NEW DEVELOPMENTS

GAO Issues Highly Critical Report on DCAA; Audit Guidance Issued

(Editor’s Note. In our consulting practice, we frequently challenge an initial audit position by taking up the issue(s) with the supervisor or branch manager of an audit office where the result is frequently a negotiated settlement where a reasonable and balanced audit report is issued. We fear the following GAO Report will negatively affect the ability of DCAA and contractors to reach mutually acceptable positions together once an initial audit position is taken and underscores the need to challenge adverse audit positions early during the audit.)

The General Accounting Office July 23 issued a report highly critical of Defense Contract Audit Agency. The report asserted (1) audit workpapers did not support reported opinions (2) audit supervisors dropped adverse findings and changed audit opinions without adequate audit evidence of the changes (3) insufficient audit work was not performed to support audit opinions and conclusions (4) contracting officers and other DOD personnel improperly influenced audit scope, conclusions and opinions (5) DCAA managers took actions against their staff that attempted to “intimidate” GAO investigators, discouraged auditors from speaking to the GAO and created a “generally abusive work environment” and (6) frequently failed to adhere to government auditing standards. As expected, several major newspapers widely reported on the GAO report and many angry calls by Congressmen (most notably Sen. McCaskill (D-MO) were made to hold DCAA “accountable” in the “biggest audit scandal in the history of this town.” The DCAA Director issued a memo to its auditors stating she took the assertions very seriously and would be investigating.

In the wake of the report, DCAA issued a memo addressing procedures to be used when there is a disagreement between the auditor and supervisor regarding audit conclusions. Differences of opinion that materially affect the audit conclusions should be elevated to the branch manager and if they still exist, to the Regional Audit Manager (RAM) and even to the Deputy Regional Director if resolution cannot be made. If opinions differ and the draft audit results are changed by the supervisor or higher management, both the auditor and supervisor are to document the disagreement in the audit workpapers. In addition, the current audit workpapers must adequately document and support the final audit opinion. An example provided is if the auditor concludes a contractor’s billing system is inadequate and the supervisor believes the auditor’s conclusion is based on insufficient audit procedures the work papers must document the additional work performed to determine a different conclusion (90-PAS-022/R).

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

The Treasury Secretary has set a rate of 5 1/8% for the period July through December 2008. The new rate is an increase from the 4 3/4% rate applicable in the first six months of 2008. 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. 37529).

House Adopts “Clean Contracting” Provisions

This political season has generated considerable proposals affecting government contractors. A good indication of where Congress seems to be heading is...
of FAR be amended to minimize the “inappropriate use” of non-competitive contracts. The provisions will require (1) the FAR be amended to minimize the “inappropriate use” of non-competitive contracts (2) limit to nine months the duration of non-competitive contracts awarded to meet urgent needs (3) require purchases made under multiple award contracts be made on a competitive basis which means that all offerors that provide relevant goods and services are provided notice of the intent to make a purchase and a fair opportunity to make an offer and (4) require federal agencies to publish notice on the FedBizOpps website of sole-source task or delivery orders that are placed against multiple award contracts.

Curbing “abuse-prone” contracts. These provisions are aimed at restricting use of certain types of “abuse prone” contracts. The provisions will require (1) the FAR be amended to minimize the “inappropriate use” of cost reimbursable contracts (2) require OMB develop guidelines for using inter-agency acquisitions (3) prohibit award of new contracts for lead system integrator functions after 2010 (4) limit use of acquisition support functions, ensure federal employees determine the course of their actions and provide the prime contractor may not recommend the award of a contract or subcontract to an entity owned by the prime (5) require the FAR be amended to prohibit payment of excess pass-through charges (6) require all contracts using award and incentive fees link such fees to outcomes defined in terms of program cost, schedule or performance and for determining percentage of fees to be paid and (7) amend the FAR to ensure that offered services that are “of a type” offered and sold competitively are treated as commercial services only after the CO determines in writing the offeror has submitted sufficient information to allow the government to determine the reasonableness of the prices being offered.

Preventing fraud. Provisions will include (1) increased protection for contractor whistleblowers by expanding the type of disclosure that is protected and accelerating the schedule for denying relief (2) amend the FAR to ensure federal contractors disclose government violations of federal criminal law or overpayments apply to contracts performed outside of the US and to contracts for commercial items (these two categories were previously excluded from such disclosure requirements) and (3) have the FAR prevent contract conflicts of interest which will include, at a minimum, a standard OCI clause.

Enhancing competition. The provisions will include (1) requiring agencies with at least $1 Billion in contracts the preceding year to develop and implement plans to minimize use of non-competitive contracts (2) limit to nine months the duration of non-competitive contracts awarded to meet urgent needs (3) require purchases made under multiple award contracts be made on a competitive basis which means that all offerors that provide relevant goods and services are provided notice of the intent to make a purchase and a fair opportunity to make an offer and (4) require federal agencies to publish notice on the FedBizOpps website of sole-source task or delivery orders that are placed against multiple award contracts.

DCAA Issues Guidance on Defective Pricing Audits.

( Editor's Note. Postaward audits (defective pricing), which are increasing in frequency not only at the prime but also subcontract level, are conducted to determine whether the contractor had factual information available that was not divulged to the government at the time a contract or subcontract price covered by the Truth in Negotiation Act was negotiated. If it is determined such factual information (as opposed to judgmental information) was not divulged the contractor is subject to an adjustment to the fixed price it negotiated. Commonly, the first step an auditor takes is to compare costs that were proposed with actual costs incurred to identify areas of potential risk to focus their attention. The following guidance addresses steps related to this comparison and subsequent audit action.)

DCAA issued guidance to emphasize certain steps taken in defective pricing audits. These include:

1. Audit baseline calculation. A precise baseline of expected costs is not required at the initial risk assessment phase. Rather, an initial baseline can be determined by using readily available data such as the latest proposal provided by the contractor. When potential defective data is identified a more detailed baseline can be prepared in accordance with CAM 14-116.

2. Underrun/Overrun testing. Potential defective pricing leads are identified by comparing actual costs incurred or if the contract/subcontract is not complete, by using estimates at completion (EAC). For incomplete...
contracts, when an EAC is not provided, the auditor is encouraged to use other records to compute an EAC such as progress payment requests, EVMS surveillance reports or latest budgetary data. The lack of a current EAC may indicate a deficiency in the contractor's billing system that should be reported as an audit lead by issuing a flash report.

3. **Probe transaction testing.** Probe transaction testing is **mandatory** to conclude there is no defective pricing. The decision to perform other additional audit steps should be based on the results of the transaction tests.

4. **Follow up on leads provided from transaction tests.** When either the initial risk assessment or probe transaction testing indicate the audit should be continued and the supervisor agrees, the auditor **must** follow up with appropriate audit steps identified in CAM 14-114c. (Editor's Note. That section does not identify specific additional steps but alludes to the five points an audit must establish to show there was defective pricing – (a) the information meets the definition of cost or pricing data (b) accurate, current and complete data existed and was reasonably available to the contractor before price agreement was made (c) the data was not submitted or disclosed to the government (d) the government relied on the defective data to negotiate a price and (e) the government's reliance caused an increase in the contract price.)

5. **Coordinating with the CO.** The auditor should confirm with the contracting officer the cost or pricing data the government relied upon the source of which is most often the PNM (proposal negotiating memo) (08-PSP-019(R)).

**DCAA Issues Guidance on Executive Compensation Cap**

DCAA issued guidance alluding to the March 25 Office of Federal Procurement Policy executive compensation cap for calendar fiscal year 2008 at $612,196. The guidance alludes to early DCAA guidelines issued March 4 that is intended to clarify the proper application of the cap. That memo reminds auditors that the FAR 31.205-6(p) compensation limitation for the top five executives impose a ceiling of allowable compensation paid or accrued in the fiscal year so auditors are told to verify that unallowable costs have first been deducted before applying the compensation cap. Examples of such unallowable costs are stock appreciation rights or bonuses calculated on changes in the price of stock securities or significant amounts of time (50% in the example) spent on unallowable lobbying activities. The guidance also reminds auditors that not all compensation cost elements are subject to the cap but are limited to wages, salary, bonuses, deferred compensation and employer contributions to defined contribution pension plans. Auditors are told to evaluate other compensation cost elements using applicable FAR cost principles where examples include: 401(k) contributions – FAR 31.205-6(j)(4); group medical insurance - 31.205-6(m)(1) and; company autos used for personal expense – 31.205-6(m)(2) (08-PPD-018(R)).

**Assad States Contractor Performance Surveillance Policy for T&M, LH Contracts.**

In a latest move of the Defense Department to tighten up justifications for using time and material and labor hour contracts, the Defense Procurement Director Shay Assad issued a July 14 memo requiring quality assurance surveillance plans be prepared in conjunction with the statement of work or statement of objectives. The memo states that COs must designate a properly trained representative in writing before contract award to assess contractor performance when T&M and LH contracts are to be used. The action follows a GAO report stating “appropriate government monitoring of contractor performance is especially important when using T&M and LH contracts because such contracts do not provide incentive to the contractor to control costs or labor efficiency.”

**GSA Proposes Mentor-Protégé Program**

The GSA is proposing a Mentor-Protégé program to encourage prime contractors to help small businesses qualify for its contracts and subcontracts. The program is intended to provide small business protégés valuable experience and knowledge about federal government contracting. The proposed rule will provide competition-related incentives to prime contractor participation as mentors where contracting officers would be permitted to give mentors evaluation credits under FAR 15.101. COs may evaluate subcontracting plans containing mentor-protégé agreements more favorably than those without such agreements and provide favorable ratings in evaluating past performance and contractor responsibility. Mentor firms can have more than one protégé and will negotiate agreements with protégés describing the elements of developmental assistance, factors for evaluating protégé progress and the anticipated dollar value and types of subcontracts that may be awarded to a protégé. Small business prime contractors may be mentors if they can provide “developmental assistance” to protégés where such assistance includes guidance on financial management, organization management, overall business management, engineering and other technical assistance,
loans, rent-free use of facilities and/or equipment and temporary assignment of personnel to the protégé for training purposes. (Fed. Reg. 32669).

ABA Opposes Contractor Disclosure, Full Cooperation Mandates Under FAR Proposal

The American Bar Association June 20 expressed strong opposition to two key elements of a proposed FAR rule requiring contractors to disclose to the government when they have “reasonable grounds to believe” a violation of federal criminal or False Claims Act has occurred in connection with a contract. The ABA calls the “reasonable grounds to believe” standard “vague” and its use would seriously erode the contractor’s attorney-client privilege and work protect protections whether or not the contractor discloses or declines to disclose possible violations of the rule. The ABA also expressed similar concern regarding the proposed rule requiring contractors to give “full cooperation” to any government agencies responsible for audit, investigation or corrective action. Such language would likely require waiver of attorney-client privilege, work product protection or employee legal rights during government investigations.

House and Senate Committees Approve a One Year Hold on All Public-Private Competitions

Both a House and Senate panel voted to approve a fiscal 2009 spending bill that would place a one-year moratorium on all public-private competitions under the OMB Circular A-76 provisions. The outsourcing competitions have generated a great deal of controversy recently so the committees voted to wait until the next administration has had the opportunity to consider and implement its own workforce policies.

Senate Passes Bill Authorizing State and Local Use of GSA Schedules

The Senate passed a recently House passed bill to expand use of General Services Administration schedule programs to purchase homeland security and public safety equipment and services to state and local governments. The bill will authorize state and local government purchasing under Schedule 84 of the Federal Supply Schedules program, which offers a wide range of commercial products and services related to law enforcement, firefighting and security at pre-negotiated favorable pricing.

CASES/DECISIONS

Board Decides Amount Due When Estimates on Which Price Was Based Were Erroneous

The maintenance contract required Admiral to have a specified minimum number of maintenance mechanics on duty at each location during specified hours and the amount Admiral would be paid depended on the number of elevators and escalators in operation. The government instructed Admiral to construct its pricing based on the agency’s estimates for how long and how many escalators and elevators would be out of service during renovation. This Admiral did but they remained out of service longer than projected and the Appeals Board decided that Admiral suffered damages due to the agency’s erroneous estimates and concluded Admiral should be in just as good a position as the one in which it would have been had the estimate been correct – no better or worse. The parties agreed the difference between what was actually paid Admiral and what would have been paid had the estimates been correct was $259,000. However, the Board reduced the amount for two reasons: (1) using an industry standard, it reduced the amount by $26,000 or 10% of the price that constituted costs of material and parts Admiral would have incurred and (2) $31,000 because for a six month period the elevators were out of service because Admiral was repairing them which was a different reason than stated in the contract for renovations or modernizations being conducted by another contractor (Admiral Elevator v. Social Security Adm., CBCA, No. 470).

Company May Recover B&P Costs But Not Lost Profits

In its IDIQ contract where delivery orders for various services would be separately awarded and bid and proposal costs were explicitly not to be considered as direct costs chargeable to a specific order, Link asserted the cost analysis conducted by the government was faulty and sought damages for B&P costs and lost profit. The Board granted Link the B&P costs stating the contract prohibitions against direct B&P costs were “irrelevant” because they concerned how to charge B&P costs if incurred not how to charge damages that Link wanted to recover. However the Board denied lost profits quoting a prior case holding that award of lost profit required that there would have been profit but for the breach where here the government rationally showed the delivery order would have nonetheless been
given to the awardee (L-3 Comms Corp., Link Simulation & Testing, ASBCA 54920).

A commentator on the case addressed some circumstances where contractors can and cannot recover lost profits. Generally a party can recover lost profit that will place it in as good a position as it would have been in had there been no breach of contract but it is not entitled to be put in a better position had the breach not occurred. Examples provided are that anticipatory profits are allowed if a requirements contract diverts work to another company or anticipatory profits are proper even if the government contracted to purchase its requirements from a limited number of contractors although no one contractor was guaranteed to receive an order. Courts have recognized that by considering the total amount of diverted work and other relevant factors can a court reasonably determine that amount of actual business and profits the company would have lost as a result of the breach. However, in another case, the Court declined to extend the right of anticipatory profits to the government's breach of a requirement contract that provided negligent estimates of the requirements in the RFP.

Discussions Are Not Required to Advise Offeror of a Price Disparity

Offerors were required to propose costs on a research and development contract where each cost proposal would be evaluated for realism, reasonableness and balance. During discussions the Air Force informed ICRC its hours proposed “to be high” so ICRC responded by reducing overall proposed labor hours where CTC ultimately got the award because its lower-cost proposal represented the best value to the government. CTC’s total proposed costs were $316,000 and ICRC’s was $979,000. In its protest ICRC asserted the agency’s discussions were not meaningful as required because they did not advise ICRC its costs were too high and did not clearly raise the matter during discussions. ICRC also claimed that CTC was ineligible for award because of an organizational conflict of interest (OCI) arising from a previous task order providing CTC with unequal access to information about the current procurement. The GAO rejected ICRC’s protest stating the government was not required to advise its total costs were not competitive. It stated that discussions, to be meaningful, could not mislead offerors and must identify deficiencies and significant weaknesses where it stated here the Air Force, correctly, did not consider the proposed costs to be a proposal deficiency. Rather the large difference in costs was based on the different approaches each offeror took where after a detailed assessment the government concluded ICRC’s approach was reasonable and the number of hours proposed for that approach was also reasonable. The GAO rejected ICRC’s assertion its proposed costs were “per se unreasonable” given CTC’s lower proposed costs stating ICRC did not show the government’s cost realism analysis produced an inaccurate measure of the likely costs of implementing the company’s proposed technical solution. As for the OCI, the GAO ruled ICRC did not show that CTC enjoyed an unfair advantage over other offerors stating the mere existence of a prior or current contractual relationship between an agency and a firm, by itself, does not create an OCI and no preference or unfair action by the government caused CTC to have an advantage (Integrated Concepts & Research Corp., GAO B-309803).

Court Rejects Constructive Change Claim

ISN’s contract required it to provide various services for Navy telecommunications networks and the contract stated the CO was the only person authorized to approve changes and should not comply with any government order or request not issued in writing and signed by the CO. When ISN lagged behind in schedule the CO asked it to submit an engineering change order (ECO) but did not approve it due to lack of funding. ISN recognized the ECP was not approved but nonetheless performed under the ECP until the contract was terminated. ISN sought $891,000 for work performed arguing, in part, that since the work under the ECP was not part of the original contract and the Navy approved the work albeit without formal adoption, a constructive change to the contract had occurred allowing for an equitable adjustment in contract price. The Court explained that such a constructive change occurs when a contractor performs work beyond contract requirements without a formal order as the result of an informal order or the fault of the government. For such a change to occur, the contractor must be truly required by the government to perform the work beyond contract requirements and also the informal order or conduct that caused the additional work must originate from one who is authorized to bind the government. The court ruled none of these conditions were satisfied and hence ruled against ISN (Information Systems & Networks v US, Fed. Cl. No. 02-796C).

Boeing Wins Protest of Tanker Award

(Editor’s Note. The particularly large dollar value and wide net of companies affected make this recent GAO decision significant to many companies.)
The GAO June 18 sustained Boeing Co.’s protest of the award of a $35 billion contract for the procurement of aerial refueling tankers to the team of Northrop Grumman Systems/European Aeronautics Defense and Space Co. Though the original decision is under protective order the GAO provided a summary of the decision stating it sustained Boeing’s protest primarily for the following reasons: (1) failed to take into account Boeing’s offer to satisfy more non-mandatory technical requirements than Northrop (2) improperly gave Northrop extra credit for exceeding key performance parameters despite the RFP stating no such consideration would be provided for exceeding key performance parameters (3) did not adequately determine if Northrop’s proposed tankers could refuel all current planes (4) conducted “misleading and unequal” discussions with Boeing where it first informed Boeing it had fully satisfied a key performance parameter but subsequently determined that it only partially met this objective and failed to inform Boeing of the change (5) failed to take into account Northrop’s refusal to agree to a specific solicitation requirement (i.e. achieve depot-level maintenance within two years) and (6) Air Force admitted it had made several errors in computing life-cycle construction costs that erroneously made Boeing the higher life cycle cost bidder. The Air Force is now considering how to rebid the contract (The Boeing Co., GAO B311344).

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Company A: Overhead rate = 80%; G&A = 12%; Wrap rate = 2.01

Company B: Overhead rate =65%; G&A = 21%; Wrap rate = 2.01

In the example, both Company A and B have a combined overhead and G&A rate of 2.01 which is often referred to as a wrap rate or multiplier. So, which of these two companies has a competitive edge? Since the total cost to the customer on $1 of direct labor will be the same, you may conclude that neither has an advantage. However, increasingly Company A will have the advantage in a cost competitive procurement even though total costs are the same. Procurement agencies are being inundated with concerns from Congress, their inspector general offices and the GAO that the government is being billed for unnecessary “add-ons”, “fees” or just extra costs. Contracting officers often consider G&A expenses as administrative “fluff.” (The DOD profit guidelines used to not allow profit calculations on G&A expenses but though that requirement has been eliminated the sentiment still lingers.) The resistance to marking up travel costs, material, subcontracts and other direct costs at 21% rather than 12% is substantial in this environment. So, there is a perception problem with Company B’s indirect rate structure. It could very well be that Company B spends no more than Company A on its administrative functions but instead may simply have a different way of accumulating and allocating costs. This is why it’s a good idea to critically evaluate Company B’s indirect rate structure, especially its G&A structure.

Though companies may treat different categories of costs differently, it is quite common to find such functional costs as human resources, security, MIS and contract administration charged to G&A. Can some of them be charged to overhead instead? Let take a look at a few functions separately.

**Human Resources**

Company B accumulates within its G&A pool costs associated with HR which is certainly reasonable in as much as the department benefits the company as a whole. However, the HR group also benefits all employees in the company where the majority of

NEW/SMALL CONTRACTORS

Adopting Service Centers

As the Grant Thornton survey we discussed in the last issue of the GCA DIGEST shows, an increasing amount of contractors are using service centers to accumulate certain types of costs. We are finding in our consulting practice similar interests in creating service centers. They provide several benefits such as accumulating certain functional costs (e.g. HR, IT, Contracts) that can then be charged on a cost basis as ODCs or when accumulated at the home office, they provide a more acceptable basis to allocate certain corporate expenses to business units conducting business with the government. Perhaps the number one benefit lies in appearances – the appearance of having a lower G&A rate.

Let’s consider an example.
employees are either direct or in the overhead pool. The HR resource group exists to provide a service and benefit to all employees. As the company grows and the number of employees rise, the human resource group expenditures also increase to accommodate the recruiting and servicing of the employees. Though many companies consider HR to be a period cost and hence allocable to G&A one can argue quite persuasively that allocating most of these costs to overhead would provide a more equitable matching of cost to cost objective. Company B may take all of its human resources employees and their proportionate share of facilities and fringe benefits, training, travel, recruiting and publications and combine them all into a separate service pool. Since the HR group benefits all employees the allocation basis for all incurred HR costs could be the total number of employees. The total accumulated HR costs would then be allocated out of the service center back into both the overhead and G&A pools where the proportionate number of employees reside. Since most of the employees reside in the overhead pool – the overhead pool supports direct projects so support costs of direct employees and overhead employees are charged to overhead – most of the HR group costs would be allocated to the overhead pool. This shift of costs is consistent with the causal beneficial relationship that must be followed.

- **Management Information Systems**

Company B, like many companies, include the costs associated with the internal information systems (IT) group within their G&A expense pool. The types of costs frequently incurred here are salaries for technical support and IT support team members, associated facility and fringe costs, hardware and software related depreciation costs, web page support and other IT related expenses. The services provided by this group generally benefit each individual who has a computer. An allocation base for this service center would be total number of computers or a more convenient measurement might be headcount if all heads have a computer.

- **Contract Administration**

It is quite common to have contract administrators handling multiple contracts and subcontracts on an ongoing basis and Company B assigns their salaries, fringe benefits, facilities costs to G&A. Like the other types of costs we have discussed, many companies believe it is simply more easy to have such costs lumped into G&A. The decision to accumulate these costs into a service center needs to be carefully considered to determine whether the costs are sufficiently material to maintain a separate service center. The allocation base could be the number of contracts administered. Since the expenses are clearly in support of contracts, allocating contract administration costs to overhead should not pose significant obstacles. Contract administration costs could simply be assigned to overhead or if there are multiple overhead pools then a service center approach makes greater sense.

- **Security**

There are numerous alternatives for treating security expenses. Security costs are commonly considered to be a part of human resource and as such may be included in the HR service pool. If significant, security may be separated into a separate service center where employee labor, fringe benefits, facilities and other indirect costs would be accumulated and allocated on an appropriate basis (e.g. headcount, facilities space are common). If certain security employees work for the benefit of one cost objective they may be charged as a direct cost of that contract where care needs to be taken to exclude such costs from the indirect cost pool or center. There is usually less opposition to such direct versus indirect costing practices since CAS 402 includes an example of security costs being charged both direct and indirect.

**A Word About Direct Billing of Service Center Costs**

Certain contracts allow for direct charging of costs commonly considered to be indirect costs (e.g. vehicles, IT expenses, subcontract administration, miscellaneous equipment). Accumulating these costs into service centers and allocating them on a representative base (e.g. miles driven, computer time, number of subcontracts, unit costs of multiple pieces of equipment, respectively) to direct contracts and other indirect cost pools represent an appealing way to quantify the costs of these services. However, auditors often become quite picky in evaluating both the service center costs and especially allocation bases when such costs are charged direct. Contractors are quite vulnerable to being accused of using inaccurate units – e.g. incomplete miles driven, computer time or incomplete number of computers, number of subcontracts, pieces of equipment. We have seen such assertions used to disallow the costs that were charged as ODCs on cost reimbursable contracts (CPFF, T&M) and even worse, assertions made that the contractor’s accounting system is inadequate. Rather than charging these types of ODCs on a cost basis we would strongly recommend negotiating unit prices commonly found in the commercial or government markets to avoid the possibility of going back and justifying charges on a cost basis.
Considerations Before Establishing Service Center

We frequently find contractors reluctant to adopt service centers in fear that such a practice would be inconsistent with “proper cost accounting” and that government auditors and contracting personnel will object. Contractors are given considerable discretion in how they decide to allocate their costs to contracts. Numerous Board and Court cases have established that a contractor-selected allocation method should not be altered by the government unless such a method produces inequitable results. In fact, the contractor’s method need not even be the “best” method but merely an equitable method. Government auditors frequently see that contractors modify their accounting systems to achieve various goals.

QUESTIONS AND ANSWERS

Q. We are in the middle of a DCAA audit of our 2007 incurred costs and our auditor is questioning Section 179 depreciation deduction costs that we have taken. We have claimed these costs for as long as I have worked here (since 1994) and probably before, and they have never been questioned. In one audit, the auditor intended to question them, but after talking to his supervisor was told that as long as we took the Section 179 deduction on the corporate tax return that it was an allowable expense.

A. If they are challenging it, you probably have an uphill battle. I checked out DCAA’s guidance - Chapter 7-409 - and it states that the first year write-off “would most likely not meet the requirements of CAS 409 and FAR 31.205-11.” For non-CAS covered contractors, “the FAR limits the depreciation to the amount used for financial accounting purposes.” There are often differences between what the IRS allows and what is acceptable for government costing and the Sect 179 write off is apparently one of those. Your only defenses may be (1) if you can show you use the same Sect 179 write-off for financial reporting purposes or (2) the actual useful life for the asset(s) in question is one year. The fact they had examined it and allowed it in the past and you had relied on this action to your detriment might provide an equitable estoppel argument but that would likely only be a “frosting on the cake” position if your other arguments are persuasive.

Q. Our electronic timekeeping system provides for only one approval signature. We use many firms who provide subcontractors to work on our contract so if we only have room for one signature who should sign it?

A. The immediate supervisor of the subcontract employees should sign off. If the subcontract employee is primarily supervised by one of your (Prime contractor) employees then that person should sign off; if the immediate supervisor is an employee of the subcontractor firm, then they should sign off. In order to show that the Prime contractor has validated the accuracy of the subcontractor hours, I would make sure that a labor distribution report identifying all hours worked be generated and a member of the Prime management (e.g. project manager) sign off on it before labor costs are entered into the system and are invoiced to the client. Better yet, I would see whether you can alter the format of the timesheet to provide for two signatures – one from the subcontract supervisor and the other from the Prime contractor manager.