GCA REPORT
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NEW DEVELOPMENTS

DCAA Issues Guidance on Executive Compensation Cap

The Defense Contract Audit Agency issued guidance alluding to the May 21 Office of Federal Procurement Policy executive compensation cap for calendar fiscal year 2009 at $684,181. The guidance alludes to early DCAA guidelines issued March 4, 2008 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*).

GAO Recommends Changes to T&M Contract FAR Provisions; DOD Releases Rule Changes

A Government Accountability Office June 24th report found widespread confusion among contracting officers about rules for using time-and-material and labor-hour contracts for commercial services. The GAO report noted these types of contracts are high risk to the government because a contractor's profit is tied to the number of hours worked. In spite of FAR Part 12 safeguards to use T&M contracts only if no other type is suitable and cost growth is monitored, the report states COs are not complying. For example, the report found that COs commonly are under the mistaken impression that the fixed labor rates in T&M contracts make those contracts fixed price. The report also found COs differ in their opinions on what constitutes a commercial service noting that some incorrectly believe a service intended to meet a specific government requirement makes the services noncommercial. The report also found the FAR determination and findings (D&F) required for using T&M contracts is rarely used and not used at all by the General Services Administration. Based on its findings the GAO recommends amending the FAR to (1) to clarify that T&M contracts are not fixed price (2) GSA schedule contracts require the same safeguards as required for commercial T&M/LH contracts and (3) provide guidance that detailed D&F's are required for the commercial services T&M/LH contracts.

In a separate action the Defense Department July 15 released rule changes to the Defense Federal Acquisition Regulations Supplement (DFARS). A new section Part 212 of the DFARS states that DOD may use T&M and LH contracts for the acquisition of commercial items only for services acquired for support of a commercial item, emergency repair services, and "other commercial services" if the CO decides certain criteria is met. These criteria include (1) the services being acquired are commercial and "commonly sold to the general public through use of" T&M and labor hour contracts and (2) use of such contracts is in the government's interest. The rule further states that "general public" and "non-governmental entities" do not include the federal government or state, local or foreign governments.

Expanded Use of GSA FSS Schedules by State and Local Governments

The House May 19 approved by voice vote an amendment to the American Recovery and Reinvestment Act (ARRA) that will allow state and local government to use the General Services Administration Federal Supply Schedules program to purchase goods and services using funds provided by the Act. The $787 billion stimulus law combines a mix of tax breaks and government spending in transportation, infrastructure, improvements, public housing, energy and other areas.

The expansion of the Act builds on prior authorization to permit state and local government to use GSA scheduled pricing for essential homeland security and public safety goods and services. e-Buy, GSA's electronic request for quote/request for proposal system for accessing the GSA Multiple Award Schedule, will soon be used to allow for the ARRA purchases.

DCAA Issues Guidance on Pension Cost Increases Due to Market Value Asset Declines

DCAA is alerting its auditors conducting forward pricing rate audits of companies with pension plans about potential unallowable costs due to the recent global stock market decline. Contractors' defined benefit positions may have become underfunded or barely funded causing an increase in annual contributions to the funds. Auditors are told to reach out to the DCAA pension specialists when significant pension plan costs are included in a proposal and be aware of three areas:

1. Auditors should question increased pension costs resulting from the contractor's use of an interest rate lower than the assumed long-term rate of return when computing the present value of pension liabilities and in estimating the return on pension plan assets. Auditors are reminded that CAS 412.50(b)(4) requires contractors to use the long term rate of return to avoid distortions cause by short term fluctuations. Auditors are told that the use of the long term rate is required to determine if pension costs are subject to the assignable cost limitation – if the actuarial value of the plan assets exceeds actuarial accrued liability plus normal costs then no pension costs are allocable to government contracts.

2. Auditors should question the contractor's immediate expensing of investment losses in 2008. The guidance states these losses represent actuarial losses that are required to be amortized over 15 years so the contractor's projected pension cost should include only one-fifteenth of these pension losses per year.

3. Auditors should be aware that some contractors average pension asset value over a three to six year average in which case the impact of recent declines should be mitigated. If the contractor uses a different asset valuation auditors are told to seek expert advice on the change. They are also reminded that if a new method is acceptable, it must be considered a voluntary accounting change in accordance with FAR 52.230-2 which prohibits any increased costs paid by the government *(09-PAC-007(R)*.

Hearings on Reauthorizing SBIR/STTR Programs; House Bill Includes Venture Capital Financed Companies in SBIR Program

House and Senate subcommittees recently held hearings on the reauthorization of key programs that fund research and development efforts by small businesses. Under the Small Business Innovation Research (SBIR) program, agencies award Phase 1 contracts worth up to $100,000 to explore the technical feasibility of an idea, Phase II awards up to $750,000 to fund more R&D to assess the commercial potential of the technology whereas in Phase III, the technology moves into the commercial marketplace where the awardee receives no further agency funds. A companion program, the Small Business Technology Transfer (STTR) program differs from the SBIR principally by requiring collaboration between a small business and research laboratories. A recently introduced amendment by Russ Feingold (D-Wis) would reauthorize the programs through 2022 and would increase maximum awards to $300,000 for Phase I and $2.2 Million for Phase II.

Legislation passed the House July 10 that authorizes the SBIR program with double the amount of funding as the prior year and would make small business firms with venture capital financing eligible for SBIR funding. Under the current program, companies financed by venture capitalists are excluded from SBIR participation. Proponents of the measure stated the government should be encouraging small firms to raise capital not penalizing them so by attracting both venture capital and SBIR funds many small firms can enhance their ability to develop innovative products and create more good paying jobs.

New FAC Issued

The FAR Council issued several amendment to the FAR in the form of Federal Acquisition Circular 2005-32. Two significant ones address past performance information and prohibition of granting awards to "inverted domestic companies."

The final rule emphasizes the use of the Past Performance Retrieval System (PPIRS) which follows a highly critical GAO report in May finding that contracting officers doubt the reliability of available past performance information due, in part, from lax management of the PPIRS. The PPIRS related changes require the FAR clearly (1) reflects the use of the PPIRS at www.ppirs.gov (2) requires evaluation of past performance on orders exceeding the simplified acquisition threshold (currently $100K) against Federal Supply Schedule contracts or under task or delivery orders against a government-wide

or multi-agency contract (3) recommends past performance information for orders under single agency contracts and (4) consolidates the past performance guidance into FAR Part 42.

Other past performance rules changes in the FAC include (1) revision to the definition of past performance to clarify that "completed contract" is a physically completed contract in accordance with FAR 4.804-4 (2) FAR 8.406-7 is modified to advise ordering activities that past performance evaluations required in FAR 42 are applicable to delivery and task orders (3) FAR 42.1503(a) is modified to clarify that agency procedures must identify those responsible for interim and final evaluations and (4) FAR 42.1503(c) is revised to clarify agencies must establish procedures for reporting past performance information to PPIRS.

The FAR has been modified to implement the Omnibus Appropriation Act of 2009 that prohibits award of contracts to any foreign incorporated entity that is treated as an inverted domestic corporation or any subsidiary of such an entity. An inverted corporation is defined in the FAC as one that was incorporated or was in a partnership in the US but is now incorporated in a foreign country or subsidiary of a foreign corporation. This is done to avoid US taxes on business income generated in foreign countries where Congress has enacted laws to discourage corporations from expatriating themselves. The Council stated the government does not know which companies are inverted because by law COs have no access to tax return information so each contractor must analyze its own status (*Fed Reg. 31561*).

CLEAN UP Act Would Rein in Outsourcing; Republican Proposals Would Expand It

The ongoing debate between Congressional Democrats and Republicans is spilling over into whether or not to out-source government functions to the private sector. Rep. John Sarbanes, with 50 co-sponsors, introduced the Correction of Long-Standing Errors in Agencies' Unsustainable Procurements (CLEAN UP) Act that generated federal union approval and Professional Services Council skepticism. The bill's author states the outsourcing "shrinking government at all costs" approach over the last decade has contributed to poor quality government services. The Act includes the following features: (1) suspend the OMB A-76 Circular public-private competition process until implementation of certain reforms (2) ensure federal employees perform "inherently governmental functions and mission-essential functions" and (3) in-source current functions performed by contractors.

The Freedom from Government Competition Act, introduced by Rep. John Duncan (R-Tenn) and Sen. John Thude (R-SD) would require, with certain exceptions, that each federal agency obtain all goods and services by procurement from private sources. The authors state the bill is intended to address the "unfair government competition with the private sector" where the bill would apply a "Yellow Pages" test to reviewing commercial activities in the federal government – the federal government provides many services that can be found simply by opening the yellow pages, saving the government $20-25 Billion annually. In spite of the Federal Acquisition Inventory Act requirements to identify non-inherently government activities, they state less than 10 percent of the 850,000 positions in the federal government deemed commercial in nature have been reviewed. The bill does not mandate privatization, preserving those activities only the government should do, while proposing competition for those functions that are commercial. The bill outlines methods of procuring goods and services from the private sector, including current OMB A-76 public-private competitions.

Industry Questions DCAA Approach to Determining Compliance with New Disclosure Rules

Industry representatives have expressed grave concerns over a DCAA letter to many contractors requesting detailed information on their ethics program such as a list of reported potential misconduct, open investigations and internal control audits. The letter's requests are keyed to a new FAR clause requiring contractors to report potential misconduct by their employees who have contracts exceeding $5 million and 120 days of performance. Specifically, the clause requires contractors to adopt a business ethics program and "timely disclose" if the contractor has "credible evidence" of a violation of federal criminal law involving fraud, conflict of interest, bribery or gratuity or violation of the civil False Claims Act. Also failure to report overpayments or criminal misconduct is grounds for suspension or debarment.

The most controversial part of the new rules is the mandatory disclosure requirements where the Professional Services Council says compliance creates a dilemma for contractors. Determining what constitutes "credible evidence" is difficult and disclosure could constitute admission that credible evidence exists which complicates settlement efforts but failure to disclose can result in suspension or debarment. In addition, since the mandatory disclosures do not constitute public disclosure of information, qui tam actions can be triggered by the disclosures. Another commentator has criticized DCAA's

request for information on activities that have not yet been investigated and the letter's definition of adequate disclosure being 5-10 days after identification. She stated that DCAA has "overstepped its bounds" where the IG should investigate mandatory disclosures while DCAA should limit itself to traditional contract audits. Several commentators have also noted that DCAA's recent elimination of the "inadequate in part" opinion concerning deficiencies in "internal controls", which includes contractor ethics programs, creates a high level of potential risk that even a single finding of an aspect of a contractor's internal controls can lead to an "inadequate" finding, jeopardizing receipt of payments and even award decisions.

A Defense Department spokesman has defended the letters stating DCAA has always evaluated contractors' ethics programs as part of the contractor's overall internal controls and though the new letter is not a standard letter included in its normal audits it does require standard information. The spokesman also stated that DCAA's audit function is different than the IG's investigation function and that it needs information related to timely discovery of and corrective actions related to improper conduct even if the contractor has not determined if a violation has occurred. The spokesman helpfully says that contractors should brief DCAA on whether disclosed information is "in-process" of being reviewed and the "Government's interests are being protected."

OMB Challenges Legality of GAO Decisions Favoring HUBZone Business Set-Asides

Two recent GAO decisions requiring prioritizing Historically Underutilized Business Zone small businesses over other types of small businesses are contrary to existing regulations according to a July 10 memo from the Office of Management and Budget. Two recent protest decisions by the GAO – *Mission Critical Solutions* and *International Program Group* – held that the agency must proceed with a HUBZone set-aside under statutory conditions over awards to a Alaska Native Corporation 8(a) firm or a Service Disabled Veteran Owned Small business (SDVOSB). In both cases the GAO ruled that a HUBZone small business set-aside is mandatory when conditions are ripe for it e.g. the agency reasonably expects that at least two qualified HUBZone small businesses will submit offers and that the award can be made at a fair price. Unlike the mandatory language of the HUBZone regulations, other small business set asides are optional where the agency *may* decide to offer them.

OMB Director Peter Orszag said the two GAO decisions violate regulations requiring "parity" among the 8(a), SDVOSB and HUBZones programs. He said pending an executive branch review of the decisions' "legality" the applicable SBA parity will be binding so HUBZone small businesses will not have an advantage over other small businesses as a result of these decisions.

CASES/DECISIONS

Settlement Costs for Sexual Harassment Case are Disallowed

(Editor's Note. The following case has generated much controversy where commentators have stated it basically amends the FAR and makes the common practice of avoiding long, expensive litigation by settling a case less attractive.)

Teton had a cost reimbursement contract for military housing maintenance where during performance a former employee sued them under Title VII of the 1964 Civil Rights Act alleging sexual harassment and retaliation. Teton settled the case without admitting wrongdoing and requested from the government the defense and settlement costs as an indirect contract cost. The government disallowed the expenses and the Board of Appeals ruled in favor of Teton stating since they had not engaged in criminal conduct, fraud or violations of the Major Fraud Act they were entitled to reimbursement for the expenses. The Federal Court reversed the decision stating that under the prior *Boeing* case, the damages, costs and attorney's fees associated with a violation of Title VII would not be allowable under the contract.

Though neither the False Claims Act nor the FAR explicitly address allowability of costs related to Title VII cases, the Court ruled that an adverse judgment in this case would make the costs unallowable because a contractor in violation of Title VII would have breached the contract and costs related to such a breach would be not be allowable. The Court stated the FAR states costs are allowable only if they comply with the terms of the contract where here the contract specifically required Tecom not to discriminate on the basis of sex. The Court held that if damages and penalties resulting from an adverse judgment are disallowed so settlement costs are also unallowable unless the contractor can prove the private plaintiff was highly unlikely to succeed on the merits. To rule otherwise, the Court concluded, would allow a contactor who engaged in conduct prohibited by the contract to nonetheless recover defense and settlement costs (*Geren V Tecom, Inc., 2009WL 1378149*).

Release of Wrap Rates Does Not Cause Competitive Harm

(*Editor's Note. The following case addresses the evolving issue of how much financial data can the government release under FOIA requests until those releases cause competitive harm.*)

Boeing was awarded a contract to build six satellites with options for 27 more. The Air Force received a Freedom of Information Act (FOIA) request for a copy of the contract from one of the other offerors. Boeing objected to the disclosure of its "wrap rates" (i.e. reflecting employee wages, taxes, benefits, overhead and profit) for 2000-2004 arguing that the FOIA's Exemption 4 prevented disclosure of the rates because they could be used to predict its future labor rates but the Air Force disagreed. The Court stated FOIA's Exemption 4 protects trade secrets and commercial or financial information from disclosure when they are obtained from a person that is privileged or confidential where "likely" harm can occur. Here the Court said Boeing provided no evidence to prove the release would cause substantial competitive harm and rejected Boeing contention that if competitors obtained pricing data going back several years it would be able to underbid Boeing because the prior years' rates varied substantially. The Court concluded Boeing overstated the ease which competitors could use the information and the harm it would be exposed to (*The Boeing Company v. Air Force, D.D.D. No 05-365*).

LOC and LOF Clauses Apply at the Delivery Order Level

(*Editor's Note. The proliferation of ID/IQ contracts where awards of task and delivery orders predominate often leads to confusion as to what level of the contract do various contract clauses apply – the contract as a whole or individual task and delivery orders. The following addresses the issue for limitation of cost and funds clauses.)*

Sharp held two indefinite-delivery, indefinite-quantity cost-plus-fixed fee contracts, one of which included both the Limitation of Cost (FAR 52.232-20) and the Limitation of Funds (FAR 52.232-22) clauses requiring notification of potential overruns while the other included only the LOF clause. The Navy issued dozens of delivery orders, some fully funded and some incrementally funded. The contractor experienced cost overruns as a result of unexpected increases in medical insurance and workers compensation costs and increased use of contract labor due to sporadic government work ordering so it orally notified the agency of an estimated $1 Million cost overrun. The Board ruled the notification was insufficient because it did not identify the amount of each DO overrun or provide an estimate of the amount of additional funds needed to continue performance. The Board also added that though the second contract did not contain the LOC clause, it nevertheless had a duty to notify the CO of overruns on the DOs (*George G. Sharp, Inc. ASBCA 55385*).

Providing Extra Data is Not a Deficiency

In the multiple ID/IQ contract to provide support services, the RFP instructed offerors to describe their management and staffing plans and to include proof of organizational-level accreditation by providing staffing plans to include "at a minimum" the percentage of staff with third party certifications. The agency determined that protester EM&I (1) did not provide proof of its accreditation and (2) did not provide a percentage of staff with third party certifications where instead, it provided the number of staff with certifications. EM&I argued it did provide proof of accreditation, which the agency eventually agreed it had and its failure to provide a percentage of staff was not a deficiency arguing its submission of actual staff number exceeded the minimum requirement. It further argued that a percentage gives no insight into the actual number possessing certifications giving an example that a 50 percent figure would not show whether there were 5 out of 10 or 50 out of 100 certified employees. The Comptroller General sided with EM&I ruling the agency improperly rejected as unacceptable the offer that provided a better understanding of the offeror's capabilities. It found the agency would have rated EM&I's proposal as acceptable but for the identified deficiencies so, at a minimum, it would have to consider EM&I's proposal as part of a technical/price tradeoff to determine a best value offer (*Eng'g Mgmt. & Integration Inc., Comp. Gen. Dec B-400356.4*)

NEW/SMALL CONTRACTORS

Government and Contractor Responsibilities on Auditing Proposed Subcontract Costs

(*Editor's Note. We often encounter uncertainty on what is the role of the prime contractor or higher tier subcontractor in validating its subcontractors' proposed costs. The prior, quite common practice of leaving audits of proposed subcontract costs to the government is being challenged by DCAA where we are finding, increasingly, failure to conduct required cost or pricing*

analyses resulting in assertions of estimating system and internal controls deficiencies on the part of both prime contractors and higher tier subcontractors. The question has taken on added urgency in the light of a June 30 issued DCAA Audit Guidance on Performing Audits of Subcontract Forward Pricing Proposals where the role of the auditor and the prime contractor is spelled out.)

Basic Requirements

Generally, FAR 15.404-3 requires prime contractors or higher-tier subcontractors (for the rest of this article, we will only refer to the Prime for simplicity but keep in mind the discussion also applies to higher-tier subcontractors) to perform cost or price analysis before awarding subcontracts. However, the contracting officer may request additional government audit or field pricing support if it believes it is necessary to ensure reasonableness of the total proposed price. The following four examples, in accordance with DFARS PGI 215-404-3a(i), illustrate circumstances when a government review is required:

1. There is a business relationship between the contractor and subcontractor not conducive to independence;

2. The contractor is a sole source and the subcontract costs represent a substantial part of the contract cost;

3. The contractor has been denied access to the subcontractor's records. However even if the records are denied, the guidance states the Prime, at a minimum, has the responsibility to perform and document (a) efforts to complete at least a price analysis as specified in FAR 15.404-1(b) and (b) coordinate with the contracting officer to obtain any necessary audit/pricing support from the government.

4. The contracting officer determines that, because of factors such as the size of the proposed subcontract price, audit or field pricing support (i.e. normally conducted by DCAA but sometimes cost or pricing specialists within the agency) for a subcontract is critical to fully detailed analysis of the prime contract.

DFARS 15.806(5) adds that "If the prime contractor's analysis is not considered adequate, the ACO will return the analysis package to the contractor for re-accomplishment indicating areas of inadequacy. In this case, the prime contractor will accomplish or cause the accomplishment of the additional review and resubmit the package to the ACO."

♦ A Word About What Constitutes Adequate Price or Cost Analysis

FAR 15.404-1, Proposal analysis techniques address the two basis types of analysis – price and cost. The section states it is the CO's responsibility to ensure the final agreed to price is fair and reasonable and that the two techniques, used singly or in combination, should be used to achieve this. Basically, a price analysis, normally conducted by price analysis within the agency, is the process of evaluating a proposed price as a whole, without evaluating its separate cost elements or profit. Examples of pricing techniques are spelled out such as comparison of prices offered by others or prices paid on previous contracts (these are the preferred methods), published lists, independent cost estimates, parametric estimating (e.g. costs per square meter) or market research. Cost analysis, normally conducted by either DCAA or other cost auditors, is the review and evaluation of separate cost elements (direct labor, direct material or subcontracts, ODCs, indirect costs) and profit. Examples of costing techniques are reviews of actual historical cost data, forecasts and estimates. (For more detail, look at prior articles in the GCA DIGEST using our Word Search function, selected texts or the Air Force Institute of Technology's five volume Contract Pricing Reference Guides.)

Government Responsibilities Under the Guidance

Whereas the recent DCAA guideline alludes to the FAR and DFARS sections identified above, it addresses additional responsibilities of government. In many procurements, the prime contractor may receive subcontract pricing proposals before it even completes its own. Under these circumstances, the guidance notes that COs often request that a subcontract audit begin prior to the prime contractor's proposal being completed in order to expedite negotiation and the award process.

The guidance also adds two more conditions to the four illustrations above where audit assistance by the government may be necessary:

5. The contractor has been cited for having significant estimating system deficiencies in the area of subcontract pricing, especially the failure to perform adequate cost analyses of proposed subcontract costs or to perform subcontract analyses prior to the negotiation of the prime contract with the government; or

6. A lower tier subcontractor has been cited as having significant estimating system deficiencies.

The guidance addresses several other responsibilities of the prime contractor auditor, most of which addresses what the auditor should do if the Prime did not adequately conduct a cost or price analysis.

a. They should assist the CO in coordinating overall audit effort relating to significant subcontract pricing actions at the prime contractor. They will decide on the need for the assist audit depending on the six factors listed above.

b. They should determine whether the Prime completed the required cost or price analysis of its subcontractors and review the adequacy of the analysis.

c. The audit report should identify subcontracts for which the Prime did not complete the required analysis and the proposed subcontract costs should be reported as unsupported.

d. The auditor will have the discretion to initiate its own audit of subcontractor costs and where if it does conduct the audit, the results of the subcontract audit will be incorporated into the prime contractor audit report. If the audit is not conducted and the Prime did not conduct an adequate cost or price analysis, the proposed subcontract costs will remain unsupported.

Finally the guidance does state that auditors should not perform audits of subcontract proposals where the prime contract is a firm-fixed price contract and has already been negotiated. However, if the fixed price contract does contain a price adjustment clause providing for a price reduction if the proposal is found to be misstated then an audit may be appropriate.

Prime Contractor's Responsibility

In practice, most prime contractors and upper tier subcontractors rarely audit their subcontractors' proposals. In recognition of this reality, the guidance stresses that even when the government audits a subcontractor, that "does not relieve the prime contractor of its responsibilities under the FAR." The guidance alludes to FAR 15.404-3(b), Subcontractor pricing considerations and explains that it is the responsibility of the Prime to conduct appropriate cost or price analyses to establish the reasonableness of the proposed subcontract prices and include the results of that analyses in the Prime's price proposal. The Prime is also responsible for ensuring the subcontractor's proposal is adequate to support the Prime's price or cost analysis as well as any examination conducted by DCAA or the ACO.

- **Penalties for Failure to Conduct Price or Cost Analysis**

The guidance states the Prime's estimating system should include written policies and procedures in place to conduct the required cost or price analyses and provide the analyses to the government negotiator prior to negotiating the prime contract price. If due to time constraints or other factors the Prime cannot complete the required analyses before it submits its proposal, it should have written policies and procedures in place to ensure a plan is implemented to complete the analyses prior to the prime contract negotiation. No size threshold is mentioned in the guidance meaning the requirements apply to all contractors having proposed subcontract costs. Alluding to DFARS 215-407-5-70(d)(d)(ii), the guidance states that a contractor's continued failure to perform subcontract price or cost analyses as required constitutes a significant estimating deficiency. The guidance instructs auditors to issue an estimating system flash report if the contractor fails to perform the required analyses. At major contractors, auditors are to take the additional step of conducting a limited scope internal control review to report as a significant internal control deficiency based on the evidence from the estimating system problem.

Though the guidance is clear about the responsibility of the Prime conducting price and cost analysis and potential penalties of not doing so, it is silent about the reasons why that function is not often taken nor how to do it. Whether it be subcontractors' reluctance to provide sensitive cost data to companies it may be competing against later, lack of resources or reluctance to spend money and effort on auditing subcontract proposals when award is uncertain Primes do not commonly conduct reviews of subs' proposals. Nonetheless they seem to have two options to avoid risk of not complying – either develop in-house capabilities where somehow there would be a firewall with the audit and proposal functions or utilize outside CPAs with experience conducting audits of contractors' proposals who will provide either the Prime or government results of their reviews without divulging sensitive cost information to the Prime.

QUESTIONS & ANSWERS

Q. DCAA has recently questioned membership costs as well as costs of attending meetings to several DOD type organizations we belong to - Navy League, Assoc of Old Crows, etc – citing FAR 31.206-43. Are these

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costs unallowable? Are they explicitly unallowable where penalties would apply.

A. Section 7-1102.2(a) of the DCAA Contract Audit Manual does identify the types of organizations you cite and does state membership and meeting expenses are unallowable. We are unaware of any court decisions that have challenged these assertions so I would say you would have little likelihood of changing DCAA's position. However, a quick review of FAR 31.205.43 indicates that no mention of the types of organizations is made and in fact the sections addresses types of costs that are allowable. Hence, I would argue that the unallowable costs are not explicitly unallowable and hence not subject to the penalty provisions of such unallowable costs.

Q. Our fringe benefits include payroll taxes, health insurance, workers comp and 401(k) contributions and we want to include fringe benefit costs in our overhead base so as to create a lower overhead rate. DCAA says we can't. What do you say?

A. I say yes. I am quite surprised that DCAA would say no because inclusion of fringe benefits in the overhead base is a common, acceptable practice and we are unaware of any prohibitions to doing so. The only reason I could see for legitimately rejecting your approach is that DCAA believes the fringe benefit costs included in the base are not complete. For example, I see no mention of paid time off (e.g. holidays, vacation, sick leave, etc) in your description of fringe benefit costs which are cost elements of DCAA's definitions of fringe benefit costs. (*Editor's Note – the questioner confirmed that our suspicion was correct and the reason their approach was rejected was that paid time off was excluded in the base.*)

Q. How have you seen companies handle the cost of security such when part of a facility is used specifically for special contracts but other parts are used to support multiple contacts as well as contain general "Home office" type effort reviewing staff & visitor clearances. If the costs were charged direct, what happens when a contract is completed? Have you seen the ongoing costs now shift to overhead or a service pool?

A. The situation you describe is similar to an example in the CAS 402. In that they distinguish between 10 firemen that provide general fire protection for multiple facilities and are charged indirect versus three fireman hired to protect one building used exclusively for one contract and they are charged direct. The example states this is compliant with CAS 402 since the similar costs are incurred for different purposes.

In your circumstances, you can distinguish between the general security support and the specific support needed on specific contracts. When that support is no longer allocable as a direct charge to an identifiable contract, it needs to be charged indirect like the other costs. Make sure you identify these differences in your disclosed practices.

Q. We seem to be seeing CO's not wanting to pay for costs that are part of the requirements on their contract. Have you seen an increasing trend here lately?
Most recently, they are refusing to reimburse us for sales and use taxes incurred for items charged directly to the government.

A. I haven't seen a particular increase of such trends at the federal level but I definitely see clear signs at the local and state levels. Why wouldn't sales and use taxes be considered a cost component of the items you charge the government? Unless the contract explicitly prohibits it I see no reason why you should not include the taxes.

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