GCA REPORT
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NEW DEVELOPMENTS

New Contract-Related Interest Rate Set for Second Half of 2004

The Treasury Secretary has set a rate of 4.50% for the period July 1 through December 31, 2004. The new rate is an increase from the 4.00% rate applicable in the first six months of 2004. The Secretary of the Treasury semiannually establishes an interest rate that is then applied for several government contract-related purposes. Among other things, the rates apply to (1) what a contractor must pay the government under the "Interest" clause at FAR 52.232-17 and (2) what the government must pay a contractor on either a claim decided in its favor under the Contract Disputes Act or payment delays under the Prompt Payment Act. The rate also applies to cost of money calculations under Cost Accounting Standards 414 and 417 as well as FAR 31.205-10 and when a discount factor is used to calculate the present value of future payments (e.g. deferred compensation) (Fed. Reg. 38,952).

OMB Increases Executive Compensation Ceiling

The Office of Management and Budget has set the maximum "benchmark" compensation allowable for contractor executives in Fiscal Year 2004 at $432,851 for all applicable contracts no matter when awarded. The benchmark will apply to contract costs incurred after January 1, 2004 and should be used on all applicable contracts and subcontracts for FY 2004 and beyond until revised by OMB.

The new cap represents a 6.8 percent increase over the FY 2003 amount of $405,273. Contractors can, of course, pay their executives more than $432,851 but the additional compensation will not be allowable under their federal contracts. Recent DCAA guidance stresses the cap covered compensation includes the total amounts of salary, bonuses, deferred compensation and employer contributions to defined contribution pension plans. The cap covered compensation does not apply to fringe benefits like health benefits and employer contributions to defined benefit plans where if they are reasonable they are allowed irrespective of the cap. The cap covers the five senior managers of a company as well as subsidiary business segments directly reporting to the corporate headquarters. The benchmark compensation amount reflects the median amount of compensation for senior executives of all surveyed corporations for the most recent year data is available. Since the benchmarked companies represent large publicly traded companies with revenue exceeding $50 million, lower caps are likely to apply to smaller companies (Fed. Reg. 26897).

DCAA Issues Audit Guidance on Recent Cost Principles Changes

The Defense Contract Audit Agency issued several audit guidelines on recent FAR changes to depreciation costs, selling costs and insurance costs. The guidance on the FAR changes include reproductions of the pre-changed regulations which show what was deleted and added.

1. *Depreciation Cost*s. The change to FAR 31.205-11, Depreciation, effective January 12, 2004 reflects two significant changes. First, the revision adopts the 10 percent residual rule provided in CAS 409. Prior to this revision, for non-CAS covered contracts, FAR 31.205-11 was silent on the issue while CAS 409-50(h) permitted contractors to not consider residual values that are less than 10 of the capitalized value in computing depreciation costs. Second, the change eliminates all references to federal income tax accounting. Prior to the revision, Paragraphs (d) and (c) of the cost principle limited the allowable depreciation costs for contracts not subject to CAS 409 to the lesser of the depreciation costs used for tax purposes or for financial statements. Now, references to federal income tax accounting are eliminated and allowable depreciation shall not exceed the amount used for financial accounting purposes. Auditors are alerted that the impact of the changes may increase depreciation costs because of the 10 percent residual rule and they are told that the annual depreciation cost should not reduce the book value of a tangible capital asset below its estimated residual value since such costs are expressly unallowable (MRD 04-PAC-015(R).

2. *Selling Costs*. The change to FAR 31.205-18, Selling costs, effective on contracts awarded after August 26

has one substantive change. The change to subparagraph (c)(2) eliminates the prior requirement that for foreign direct selling costs to be allowable they had to be related to sales of products normally sold to the U.S. government. The new rule allows costs of all "direct selling" efforts, regardless of domestic or foreign selling activities (MRD -4-PAC-014(R).

3. *Insurance and Indemnification.* The FAR 31.205-19 cost principle was restructured so that all provisions related to self-insurance are in one paragraph and those related to purchased insurance are in another. Also, the revision change deletes language on using actual losses as the basis for self-insurance charges since that duplicates language found in CAS 416 and the cost principle requires that self-insurance costs be measured, assigned and allocated in accordance with CAS 416 whether or not the contract is CAS covered (MRD 04-PAC-016(R).

OMB Issues New Pay Raise and Inflation Factor Assumptions

(Editor's Note. It is not always clear what inflation factors are appropriate for contractor use but here are some that the government uses.)

The Office of Management and Budget is updating the annual federal pay raise assumptions and inflation factors used for computing the government's in-house personnel and non-pay costs in public-private competitions conducted under OMB Circular A-76. The changes are based upon the President's Budget for FY 2005. Federal pay raise assumptions for January 2004 are 4.1 percent for civilians and 4.15 percent for military and for January 2005, 1.5 percent for civilians and 3.5 percent for the military. The pay raise factors provided for 2005 and beyond shall be applied to all employees with no distinctions made for possible locality and base pay increases. For January 2006 and beyond, the OMB states that the Employment Cost Index of 4 percent should be used to estimate in-house personnel costs for A-76 competitions. The notification indicates that as future A-76 guidance is updated, the 4 percent assumption for out years may change.

Non-pay categories (supplies, equipment, etc) for 2004, 2005, 2006, 2007, 2008 and 2009 and beyond are 1.3 percent, 1.3 percent, 1.5 percent, 1.7 percent, 1.9 percent and 2.0 percent, respectively (Fed. Reg. 26900).

New FAC 2001-24 Issued

A new government-wide rule issued June 18 amends certain sections of the Federal Acquisition Regulation. Of interest to our readers:

1. An interim rule seeking to implement the National Defense Authorization Act for FY 2004 provides that performance-based contracts or task orders for services will be treated as commercial items if certain conditions are met and the rule requires agencies to report on these awards. The definition of commercial item will be amended to add performance-based language. COs will now be able to use FAR Part 12, Acquisition of Commercial Items and Part 37.6, Performance-Based Contracting for non-commercial services and treat these services as commercial items. This provision was made into a final rule in the Defense Federal Acquisition Regulation Supplement on June 25 (Fed. Reg. 35,532).

2. Deletes the cost principle at FAR 31.205-24, Maintenance and repair cost, because either the Cost Accounting Standards or Generally Accepted Accounting Practices adequately address such costs. In addition, non-substantive revisions to remove unnecessary and duplicative language were made to FAR 31.205-7, Contingencies; FAR 31.205-26, Material costs and FAR 31.205-44, Training and education costs.

3. Intending to strengthen the procedures for establishing Blanket Purchase Agreements (BPAs) under the General Services Administration's Federal Supply Schedules (FSS), the rules (1) makes clear that the CO placing an order on another agency's behalf is responsible for applying that agency's regulatory requirements (2) contains new coverage on use of statements of work when acquiring services from the schedules (3) requires that when an agency awards a task order requiring a statement of work that if the award is based on other than price (e.g. best value) the CO shall provide a brief explanation of the basis for the award to any unsuccessful contractor requesting such information (4) requires the ordering activity to document the results of its BPA review and (5) reminds (encourages) agencies they may seek a price reduction at any time, not just when an order exceeds the maximum order threshold (Fed. Reg. 34233).

SBA Withdraws Proposal to Restructure Size Standards

Much to the relief of industry groups, the Small Business Administration July 1 withdrew its proposal to restructure the size standards that govern eligibility for federal small business procurements. The proposed rule, issued for comment March 19, intended to simplify size standards by establishing number of employees as a common standard for all industries and reducing the number of individual size standard levels from 37 to 10 that are based either on monetary receipts or on number of employees. Several industry groups raised concerns that the changes

would have detrimental effects on small businesses making thousands of firms ineligible for small business set asides and asserted the current system is neither complex nor difficult to use and hence should not be changed. SBA said it will continue to study opportunities to simplify size standards (Fed. Reg. 39,874).

DCAA Issues Guidance on FAR Part 31 Changes

The Defense Contract Audit agency issued guidance on recent general revisions made to FAR Part 31 to make them consistent with the cost accounting standards. Though the changes do not materially change the substance of FAR, some changes are "noteworthy." The guidance portrays the changes to the cost principles in a line-in line-out format and those changes we consider noteworthy are:

1. FAR 2.101, Definitions, Direct cost means "any cost that is identified specifically with a particular final cost objective" while indirect cost means "any cost not directly identified with a single final cost objective but identified with two or more cost objectives or with at least one intermediate cost objective."

2. In FAR 31.201-1, Composition of total cost, references to FAR 31.201-2 are removed. Total costs represents the sum of direct and indirect costs allocable to the contract including standard costs properly adjusted for variances and cost of money less any allocable credits.

3. In FAR 31.201-2, Determining allowability, the introductory sentence that used to mention five factors that should be "considered" are now "required" for allowability. The five factors are (1) reasonableness (2) allocability (3) compliant with CAS, GAAP or is appropriate to circumstances (4) contract terms and (5) limitations set forth in the cost principles.

4. FAR 31.203, Indirect costs, adds a new paragraph that states all CAS provisions apply to fully CAS covered contracts while the applicable CAS provisions identified in the paragraphs of FAR 31.203 apply to all other contracts.

5. In FAR 31.203 contractors must use its fiscal year for its accounting period if not CAS covered while it must use CAS 406, Accounting periods if contracts are fully or modified CAS covered (04-PAS-03(R).

GSA Modifies Program to Allow State and Local Purchases Off its FSS Schedule

The General Services Administration May 18 issued a final rule implementing the statutory provision that authorizes state and local governments to acquire information technology equipment and services under GSA's Federal Supply Schedule 70, known as the cooperative purchasing program. The GSA explained the boundaries of the program are established by Section 211 of the E-Government Act of 2002 which authorizes cooperative purchasing. It provides (1) services and goods may be purchased by state and local government under cooperative purchasing program only if they are through Schedule 70 (2) while Congress authorized GSA to make available to state and local government the simplified acquisition procedures and discounts offered by GSA it did not authorize GSA to exercise oversight over state and local purchases and (3) GSA does not offer dispute resolution.

The final rule makes "minor changes" to the May 2003 interim rule:

- Makes clear an FSS contractor's sales to state and local government does not trigger the price reduction clause that applies to federal agencies under which a vendor that lowers its schedule price for one federal agency must reduce its price to other agencies
- Defines domestic and overseas delivery and provides the contractor the option of providing supplies and services internationally
- Clarifies the contractor's option to accept or not accept orders from outside the executive branch of the federal government
- States that both contracts and blanket purchase agreements established under cooperative purchasing are separate contracts
- Asserts the state and local agencies may add supplemental terms and conditions (Fed. Reg. 26,063).

Industry Group Criticizes Proposed Rule Change to Training and Education Costs

An influential industry group has strongly criticized a December 3 proposed rule to change the cost principle on training and education (FAR 31.205-40). The proposed change will disallow costs of training and education "for the sole purpose of providing an employee an opportunity to obtain an academic degree or to qualify for appointment to a particular position for which the academic degree is a basis for requirement." The National Defense Industrial Association stated in a recent memo the change (1) erroneously applies tests applicable to federal employees where education expenses are not reimbursable rather than commercial practices that encourage continued training and education of the workforce and (2) contradicts the intent of the changes to simplify and clarify the cost principle by imposing "burdensome and costly" distinctions about

allowable and unallowable costs in determining which costs are related *solely* to obtaining an academic degree or related specifically to a particular position. Further the proposed rule would undermine efforts to encourage upward mobility to disadvantaged groups working for contractors.

New Procurement Websites Established

The government has opened up several websites. The Small Business Administration has launched a Website to help businesses connect with federal agencies. www.Business.gov will provide one-stop, online Federal government information and services that businesses need such as links to business development, financial assistance, taxes, laws and regulations, international trade, workplace rules, buying and selling and federal forms.

The Department of Homeland Security and the Defense Logistics Agency announced their partnership to provide DHS a tailored version of the Department of Defense's EMALL. The DOD Electronic Mall is an internet based marketplace allowing purchasers access to DOD's vendors and 383 catalogs containing more than 12 million goods and services items. DHS will now be able to purchase goods and services under DOD contracts as well as their own exclusive contracts.

TRAVEL…

(Editor's Note. Though only three parts of the Federal Travel Regulation formally apply to contractors – combined per diem rates, definitions of meals and incidentals and conditions justifying payment of up to 300% of per diem rates – many contractors choose to follow the FTR either because some contracts call for incorporation of it or they choose to follow it. Therefore, we continue to present significant new changes or decisions likely to affect contractors' travel and relocation expenses.)

Congress is Proposing Comp Time for Workers on Travel Status

Congress is considering a bill that if passed would grant employees compensatory time off for traveling on official government business. The proposed bill would require agencies to provide employees one hour of compensatory time off for each hour they spend in travel status during non-business hours. Though the Office of Personnel Management opposes the proposal, stating that federal employees already are compensated for travel time, the full Senate has already approved the measure which is now before the House (go to http://thomas.loc.gov. for a copy of the bill)

Government Can't Presume Employees' Lodging Choices

While on two week temporary duty (TDY) in Huntsville Frank stayed with relatives rather than in a hotel but on a weekend side trip he stayed at a hotel. In rejecting his request for reimbursement for the hotel, the Air Force argued that section C4563-E of the JTR limited reimbursement to the amount payable had Frank stayed at the TDY site which in this case was zero, reasoning had Frank stayed in Huntsville he would have stayed with relatives. The Board agreed the cited regulation applied but disagreed that Frank was not entitled to lodging. It concluded an employee is free to stay any number of nights with relatives and the remaining time in commercial lodging, reasoning that each night is a separate transaction and the agency cannot presume a choice for an employee (*Frank Condino, GSBCA 16365*). *(Editor's note: Some contractor's choice to reimburse employees' per diem amounts rather than actual expenses would likely not be effected.)*

Non-Reimbursable Expense Not Paid Even if Maximum Per Diem is Not Met

Corrigan was authorized for three separate trips for temporary duty with return trips home between each TDY assignment. Rather than return home from his first TDY assignment, he flew to the second destination before the scheduled time and stayed with his son. While there, he rented a car to sightsee. Though his revised schedule saved the government travel costs home they still rejected his request for reimbursement for the car rental. Corrigan argued to the Appeals Board the agency had "no say" as to what he was entitled to as long as total payment does not exceed the maximum cost he was entitled to. The Board disagreed ruling the government does have a "say" stating though an employee may deviate from approved travel plans they may not seek reimbursement for costs solely for personal convenience. The Board concluded authorization for travel does not equate to authorization of any travel costs as long as the employee's total expense does not exceed the prescribed maximum (GBSCA 16096 TRAV).

CASES/DECISIONS

GAO Upholds Purchase Order Issued at a Price for Which Quote Had Expired

The government issued a purchase order in September even though Serena's quote in response to a request for

quotation stipulated the quotation of a discounted price was valid through June. CA protested the discounted price award to Serena, asserting Serena's quote did not represent the best value because the reduced price was "unavailable" at the time the agency made a determination and hence Serena's undiscounted price was $6 million more than CA's. The GAO ruled the government's evaluation was "in accord with the fundamental nature of a quotation." It stated in contrast to submission of a bid or proposal, which creates a binding legal obligation on both parties and hence requires a reasonable period of acceptance, a quotation "is not a submission for acceptance by the government to form a binding contract" but is rather "purely informational" (*Computer Associates GAO, B-292077*).

No Equitable Adjustment for Requirements Contract

Centurion entered into a contract to provide repair and maintenance for computers where the contract stipulated it would receive $80,000 in materials and 3,620 service hours per year for the life of the contract where the contract's total value for the base year and four option years was set at $1.3 million. Due to lower than expected demand the contract was modified downward twice and in the end the government ordered 667 service hours the first year and 590 hours for the second and did not exercise the three other option years. In response to its claim for $346,000 of "unused hours" the CO offered Centurion $80,000 to cover both years and Centurion appealed. Because Centurion promised to provide "all per call repairs" and failed to negotiate a guaranteed number of billable service hours, the Board ruled the agreement was a requirements contract. This meant that though the actual requirements were substantially less than estimates Centurion was not entitled to damages on a requirements contract because there was no guaranteed minimum and since there was neither negligent prepared estimates nor bad faith, there was no legal basis for any adjustment. The appeals court concurred (*Drew v. Brownlee, 95 Fed. Appx. 978*).

Limitation of Cost Clause Applies to Each Delivery Order, Not the Entire Contract

The cost type indefinite delivery/indefinite quantity contract identified no estimated cost value for environmental services and included the Limitation of Cost (LOC) clause that required the government be notified whenever the contractor had reason to expect that within the next 60 days, its costs would exceed "75% of the estimated costs in the Schedule." The government rejected an invoice for $223,000 on one of its delivery orders because the contractor failed to provide notice under the LOC clause while the contractor claimed the clause applied to the ID/IQ contract as a whole not to individual delivery orders. The Appeals Board examined sections A through H of the contract where there was no dollar amount specified in "estimated cost" but in Schedule B-1 there was language limiting a fixed fee for "each task/delivery order." The Board stated Schedule B-1 connected the phrase "estimated cost" with each DO and concluded the FAR ordering clause and documentation for each DO stated the terms of the contract applied to the DO, which "included the LOC clause." The Board sided with the government, concluding the LOC clause applied to each delivery order rather than 75 percent of the "$0" estimated cost of the total contract (*Analysas Corp. ASBCA No. 51483*).

"Best Value" Contract Usually Weighs Price and Technical Factors Equally

A "best value" solicitation indicated that technical and price factors would be weighed in evaluating offers even though it did not specify what weight and importance it would give to each factor. The Contracting officer gave approximately equal weight to each factor and the protester asserted that price was not among the "primary areas" specified in the solicitation for use in determining which proposal offered the best value. The Federal Court ruled that the CO properly gave equal weight to the technical and pricing evaluations noting that the GAO has several times held that price and technical considerations will be accorded approximately equal weight and importance in a proposal evaluation when a solicitation indicates that price will be considered but does not explicitly indicate the relative weight to be given to price versus technical factors (*Banknote Corp. of America Inc. and Guilford Gravure Inc. v U.S., Fed. Cir., No. 03-5104*).

Low Bid With Intent to Issue Change Orders Did Not Violate FCA

(Editor's Note. Underbidding contracts with intent to recover revenue through change orders is not an uncommon bid strategy. Can such practices be considered fraudulent?)

OCC was awarded a $167 Million contract to construct a dam where its bid was $30 Million lower than the next low bidder and $35 Million below the government's estimate. Modifications issued after work began totaled more than $100 Million. An employee asserted OCC intentionally underbid the work and planned to recover lost revenue through change orders and charged OCC violated the False Claims Act by fraudulently inducing the government to execute the contract with the intent

to seek later adjustments to the price. The Court rejected those arguments stating only claims intended to cause the government to pay money not otherwise due are actionable under the FCA. The mere submission of a low bid fails to make the government pay funds not otherwise due under the contract. Change requests are commonplace in government contracts and the intent to defraud test is not met because the contractor obtained additional funds under the contract (*US. Ex rel Bettis v. Oderbrecht Contractors of California, 2004 WL 161326*).

FAR "Rights in Data" Clause Get its First Interpretation

Ervin claimed that HUD breached its contract and violated its copyright protections by providing data to competitors and incorporating portions of that data into HUD's data warehouse. The Court noted that this was the first time it had been confronted with determining the scope of FAR 52.227-14, Rights in Data-General. The Court concluded that essentially it was "tough luck" for Ervin because the clause "does not provide any rights to the contractor" but instead "tends to limit rights a contractor may have in data" by requiring the license of the technology to the government. In order to assert the data was developed at Ervin's private expense and hence qualifies as "limited" data (giving the contractor who developed it more rights than the government) Ervin was required under the FAR to identify the data as such, withhold the data and instead either furnish "form, fit and function" data or affix notices. Since Ervin did not do so the government had unlimited rights to the data to do whatever it wanted to (*Ervin and Assoc. Inc. v. United States, Fed. Cl., No 91-153(C)*.

NEW/SMALL CONTRACTORS

Screening Unallowable Costs

A government contractor must, at some point, demonstrate its accounting system can identify and exclude—screen—unallowable costs from proposals, billings and incurred cost submittals. FAR 31.201-6 and CAS 405 are the guiding regulations for screening and accounting for unallowable costs. A determination of inadequacy in this area can range from a recommendation to make improvements to the conclusion the contractor's accounting system is inadequate for government contracting purposes. This determination, in turn, can result in failure to award a contract until adequacy is demonstrated, suspension of vouchers and progress payments and/or inability to obtain government work in the future.

Unallowable costs include (1) costs identified by *pertinent laws and regulations* such as FAR 31.205 cost principles, departmental supplements and OMB Circulars which are continuously being interpreted by court and board decisions, expert opinion and the Defense Contract Audit Agency (2) *contract specific* costs (e.g. include travel and subcontracting costs must be approved, overtime over a specific level is not reimbursed, indirect cost rates are capped (3) *advanced agreement* usually negotiated with Administrative Contracting Officers to affect one or more costs categories and (4) *directly associated* costs which are normally otherwise allowable costs but become unallowable because they would not have occurred had not the unallowable cost been incurred (e.g. travel costs associated with attending an unallowable golf event).

The following areas are commonly scrutinized by government auditors:

General policies and procedures. These should be in writing and should provide that direct and indirect costs are properly classified as allowable or unallowable (including associated costs). The policies and procedures should demonstrate that unallowable costs are identified and segregated from contract costing, billing and pricing when the contract amount is not completely based on catalog or market prices. These written procedures should address, at a minimum:

a. General ledger accounts for unallowable costs. One account is acceptable for a very small business but other separate accounts should be created where cost categories may contain significant unallowables (e.g. travel, legal, advertising etc.).

b. List of unallowable costs. All unallowable costs should be identified with relevant FAR references. A brief discussion of conditions that make an unallowable cost allowable (e.g. product or service advertising is unallowable while advertising for employees is allowable) should be included.

c. Internal controls. Normal internal controls for financial accounting should be included in efforts to screen unallowable cost. A list of duties by position, management review evidenced by signature requirements, separation of duties to ensure unallowables "don't slip through" and flowchart or narrative of the screening process.

d. Communication and training. Describe how appropriate personnel are informed and what, if any,

training is provided. For example, do traveling employees and their supervisors know about travel and entertainment rules and are key accounting and contracts personnel knowledgeable about all relevant cost principles?

e. Adequate documentation and record keeping. Do procedures exist on how to brief a contract, document reasons why a specific cost is allowable, and identify relevant forms (e.g. travel expenses with space for purpose of travel and excess travel costs)?

Attention to "Hot" Areas. You can usually expect DCAA to audit "risky" (i.e. probability of finding unallowable costs) accounts that are either significant in amount or were problematic in the past. Also, individual auditors and supervisors often have their own "hot" areas to scrutinize which is usually based upon their experiences at other contractors. In addition, DCAA occasionally focuses on certain areas to coincide with regulation changes, clarifications or guidance put out to its auditors. Though not exhaustive, the following represents quite common areas:

1. Entertainment (FAR 31.205-14). Distinctions contractors make between unallowable entertainment costs and allowable costs such as certain travel, public relations, employee morale and health, etc.

2. Independent Research and Development and Bid and Proposal (FAR 31.205-18 and CAS 420). Are these properly indirect or direct costs.

3. Legislative Lobbying (FAR 31.205-22). Association fees may often include such unallowable costs.

4. Professional and Consultant Services (FAR 31.205-33).

5. Executive Compensation (FAR 31.205-6). Is compensation within OMB annual caps? For smaller companies, is compensation excessive even though it is below annual OMB caps.

6. Fringe benefits (FAR 31.205-6). Are certain fringe benefits (e.g. bonuses) added to compensation to determine reasonable total compensation? Are other categories of fringe benefits (e.g. severance, insurance) excessive?

7. Idle facilities and capacity (FAR 31.205-17).

8. Organization costs (FAR 31.205-27). Are external and internal restructuring costs distinguished and is the former costs identified across different accounts (e.g. legal, consulting, etc.)

9. Travel and relocation (FAR 31.205-46). Excess travel and associated costs of unallowable activity.

10. Trade, Business, Technical and Professional Activity. Procedures should be in place that adequately describe the business purpose of meetings or conferences.

Point of Entry Screening. The organization should screen for unallowable costs up front rather than after the fact when cumbersome and expensive screening is required for certification or incurred cost submittals. Individuals incurring the expense and reporting it on a document should identify the unallowable cost. Personnel reviewing expense reports and vendor invoices should clearly identify the unallowable cost on the document and enter the cost into the appropriate account in the general ledger. These point of entry practices not only save time and money but can reduce the perception of your organization being considered a high audit risk requiring extensive transaction testing.

Statistical Sampling. A recent change to DCAA's Contract Audit Manual (Chapter 7-1002-4) recognizes the validity of using statistical sampling methods in lieu of direct identification of unallowable costs in certain accounts where unallowable portions of costs are likely to be "immaterial". Though direct identification is considered preferable, the results of statistical sampling for both incurred cost and forward pricing proposals are considered acceptable. So, for example, statistical sampling of travel accounts are rejected as not meeting "the requirements of the CAS and FAR" while statistical sampling of travel accounts at the corporate home office would be acceptable when government work represents a small portion of total work and the costs of identifying and segregating unallowable per diem costs would exceed the unallowable portions.

QUESTIONS & ANSWERS

Q. We have decided to reassign our contracts administration costs from G&A to overhead. We have four overhead pools and are not sure how much of the contracts administration costs should be allocated to each pool. What do you think?

A. You may consider contract administration costs, like other primarily administrative functions, to be a cost center and you can allocate the costs to various overhead pools on a representative base. Common methods are headcount or direct labor dollars in the individual bases. More precise methods can be developed where the usage factor represents contract transactions (e.g. number of contracts) but we usually don't like it because of the added administrative effort of tracking the data and your

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vulnerability to assertions that you have not accurately identified all relevant transactions. Alternatively, a simpler means may be to assign the entire department or individuals to a particular overhead pool(s) and justify this practice on the basis that those individuals primarily support the relevant overhead base or more precise measurements have an immaterial dollar impact.

Q. I read your survey on Accounting Treatment of Uncompensated Overtime a few issues back and was wondering if I can bill the government for 45 hours a salaried employee worked on a direct contract. We pay him a salary with the expectation he will work 40 hours a week and hence the extra five hours he is not paid for.

A. Yes, assuming you record total time on your timesheets, you may charge all hours worked to the contracts or indirect projects the employee worked. The issue is not so much hours charged but what is the hourly rate you charge for those extra five hours. For exempt employees (e.g. salaried employees exempt from the Fair Labor Standards Act), the government prefers (though does not require) that you use an "effective" rate by adjusting the hourly rate charged by dividing weekly salary by hours worked. You may also charge the contract for the 45 hours at the standard rate (weekly salary divided by 40 hours) and credit the excess dollars charged to the contract and amount paid to the employee to overhead.

You can adopt this second option certainly under one and possibly under two circumstances. One of the three acceptable methods DCAA has established for treating uncompensated overtime is you may use a "standard" rate if that rate is based on projected hours worked for a year (say 2,080) divided into annual salary. Then any variance between salary paid and amount distributed is charged or credited to overhead. Even if you do not compute a standard hourly rate based upon estimated annual hours, you may still charge the contract at a standard hourly rate and charge or credit overhead if you can demonstrate that this practice causes no adverse impact to the government (e.g. uncompensated hours are immaterial, excess hours charged over time are evenly distributed to all contracts, the amount charged or credited to overhead is fairly distributed to all contracts).

Q. For the first time we recently terminated an employee who was not bringing in enough contract revenue to justify his salary and paid him five weeks of his salary as severance. I looked at FAR 31.205-6 which states severance pay is allowable if it is required by an employer-employee agreement but we don't have an "employer-employee agreement" so is the cost allowable?

A. Severance payments are generally allowable if they are reasonable and FAR 31.205-6 provides for this. To determine reasonableness, the government may use a survey to benchmark your practices but the five weeks severance arrangement for your terminated employee appears to be in the normal range of reasonableness. An aggressive auditor could seek to determine what your company practices are and finding none, might question the severance on that basis but that would be unusual because reasonable severance costs are allowable. To prevent such an occurrence, I would draft a policy related to severance costs where, for example, employees with certain periods of employment receive specific amounts (e.g. X weeks of compensation). In the policy, make sure to provide for exceptions so you will have the flexibility to provide more severance payments to special employees.

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