
GCA REPORT

(A publication of Government Contract Associates)

July - August 2002

Vol 8, No. 4

NEW DEVELOPMENTS

FAR Council Issues FAR 2001-08

The FAR Council has issued three substantive final rule changes comprising amendments to the Federal Acquisition Regulation (FED. REG. 43,512).

Allowable Relocation Costs. Following numerous proposals in the last few years, the new rule amends the FAR relocation cost principle at FAR 31.205-35. The final rule recognizes the growing commercial practice of reimbursing relocations on a lump sum basis. When a lump sum approach is used, the current limit of \$1,000 for miscellaneous expenses has been increased to \$5,000 (the original proposal was to eliminate the ceiling completely). The cost principle continues to have no ceiling for miscellaneous expenses when the reimbursement is based on actual expenses.

The new rule also (1) eliminates the prohibition of reimbursing so call "tax gross up" expenses and now allows payments for increased employee income and FICA taxes caused by relocation reimbursements and (2) reimburses employees for spouse employment assistance. The refusal of Government to reimburse these customary expenses of relocation has been a bone of contention with contractors. The Council now says that when contractors incur these expenses in a good faith effort to keep transferred employees from being adversely affected by relocation, it is equitable to reimburse contractors for the costs. The new rule also amends the "compensation for personal services" cost principle at FAR 31.205-6(e)(2) to clarify that though differential allowances paid to compensate for increased taxes on *employee compensation* payments to compensate for increased taxes incident to allowable reimbursed *relocation* costs are allowable.

Federal Supply Schedule Incidental Item and Dispute. The change incorporates rulings from several recent cases that "incidental items" purchases from FSS contractors that are not included in FSS schedules must be competed separately. FAR 8.401 is amended to require that the ordering officer follow pertinent regulations (i.e.

publications, competition, etc.) when purchasing items not on the FSS. The price for the incidental item must be fair and reasonable and all clauses applicable to items not on the FSS must be included in the order. In addition, to expedite disputes arising from FSS orders, FAR 8.405-7 is amended to have *performance* disputes resolved by the ordering office or by referral to the schedule CO while disputes to *terms* of a schedule contract resolved by the schedule CO. Contractors can still appeal to appeals boards or U.S. Court of Federal Claims but COs are advised to use alternative dispute resolution procedures to the "maximum extent possible."

Definition of "Claim" and Terms Related to Termination. The definition of "claim" and other terms related to termination have been added to the "Definition" section of FAR 2.101. The purpose of the changes is not intended to alter the meaning but only to consolidate the definitions that are found in various sections of the FAR. The final rule also revises FAR 33.213(a) to clarify the distinction between claims "arising under" and claims "related to" a contract. Claims "arising under" a contract can be resolved under a contract clause other than the FAR 52.233-1 "Disputes" clause or under it while a claim "relating to" a contract cannot be resolved under a contract clause other than the Disputes clause.

DOD Clarifies the Prime Must Decide if Subcontract Items are Commercial

Effective May 31, the Department of Defense has issued a final rule intending to clarify the responsibilities of contractors and contracting officers regarding determination on whether a subcontract items meets the FAR 2.101 definition of commercial item. The final rule amends the Defense Federal Acquisition Regulation Supplement Part 244 specifying (1) it is the contractor's role to determine whether a particular item meets the definition of commercial item and (2) when conducting a contractor purchasing review (CPSR) the CO will review the adequacy of contractors' documenting commercial item determinations. (CPSRs are required when contractors' sales to the government are expected to exceed \$25 million during the next 12 months or where the ACO determines the contractor poses a sufficient "risk" to need a CPSR. (Fed. RE. 38.023).

DOD Memos on Improper Information Holding up Speedy Payments and Improper Use of Fast Payments

The Department of Defense issued two separate internal memos addressing (1) improper information holding up timely payments to contractors and (2) fast payment procedures.

Improper Information. A memo from Director of Defense Procurement Deidre Lee stressed the need for proper inputting of information into automated systems to ensure contractors get paid correctly and on time. Several examples of either improper inputs or inadequate information received from contractors include: (1) contract line items that indicate end items are inconsistent with the way contractors actually ship and bill items that reference a component level (2) when “lots” (the unit of issue where partial shipments are not payable) are specified in the contract and the contractor separately ships various components of the “lots” making matching difficult or (3) reference by the contractor of requirement descriptions in the proposal which do not match descriptions in the contract where most paying activities have no access to the proposal. The memo stresses the need to work with suppliers to provide adequate information to assure faster payments.

Fast Payments. Lee also expressed concern there have been excessive fast payment procedures included in contracts without the precondition for such procedures being met. FAR 13.402 allows payment of a contract prior to verification that supplies have been received and accepted under limited conditions: delivery of supplies occur at locations where there is both a geographic separation and disbursing activities that make it impractical to make timely payments. In response to these concerns, Lee issued guidance saying use of fast payment procedures should be employed only when payment must be made inside the U.S. for delivery made outside.

Industry Wants Greater Clarity on Contract Flowdowns

(Editor's Note. The following helps clarify what clauses are required flowdowns from prime contracts to subcontracts and the status of other clauses.)

The Council of Defense and Space Industry Associations (CODSIA) said several proposed revisions to the FAR regarding flowdown of certain clauses to subcontracts involving commercial items need to be clarified. CODSIA is concerned that a recent proposal to update FAR 52.212-5 on contract terms and

conditions intended to ensure various statutes and executive orders containing civil and criminal penalties be included on the list of mandatory flowdowns will confuse contractors. The proposal deletes the current clause's language that prime contractors are only “required” to incorporate five designated clauses in their subcontracts and CODSIA is worried prime contractors might conclude that all 23 required prime contract clauses should be “flowed down” to subcontracts. CODSIA also expressed concern that the proposed additional language stating a prime contractor “may include in its subcontracts a minimal number of additional clauses to satisfy its contractual obligations” is problematic. CODSIA says the additional language is unnecessary since prime contractors “always” have the right to include discretionary terms and conditions and the language seems to allow additional flowdowns to lower tier suppliers, which is contrary to government policy.

DCAA Issues Guidance to Auditors

The Defense Contract Audit Agency has been quite active in the last two months issuing various guidance to its auditors in the form of Memorandum to Regional Directors. Of particular interest to our readers:

- **“Fraud Risk” as Additional Area of Audit**

DCAA has advised its auditors to add a preliminary audit step for reviewing “fraud risk indicators” to its audit programs. Auditors are instructed to review the principle sources for fraud risk indicators (listed in the Contract Audit Manual Figure 4-7-3) and become familiar with those that are applicable to the type of audit being conducted. Based on this preliminary review, auditors should assess the risk of fraud. If no fraud risk indicators are identified, this should be documented with a statement saying which indicators were considered. If fraud risk indicators are identified, they should be documented along with the auditor's response/actions to the risks and any additional audit steps to be performed.

Examples of fraud indicators are:

1. Unexplained changes to timecards transferring hours from commercial firm fixed price contracts to government cost type work.
2. Employee time charged differently than associated travel costs
3. Significant material costs charged to cost type contracts where follow-up work shows the material was not needed.

4. Inter-company profit claimed and billed for an inter-company affiliate who the contractor represented as an independent subcontractor.
5. Overrun contract costs or otherwise unallowable direct costs charged to indirect expenses for allocation to other contracts.
6. Expressly unallowable costs recorded in accounts that are generally allowable such as small tools and supplies (MRD-02-PAS-039(R)).

- **Expand Search for Billings Exceeding Actual Costs**

DCAA has been conducting special audits of contractors' vouchers for overpayments and has found numerous instances of billings exceeding actual costs. It has issued guidance on lessons learned from these audits and provided guidance on expanding the search for such overpayments, either in audits of overpayments, billing system reviews or other audits. Auditors are instructed to test contractors' procedures for reconciling recorded costs to billed costs and ensure procedures are provided for prompt adjustment to billing when recorded costs become less than billed costs.

Auditors are told to compare billing rates to year-end submitted rates, audit determined rates or CO negotiated rates to see if billings need adjustment. After billing rates are settled, auditors are to selectively review paid billings and billing records for physically complete but not closed contracts to ensure correct billing rates are being used and that retroactive downward adjustments have been made. If the contractor does not make necessary adjustments to its billings after being notified that billed costs exceed recorded costs, the audit office is to issue a Form 1 on cost type contracts and on non-cost type contracts, to notify the COs and payment offices of the overpayments (MRD 02-PPD-044(R)).

- **Expand EDP Reviews at Non-Major Contractors**

Whereas DCAA has long audited major contractors' computerized information systems in its system reviews, non-majors have been pretty much left alone. In response to GAO concerns over the validity of computer generated data and the amended "Yellow Book" of government auditing standards to better assess computer controls, DCAA auditing "non-major contractors" must now document working papers to show the level of reliance it can place on data generated from contractors' computerized information systems. The new guidance says if the audit is "highly dependent" on computer generated information and the controls related to these systems have not been adequately tested

in other audits, DCAA must either (1) develop, document and reference in a new section of standard working papers (B-2) which procedures/tests in this audit will support reliance on the data or (2) qualify the audit report to reflect the results that could be "significantly" impacted by computerized systems whose reliability has not been determined. (*Editor's Note. It remains to be seen what additional audit steps will be taken. It would seem most contractors these days are "highly dependent" on computer generated data. Auditors conducting system reviews at major contractors are usually specially trained and skilled in this unique field and we would hate to see less trained auditors conducting EDP audits at non-majors.*) (MRD 02-PQA-050(R)).

- **Unilaterally Decrement "High Risk" Contractors' Total Contract Costs by 20%**

DCAA revised its guidance for auditors developing unilateral rate recommendations for high risk contractors and now advise them to decrement total contract costs by 20 percent unless their conditions allow a lower rate. A high risk contractor is considered one that fails to submit its final indirect cost proposal within six months after it is due – in other words, 12 months after the end of its fiscal year – and has not been granted an extension. Under these circumstances the auditor is told to recommend to the CO that they exercise the authority provided in FAR 42.703 and 42.705 to unilaterally establish contract costs.

DCAA says it developed the 20 percent decrement factor after reviewing actual audit experience of 100 contractors. The new guidance replaces prior guidance that provided for use of the lower of approved provisional billing rates or actual rates reduced by a decrement factor using prior years' audit experience. DCAA explained they believe this older guidance would not "result in unilateral rates that were set low enough" to reflect all unallowable costs.

The guidance does allow contractors to use "recent relevant historical data" only when the following criteria is met: (1) prior fiscal year has been audited (2) all contractor submissions received have been audited (3) the indirect cost pool and base data for the subject fiscal year is readily available in the contractor's books and records (4) there has been no significant changes in the contractor's business base (5) there has been no significant reorganization and (6) there has been no changes in the indirect cost rate structure from the last year of audit. If there are multiple overdue submissions, the auditor is to use recent relevant historical data only for the earliest fiscal year and use the alternative 20 percent decrement for the remaining years.

The new guidance also adds a new notification requirement when contractor submissions are five months overdue. In this fifth letter – only four were required earlier – the contractor is to be notified that unless submission is provided or the CO has extended the deadline, DCAA will recommend the CO unilaterally establish either indirect cost rates or total contract costs (MRD 02-PPD-049(R)).

- **Responsibility of Settling Incurred Cost Rates Convert From CO to DCAA**

In continuing efforts to expedite contract closeouts DCAA is taking the initiative to transfer the responsibility of settling final indirect rates from the CO to an audit determination. The DCAM Chapter 6-703.d(1) provides procedures for transferring the responsibility when (1) the impact of costs questioned from the incurred cost audit is less than \$300,000 on flexibly priced contracts and (2) the audit issues were clean cut (e.g. not precedent setting) so the rates can be settled with little difficulty. The conversion can be made when the ACO has not started negotiations on the affected year and the ACO and auditor believe the change saves time and effort. The guidance identifies 547 incurred cost reports that meet the criteria and auditor are instructed to begin the conversion (MRD 02-PPD-024(R)).

TRAVEL...

- **Agency Policies Override Travel Regulations**

(Editor's Note. The following two cases should alert employees that though travel regulations may generally provide for a cost reimbursement some agencies may have policies to override this so it's a good idea to become familiar with travel and relocation policies of agencies you do business with.)

Reimbursement for taxi expenses are usually allowable but... An employee for the Veterans Administration asked for permission to rent a car to travel to a local but out of the way course the agency had agreed to pay for. Though she was able to borrow a friend's car for the first two days she took a taxi to the course for the next two days believing travel regulations allowed taxi costs. The VA refused to reimburse the employee stating it was against agency policy to reimburse her because the agency had a policy against reimbursing rental car and taxi fare for local travel. The General Board of Contract Appeals denied her appeal noting the Federal Travel Regulations provide for reimbursement of local taxi fare when an agency deems it is "necessary" and "advantageous" to the government. The agency's standing policy against using taxis for local travel is within their discretion to prohibit (GSBCA 15693-RELO).

Employees are usually entitled to actual lodging rates under special circumstances but... Though the per diem lodging rate in Albuquerque was \$65 the employee was told there were no rooms available for a conference and sought reimbursement of \$432 (\$144 per night) while the agency paid him \$195 (\$65 per night). In the appeal, the Board noted the Department of Education allowed that actual expense travel may be approved after the fact in only "emergency or unexpected travel situations." GSBCA sided with the agency stating it had the discretion to set its own policies and had determined the employee did not qualify for approval since he knew about the lack of government rate hotel rooms (GSBCA 15803-TRAV).

- **Costs Incidental to Financing a New Home are Unallowable**

The Department of Defense refused to reimburse a civilian employee who was transferred the following charges: (1) an underwriting fee (2) a tax service charge for determining the actual amount of taxes still owed at closing time and (3) a courier fee for buying a new home. The GSBCA denied the appeal noting the FTR precludes reimbursement for fees, charges, costs or expenses that are part of finance charges under the Truth in Lending Act, which explains that finance charges are those "charged direct or indirectly by the creditor as incidental to extending credit." The Underwriting fee and tax service charge are expenses connected with the "extension of credit." The courier fees are not part of extending credit but ruled that unless fees are "necessary" for the purchase of a house they are not reimbursable and the title company's use of courier service was considered "a matter of convenience not necessity" (GSBCA 15069-RELO).

- **Recent Regulatory Changes**

Both the Joint federal Travel Regulations and the Joint Travel regulations have been amended to: (1) Effective January 21, 2002, mileage rates for privately owned vehicles (POV) are \$.365, motorcycles \$.28 and airplanes \$.975 (U2600, U4125-B, U4130-B, U7150-65b) (2) modify the definition of "conference" to indicate the term does not include regularly scheduled courses of instruction conducted at a government or commercial training facility (U2550) (3) allows a traveler to use a more expensive carrier when the traveler must change airlines to get to a destination and the first airline does not interline baggage (U3100-A) and (4) authorizes an annual round trip for a dependent student who participates in a study program in a foreign country (U5243).

- **Extra Time Resulting from Unauthorized Travel Disallowed**

An employee was authorized to travel by plane for temporary duty from February 16 through February 19. Instead, the employee drove, where he spent five hours on the road February 19, stayed over and completed the trip the next day. He requested reimbursement through February 20, including hotel expenses, full per diem on the 19th and three quarters per diem on February 20. When the Navy refused the 19th lodging and 20th per diem he appealed, asserting the lodging and next day per diem were necessary to avoid traveling off-duty hours. The board rejected the appeal stating travel by plane would have got him home by 6:30 on the 19th and the test for reimbursement is the schedule he would have kept had he traveled by air, not the schedule resulting from his choice to travel by car (GSBCA 14966-TRAV).

BRIEFLY...

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

The Treasury Secretary has set a rate of 5.25% for the period July 1 through December 2002. The new rate is a decrease over the 5.50% applicable in the first six months of 2002. 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 44264)

DOD Proposes Mandatory Electronic Payment Requests

In a delayed action to implement the 2001 Defense Authorization Act, the Defense Department is proposing to amend the DFARS by (1) requiring contractors to submit requests for contract financing and invoice payments in electronic form and (2) requiring DOD officials receiving payment requests and supporting documentation in electronic form to process them electronically. The proposal identifies three acceptable electronic forms, permits COs to authorize other forms

and identifies exemption categories. The rule will take effect no later than October 2002 (Fed. Reg. 38057).

Proposal to Clarify When Contract Prices Can Change When Taxes Change

The FAR Council is proposing to amend FAR Part 29.401 to clarify how federal, state and local taxes should be accounted for in determining the price of various contracts. The proposed rule will specify that FAR 52.229-3 be included in fixed price contracts exceeding the simplified acquisition threshold (currently \$100,000) while FAR 52.229-4 may be included for noncompetitive fixed price contracts if the CO determines that a contract price would otherwise include an inappropriate amount in anticipation of potential post award changes in state or local taxes. FAR 52.229-3 provides for price changes to a contract when taxes are changed as long as they were not included in the price or as a contingency while FAR 52.229-4 considerably limits the amount of post award changes to the price that can be made (Fed Reg. 38551).

Correction to Training and Education FAR Proposal

The recent proposal to revise the FAR cost principle on training and education costs mistakenly stated the proposed changes would eliminate the requirement there be relationships between the education and work. The FAR Council said it erred and though it considered eliminating the job relationship requirement, the change was not adopted (Fed Reg. 40136).

CASES/DECISIONS

Unopened Bids are Defective Pricing

(Editor's Note. The increased frequency of defective pricing audits makes cases addressing what is and is not cost or pricing data especially timely. When a contract is covered by the Truth and Negotiations Act (TINA), it requires a contractor to furnish current and pricing data during price negotiations and authorizes the government to reduce the contract price when defective cost or pricing data increases the contract price.)

Aerojet was awarded a sole-source TINA-covered contract to supply 396,000 pounds of nitroplasticizer, an ingredient in plastic bonded explosives. During contract price negotiations, Aerojet disclosed various "price in effect" quotes from suppliers (bidders' current price when submitted but does not bind the bidder to that price) including one for nitroethane at the then

current price of \$1.98/pound. Unbeknownst to the government, Aerojet during negotiations had solicited and received additional “price in effect” sealed bids for nitroethane that stated a reduced price of \$1.45/pound. Aerojet did not open the second bids during negotiations and its negotiators were unaware of the lower prices when they negotiated the final contract price. 16 months later DCAA conducted a post award audit (defective pricing) of the fixed price contract and learned Aerojet was paying less for the nitroethane and demanded Aerojet refund the difference, \$483,813, between the contract price and the price that would have been negotiated had the government known about the second “price in effect” bids.

After it paid the amount Aerojet put forth a claim to get it refunded asserting the bids were not cost or pricing data and hence did not have to be disclosed. Also, since its negotiators were unaware of the second bids, it had no effect on the negotiations. The Federal Court rejected Aerojet’s arguments noting that TINA defines “cost or pricing data” as all facts that a reasonably prudent buyer or seller, on the date of contract price agreement, would reasonably expect to significantly affect price negotiations. Here, chemical prices were fluctuating widely during the period of negotiations and Aerojet could have manipulated the negotiations – sped them up before bid opening to take advantage of the later lower price or slow them down to have the contract price reflect a later higher price. Even though it did not open the bid nor did the negotiators know of them, the company’s “mere knowledge” of their existence could have given Aerojet an advantage. Hence the bids were cost or pricing data under TINA, whatever the “subjective knowledge” of the negotiators was or whether the information was actually used (*Aerojet Solid Propulsion Co. v. White*, 2002 WL 1068289). There was a dissenting judge in the 2-1 decision who asserted the sealed bids were not cost or pricing data because (1) Aerojet was under no duty to open the bid before negotiations and (2) the bid was not binding on the suppliers and also there was no evidence Aerojet manipulated the negotiations.

New Certification Not Required for Revised Claim Proposal

(Editor’s Note. After submitting a claim, there are often many reasons to revise the original numbers. Many claimants are reluctant to do so fearing the revisions represent a new claim. The following addresses this.)

The contractor submitted a certified claim for \$242,875 after which the parties met and the contractor submitted

a “revised proposal” for \$259,711 incorporating the results of the meeting. The government rejected the second proposal because it was not certified. The Appeals Board sided with the contractor, approving the higher amount and ruling recertification is not necessary so long as a new claim is not being asserted. The Board said the “revised proposal” is the same claim “but an increased amount based on further information” (*Morgan & Son Earthmoving Co. ASBCA No. 58524*).

FAR Trumps CAS in Tax Refund Credit

Hercules reaped a capital gain on the sale of an asset which increased its state tax liability resulting in payment of the tax and reimbursement from the government of \$4.8 million representing 45% of the government’s share of indirect cost allocation. In a subsequent year, Hercules received a refund for the tax and the government claimed it was owed 45% of the refund. Since the government’s share of business was less in the subsequent period Hercules asserted in accordance with its accounting practices it should compute the share of the refund going to the government in the year the tax was refunded. The contract was covered by various FAR provisions (e.g. FAR 31.205-41, “Taxes; FAR 31.205-5, “Credits” and ; FAR 52.216-7, “Allowable Costs and Payment”) that required credit to the government for any refunded taxes to utilize the same method originally used to determine the original allocation. Hercules asserted the cost accounting standards should prevail and since they did not address how to calculate the amount due the government it should follow consistently its historical cost accounting principles which in Hercules’ case provided that tax refunds are to be computed in the year received.

The Court sided with the government noting the FAR clauses governed the case and in this instance, there was no conflict with CAS because CAS principles did not address the specific issue. It concluded CAS did not grant immunity from FAR cost principles (*Hercules Inc. v. U.S.*, 2002 WL 1068289).

Subcontractor’s Conflict of Interest is Grounds to Reverse Award

(Editor’s Note. The following demonstrates the need to determine potential conflicts of interest (COI) your subcontractors may have, no matter what their size.)

Ktech protested an award to Maxwell for operation of a defense facility on the grounds Maxwell’s subcontractor, ITT Industries, had access to protester’s proprietary data. Though there was no evidence the subcontractor misused the information, it was unable

to rebut the assertion the subcontractor's COI resulted in an unfair competitive advantage under FAR 9.501 and 9.505. When an actual or apparent OCI exists, the agency must either waive the OCI or take action to neutralize it – here unequal access to information constituted an OCI that was neither waived nor neutralized by the agency (*Ktech Corp., Comp. Gen. Dec. B-285330*).

SMALL/NEW CONTRACTORS

Quick-Closeout Procedures

Increased pressure on contracting officers to close out old contracts has accelerated use of tools to close out contracts faster including a technique that most contractors favor – quick-closeout procedures. The incentive to close out the contracts has led to a more liberal interpretation of when the techniques may be used, leading to more frequent use of the procedures. We thought it would be a good idea to review the basic rules and identify where application of the rules are being liberalized.

The final period of performance under a contract is generally less than a full fiscal year and many contracts will, in fact, be competed early in the year. Following normal procedures a determination of the amount of indirect and direct costs incurred on that contract may take a considerable amount of time – the incurred cost proposal may not be submitted until six months after the end of the contractor's fiscal year, the submittal may take another twelve months or more to be audited and then an additional six months more to settle not to mention the time to submit and process the closeout documentation. An expeditious settlement of direct and indirect costs and a prompt closeout of physically completed contracts have considerable appeal to both contractors and the government.

FAR 42.708 provides for quick-closeout procedures. They allow COs to negotiate a settlement of indirect costs for a specific contract in advance of final settlement of the incurred cost proposal. The procedures can be applied not only to the final fiscal year of a contract but also to all other open fiscal years with unsettled indirect cost rates as long as the criteria contained in FAR 42.708 are met. Use of the quick-closeout procedures for a specific contract will be binding on that contract and no adjustment will be made to other contracts for the over or under recovery of costs

that may result from the agreement on that quick-closeout contract. Likewise, using the quick-closeout procedures will not be considered as a precedent when establishing final indirect rates for other contracts.

Where a contract is to be closed using the quick-closeout procedures, an agreement should be reached by the contractor and contracting officer which often but not always includes the auditor as to what indirect costs will be allocated to the contract. There are three methods commonly used: (1) final indirect rates agreed upon for the immediately preceding fiscal year (2) the provisional billing rates for the current year or (3) estimated rates based on the contractors actual data usually reflected in its incurred cost proposal which is adjusted for a decrement based upon prior years' historical disallowances. The contractor should take the initiative in proposing one of the methods keeping in mind the ACO may ask for an opinion by DCAA.

To encourage greater use of the procedures, the FAR 42.708 was revised in 1996 to *require* the contracting officer to negotiate settlement of indirect costs for a specific contract in advance of the final indirect rate if certain criteria are met. The criteria of requiring application of the procedures are: (1) the contract is physically complete (2) the total unsettled indirect costs allocable to any one contract does not exceed \$1 million (3) the cumulative unsettled indirect costs to be allocated to one or more contracts in a single fiscal year do not exceed 15 percent of the estimated, total unsettled indirect costs allocable to cost type contracts for that fiscal year and (4) agreement can be reached on a reasonable estimate of allocable dollars.

Many contractors and government officials believe that if these conditions are not met quick closeout procedures may not be used. This is not true. These criteria are often lifted. For example, the contracting officer may (and frequently does) waive the 15 percent restriction. The conditions for waiving this are to be based on a "risk assessment" that considers such factors as a contractor's accounting, estimating and purchasing systems as well as other concerns cognizant auditors may have or other pertinent information.

Though quick close out procedures are usually considered to apply only to cost type contracts, FAR 42.703-1(c) was amended as of February 1998 to make clear the procedures may also be used to establish final price of fixed price incentive, fixed-price redeterminable and similar contracts and awards that require settlement of indirect costs before final contract prices are established as long as the criteria of FAR 42.708 are met.

July - August 2002

GCA REPORT

QUESTIONS & ANSWERS

Q. We have always charged facilities and equipment costs to our overhead pool. We have just won a contract where these costs will be substantial and we can charge them direct to the job. Do we need to remove all the other facilities and equipment costs from our overhead pool to remain consistent?

A. Not necessarily. Even though you are not CAS covered, CAS 402 provides instructive guidance. It requires all like costs incurred for the same purpose to be treated consistently. If the facilities and equipment costs meet this definition then, yes, the costs should be deleted from the overhead pool; if they do not, then they may be treated differently. CAS 402 provides an interesting illustration of a “like” cost not incurred for the same purpose: a contract requiring three full time firemen assigned to a fixed post could be charged directly while firemen responsible for serving the entire area of multiple buildings could continue to be charged indirect.

Q. We incurred costs on an unsigned contract in 2002 and our financial auditor told us we had to remove the revenue and costs from 2002 (because it was not signed). Should we remove the costs from 2002 for government costing purposes?

A. Assuming the auditor is correct, your question is a good example of where accounting practices for financial accounting purposes diverge from accounting for government contracts. If the costs were incurred, they should be assigned to the unsigned contract since

it is a cost objective in the year incurred. Whether or not the costs can be recovered is not relevant to how they must be reported.

Q. A state auditor is questioning our operating lease expenses included in our forward pricing rates asserting they “probably” include interest costs and since we cannot prove otherwise, they should be questioned. DCAA never questioned these costs. Is the auditor correct?

A. Just when many contractors were getting used to federal government auditors, they are increasingly being inundated by state auditors who audit state programs financed with federal funds (e.g. DOT, HUD, etc.). These auditors usually follow FAR cost principles (not always, sometimes they have their own state regulations) and often demonstrate a “creative” interpretation of them.

As for interest costs in the operating leases. You are required to make a determination of allowability on the expense you paid in accordance with FAR and contract terms – e.g. is it reasonable, arms length transaction, not associated with prohibited costs found in the FAR or contract. Unless the costs you are paying on the operating lease come from a cost type subcontract (highly unlikely) you are not required to inquire into the component costs of the invoice you paid nor is the vendor required to provide the information. An invoiced expense is the price set by the vendor and does not represent a cost build up for you to analyze – whether they incurred “unallowable” costs is irrelevant.