(o) allows contractors to chose three different accounting methods for PRB costs – pay-as-you go (cash basis), terminal funding or accrual. If the accrual method is used, the FAR currently requires costs to be measured based on the requirements of Financial Accounting Standard 106. However the tax deductible amount that is contributed to the retiree benefit trust is determined using IRC 419 which has a different measurement criteria normally less than using the FAS 106 method.

So contractors had a dilemma - fund the entire amount of the trust using FAS 106 to receive full reimbursement without getting full credit as a tax deduction or use IRC 419 to receive full tax deduction for the amount yet not receive full reimbursement for the maximum amount on its government contracts using FAS 106. Under the change, contractors now have the option of measuring its PRB costs using either method for government accounting purposes while they may still fund the entire tax deductible amount using IRC without having a portion disallowed because the FAS 106 method was not used. The amendment to FAR will not change the total measured PRB costs and the FAR Council states the government will not pay higher PRB costs because the resulting difference from contractors' previously funding the lower IRC amount will continue to be unallowable where the change will affect only current and future costs..

The published rule also addresses the transition between accounting methods but it is a bit complex to cover here (*Fed. Reg. 65608. It is available at* http://edocket.access.gpo.gov/20009/pdf/E9-28934.pdf

## Air Force Guidance on Releasing Unit Price Information During Debriefings

(*Editor's Note. We have been reporting on certain cases the last few years that require disclosure of certain cost and pricing information after an award is made while other cases state such disclosures should not be made because the information is protected by the exemption rules under the Freedom of Information Act. What information should be released versus withheld has become confusing. The following guidance tries to help.)*

A recent Air Force contracting office memo provides guidance regarding contracting officers' obligation to disclose successful offerors' unit prices during post-award debriefings. The Dec 23 memo states the confusion stems from apparently contradictory FAR provisions. On the one hand, FAR 15.503(b)(iv) states post-award notices to unsuccessful offerors should include stated unit prices and similarly FAR 15.506(d)(2) states "overall evaluated cost or price (including unit prices)" should be disclosed. On the other hand, FAR 15.506(s) states COs cannot reveal in debriefings such information that is exempt under FOIA where such release would harm competitiveness in the marketplace. The memo states several recent cases have held that unit prices are considered to be such protected information.

The memo advises COs to read the FAR provisions "in harmony" when deciding whether to release unit price information. COs should disclose the successful offeror's unit prices only if they have (1) obtained the offeror's consent in writing or (2) previously determined, from a formal FOIA request in consultation with legal counsel, that unit pricing information is not protected. The memo states that if an unsuccessful offeror requests unit prices from a successful offeror who has not consented to release then the unsuccessful offeror may use the FOIA process to seek such information. COs are to coordinate all such requests with local legal counsel.

## DOD Policy Issues Policy Statement on Resolving Proposal Negotiation Disagreements with DCAA

DOD has issued a prescription on how to process "significant disagreements" between contracting officers and DCAA auditors during proposal negotiations on a contract exceeding $10 million. Significant disagreements – when the CO's pre-negotiation objective sustains less than 75% of DCAA recommended questioned costs – are to be documented in written communications to the auditor prior to commencing negotiations (an email is acceptable). DCAA is provided the opportunity to escalate the disagreement with the CO to several levels of "DOD components" within three days of receiving the communication. The prescription, to be followed by a FAR proposal soon, includes statements that it is neither expected nor necessary for the CO and DCAA to agree on every issue and that it is expected for them to work together recognizing it is the CO's ultimate responsibility to determine fair and reasonable prices. The policy follows recently released concerns by lawmakers, members of the Commission on Wartime Contracting and industry observers regarding how COs are supposed to treat DCAA report recommendations (*the prescription*

*memo is available at "acq.osd.mil/dpap/policy/policyvault/USA006857-09-DPAP.pdf").*

## Subcontract Pass-Through Limitations Continues to be an Issue

The new interim rule we addressed last issue limiting excessive pass-through charges by contractors from subcontractors or tiers of subcontractors continues to be a hot issue. Dec 23 the DOD issued a "class deviation" which states interim FAR language recently passed will replace DFARS language that extends the limitations to contracts government-wide rather than just DOD contracts. The class deviation also exempts fixed-price incentive contracts awarded on the basis of adequate price competition. The interim rule aims to protect the government from paying for work performed by lower-tier subcontractors that is of "no or negligible value" to the government, requires offerors and contractors to identify the percentage of work that will be subcontracted and when the percentage exceeds 70 percent of total cost of work the offerors must provide information on indirect costs, profit/fee and value added regarding the subcontract work.

The Section of Public Contract Law of the American Bar Association issued critical commentary on the new rule. The current rule lacks guidance on how COs can "consistently apply" tools to conduct their assessment and the ABA fears the new rule will simply be used to re-price contracts. The ABA also believes the FAR Council did not adequately consider how the rule could negatively affect small businesses performing as prime contractors where they could experience significant adverse financial results as a result of disallowed pass-through costs. It also may result in contractors retaining work in-house to avoid pass-through charges that may be disallowed even though work could be more efficiently performed by subcontractors. Finally, the new rule may conflict with the Cost Accounting Standards that require all indirect costs be fully absorbed and allocated to final cost objectives. Though COs are responsible for determining whether certain allocable costs provide value, G&A costs are really residual (what's left) which does not permit the assignment of clear beneficial or causal relationships where the only consideration should be are the costs allowable and reasonable.

## Recent DCAA Guidelines

- **DOD Implements 35% Indirect Cost Limit for Basic Research**

The Defense Contract Audit Agency issued guidance stating the 2008 and 2009 DOD Appropriations Acts limit payments of indirect costs to 35% of total cost of a DOD contract, grant or cooperative agreement for certain work. The guidance instructs auditors to request recipients of "basic research" awards demonstrate their compliance with this limitation. The guidance includes an Oct 2008 memo and Dec 2007 memo written by the Department's acquisition chief John Young which we discussed in the Jan-Feb 2008 GCA REPORT. 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. 13, 2007 using FY 2008 funds or after Sep. 30, 2008 using FY 2009 basic research funds.

The guidance addresses the meaning of the 35% cap. 35% cap is not an indirect cost wrap rate but translates into a 53.8% wrap applied to direct costs. It is derived by considering an award of $100,000 where $35,000 in indirect costs is the maximum allowed ($100,000 X 35%). If $35,000 is indirect then $65,000 is direct so the resulting ratio is $35,000/$65,000 or 53.86%.

- **Update Audit Reports for Noncurrent Systems and Internal Control Audits**

Current audit guidelines require that relevant accounting and management system reviews should be conducted every 2-4 years and no less frequent than every 4 years. This cycle of audits commonly do not occur but sections of audit reports (e.g. forward pricing, incurred cost) normally address prior findings in the Contract Organization and Systems and Scope of Audit sections of the reports. Auditors are now told to address the status of the noncurrent audits by indicating in those sections that a current audit of the system has not been performed. Auditors are also reminded that where a contractor's internal controls are not current that "control risk" is to be assessed at maximum where planning of related audits are made and that expanded substantive testing must be performed (*MRD 09-PAS-021(R*).

♦ **MRDs Take Precedence over DCAM**

Updates to DCAA audit guidance we commonly report on usually come in the form of Memorandums for Regional Director (MRDs). Recent guidance informs auditors that the MRDs, which are later incorporated into DCAA Contract Audit Manual, supersede guidance reflected in the manual. Auditors are told to review relevant MRDs when starting a new assignment (*MRD 09-PAS-023(R).*

## DOD Continues to Make 8(a) Awards

The Small Business Administration and DOD has extended its partnership agreement to allow DOD contracting officers to award prime contracts directly to SBA 8(a) firms through Sep. 20, 2012. The Dec 18 agreement, similar to what the SBA offers other government departments, delegates SBA contract execution functions of providing 8(a) awards to DOD and establishes the basic procedures for expediting the 8(a) awards. The SBA will no longer review 8(a) eligibility status of all offerors within the competitive range but will now conduct eligibility reviews on a "sequential" basis, starting with the apparent successful offeror and then proceeding to the second offeror if the first is not eligible.

# CASES/DECISIONS

## FSS Award is Improper Where Some Items are Not in FSS Contract

The State Department issued a request for manufactured metal and bomb equipment listing eight items for vendor pricing under a GSA Federal Supply Schedule (FSS) contract. Rapsican was awarded the order where it had the lowest price, technically acceptable quote while SAIC protested asserting that two of the required items were not included in Rapsican's FSS contract. Explaining that the two missing items were added to Rapsican's FSS contract before the required delivery date, State argued the award was valid because the RFQ did not require all items to be on the FSS when quotes were submitted or the order issued. The GAO disagreed, stating that if an agency announces its intention to order from existing FSSs all items quoted and ordered must be on the vendor's schedule as a precondition of its receiving the order. Because the RFQ limited the competition to vendors holding a specific FSS contract, State limited competition to vendors whose FSS contracts included all required items. As for States' argument that award was proper because items were added before delivery date, the GAO stated there was no way to determine with certainty whether a vendor's FSS contract would include the items in the future and to rely on such uncertainty would "undermine the requirement that all non-FSS items be purchases using full and open competition" (*SAIC, Comp. Gen. Dec. B-401773*).

## Tradeoff Analysis Did Not Consider Lower Rated, Lower Priced Offer

The agency sought proposals to provide various professional services on a fixed price ID/IQ task order contract. The contracting officer reviewed the agency's evaluation of the eight offerors and performed a price/technical tradeoff between the two most highly rated proposals where it selected ECC after concluding its technical superiority justified its higher price. Coastal, one of the other six offerors, filed a protest asserting the government did not consider the significant price advantage associated with its technically acceptable, low-risk proposal. The GAO agreed, stating that even where price is stated to be less important than non-price factors, which was the case here, an agency must meaningfully consider cost or price in making its decision. It said that an award decision must be supported by a rational explanation of why a higher price proposal is in fact superior and warrants a higher price. The GAO ruled the CO impermissibly limited the price/technical tradeoff analysis to the two highest rated price proposals without assessing the technical differences between these two proposals and any other technically acceptable proposal including Coastal. The GAO added the CO did not identify what benefits ECC's proposal warranted paying a premium compared to Coastal's lower-priced proposal (*Coastal Environments Inc., GAO B-401889*).

## Contractor's Interpretation of Contract Was Reasonable Way to Resolve Ambiguity

(*Editor's Note. The following case includes some key concepts for determining eligibility for an equitable adjustment.*)

States Roofing entered into a fixed price contract for roof replacement, wall repair and painting. In response to objections over use of waterproofing paint States agreed to use material suggested by the Navy and requested an equitable adjustment for additional costs where the Navy refused saying the material in question was a no-cost change. The Court overturned the Appeals Board ruling in favor of the Navy. First, States cited the rule *contra proferentem* which provides that if a contractor relies on its bid on a reasonable interpretation of contract documents and specs then any change based on a different

interpretation by the government is not chargeable to the contractor. States argued its contract language could have been clearer and that its interpretation of the contract was reasonable. Next, the disagreement between the Navy's witnesses called into question the Navy contention the contract drawings clearly prohibited use of waterproofing paint and that States interpretation was reasonable because of the prior use of waterproofing paint on other walls of the same roof. Lastly the Court rejected the Board's ruling that any contract ambiguity was "patent" obligating State to inquire into how to interpret the contract. A patent ambiguity must be a "glaring conflict or obvious error in order to impose the consequences of misunderstanding on the contractor" whereas here the ambiguity was "latent" and did not meet the criteria of patent ambiguity requiring an inquiry. The Court concluded Sates was entitled to compensation for the additional painting costs (*States Roofing Corp. v Navy, cir. No. 2009-1067*).

## Commercial Item Termination Limits Costs Recovery

(*Editor's Note. The following case highlights the difference between the termination for convenience clause in a commercial item versus non-commercial item government contract.)*

After receiving a commercial item contract to prepare a vessel for vessel charting, the contractor incurred many costs such as purchasing and installing specialized equipment and received a $17.3 million loan to finance the vessel's purchase, reflagging, modification and insurance costs. When the contract was terminated two months early, it could not find an alternative use for the vessel, could not reduce the interest and principal payments and continued paying insurance costs of the vessel. It included many of these costs in its termination settlement proposal. The Board held that a commercial-item contractor was not entitled to recover either its capital or fixed costs that could not be avoided or reduced when the government terminated its vessel charter. The Board stated the conceptual basis of the commercial item clause is wholly different than the FAR 52.249-2 termination clause applied to non-commercial item contracts which effectively converts a fixed price contract to cost reimbursable contracts for purposes of terminations. Under the commercial item provision, the contractor receives a percentage of the price regardless of what his costs are (plus reasonable charges resulting from the termination). The Board concluded such costs as preparatory and insurance expenses might be allowable in terminated non-commercial item fixed price contracts but not for commercial items under FAR 12.403(a) and FAR 52.212-4(l). It also ruled the cases and regulations the contractor put forth as supporting the allowability of its proposed termination costs applied to non-commercial item contractors (*Red River Holdings, LLC, ASBCA 56316*).

## Testimony in Absence of Documentation Can Establish Allocability of Subcontractor Costs

*(Editor's Note. The following case provides an interesting exception from the normally strict documentation rules needed to make a cost reimbursable.)*

BearingPoint acquired the security services of Custer under its USAID contract for economic recovery in Iraq. Custer lacked adequate documentation of its labor and ground transportation costs due to the loss or destruction of its records resulting from a change of the security detail at the Baghdad International Airport. The USAID contacting officer disallowed $3.9 million in claimed Custer costs because of lack of adequate documentation, arguing the costs were not allocable arguing that Custer was required to maintain records or other sufficient evidence of costs incurred. On its appeal, BearingPoint relied primarily on testimony from three employees who were present in Iraq, personally knew the Custer security forces and reviewed the Custer invoices. The Board rejected USAID's argument the disputed labor costs were not allocable because of insufficient documentation noting the contract clauses do not impose stringent requirements of either "nice neat little files" expected by the CO or contemporaneous records USAID was looking for. Though it affirmed the contractor bears the burden of proving allocability, the Board ruled BearingPoint met its burden (*BearingPoint, Inc., ASBCA 55354*).

## Limitations of Discussions

The agency told SAI it had identified several uncertainties regarding its specialized experience to design and build a military barracks while SAI asked the court to set aside the awards to others and reopen discussions with SAI, arguing the FAR requires the agency's concerns be raised during discussions. The Court disagreed explaining that mandatory discussions are designed to point out shortcomings in an offeror's proposal as judged by the government's stated needs as opposed to the proposal's relative competitiveness. It ruled agencies do not need to discuss every aspect of a proposal that receives less than the maximum score or identify relative weaknesses in a proposal that is technically acceptable but presents a less desirable approach (*Structural Assocs. et al v US, Fed. Cl. No. 09-372(C)*.

# NEW/SMALL CONTRACTORS

## The ICQ

As we have been reporting for over a year now, auditors are increasingly examining contractors' internal controls where negative findings on these controls are resulting in opinions of inadequacies on a variety of contractor systems e.g. accounting, billing, purchasing, estimating and planning or budgeting. Whereas internal control reviews used to be focused mainly on major contractors, we now see audit scrutiny of these controls at small contractors, even with less than $1 million worth of federal work. A key checklist DCAA uses with great frequency these days to identify sufficient internal controls is the "Survey of Contractor's Organization, Accounting System and System of Internal Controls (ICQ) Contractors with CCFY Dollars Between $15 Million and $90 Million" which is referred to as the ICQ. We urge contractors become familiar with this document because (1) they will likely be required to fill one out and (2) it provides a good roadmap of what policies and procedures should be prepared to show the government that good internal controls exists.

## Basics

The ICQ is in the form of a questionnaire that is normally provided to the contractor who then must fill it in. The purpose of the ICQ is to provide the auditor a basis for documenting their understanding of the contractor's internal control components which is then supposed to be used to plan the audit. The ICQ questionnaire is designed to apply to non-major contractors with auditable dollar value (flexible type contracts) between $15-$90 Million but, in practice, we see the ICQ distributed to virtually all non-major contractors no matter what their ADV is. The ICQ is supposed to be completed or updated as part of the auditor's periodic visits to non-major contractors where a new ICQ should be completed every year if a field visit is required. Also the ICQ consists of four parts A thought D. Part A is specific information about the contractors' business whereas Parts B though D are of primary interest here.

The primary justification cited for the ICQ and focus on internal controls in general is the Generally Accepted Government Auditing Standards (GAGAS) Chapt. 6 that states "Auditors should obtain a sufficient understanding of the internal control that is material to the subject matter or assertion to plan the engagement and design procedures to achieve the objectives of the attestation engagement." A significant motivator for focusing on internal controls lies in DCAA quest to improve its productivity – good internal controls means to them less work required for audits (e.g. transaction testing)

The ICQ outlines steps needed to obtain an understanding of the contractor's internal controls. Knowledge is gained ordinarily through previous experience with the contractor, though an understanding of written procedures and observations of contractors' operations as well as inspections of their documents and records. In other words, you may expect both a reading of written policies for adequacy and then reviews of actual practices to ensure they are consistent with the policies.

The questionnaire consists of a Yes-No format where though a few desirable answers are "No" most are either "Yes" or "NA" where other answers would be significant red flags to form the basis of negative opinions.

## Part A – Basic Organization

This section provides basic information about the contractor – location(s), corporate structure, breakdown of business, officers and their salary and information about contracts and subcontracts.

## Part B – Control Environment and Overall Accounting System.

This section comes close to reflecting the elements of a pre-award survey most contractors who have cost type work must go through. However, it goes further by asking whether a written policy exists that describes such government accounting requirements as assignment of responsibilities and authority, the general accounting system, screening unallowable costs, direct and indirect charging practices, allocation of indirect costs, approval and documentation of journal entries, establishing account and contract charge numbers and allocating income, rebates, etc. It further asks whether the cost accounting records are reconciled with the general ledger, whether costs are identified by final cost objectives in a job cost ledger and whether external negative CPA management letters are promptly addressed. Whereas the last item may be NA, there should be a "Yes" marked for each item.

## Part C - Contractor's Risk Assessment, Information and Communications and Monitoring.

Each of the three areas identified in the title are separately identified. The Risk Assessment section asks

whether significant accounting changes have occurred in the last two years, does the contractor have a "risk assessment process" for identifying problems in its required submissions and has any previous audits identified failure to properly assess risk.

The Information and Communications section addresses written policies covering the IT system, whether it be manual or computerized. This section has been updated in recognition that there may have been insufficient attention put on the IT system at non-major contractors. The written policies and procedures should cover the processes of how transactions and journal entries are made, how totals are put into the general ledger, how recurring or non-recurring adjustments are made if not by journal entry and how hard-copy documents are converted electronically. In addition, the policies should address the role and responsibilities of people, whether the policies are distributed to relevant employees and whether there has been any reported deficiencies in the past.

The Monitoring section asks whether the contractor has "ongoing monitoring procedures" and/or separate internal control reviews to ensure its internal controls are operating properly. It also asks about prior deficiencies reported here.

### Part D – Accounting System Control, Objectives and Activities

This part is broken down into seven sections:

1. *Labor System*. Is there training for timekeeping with proper written timekeeping policies and procedures (PPs). Also does the contractor have written PPs covering other labor charging issues such as "labor document/work descriptions" identifying work to be performed, are the labor charges tracked to final cost objectives and are they direct or indirect or allowable or unallowable.

2. *Materials/Purchasing Systems*. Are there PPs and do they describe major manual and automated systems material management and accounting systems. The material portion of the requirement is oriented primarily to manufacturing firms but note the purchasing system PP applies to controls over purchasing subcontractor services and other high dollar purchases.

3. *Estimating*. This section states PPs need to address, at a minimum, employee training, assignment and authority of responsibilities, cost estimate development and estimating processes, activities and functions.

4. *Billing*. Are appropriate PPs disseminated to employees and do the PPs address employee training, contract briefing to identify special billing provisions and limitations and management review of billings.

5. *Planning/Budgeting*. Again, do PPs exist for how the company plans and budgets that must include a description of the system and assignment of duties and responsibilities. We used to recommend including the process of developing forward pricing rates as well as proposals in the estimating PPs but since there is a section addressing planning and budgeting it may be better to identify methods of estimating future costs and developing forward pricing rates here. The method of monitoring rates during the year is generally best identified in the accounting system policy, close to where indirect costs are described.

6. *Compensation*. Written PPs are required here that must include salary structure and administration, a description of fringe benefits that are provided to employees and a system for determining pay increases, bonuses and promotions. More and more, auditors want to see that contractors use bona fide compensation surveys to ensure their compensation levels are reasonable where there is often an independent audit conducted by the special Philadelphia based compensation team.

7. *Overall Accounting System Control Objective and Activities*. This section seeks to ensure that not only do written PPs exist but whether actual practices are consistent with the PPs. It asks whether any previous audit assignments identified failures to properly implement any of the internal controls which will be used to focus audit scrutiny on those areas.

## QUESTIONS AND ANSWERS

**Q.** We are a subcontractor on a cost type contractor and commonly buy airline tickets way in advance to save airfare. Our prime contract administrator is disallowing them saying we can invoice for the tickets only after the trip is made. What does the FAR or Federal Travel Regulations say about it.

**A**. I am unaware of any FAR or FTR prohibitions against being paid for prepaid airline tickets. The government may have such a prohibition on a specific contract. Or perhaps the prime contractor says they will pay for travel only after an approved travel expense report is submitted. Though such a prohibition may not be unreasonable, the fact the costs were incurred should under normal circumstances be sufficient basis

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to be reimbursed. If the trip is not taken, a credit can always be made. It would be best to commit this practice to writing so you can demonstrate it is your policy.

**Q**. Though our normal business is a combination of manufacturing and services, we are being asked to provide a unique service. A vendor will charge the government for its services and receive payment (let's say $1000 as an example). Then they will send us money (say $800) for administering their vendor and subcontract payments (we will use an executive part time for this effort) where we will pay the vendors (say $750) and keep the remaining amount ($50) as our fee. Though we will only record our payments as revenue (the $50) and not record either the pass through ($800) or subcontract payments ($750), we are concerned that the amount paid to vendors and subcontractors (the $750) will be required to be included in our total cost input G&A base, which would significantly lower our G&A charged on our other contracts. What can we do?

**A.** Your concern is quite valid. There are three alternatives that come to mind:

1. Arrange a special agreement with your cognizant ACO. This would be fine but ACOs are often reluctant to provide special agreements, especially without thorough review by both their analysts and DCAA. This approach makes everything visible and who knows what can be the result.

2. Create a special business segment for the pass through business. This would appear to be the "cleanest" approach. You need to avoid having to allocate "home office" costs (the current overhead and G&A costs) to both business segments so be sure all administrative costs for the new segment are included there while making clear all other costs benefit only the original business segment.

3. Treat the pass-through business as a project where all administrative costs are charged as direct labor to that project. Since neither the pass-through payments to or from your firm are on the books, there would be little likelihood it would be picked up by a government auditor. But who knows? ,

**Q**. When we purchase equipment on a cost plus contract we are only able to use it on that contract and then the Government retains ownership. We are contemplating purchasing some new equipment (computers included) and then "renting" it out to our various contracts on a monthly basis. Can you offer some guidance as to how this is accomplished?

**A**. I see nothing wrong with your renting out plan but it probably needs approval on a contract by contract basis. The rental amount would also likely need to be based on a cost of ownership rather than market based rental amount (unless that's your business) since it is a less than arms length transaction..

**Q**. Are the costs of developing our website allowable or unallowable?

**A**. Interestingly, we have not seen any guidance from the government on this issue (if you have, let us know). I would think the expenses would best fall under the category of FAR 31.205-1, Public relations and advertising. This is one of those "gray" cost principles where what is considered to be unallowable public relations costs or advertising by one person (e.g. brochures) could be considered by someone else to be allowable communications (e.g. dissemination of technical information or communications with the public and press). Ultimately, it's a judgment call until more clear guidance is offered by the government.