GCA REPORT

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NEW DEVELOPMENTS

New Contract Reporting Requirements

An interim rule was issued July 8 requiring contractors to report both first-tier subcontract awards of $25,000 or more and to disclose the compensation of their top five executives if certain thresholds are met. The stated reasons for the disclosure requirements is to provide the American taxpayer more information that should be used to impose greater fiscal discipline from the executive and legislative branches of government. It should be noted, based on inquiries we have received, that the requirements are separate from similar ones for receipt of Recovery Act monies. The rule applies to all negotiated contracts, commercial item and commercially available off-the-shelf contracts as well as those meeting the simplified acquisition threshold regardless of size of contractor but not to contracts that are classified or made to individuals or contractors and subcontractors with gross revenue less than $300,000.

Until September 2010, new subcontracts must be reported only when the prime contract is more than $20 Million, from Oct 1 to Feb 28, 2011, reporting is required for prime contracts of more than $500,000 and starting March 2011, for all contracts meeting the $25,000 minimum. The rules are:

1. The month following the month of award of a contract and annually after that the contractor will report the names and total compensation of each of the five most highly compensated executives for the contractor's preceding completed fiscal year.

2. Unless directed otherwise by the CO, by the end of the month following the month of award of a first-tier subcontract and annually after that, the contractor shall report the names and total compensation of each of the five most highly compensated executives for the first-tier subcontractor's preceding fiscal year.

3. The rule will require contractors to report subcontracts of $25,000 or more and any modifications made to those.

The compensation disclosure is required only if a contractor or subcontractor received at least 80 percent of its annual gross revenue and $25 million from federal awards if senior executives are not already required to publicly disclose the compensation information (e.g. SEC or IRS requirements). "Total compensation" means the cash and noncash dollar value earned by the executive in the last fiscal year, including salary, bonus, awards of stock, stock options and stock appreciation, earnings for services under non-equity incentive plans, changes in pension value, above market earning on deferred compensation which is not tax-qualified as well as other compensation such as severance, termination payments, value of life insurance paid on behalf of the employee, perquisites or property over $10,000. One area of potential confusion that seems unresolved is whether the "contractor" refers to an individual business segment or the company as a whole. First tier subcontractor refers to a contractor furnishing goods or services for performance of the prime contractor but excludes supplier agreements with vendors such as long term arrangements for materials and supplies that are normally part of indirect cost pools.

DCMA Issues Guidance on What is Direct Versus Indirect B&P Costs

The Defense Contract Management Agency Cost and Pricing Center issued May 24 guidance to ACOs on treatment of bid and proposal costs resulting from the *ATK Thiokol* case (*discussed in detail in the next DIGEST issue*). The case provided that research and development costs, like B&P costs, should be charged as independent research and development and hence charged indirectly only unless there is a specific requirement of an existing contract to charge it directly. In clarifying limited circumstances when B&P costs may be charged direct, the memo states that "follow-on work does not automatically qualify to be charged direct merely because there is an implied requirement that the contractor submit a proposal." Rather there must be a specific requirement of an existing contract, not just an implied requirement, to charge B&P costs directly. The memo adds that this or similar language should appear in a company's disclosed practices.

FAC 2005-42 Issued

The FAR Council issued FAC 2005-42 consisting primarily of two rules implementing provisions of the 2008 defense authorization act addressing market research and justification and approval (J&A) documents for non-competitive contracts and treatment of ESOP costs. The interim rule requires agencies to conduct additional market research for ID/IQ task or delivery orders under prime and subcontracts in excess of the simplified acquisition purchase (SAP) threshold (currently $100K). In addition, contractors with contracts in excess of $5 million for noncommercial items must conduct market research before making any purchases under those contracts exceeding the SAP threshold and agencies are told to take appropriate steps to ensure the market research has been conducted before the contractor makes purchases on behalf of the government. The final rule also requires that documents be made available on the federal business opportunities website and the contracting agency's website within 14 days of award and remain posted for at least 30 days. The rules do not apply to Federal Supply Schedules where a separate set of rules will apply to sole source task or delivery order awards.

The FAR Council also issued an interim rule intended to align the FAR and Cost Accounting Standards with respect to proper treatment of employee stock ownership plans (ESOPs). The rule follows the CAS Board requirement to account for ESOP costs, regardless of type, in accordance with CAS 415, deferred compensation rather than CAS 412, pension costs. FAR 31.205-6(q) was amended to reflect the change (*Fed. Reg 34256*).

DCAA Issues Guidance on Signature Authority

(Editor's Note. Who signs an audit report – the branch manager, supervisor or even auditor – has implications on who reviewed it and what can be done to challenge an adverse opinion. For example, if a branch manager is supposed to sign a report but a supervisor did so, that should provide a valuable opportunity to get a "second look" from the branch manager.)

The Defense Contract Audit Agency has recently released two audit guidelines addressing signature authority. The first instructs regional and branch offices to revise the delegation of signatory authority to permit supervisory auditors to sign selected audit reports and memorandums such as non-major desk reviews, non-major contractor labor floorchecks, eligibility for direct bill programs, evaluation of final vouchers, provisional billing rate audits, limitation of payments, progress payments, preaward accounting surveys, contract closing statements on DOD commercial T&M/LH contracts, price proposals for a fixed price proposal under $25 million and cost type proposals under $100 million, and specific cost/rate information. Signature authority will continue at the branch manager (or temporary branch manager) or higher level for all other audit reports, Form 1's, indirect rate agreements and memos to close or cancel audits (*01-PPS-019(R)*.

DCAA also issued separate guidance changing its signature authority to permit delegation to GS-9 level auditors and above authorization to provisionally approve interim public vouchers. This approval authority is subject to the discretion of the individual branch office and branch manager to ensure auditors who are delegated this authority possess the necessary experience and competence to protect the government's interests (*01-PPS-017(R)*.

DCAA Issues Guidance on Unfinished Audits of Forward Pricing Rates

As part of its overall efforts to tighten its Quality Assurance DCAA issued guidance addressing the reporting of forward pricing rates included in a pricing proposal when the audit of those rates have not been completed. The guidance states since direct and/or indirect rates usually represent a significant portion of a pricing proposal, auditors are told to disclaim an opinion on the proposal taken as a whole if the audit of those rates has not been completed. The audit report should clearly describe what parts of the proposal were examined and the opinion in the report should only address those parts. If it is requested to audit the entire proposal the audit report should state a supplemental report will be issued once the audit of the direct or indirect rates is completed.

The guidance provides several illustrations. If the proposed rates do not differ significantly from pre-established rate agreements auditors may include the latter in the pricing proposal and express an opinion while if there is a difference the issue should be elevated within DCAA and if not resolved, then the auditor is told to incorporate the rate agreement. In both cases, the auditor is told to conduct an analysis to determine whether the impact of the proposal would materially impact the rate agreements. Also, if a rate agreement is used for only a partial period (e.g. 2010-2011 while the proposal is for four years) and no additional data is provided for out years, the auditor is told to report the proposed costs as unsupported with either a qualified or adverse opinion depending on the significance of the proposed indirect costs (*10-PSP-018(R)*.

Agencies Directed to Include Plans to Reduce High-Risk Contracts

A recent Office of Management and Budget cost cutting directive instructs federal agencies to include in the budget submissions for FY 2012 "specific actions and goals" to reduce reliance on high risk contract vehicles "including contracts awarded noncompetitively, procurements where only one bid is received and cost reimbursement and time and material contracts."

In a separate memo, OMB issued a July 7 report saying it was having success in reducing use of high risk contracts. Comparing the first half of FY 2010 with 2009, the report said there were reductions of (1) 2 percent in new contracts receiving only one bid (2) 7 percent in the amount awarded for new T&M/LH contracts and (3) 6 percent for new cost reimbursable contracts. Citing several examples, the report found use of a fixed price contract rather cost type EPA contract saved $5.2 Million, a fixed price DOE contract awarded competitively to a small business saved $22 Million over a sole source cost reimbursable contract to a large business and over 2,500 reverse auctions for DHS goods valued at $340 Million saved $40 Million.

More Notification of Impending Bundling of Contracts Required

The Defense Department issued an interim rule, which implements a section of the 2010 DOD authorization act, that broadens requirements for public notice of potential contract bundling actions. The rule requires that notices of potential contract bundling be published on FedBizOpps.gov at least 30 days prior to release of a solicitation for a bundled acquisition. The intention is to enable small businesses to compete for more work by either submitting a proposal for the bundled work or take action against the agency to unbundle the procurement before the solicitation becomes finalized. The rule expands on existing rules that require notification to incumbent small businesses only when the tasks being bundled was currently held by a small business (*Fed. Reg. 40174*).

"Hot" Topics Being Debated

There are several recent issues being proposed by the government that is generating a great deal of reactions by various procurement stakeholders. The following represent most of the hot ones being discussed in recent weeks.

- **Industry Group Criticizes Proposed Rule to Mandate the Hiring of Incumbent Employees**

The influential Professional Services Council has criticized the Department of Labor's recent proposed rule on displaced incumbent contractor service employees as "illogical, imbalanced and legally questionable." The proposed rule would require successor contractors of the same or similar services to provide a 10 day right of first refusal for positions they are qualified for. The PSC says that requiring successor contractors to hire incumbent employees is really a "solution in search of a problem" noting there is no evidence that successor contractors replace qualified incumbent employees. The PSC put forth several criticisms of the proposal:

1. The proposed rule would subvert a successor's right to select its own workforce where the exceptions to the proposed rule are too narrow. The incumbent may have decided not to transfer poorly performing employees to new projects but to do so the new contractor would need to show evidence of "past unsuitable performance." Such evidence would often be very difficult to show where, for example, poor performance may not have led to discipline or former employers may be reluctant to divulge information to the incumbent for fear of privacy violations.

2. Rational business decisions usually underlie decisions about not keeping employees where, for example, their performance may have been the cause of the incumbent loosing the contract or new processes may be called for where prior work should not be the primary criteria for continuing work.

3. PSC says the rule should require at least six months of continuous employment on the prior project to establish the employee is qualified while the proposed rule can conceivably entitle a temporary employee a job on the successor contract after a single day of work. The Group fears prior contractors will pull top employees or even worse, move their worse employees to an expiring contract after award is made to another contractor, keeping their best employees and minimizing the successor's chance to take away its employees.

4. The proposed rule would require the expiring contractor to provide a list of employees 10 days before the end of the contract, a time terribly short for the new contractor to evaluate those employees. Further, the rule will give the selected employees a 10 day right of first refusal where the offers would remain open resulting in the new contractor not having a sufficient labor force in place to avoid service deficiencies.

5. The proposal will invite "parasitic" litigation by affording administrative standing to "any aggrieved

party" or "interested party" without defining those terms. Also, by requiring successor contractors to show why terminations of newly hired incumbent employees are bona fide the proposed rule would preempt state laws that permit at-will employment.

6. The ability to waive the rules is too limited where only agency heads are allowed to do so. PSC recommends the waiver authority should be delegated to contracting officers who are better positioned to indentify the government's interests.

♦ Groups Chime In on When is Work to be Insourced

The Bush Administration's emphasis on outsourcing government work to private firms has been significantly challenged by the Obama Administration's emphasis on insourcing more government work resulting in more and more work that was previously performed by private firms being transferred to the government. The basis for determining what work is to be insourced or outsourced largely hinges on defining what type of work should be performed solely by federal employees. That determination has come down recently to deciding what is the definition of "inherently governmental function" which has become one of the hottest topics this year. In March the Office of Federal Procurement Policy solicited for public comment guidance to federal agencies for deciding when work would be performed by federal employees where the policy letter adopted the definition of inherently government function as that used in the Federal Activities Inventory Reform (FAIR) Act of 1998 which originally defined it as "so intimately related to the public interest as to require performance by federal government employees." The policy letter generated a flurry of responses from various industry, labor and political groups that either advocated use of a more restrictive approach that places additional limits on the types of work that should be reserved for government employees or a broader approach that would set aside additional functions for performance solely by government employees. Examples of responses include:

The Construction Industry Roundtable complained the guidance letter "constructively reverses" the long held intent to contract out for goods and services unless they are "inherently governmental" in nature.

The National Treasury Employees Union, on the other hand, expressed concern the proposed policy's interpretation of FAIR Act's definition is too narrow and subject to abuse where if read by someone opposed to federal employee performance of the work would be interpreted to mean "only the highest agency positions" should be insourced.

The Small Business Coalition for Fair Contracting expressed concern that the "insourcing initiative" though well intentioned would "disproportionately affect small businesses."

Other comments questioned the wisdom of the OFPP plan to identify functions, though not inherently governmental, as still restricted to government employees because they are "closely associated with such work" or are "critical functions" that materially affect missions. For example, the Council of Defense and Space Industry Association wrote these two sections should be merged because by creating three categories – inherently governmental, associated or critical – determinations were too "complicated" and "confusing." The Project on Government Oversight warned the three categories would result in excessively "subjective" decisions which would result in functions that fall outside the original FAIR definition would still be outsourced.

♦ Industry Releases its Legislative Wishlist

The Acquisition Reform Working Group (ARWG), an influential coalition of industry groups, released its 2010 legislative recommendations to be included in the 2011 National Defense Authorization Act.

Commercial Products. Though considerable legislation over the last 20 years has shifted federal acquisition from government-unique products with detailed specs to commercial items with streamlined commercial practices, many regulatory changes have eroded the government's ability to access the commercial marketplace. Use of government-unique clauses and additional costs to demonstrate prices are fair and reasonable unnecessarily limit competition at the prime contract level and discourage small and innovative businesses from competing. ARWG recommends Congress stop imposing new government unique requirements and have Congress study existing requirements.

Fixed-Price Preference. Since advanced development is inherently risky, ARWG says fixed price contracts are not suitable for high risk development of major weapons programs. Contracting officers should be able to maintain flexibility in selecting the contract type best suited to its requirements and recommended repeal of the 2007 Defense Authorization Act which required the Defense Department to modify its regulations on determining contract type for major development programs.

Insourcing. ARWG states the DOD has "aggressively and inappropriately" been threatening contractor employees with loss of their private sector jobs to force them to convert to government employment and recommends barring the solicitation of contractor employees if the agency and contractor has a direct business relationship.

Other Issues. ARWG also recommended that Congress (1) repeal the three-percent tax withholding on government payments to contractor that is effective Jan. 1, 2012 (2) eliminate the 12 month limit on Prompt Payment Act interest and (3) hire up to 500 highly qualified experts to augment the acquisition workforce (*ARWG's recommendations are at www.pscouncil.org*).

- **ABA Criticizes Proposed Rule on Technical Data**

The American Bar Association has criticized a recent proposed rule on technical data, issued May 7 (*Fed. Reg. 25161*), as having the "unintended effect of discouraging commercial companies from doing business with the Defense Department." Currently, there is a presumption that a commercial item was developed entirely at private expense where restrictions on government use of technical data is justified. If a contracting officer challenges this restriction it is sustained only if the government can show it was not developed exclusively at private expense. The proposed rule shifts this burden of proof where CO's can now challenge restrictions of technical data for major systems (including subsystems and component parts) where they are sustained unless the contractor can show it was developed at private expense. With the exception of commercial off-the-shelf- items, the rule will apply to all acquisitions including commercial and noncommercial at both the prime contract level and lower tier subcontract level. The rule also seeks to expand the restriction from technical data to computer software where the rule states there are common issues applicable to both technical data and computer software.

The ABA group warns that the proposed rule would impose the non-commercial DFARS data rights clauses and marking requirements on any contract for commercial items if there is any government funding of development of the item, component or process. The ABA group also states the proposed rule would now apply to all subcontracts for commercial items rather than the prior restrictions applicable only for major systems and their subsystems and components. Finally, the ABA states the proposed rule would apply to noncommercial software where the drafters of the original rules intended to limit the rules to technical data and not computer software (*ABA comments are available at www.op.bna.com*).

CASES/DECISIONS

Protest Sustained Due to Bait and Switch

(*Editor's Note. The following demonstrates the need to timely inform the government of changes to proposed key personnel.*)

CSSI offered two employees as air traffic control specialists in its proposal, one of whom resigned shortly after CSSI submitted its offer. CSSI did not inform the agency of this development where the agency did not learn of the resignation until after award decision, which rested in part on the mistaken perception that CSSI would use the employees in performance of the contract. The Board concluded that CCSI's silence amounted to a misrepresentation and an impermissible "bait and switch" because the agency was not informed of the resignation. As a result, the protest was sustained (*Sentel Corp., ODRA, No 09-ODRA-00512*).

Lockheed Does Not Owe the Government a Price Adjustment in its F-22 Contract

(*Editor's Note. Contractors want to make accounting changes from time to time and when they do so, the government will ask them to prepare a cost impact analysis where they need to show how the accounting change(s) impacts "affected contracts." The following case illuminates what is and is not an affected contract.)*

The contract in question here included the FAR 52.230-2 clause that provides if a contractor wants to modify its accounting practices it must first negotiate terms and conditions under which the change will be made. If the accounting change results in increased costs it must agree to a contract price adjustment and repay the government for any increased costs caused by the accounting change. The amount of the price adjustment is generally measured by the additional amount paid by the government "in the aggregate" over all "affected" CAS covered contracts and subcontracts.

In 1991 the Air Force (AF) and Lockheed entered into a $9.5 billion cost plus contract for the development of the F-22 "new generation" aircraft. In 1992, there was a shortfall in funding so the AF "rephrased" the contract (e.g. less aircraft, longer delivery dates) and issued an undefinitized contract mod to reflect the rephrasing. Meanwhile, the AF, after conducting overhead rate analyses, recommended specific accounting changes to various contractors including Lockheed to make accounting changes such as charging certain indirect

costs direct to contracts. Lockheed agreed to make the changes (charging certain indirect labor direct) where in mid June 1993 it presented a cost impact study of the changes to the CO, changed its disclosure statement and submitted forward pricing rates reflecting the change. The next month it submitted a cost proposal using the new rates intended to price the "rephrased" work and in Nov 1993 the AF and Lockheed agreed to a total estimated cost award proposal and fee for the rephrased work where a contract mod was issued reflecting the price for the rephrased contract. Five years later, DCAA issued a report on the cost impact study concluding Lockheed's accounting change caused a significant increase to the F-22 contract, the F-22 contract should be considered an affected contract because the rephrasing was only a contract mod of the original contract and not a new contract and as a result of including the F-22 contract with higher costs due to the accounting change, the government claimed $14.7 million against Lockheed for the impact of the accounting change.

The Appeals Board sided with Lockheed with respect to excluding the F-22 as an affected contract. It stated the negotiations were "unusually comprehensive", the parties described the effort as a "repricing" of the contract, the rephrased scope of work was comprehensively examined and concluded the parties intended to determine the cost of the entire program and "re-baseline" the costs within new budget constraints. The Board added the changed practices were fully disclosed and incorporated into the forward pricing rates used to cost out the rephrased contract and concluded the F-22 contract was not an "affected contract."

The Appeals Court agreed with the Board. It stated that a contract is "affected" and requires a price adjustment when the contractor used one accounting practice to estimate costs and a changed accounting practice to accumulate and report costs under the contract. It is not affected when each contract cost is estimated and reported using the same method as was the case here. In response to the government's assertion that the 1992-93 rephrasing was only a modification and not a new contract replacing the original contract, the Court stated the critical inquiry is not whether there is an entirely new contract but whether the estimate and reported costs are consistent ruling the Board got it right by asking whether the negotiating parties knowingly repriced the contract being fully aware of the accounting changes. The Court answered in the affirmative saying Lockheed had disclosed in detail the accounting changes, the CO used the forward pricing rates incorporating the changes and the intention was to compute a rephrased F-22 contract price where the question of whether the formation of an entirely new contract occurred is immaterial (*Michael B Donley, Fed Cir. No 2009-1261*).

Termination of Contract to Obtain a Lower Price is a Breach of Contract

Sigal was given a renovation contract that included a firm fixed price, lump sum price for the base contract work and firm fixed price unit prices for 16 items of repair and restoration. After award but before it began work on the unit price work, the GSA project manager solicited a cost proposal to perform work from another contractor where the agency subsequently suspended work for 12 of the 16 items. GSA took no action to reinstate the suspended work so Sigal submitted a certified claim asking for lost profit asserting GSA breached Sigal's contract by improperly eliminating unit-price restoration work in order to have it performed by another contractor at a lower price. The GSA contracting officer denied the claim stating even if the unit-price work was part of the contract (which it did not admit) it had broad rights to delete or terminate the work and the contractor was not entitled to profit on work not performed. The Board sided with Sigal finding the contract unambiguously required Sigal to perform all restoration work at the applicable unit price bid schedule and one of the few limitations on the government's right to terminate a contract is it may not do so to get a better price for performing needed work. However as for lost profit, though it was entitled to lost profits as a result of the government breach of contract, Sigal had not established the amount of profits it would have earned (*Sigal Constr. Corp vs Gen Servs Admin., CBCA 508, 10-1 BCA*).

Cost Guard Properly Used Settlement Payment to Offset Debt Owed

Global had a contract with the Coast Guard to perform repairs and maintenance where it filed a certified claim for some out of scope work and the parties mediated the claim and entered into a settlement agreement. After receiving the CO's request for payment per the settlement, the Coast Guard's finance office applied the full amount as an offset against amounts owed under a separate contract with Global that had been terminated for cause. In its appeal, Global stated the agreement provided the CO would ask the Coast Guard payment center to make a payment via electronic transfer into its account and it would not have agreed to the settlement if it knew the Coast Guard would use the money as an offset while the Coast Guard argued the settlement agreement had been fully performed. The Board sided with the government explaining the government has the right to apply

unappropriated monies of a contract to debts it owes where this right extends to offsets. If Global had wanted to ensure the settlement would not be subject to the right of offset, it should have sought such a provision in the settlement agreement. The settlement provision requesting payment be deposited in a designated account did not explicitly invalidate the government right of offset (*Global Shipping Systems v Dept of Homeland Security, CBCA, No 923*).

SMALL/NEW CONTRACTORS

What is a Business Unit or Segment

As consultants helping clients create the best way to allocate direct and indirect costs to government contracts, we frequently come upon businesses that have more than one business unit or even if only one, considers the option of creating separate business units that will have its own unique cost accounting practices. Such considerations usually raise the question of what are the characteristics of a business unit or segment (we will use the term interchangeably for now). In approaching this question we have used numerous texts, most notably Mathew Bender's Accounting for Government Contracts as well as our own experience.

The definition of business unit for cost accounting purposes is distinctly different than what is the legal definition. Though a legal business unit may also be a distinct business unit for cost accounting purposes (the legal basis may be a strong justification for the accounting entity) the two often differ – a separate legal entity may not be considered one for accounting purposes and similarly, a separate segment for accounting purposes need not be a separate legal entity.

Though the FAR is relatively silent on the definition of business units, several cost accounting standards – namely CAS 403, 410, 418 and 420 – address the term "business unit" in the context of discussing their requirements which for practical purposes is instructive even if a company has no CAS covered contracts. CAS 410 was the first standard to address the issue defining a business unit as any segment of an organization which is not divided into segments. How was a segment defined?

CAS Requirements

The basic requirement of CAS 410 is that a business unit's general and administrative (G&A) expenses will be accumulated into separate indirect cost pools of a business unit. Though CAS 403 suggests some management and admin work may be performed outside of the business unit (e.g. corporate level) and transferred to the business units' G&A pool both CAS 410 and 403 suggest the main functions are performed within the business unit. The implication here is that a business unit has the full complement of management and administrative functions necessary to operate as a business.

CAS 418, which emphasizes the need to have a written policy to distinguish direct and indirect costs and how they are accumulated and allocated, discusses indirect cost pools traditionally known as overhead as well as intermediate or service center pools. The implication here is that a business unit will have its own cost pool structure and that this structure is distinct and separate from other business units. CAS 420 discusses how IR&D and B&P costs are to be placed in separate expense pools and allocated on a similar base as G&A even when they are originated elsewhere they are transferred to the benefitting business segment. This reinforces the notion that a business unit has its own pool structure separate and distinct from other business units.

Characteristics of a Segment

CAS 403 first defined a segment as follows: two or more divisions, product departments, plants or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit or production of a product or service. A few considerations of terms would be helpful:

The critical issue is what is the essential characteristics of the subdivision not the *designation* used to describe it. Segments must report to a *home office* and if one does not exist then no subdivision can be considered a segment. Though a separation is common, *geographical location* is not, in itself, indicative of a segment so a separate segment can be located in the same location as a home office or other segment. Though a certain amount of *responsibility* is contemplated as qualifying a subdivision as a segment, there is no clear test of the amount or kind of responsibility required. For example, profit responsibility may be a common characteristic of a subdivision but if not responsible for profit it may still be considered a separate segment. A segment must *control* its own destiny where management is independent and autonomous to make its decisions about performance and what contracts to pursue.

In addition to these elements DCAA has four conditions that it instructs its auditors to consider: (1) separate product lines (2) profit and loss responsibility (3)

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separate identification of assets, results of operations and activities and (4) a full complement of general management and administration.

The rule of thumb is that a segment or a unit exists if it has all the essential components to operate as its own self-standing company. Of course, not all elements need to exist initially – newly created segments may use the resources of other segments or home office help until it has the opportunity to become fully self sufficient. Bender identifies the following elements that would constitute a business unit:

- The unit has a well-defined operational mode, product or service line that is different than other units in the company.
- The unit has its own general management and administration and its own G&A pool which is allocated only to that unit's contracts.
- The unit has its own overhead pools and/or intermediate cost pools or service centers. A few pools may be shared with other units but they would be small in number.
- IR&D and B&P effort is unique for the unit and is charged to that unit.
- At least one home office exists where the home office costs are allocated appropriately e.g. in accordance with CAS 403.
- The unit has all the essential functions to operate on its own as a separate company.

QUESTIONS AND ANSWERS

Q. We want to purchase a piece of equipment now which will be used almost exclusively on a government contract we do not expect to receive for 2-3 years which we expect to last for a good 4-5 years. How can we charge the costs of the equipment to the contract rather than recognize most of the costs before the contract is awarded.

A. Useful life and depreciation costs are a couple of examples of items that can be treated differently for government contract purposes than for GAAP or tax purposes. You will need to capitalize the asset when purchased but you can recognize the amortization costs during the "period of economic usefulness" which in your case would begin when you receive the contract.

Q. We have no cost reimbursable contracts, only fixed price and a couple of time and material contracts. We see no need to prepare an incurred cost proposal but DCAA is insisting we must do so.

A. In the past the requirement to submit an incurred cost proposal was either waived or limited to submitting Schedule K that identified T&M contract billings and costs, especially when T&M contracts represented an insignificant amount of activity. If you did not charge provisional rates to any T&M costs you can always say so and ask to limit your submittal to Schedule K. We used to be able to point to the titles of the exhibits that explicitly mention only "Cost Reimbursable Contracts" but most of those titles and even format of exhibits have been changed. You are on weak grounds to challenge DCAA if they insist on the entire submittal. A T&M contract is really a hybrid of fixed price and cost reimbursable elements. The hourly pay rates and indirect costs rates used to establish billing rates are fixed but the hours billed, other direct costs billed and any rates applied to ODCs are cost based. Also, DCAA wants to make sure the fixed hourly rates used to bill the government are consistent with contract terms.

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