GCA REPORT
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NEW DEVELOPMENTS

New Contract-Related Interest Rate Set for First Half of 2012

The Treasury Secretary has set a rate of 2.0% for the period January through June 2012. The new rate is an increase from the 2 5/8% rate applicable to the first six months of 2011 and the 2 1/2% rate for the last six months of 2011. 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).

FY 2012 DOD Act Passed

President Obama signed into law Dec. 31 the FY 2012 Defense Authorization Act. Significant provisions relevant to the government contract community include:

1. Extending the current cap on reimbursable contractor compensation from the top five senior executives to all contractor employees where there is an exemption for scientists and engineers when necessary to ensure continued Defense Department access to necessary skills and capabilities. The compromise allows the continuation of the current formula-based approach to determine the amount of the cap – considering compensation of large, publicly traded companies – where the final bill rejected the Senate passed provision that would have limited compensation to the amount paid to the President, around $400,000 per year.

2. A requirement to give contractors up to 14 calendar days to provide comments or rebuttals before past performance information is posted on government websites.

3. Capping DOD spending on service contracting to the level of the Presidents FY 2010 request which resulted in a $23 Billion reduction from the President's request.

4. A ban on recent Obama Administration proposals to require contractors to provide political contribution information in conjunction with the federal acquisition process.

5. Extends authorization for the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (SBTT) programs seven years through 2017.

6. Makes various changes to DOD's cost comparison methodology for determining the appropriate mix of federal and contractor personnel and clarifies that the functions closely associated with inherently governmental functions may be contracted out.

DOD Wants Use of an Adequacy Checklist for Proposals Requiring Certified Cost or Pricing Data

The Defense Department published a proposed rule to amend the Defense Federal Acquisition Regulation Supplement (DFARS) to add a checklist for DOD contractors to complete under solicitations requiring submission of certified cost or pricing data. Use of the checklist will be at the discretion of the contracting officer. The 47 item checklist will require offerors to identify, by proposal page number, each of the items specified in the FAR 15.408, Table 15-2 or to provide an explanation for not providing each item of information. So, for example, even if the solicitation did not request data other than certified cost or pricing data the offeror would have to state the judgmental or other factors applied in the estimate where the nature and amount of contingencies assumed and the basis of all cost estimating relationships for labor or material that are not based on a discrete estimate. The checklist also includes boxes for such things as the identification of any outstanding CAS noncompliances or estimating deficiencies that may impact the proposed price, determination of uses of commercial items at either the prime or subcontract level, whether the Service Contract Act is applicable and all minimum requirements

and any special requirements such as performance-based payments. The stated reason for the checklist is to "ensure offerors submit thorough, accurate and complete proposals" where they will be able to "self validate the adequacy of their proposals." If the proposed DOD clause is included in a solicitation and the contractor does not complete it adequately the proposal can be considered non-responsive (*Fed. Reg. 71833*).

New FAR Changes Issued

The FAR Council has issued Federal Acquisition Circular 2005-55 to change the FAR. Significant changes include:

1. A final rule aimed to ensure COs are aware of restrictions on use of time-and-material and labor-hour contracts for commercial services. The rule implements recommendations by the GAO to (a) ensure T&M/LH contracts are used to acquire commercial services only where other types of contracts are not suitable and (b) instilling discipline in the determination of contract type to better manage risk to the government (*Fed. Reg. 194*).

2. A final rule ensures public access to the Federal Awardee Performance and Integrity Information System (FAPIIS). The rule revises the prior practice of having FAPIIS available only to government officials, including acquisition officials, to now allow a seven-calendar day review period to identify information in the FAPIIS that is covered by the disclosure exemption under the Freedom of Information Act (FOIA). Under the new rule, the information entered into the FAPIIS such as past performance information by the contracting officer will be made publicly available within an additional seven day calendar period unless the contractor asserts to the government official who posted the item that it is protected under FOIA. In such a case the information will be removed and the issue resolved in accordance with the agency's FOIA procedures. If the item is not removed it will automatically be released to the public site within 14 calendar days after the review period starts (*Fed. Reg. 197*).

3. A final rule to prevent abuses of interagency contracts that may be needed to allow supplies and services to be obtained by multiple agencies to allow one agency to provide assistance to another one to award or administer a contract, task or delivery order. The rule will (a) broaden the scope of coverage to address all interagency acquisitions with the exception of federal supply schedules orders under $500,000 (b) requiring agencies to support their decision to use an interagency acquisition with a determination that such action is the "best procurement approach" and (c) directing that assisted acquisitions be accompanied by written agreements between the requesting and servicing agencies documenting their roles and responsibilities (*Fed. Reg. 183*).

DOD Issues Final Rule on Contractor Business Systems

(*Editor's Note. The following rule is partially behind the proliferation of "systems audits" we see being conducted by DCAA.)*

The Defense Department issued a final rule Feb 24 to amend the Federal Acquisition Regulation Supplement that will allow contracting officers to withhold payments if they find "significant deficiencies" in contractor business systems. The rule finalizes an earlier interim rule issued in May 2011. The rule defines business systems as accounting systems, estimating systems, purchasing systems, earned value management systems, material management and accounting systems and property management systems. Both the interim and final rule stipulate the total amount of withheld payments for a contract cannot exceed 10 percent where (1) there is a limit of 5 percent of withheld payments for significant deficiencies in a single contractor business system and (2) requires that a withhold be reduced by at least 50 percent if a CO has not determined whether the contractor has corrected significant deficiencies or if there is reasonable expectation that corrective action have been implemented (*Fed. Reg. 11355*).

DCAA to Perform CAS Compliance Steps During its Regular Audits

The Defense Contract Audit Agency issued an audit alert reminding its auditors that they are required to consider compliance with applicable cost accounting standards in every contract audit they conduct. It reminds auditors that current policy requires a comprehensive audit of all applicable standards (except for the four covering modified covered contracts – 401, 402, 405 and 406 – because these standards are supposed to be reviewed as part of all audits) once every three years unless circumstances call for audits sooner. The guidance states that other workload requirements and priorities have resulted in a failure to conduct these audits every three years so to ensure compliance auditors are told now to design steps to ensure compliance during other regular audits. The guidance states these steps are not expected to include all steps of a normal CAS compliance audit but rather only those steps associated with significant costs (*11-PAC-02(R).*

Proposed DOD Rule on Cost or Pricing Data to Align DFARS with FAR Changes

The Defense Department is proposing to change the DFARS to ensure its definition of cost or pricing data as well as requirements for submission of certified cost or pricing data and data other than certified cost or pricing data is consistent with FAR provisions including 2010 changes. The 2010 changes resulted in (1) refinements to the definition of cost or pricing data (2) the addition of a definition of certified cost or pricing data (3) the addition of a definition for data other than certified cost or pricing data and (4) deletion of the phrase "information other than cost or pricing data." DOD states the proposed rule does not expand or delete CO's rights to obtain cost or pricing data but rather "merely aligns" the DFARS with the FAR. For more information on the 2010 FAR changes see the Sep-Oct 2010 issue of the GCA REPORT and the 4Q10 issue of the GCA DIGEST (*Fed. Reg. 2680*).

SBA Size Standards Increase

As part of its first comprehensive review of size standards since the 1970s the Small Business Administration has issued a final rule Feb 10 increasing size standards for firms providing technical, professional or scientific services to the government. The final rule, effective Mar 12, modifies 18 standards from an interim rule issued last year. In the final rule the SBA increased size standards for 34 industries and three sub-industries in NAICS Sector 54 including: (1) Engineering Services, from $4.5 Million to $14 Million (2) CPA firms, from $8.5 Million to $14.5 Million (3) Human Resources firms from $7 Million to $19 Million. In addition, computer facilities management and computer systems design services increased slightly while the SBA kept 11 industries in the NAICS Sector 54 at their current levels such as interior and graphic design (*Fed. Reg. 7490).*

Final Rule on Labor Relations Costs

A final amendment to FAR 31.205-21 was passed to make unallowable the costs of any activities to persuade employees of any corporate entity either to exercise or not exercise its rights to organize and bargain collectively through representatives of their choosing. The stated purpose is to promote economies and efficiencies to disallow costs "not directly related to the contractors' provision of goods and services." The final rule left in tack the allowability of such costs as shop stewards, labor management committees, employee publications and other related activities that FAR 31.205-21(a) allows for. However, the new rule adds a new paragraph, 31.205-21(b), making unallowable any costs of so-called "persuader activities" including, but not limited to (1) preparing and distributing materials (2) hiring or consulting legal counsel or consultants (3) meetings that include paying the salaries of attendees and (4) planning or conducting activities by managers, supervisors or union reps during work hours. For example, in responses to public comments on the rule, the drafters stated costs of employees' time spent on collective bargaining or other activities between employers and unions to minimize labor disputes would be considered costs of collective bargaining and not persuader activities and hence allowable in accordance with section 21(a) while any legal efforts that emerge from activities associated with the new section 21(b) provisions would be unallowable (*Fed. Reg. 68040*).

DOD Requires Cost or Pricing Analysis for Spare Part Acquisitions

In response to numerous IG and GAO reports criticizing overpricing of acquisition of spare parts, Shay Assad, Director of DOD Pricing issued a memo directing contracting officers to conduct cost or pricing analyses of proposed spare parts before exercising options on firm-fixed price contracts containing spare parts. The memo states COs should use appropriate sampling techniques or request field pricing assistance and include in the contract file a written determination that exercising the option complies with option terms in FAR 17.202 and FAR Part 6 (for a copy of the memo go to www.acq.osd.mil/drap/policy.)

DCAA Appears to be Increasing Audits of Public Vouchers

Comments from clients, subscribers, consultants and auditors themselves indicate that audits of contractor public vouchers are becoming more of a priority of DCAA and as a result many contractors are seeing a significant increase in such audits. Though we have not yet seen any formal guidance and rumors of audits of 100% of all vouchers proved incorrect, DCAA is nonetheless auditing more of both new contractor vouchers as well as applying statistical sampling plans to vouchers of veteran contractors resulting in the perceived increase.

Final Rules on IR&D

To help ensure the condition of allowability that independent research and development costs have a "potential interest to DOD" a final defense rule was

passed that imposes new requirements on "major" contractors to report on their IR&D activities. The changes to DFARS 231-205-18(C) state that for IR&D costs to be allowable, the IR&D projects must be reported at least annually and when a project is completed. This requirement applies to IR&D projects exceeding $50,000 and only to "major" contractors who are defined for this purpose as those segments with annual IR&D and Bid and Proposal costs exceeding $11 million. Covered contracts exclude firm fixed contracts and segments are excluded who have less than $1.1 million of annual IR&D/B&P costs *(Fed. Reg. 4632).*

DOD Memo Distinguishing Between Direct and Indirect Bid and Proposal Costs

The Director of Defense Pricing, Shay Assad, issued a memo reminding DOD officials that certain bid and proposal costs are indirect costs whereas proposal preparation and negotiation support costs associated with a contractual requirement under an existing contract are direct costs only. The memo stresses that the B&P costs as a contract requirement must be allocated to the contract that requires the proposal and cannot be transferred either to the new contract resulting from the proposal nor charged as indirect B&P.

DCAA and DCMA Seeking Increases in Staffing

The Feb 29th issue of the Darrel Oyer Newsletter drew our attention to a Feb 29 Washington Post article stating that the Defense Department is seeking to add 1,612 employees to increase staffing to DCAA and DCMA to "oversee and audit contracts next year" even while it is planning on cutting the US military budget by 5%. DCAA is seeking a 16% increase in funding to catch up on an audit backlog worsened by the surge in spending following Sept. 11. DCAA expects to complete $173 billion of incurred cost audits in FY 2013, compared to only $19 billion in 2011 which, in turn, represented a 44% decrease over the prior year audits of $34 billion. The article states the contractor community favors the increase because it is aimed at reducing the $400 billion in unaudited contract bills where the moneys left on the table now will be highly welcomed in an anticipated austere environment. (*Editor's Note. This development is consistent with recent emphases within DCAA to reduce the incurred cost audit backlog where we are seeing the creation of specialized, dedicated incurred cost teams who focus only on IC audits.*)

CASES/DECISIONS

Board Rejects DCAA's Executive Compensation Findings as "Fatally Flawed"

(*Editor's Note. Unless a contractor is a large company DCAA will not apply OMB determined annual caps but will, instead, conduct its own review of reasonableness of executive compensation where significantly lower caps will apply. The following case has extensive relevance to those reviews where there are far too many points made to adequately summarize here so we will provide a detailed analysis of the case in the next issue of the GCA DIGEST.*)

J.F. Taylor included executive compensation of one CEO and four VPs in its indirect cost pools contained in its incurred cost proposals for FYs 2002-2005. DCAA's compensation team conducted its usual review of the reasonableness of these executives' compensation where it utilized 4-5 compensation surveys, took an average amount of compensation for each benchmarked position, added a 10% "range of reasonableness" (ROR) factor" and questioned the difference, $590,000, between its findings and actual compensation paid. In its appeal, the ASBCA ruled there were "statistical flaws" in the government's methodology where eight of nine allegations of flaws by JF were upheld, resulting in the board ruling the $590,000 of questioned costs should be reduced to $42,000. The eights flaws included:

1. Most notably, the board rejected the 10% ROR amount stating the dispersion of data was much larger than 10 percent.

2. Large differences in survey sizes are not taken into account where, instead, DCAA simply treated each survey as equally valid and takes an average of all surveys used.

3. DCAA fails to take into account relative financial performance of the company it is measuring when it puts forth its initial results.

4. Relevant discriminators are not taken into account when comparing survey results with JF compensation. The Board mentions two such factors as security clearances and customer satisfaction.

5. Different industry classifications over the four year period were examined.

6. Varied position titles were used from one period to the next.

7. Different surveys were used from one year to the next.

8. Inconsistently used different measures such as means and medians.

The ninth practice which was brought to the board's attention as flawed, was accepted by the board. VPs, who were paid equally but are responsible for various service and product areas of the company, were benchmarked in the surveys against different revenue amounts corresponding to the revenue generated from the different sectors of the business they were responsible for (*J.F. Taylor, ASBCA Nos. 56105 and 56322)*.

We are expecting lawyers to offer their opinions on the impact of this striking case on current outstanding audits and future compensation practices. As of this printing, DCAA is not telling its auditors about the case where they are continuing to follow the same approach they have in the past. Thus far, there appears to be no plans to appeal the case – DCAA does not have legal status to make an appeal but the Defense Contract Management Agency does. However, DCMA has until May 31 to file an appeal. Though there is no decision yet about an appeal, DCMA has apparently filed for reconsideration of the ASBCA decision where JF will have until March 31 to respond.

Appeals Board Rules Conditions for a Bid Mistake Were Not Met

The Department of Agriculture issued a solicitation for a restoration project where the government's total estimated cost was $452,000 and it awarded the contract to Singleton, the low bidder, for $482,000. Seven months into the contract Singleton notified the CO of a mistake in its bid saying it underbid for a line item for excavation and dredging stating the bid should have been $751,000. The CO found there was no convincing evidence of a mistake while Singleton argued it satisfied the requirements of FAR 14.407-4 for establishing a mistake in bid and sought a contract reformation for the mistake. The appeals board stated that when a contractor seeks reformation of a contract based on a unilateral mistake in bid it must show (1) a mistake in fact occurred prior to award (2) the mistake was a clear cut clerical or mathematical error or a misreading of the specification and not a judgmental error (3) the government knew or should have known about the mistake prior to award (4) the government did not request bid verification and (5) proof of the intended bid was established. The Board denied the appeal stating the third condition was not met where Singleton did not present to the CO or the board clear and convincing evidence the government should have known about the mistake before the award. It stated that Singleton's bid was within seven percent of the government's estimate which was reasonably calculated and further the CO reasonably concluded there was no meaningful disparity between Singleton's bid and the second-lowest bid resulting in the conclusion no pre-award verification of bids was necessary (*Singleton Enterprises vs Dept. of Agriculture, CBCA No. 1981*).

Court Rules that CAS 418 Allows For Allocation of Material Support Costs on a Direct Labor Base

Sikorky's accounting practice was to allocate a pool of material support costs on a direct labor cost base. The government, alluding to CAS 418-50(e), which addresses indirect cost pools of service center costs, asserted it was improper to allocate material related indirect costs on a direct labor base rather than a direct material cost base. Sikorsky argued, and the court agreed, that the plain language of CAS 418-50(d) is applicable here where it demarcates indirect cost pools using two criteria: whether the pool contains significant management or supervisory costs and second whether the activity being managed involves "direct labor or direct material costs." The Court ruled that CAS 418-50(d) applies here where the overhead pool included (1) a material amount of. management and supervision costs (2) and a base of activities involving direct labor or direct material costs (*Sikorsky Aircraft Corp. v U.S., 2011 WL 5970962*).

Bid is Not Unresponsive

(*Editor's Note. The following shows that a minor failure to respond to a solicitation need not be fatal.*)

The Army Corps of Engineers' Invitation for Bids required bidders to complete a schedule listing 378 separate line items that included spaces for bidders to insert their prices. The Corps rejected WB's bid as nonresponsive because it (1) failed to include a unit or extended price for a line item for tree removal services and (2) contained a number of line item prices that were unbalanced i.e. significantly higher and lower than the prices in an independent government estimate. WB filed a protest asserting the omission of one line item was immaterial where the Corps should have waived it as a minor informality. The GAO agreed with WB stating (1) the line item was divisible from the solicitation's overall requirements and was not an essential part of

the contract work effort and (2) the line item was de minimis as to the overall cost and would not affect the competitive standing of the bidders. The GAO also agreed with WB that the Corps had incorrectly found the bid unresponsive due to unbalanced pricing. Citing FAR 15.504-1(g) the Corps could only reject an unbalanced bid if it posed an unacceptable risk but the CO had failed to conduct such an analysis (*W.B. Construction & Sons, GAO. B-405818*).

Mandatory Waiver of Penalties Apply Only When the Aggregate of Unallowable Costs Exceed $10,000

(*Editor's Note. We have been writing about penalties imposed on unallowable costs lately because contracting agencies are pushing for imposition of these penalties. One of the exceptions we have mentioned is if those unallowable costs are less than $10,000. The following case addresses how to measure this $10K limit.*)

FAR 42.709-5(b) provides that a mandatory waiver of penalties applies to unallowable costs less than $10,000. In its initial decision in *Thomas Assocs. Inc* the appeals board ruled the contracting officer was required to waive the penalties for *individual* items that were less than $10K. The government moved for a reconsideration of this ruling arguing that the "amount" referred to in the FAR is the total of all costs, not each cost analyzed separately. The government argued that during the rule making process the General Administration Services Administration admitted the issue was unclear and stated "We note that the waiver threshold refers to the portion of the total penalizable costs (included in a settlement proposal) which are allocated to covered contracts using the contractor's established allocation practice." The Board sided with the government finding the drafters "clarification" persuasive, reversing its earlier determination, ruling the waiver applies only if the *aggregate* amount unallowable costs are less than $10,000 (*Thomas Associates Inc,., ASBCA No. 57126).*

NEW/SMALL CONTRACTORS

Differences Between a Request for Equitable Adjustment and a Claim

(*Editor's Note. We help many clients prepare and justify both requests for equitable adjustments (REAs) and claims. Both have separate rules where we frequently find confusion from both our clients and even their attorneys. Since contractors are likely to file for one or both and recent court cases have caused some confusion we thought it would be a good idea to clarify the differences and rules. We came across an excellent article by Professor Ralph Nash and Vernon Edwards in the February issue of the Nash & Cibinic Report where we have used their ideas as well as our experience for this article.)*

Is there a difference between a REA and claim – the two authors differ a bit on this question. Prof Nash states yes where an REA is a request that the CO enter into negotiations for a contract modification to provide an equitable price adjustment for some event(s) that occurred during contract performance (mostly an ordered or constructive change). A claim is a request to the CO to render a decision under the Contract Disputes Act (CDA) to start the disputes process.

The two have different characteristics in terms of timing considerations, cost reimbursement and various rules of presentation. As for timing, an REA does not put any specific time constraints on the CO to work on the issues raised while under CDA rules, a the CO must respond to a claim within 60 days if less than $100K and within a reasonable period of time if more than that amount. As for reimbursement of outside and inside effort related to preparation and negotiation of an REA all reasonable costs are reimbursable while such costs after a claim is submitted are not reimbursable per FAR 31.205-47(f)(1) even if negotiations continue. In contrast, a claim starts the clock running for interest payments for any recovery of costs through either litigation or negotiation while no such interest is due under a REA. In effect, a REA sacrifices interest for reimbursement of costs for preparing and negotiating a recovery. With the exception of routine requests for payment (which cannot be considered a claim) the contractor is free to submit either a REA or claim where in practice, an REA is usually submitted first so as to negotiate a settlement before litigation and have its preparation and negotiation costs be allowable.

REAs and claims are distinctly different documents with their own set of rules. An REA should request the CO enter into negotiations as soon as the REA is examined. Though there is no required format, each REA should describe the adjustments requested, state the grounds for the request, identify the contract clause(s) that provides for the adjustment and state the basis on which any requested amount is calculated. If the REA is part of a defense contract over the simplified acquisition threshold (currently $100K) the REA must certify "the request is made in good faith" and that "the supporting data are accurate and complete to the best of (the

certifier's) knowledge and belief." (See DFARS 243-204-71 and the clause in the DFARS at 252.243-7002. Some other agencies often have their own specific requirements e.g. NASA in the NASA Supplement 48 CFR 1852.243-72.)

A claim, in contrast, should request a decision by the CO under the "Disputes" clause of the contract. Like a REA no specific format is required but it should include a request for a "sum certain" (specific dollar amount) the contractor is entitled to. If the amount of the claim is over $100,000 it must certify (1) it is made in good faith (2) the supporting data is accurate and complete to the best of the certifier's knowledge and belief (3) the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable for and (4) the certifier is duly authorized to certify on behalf of the contractor. This certification is required even if the REA contained a separate cert.

Several cases have addressed what happens when these rules are not followed. The authors allude to two recent cases. In *Zafer Taahhut*, the contractor called its submission an REA where it more closely resembled a claim, requesting a CO decision, stating a sum certain and including claim certification language except the wording for "claim" used "REA" instead. The CO treated it as a REA, entered into negotiations and issued a decision granting the contractor half the amount it was requesting. The contractor responded it did not agree to the amount in the decision, asking for a CO decision for more compensation which included an unsigned certification using correct claim language. The Government contented the appeals board had no jurisdiction since the second submission was not a CDA claim because there was no signature and the first submission was not a claim since both parties treated it as an REA. The Board disagreed saying it did have jurisdiction ruling the first submission had all the elements of a claim and the fact that the word "request" was used instead of "claim" was "inconsequential."

In *Environmental Safety*, the Government asserted the contractor was late in its appeal (90 days after a final CO decision for the Appeals Board and one year for an appeal court) The contractor contended it had submitted two "claims" to the CO that had not been acted upon and as a result they were "deemed denied" which under prior case law had established there was no time period for which they had to be appealed. The court rejected the contractor's position because the contractor had not included a CDA certification in its letter requesting the contract be modified to increase the price from the change.

The second author, Vern Edwards, added some different points of emphasis that shows it is not always clear whether an REA is or is not a claim. He asserts that there is not an official definition for an REA where like a claim it is a request for something. If an REA has all the attributes of a claim as defined in FAR 2.101 and 53.233-1 and asks for a CO decision, either explicitly or implicitly, then a REA is a claim. According to Mr. Edwards it is well established in case law that a claim need not state it is a claim, the request for a CO decision need not be express and the request need not refer to the CDA or Dispute clause in the contract. He concludes that an REA may or may not be a claim and recommends that the contractor make its intentions clear.

QUESTIONS & ANSWERS

Q. We have a commercial business. Since our firm has one EIN number, are we required to include the commercial business costs in our indirect cost bases?

A. If the firm is one business then all costs, whether they be government or commercial, should be included in the indirect cost bases. However, if the commercial business qualifies as a separate business segment (e.g. reports to a "home office", has its own complement of management and administration services, distinct product or service lines) then you can exclude those costs from your indirect costs just as any other business segments would be excluded. For government accounting purposes, a business segment need not be a separate legal entity but needs to meet the conditions for a business segment. FAR 2.102 and various sections of the cost accounting standards (e.g. CAS 403) provide definitions of business segments.

Q. We overbilled the government about $1 million in 2011 due to the fact we received a significant amount of unexpected material costs which resulted in lowering our actual indirect cost rates. What do we do?

A. Once you make sure the material costs are bona fide costs for 2011 (as opposed, for example, simply inventory costs for future work) I would notify your ACO as soon as possible and issue a credit invoice for the amount of the overbilled amount. These days, the government is definitely on the look out for contractors who do not adequately monitor their indirect cost rates and adjust billings for actual amounts on a timely basis where failure to do so are increasing met with such

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opinions as inadequate billing and accounting systems. I would make sure your written policies address these issues and you have a model in place to monitor indirect costs though out the year. Such negative opinions, together with the significant amount of overbilling, can adversely affect your ability to obtain new work.

Q. We are a small business where for financial accounting purposes we apply IRS tax practices for depreciation. So for some of our assets we declared $40K of section 179 costs (where you write off the whole amount) on our income tax, financial statements and government accounting forms. FYI, our depreciation costs following generally approved accounting practices (GAAP) would have been $15K this year. Do you see a problem?

A. Yes. Unless you were allowed to assume a useful life that was considerably less than IRS guidelines (e.g. use of a dedicated piece of equipment on a one year contract) you need to follow GAAP practices for government accounting of depreciation costs. (It may be a different story if you are CAS covered which is not the case here.). Your decision to follow tax accounting for financial reporting purposes would likely be problematic but you need to use the $15K figure for government accounting purposes.

Q. We have an employee that sometimes charges his time direct and sometimes to G&A for marketing and planning activities. Our corporate controller states there is a FAR clause that prohibits charging G&A people direct? Could you give me your opinion.

A. We are unfamiliar with any such FAR clause or any other regulation so I would be curious for him to provide it. Unless there is some contract provision that identifies who may charge direct, which would be highly unusual, any employee should be able to charge direct or indirect as long as there is adequate documentation (e.g. timesheets) supporting such activity.

Q. We have a subcontract agreement with one of our vendors. Is that subcontractor required to submit certified cost or pricing data and are we required to conduct cost or price analysis for their proposed costs on our new proposal?

A. Several years ago the FAR made a distinction between actual and prospective subcontractors where actual subcontractors were not required to submit certified cost or pricing data as long a there was a bona fide agreement in place. However, a review of the FAR indicates those FAR provisions no longer exist. Now, the government is highly focused on adequate submissions by subcontractors and whether prime contractors are adequately analyzing proposed subcontract costs so unless you can provide evidence the proposed subcontract prices are based upon compliant commercial item pricing you should play it safe and ask for the certified cost data if thresholds are met and follow requirements to adequately conduct price or cost analysis.

Q. Our former owners are paid, sometimes for direct projects they work on and then the remaining amount is charged to G&A. Can we add G&A to any of these costs?

A. No for the G&A costs (can't add G&A to G&A pool costs) but yes for the direct costs assuming they are included in the G&A base. If they are classified as employee costs or "consultant" costs then it depends on whether those categories of costs are included in the G&A base.

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