
GCA REPORT

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NEW DEVELOPMENTS

New Contract-Related Interest Rate Set for Second Half of 2013

The Treasury Secretary has set a rate of 1 3/4% for the period July through December 2013. The new rate is a slight increase from the 1 3/8% rate applicable to the first six months of 2013. 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).

DCAA Issues New Guidance

The Defense Contract Audit Agency periodically issues new guidance to its auditors which are then incorporated into the DCAA Contract Manual. Recent guidance issued includes:

◆ **Alternative Procedures for Testing for the Existence and Allocation of Labor**

During its floorchecks or even its incurred cost proposal (ICP) audits DCAA will verify the physical existence of labor being charged to government contracts and will often test for the existence of employees and the proper allocation of their costs. When such testing has not occurred the new guidance, with an accompanying Q&A section, provides alternative procedures to use when conducting ICP audits. The stated purpose is to ensure employees are actually at work, they are performing in their job classification and their time is being properly charged to appropriate contracts and subcontracts.

Alternative procedures used to test for the **existence** of the employees are (1) physically observe employees that are still employed and inquire into their start date

to ensure they worked during the respective audit year (2) for employees no longer employed at the time of audit, examine personnel records (e.g. copies of drivers' license, passport, badge, etc.) (3) validate payment of selected employees to bank statements, electronic transfer or third party payroll records (4) review other documents the employee may have created, processed or approved during the audit period (e.g. travel or expense reports, W-4s, leave requests) and (5) determine if the CO has corroborating evidence.

Alternative procedures for the **allocability** of employee costs may include (1) review contract requirements such as key employee, job title or labor category (2) review statement of work and work orders/authorizations to ensure labor type of employee is required on the contract (3) determine if CO has corroborating evidence showing the labor is allocable to the contract.

In conducting this real time testing the audit team must use their judgment to determine whether the evidence gathered is sufficient. In its effect on the audit opinion, the auditor should consider such factors as audit risk, significance of the labor costs and mix of contract types where "in most cases" a qualified opinion will be issued (13-PPD-012R).

◆ **Testing Incurred Cost Payments**

The audit guidance references the need for compliance with the FAR clause covering cost reimbursable contracts at FAR 52.216-7 where section (b)(1) states allowable costs should be reimbursed when paid in the ordinary course of business (ordinarily within 30 days of the request for payment) and if not paid the costs should be questioned if they were never paid and considered as a fraud risk indicator.

For audit planning of an ICP audit the audit team will (1) perform testing to payments if real time testing has not occurred (2) consider the results of prior testing if it has occurred in other audits (e.g. paid vouchers, accounting/billing system) to see if it was sufficient to support conclusions of the current ICP audit and if not, determine appropriate testing to conduct and (3) limit current testing to verification of reports (e.g. check register, bank statements, AP aging) if the team has already established the reliability of computer-based data.

For testing considerations the audit team should design appropriate tests to ensure compliance with FAR 52.216-7(b)(1) based on an understanding of the contractor's environment, internal controls, payment process and identified risk in this area. Based upon the assessed risk the audit team will conduct either of the following procedures on all costs except for labor. If risk of non-payment is low, conduct a judgmental sample of all payments, trace to source documents (e.g. cancelled checks, electronic funds transfers, bank statements) and then perform a separate sample to test individual accounts for allowability. If risk is high, establish payment as a criterion when conducting a normal allowability review. When testing labor the auditor, at a minimum, should (1) reconcile payroll totals with totals of related labor cost distribution records (2) evaluate Schedule L, Reconciliation of Total Payment Per IRS Form 941 to Total Labor and (3) test quarterly taxes for evidence of payment.

In most cases the audit report will need to be qualified if testing of payments is insufficient. The incurred cost audit program is being revised to add audit procedures that address testing of payments (13-PPD-013R).

◆ **Detecting Instances of Fraud on Attestation Engagements**

Guidance is issued for the stated purpose of designing examinations that detect instances of fraud and noncompliance with provisions of laws, regulations, contracts and grant agreements that may have a material effect. The procedures include management inquiries, analytical procedures, audit team discussions and understanding of relevant internal controls that address identified risk factors where the understandings gathered from these procedures will assist auditors in determining risk and designing the audit procedures.

Management inquiries. The guidance states inquiries made to actual contractor employees often convey information that otherwise would not surface. Access to employees responsible for day-to-day management or accomplishment of major accounting or estimating functions are considered essential. The following inquiries are suggested: (1) does management have knowledge of any fraud or suspected fraud affecting the subject matter of the audit (2) is management aware of allegations of fraud (e.g. communications from employees, former employees) and (3) what is management's understanding about the risk of fraud including specific fraud risks the contractor has identified. The audit team is to conduct these inquiries in every audit and they are to use professional judgment to determine if there are other employees who may have additional information.

Analytical procedures. This is defined as evaluation of financial information through analysis of plausible relationships among financial and nonfinancial data. Analytical procedures are used to gain an understanding of the contractor and to identify areas of potential risk. The objective is to find the existence of unusual transactions or events, amounts, ratios and trends that might be suspect. When the results differ from expectations auditors should resolve them through inquiries. Analytical procedures can be as simple as reviewing changes in account balances from the prior year to more complex procedures such as comparing production schedules to financial representations.

Audit team discussions. Members of the audit team (auditor and supervisor at a minimum) should discuss material noncompliances caused by error or fraud. It should be an exchange of ideas in how and where they believe there may be error or fraud where auditors should maintain "an objective level of professional skepticism." The discussions should include considerations of prior audit experience (e.g. questioned costs, accounting or estimating deficiencies, audit leads), relevant risk factors and internal control weaknesses. Also other considerations include several discussions if there is more than one location as well as the need for specialists such as IT professionals.

The guidance states though they are not auditing to the risk factors, auditors should be aware of fraud risk factors identified in the DODIG Handbook of Fraud Indicators (we have written about these several times in the past) and have familiarity of weaknesses in contractors' internal controls (e.g. lack of segregations of duties, inadequate monitoring of compliance with policies, laws and regulations, lack of asset accountability). The guidance states many of these factors may be present in many small contractors which do not necessarily indicate the existence of fraud where the audit team must be mindful that levels of internal controls for smaller contractors are likely to be less formal and structured. When fraud is suspected inexperienced auditors should not be assigned to the audit. Also, auditors should be aware of opportunities contractor management may have in overriding certain controls such as journal entries and other adjustments for possible misstatements or opportunities to manage contracts to budgets (13-PAS-014R).

◆ **Access to Contractor Employees**

In response to several contractors objecting to DCAA's right to interview and observe employees during audits DCAA has issued guidance stating it considers access to be a routine and established audit procedure that is

necessary to satisfy Generally Accepted Government Auditing Procedures (GAGAS). The guidance states GAGAS requires auditors to inquire with management and others within the organization where, for example, those individuals who actually perform the work should be the ones providing auditors with demonstrations and explaining how they perform their work. The guidance also cites GAGAS 2.09a, which requires auditors to obtain sufficient and appropriate evidence to make a reasonable conclusion, as justification and if the contractor fails to permit the auditor to interview those employees then auditors are instructed to pursue access to records procedures prescribed by the agency. The guidance also states it disagrees with contractor citations of FAR 52.215-2 that limits auditor access to records, stating the prohibition does not apply to employees (*13-PPS-015R*).

GAO Study Shows Impact on Lower Compensation Cap; Interim Rule Extends Cap to All Employees

In a study sampling 27 contractors of various sizes, the General Accounting Office reported that under the current compensation cap effective in 2010-2012 there were 166 employees whose compensation exceeded the caps but the figure would rise to 635 if the cap was lowered to the president's salary of \$400,000 and 3,486 if the cap were further lowered to the vice president's salary of \$230,700 as some legislators are recommending. The Obama Administration is recommending the cap be lowered to the president's salary while the National Defense Authorization Act of FY 2014 recently passed by the House of Representatives would freeze the cap at the current \$763,029 level. The salary data for the 27 contractors would result in \$80 million of questioned costs if the current cap was in place and \$180 million and \$440 million if the cap is tied to the president or vice president levels, respectively. The study also sought government and industry views on the ceiling where the government representatives generally supported reducing the cap to help reduce the cost of DOD contracts while most contractors stressed that reducing it would cut into profits undermining efforts to attract capital and would hamper their ability to attract top talent (the study is available at www.gao.gov/assets/660/655310.pdf).

In a separate move, an interim rule was published June 26 extending the current \$763,029 cap to all contractor employees for DOD, NASA and Coast Guard contracts rather than just the five highest paid executives. The interim rule would exempt highly skilled employees from the cap such as engineers and scientist. The rule

implements section 803 of the FY 2012 National Defense Authorization Act applies to costs incurred after Jan 1, 2012 (the rule is available at www.ofr.gov/OFRUpload/OFRData/2013-15212_PI/pdf).

Final OASIS RFP Issued

The General Services Administration released July 31 two final requests for proposals for its One Acquisition Solution for Integrated Services (OASIS) program. The program is divided into two contracts – OASIS, an unrestricted contract that includes 50 percent small business subcontracting goals and OASIS Small Business, a 100 percent small business set aside. The GSA is calling OASIS a “one-stop shop for both commercial and noncommercial needs” across the government to give federal agencies “comprehensive, integrated professional services contract options.” OASIS will provide a “government-wide contract vehicle” that will reduce the number of procurements across the government. The two programs, which are intended to complement the GSA's multiple Award Schedules (MAS) program, will offer agencies a new way to meet requirements for both commercial and non-commercial professional services which will be provided through different types of contracts and pricing at the task-order level. OASIS professional and ancillary services are grouped under seven categories - program management, management consulting, engineering services, scientific services, logistics services, financial management services and ancillary support services. The OASIS pools are based on North American Industry Classification System size standards and are associated with specific NAICS codes for determining which pool is eligible to compete for a given task order. Each pool originally was to be composed of the 40 highest technically rated offerors with fair and reasonable pricing. Contractors are to indicate which pool is of interest in their proposal cover letters and may compete in more than one pool. It appears as if DCAA will be involved in conducting pre-award surveys of the accounting systems of the successful offerors. OASIS awards will have a base period of 5 years and a 5-year option and the procurements are unrestricted. There will be flexibility for all contract types and prices at the task order level. Proposals are due Sep. 17 at 4:00 PM central time. (*References for where to find the RFPs are conflicting as of this writing so we would recommend a google search.*)

Everyone Seems to Agree that Sequestration Has Been Bad and Will Likely Get Worse in 2014

Testimony on the impact of sequestration by government officials and industry representatives in several Government forums and panels are unanimous

in expressing the sentiments that things will only get worse. For example, the head of the Professional Services Council predicted a more severe impact from sequestration in FY 2014 than 2013 because budget cuts take effect at the start of the fiscal year instead of months into it after some programs have been fully funded. Comments by several attorneys indicate there will be substantially more terminations for convenience. In addition to sequestration, another dispute over raising the national debt ceiling is looming which can feasibly lead to a government shutdown.

In a round table discussion sponsored by a Senate committee hearing, several government officials addressed the disproportionate negative impact on small businesses. Because much of the small business contracts rely on science, technology, R&D and testing and evaluation funds they are more heavily hit by cuts than larger operations and maintenance government contracts which are held by larger firms. Also, many large businesses are going after contracts that were previously considered “small potatoes” where increased competition by larger firms was “unanticipated.” Small businesses, dealing with uncertain futures, must now find ways to “weather the storm” without support that banks and venture capitalists used to provide.

In addition, some policy experts at a Brookings Institution meeting said that national security will be “irreversibly damaged” if sequestration hits the DOD budget in 2014. Where continued cuts will force DOD to alter its strategic focus on the Asia-Pacific region and leave it incapable of fighting in more than one conflict at a time.

Rule Changes to Past Performance Evaluations

A final rule providing government-wide standardized past performance evaluation factors and performance ratings as well as requiring entry of all past performance information into the Contractor Performance Assessment Reporting Systems (CPARS) will take effect Sept 3 (*Fed. Reg. Aug 1*).

A proposed change to the FAR past performance evaluation procedures would cut the time contractors have to respond to ratings from 30 to 14 days. The rule writers say the proposed rule, consistent with recent urgings to have government agencies step up efforts to collect data on contractor performance, will have past performance evaluations with contractor comments and explanations available to source selection officials within 14 days which will benefit most contractors (*Fed Reg, Aug 17*)

DOD Report Says Contract Type Is Irrelevant to Cost Control

(Editor's Note. The following provides opposing information on recent attempts by the Administration and certain legislators to eliminate or, at least, minimize use of cost type contracts to reduce risk and contract costs.)

The first annual Study of the Major Defense Acquisition Programs (MDPAs) has reported that there is little difference between use of fixed price and cost plus contracts when it come to either predicting or controlling costs. In concluding that no individual contract type was found to be better than others for controlling costs the report states “relying on contract type alone to achieve better affordability outcomes will not likely be successful” finding that fixed priced contracts are not “a magic bullet to controlling costs.” The report concludes that “we need to consider and select the most appropriate contract type given the maturity, system type and business strategy for each system” which has been interpreted as giving the green light for use of cost plus contracts under appropriate circumstances such as when the scope of effort is not well defined.

GSAOIG Criticism of MAS Management Seems to Duplicate Earlier DCAA Events

(Editor's Note. We have frequently written about how 2008 and 2009 GAO and DODIG reports criticizing DCAA management intervention in its audits has transformed the way DCAA conducts business where now DCAA management is extremely reluctant to change an audit opinion no matter how poor it may be, contracting officers are very reluctant to challenge a DCAA finding and junior auditors' referrals of suspected fraud go directly to the DOD Inspector General without review by DCAA resulting in a proliferation of DODIG investigations. This recent development at the GSA seems to be in the words of Yogi Berra “déjà vu all over again.”)

In June the Office of Inspector General (OIG) for the General Services Administration (GSA) issued an audit report finding “management intervention” of contracting officer decisions for multiple award schedule (MAS) contracts caused the agency to extend flawed contracts resulting in “inflated pricing and/or unfavorable contract terms.” The report found that the Federal Acquisition Service (FAS) managers, who provide MAS management services for GSA, “undermined the procurement process” by overruling subordinates and altering administration of \$900 million in MAS contracts. Based on these finding the OIG is requiring FAS to (1) ensure its management does not intervene in contracting actions in response to contractor requests except where there has been

misconduct or other serious administrative issues (2) require that its management fully document all conversations and correspondences with COs regarding specific contracts and (3) issue a memo stating it supports a policy that encourages contracting staff to make independent determinations, including when to award or extend a contract. Comments we have seen are concerned that the GSAOIG is saying FAS management should be taking a hands off approach for awarding contracts which creates the risk that less experienced COs will be in the drivers seat while more experienced management personnel will have their hands tied unless there is misconduct.

Small Business News

The US Small Business Administration issued a final rule July 16 amending its regulations governing small business subcontracting intended to ensure subcontracting plans are adhered to. The rules apply to all covered contracts that contain a small business plan whose value is above \$1.5 million for construction and \$650,000 for all other contracts. Significant provisions include new regulations (1) requiring a prime contractor to either award subcontracts to small businesses that were identified in its proposal or provide a written justification for not doing so (2) the prime contractor must fully pay the valid invoices of its small business subcontractors in a timely manner or report its failure to do so and (3) authorizing agencies to consider an offeror's small business subcontracting performance as an evaluation factor. The provisions are being lauded for lessening the incentive to freeze out subcontractors, especially in this time of spending cuts at the prime contract level and for clarifying the responsibilities of the CO in monitoring small business subcontracting plan compliance.

In separate SBA news, the SBA issued a final rule, effective Aug 27, that states if a firm willfully seeks and receives an award by misrepresenting its size or status as a small business there is the presumption that the loss is equal to the value of the contract, subcontract, cooperative agreement or grant. The final rule also provides that an authorized official must sign in connection with a size or status certification of a contract and businesses that files to update their size or status in the Online Reqs and Certs Application database at least annually will no longer be identified in the database as small or other socioeconomic status until the representation is updated (*Fed. Reg. 38811*).

Finally, the Office of Management and Budget issued a memo July 11 announcing it would extend its 2012 policy for accelerating payment of invoices to prime contractors having small business subcontracts, with

the intent to improve cash flow for the subcontractors. The original policy guidance was established in July 2012, extended to July 2013 and now extended again to July 2014 which required agencies to pay prime contractors as promptly as possible, with the goal of 15 days. The expectation is this will, in turn, allow prime contractors to pay their small business subcontractors in a more timely fashion.

CASES/DECISIONS

Failure to Divulge Increased Profit is not a “False Claim”

Post and Parson entered into a joint venture for a fixed price ID/IQ contract under which fixed price task orders would be placed. Prices on the task orders were based on lump sums arrived at by using agreed to labor rates multiplied by number of days to be required to complete the task plus profit. The joint venture was able to reap significantly more profit by lessening the time to complete the task and using lower priced personnel. A qui tam relater alleged the joint venture submitted “false claims and statements” under the False Claims Act where the increased profit was not divulged. The relater put forth the “implied certification” argument that provides a claim is “false” because at the time the defendant was allegedly in non-compliance with a statute, regulation or contract terms. The Court ruled against the relater stating even under the “implied certification” rationale, no contract violation occurred. It ruled the contract did not require use of specifically named personnel where under the risk allocations of a fixed price contract the joint venture was merely reaping the benefits inherent in using lower cost personnel on a fixed project (*Prime v Post, Buckley, etc. and Parsons Corp., No. 10-cv-1950*)

Contractors Relied on Inaccurate Cost Data to its Detriment

Two cases address impact of relying on Inaccurate Data

IAP received a firm fixed price contract for basic services including facility operations and service calls and repairs at six facilities. Prior to award the agency provided offerors information it said was to be used to determine material and equipment costs required to support the service calls. IAP found during performance it was spending more time per service call than had been noted in the information provided by the agency where, for example, the actual costs of providing the calls at the Philadelphia site were \$480,000 more than its proposed costs. IAP filed a

claim after the CO denied its request for an equitable adjustment. Citing an *Admiral Elevator case (CBCA 470, 07-2)* the board ruled that when an agency directs offerors to base their contract prices on significant, incorrect representations and the contractor does to its detriment the agency is responsible for the losses a contractor subsequently suffers. In this case the same principle applies where IAP relied on agency-provided data that was faulty and the board ruled the resulting additional work constituted a constructive change for which the agency was responsible (*LAP World Services Inc. v Dept of Treasury, CBCA No. 2709*).

TRG was awarded a fixed price IDIQ contract to provide housing maintenance services where it relied on the Army's estimate to expect 50 routine calls per month. When TRG began receiving 90 service calls a month it complained it was losing money and submitted a revised pricing proposal that was rejected where the government asserted its estimates could not be misleading because the data was unavailable to make accurate estimates. The Court explained that the risk of variance on contract estimates generally rests with the contractor but the government may be liable for breach of contract if it (1) failed to prepare an estimate in good faith (2) prepared the estimate negligently or (3) failed to use reasonable care. Here the Army breached its contract by providing misleading or negligent estimates upon which the contractor relied on stating the Army maintained the historical numbers and scope of service calls by month and this information could be available to TRG upon request. However, the court did not provide monetary damages to TRG stating the fact the service calls were above 50 does not in itself establish economic injury but TRG must also establish the excess service calls resulted in labor hours requiring compensation beyond the sum provided in the contract which it failed to do (*The Ravens Group v US, Fed. Cl., No 07-754C*).

Government CAS Claims are Barred by Statute of Limitations

Raytheon submitted four consolidated appeals arising out of government claims for increased costs paid as a result of several changes made to its cost accounting practices. In all four cases Raytheon submitted its revised disclosure statement more than six years before the CO issued a final decision and for three of the cases Raytheon also submitted a general dollar magnitude cost impact estimate more than six years before the CO's final decision. The Board ruled that the government's claim in three of the appeals was untimely. In response to the government's assertion that Raytheon had not provided enough supporting data as to the cost impact,

described the cost impact as immaterial and revised numbers later the Board ruled the claim accrual does not depend on the degree of detail provided, or whether calculations are revised later but it is enough the government knows or has reason to know that some costs have been incurred even if the amount is not finalized or a fuller analysis will follow. However, the Board ruled the fourth claim was timely because Raytheon reported only the fact of the change not the implication of it or other data. A comment on the case states FAR 52..230-6, Administration of Cost Accounting Standards should be adhered to where both a disclosure statement and cost impact assessment should be addressed before making a unilateral accounting change (*Raytheon Company, Space & Airborne Systems, ASBCA No. 57801*).

SMALL/NEW CONTRACTORS

Basic Record Keeping Requirements

(Editor's Note. We have addressed adequate accounting systems several times in the past – what is an adequate system, what you can expect from DCAA and how you can evaluate your own system. Whereas several types of audits have been transferred to the Defense Contract Management Agency (e.g. large forward pricing proposals, purchasing systems reviews) and others have been reduced (e.g. low dollar incurred cost proposals) those remaining audit areas are getting more intensive scrutiny by DCAA. Since DCAA is tasked with determining whether contractors' accounting systems are adequate, we have found many changes in their approach so we thought now was a good time to identify what now constitutes an adequate accounting system and what we see DCAA focusing on these days.)

When the term “accounting system” is used it does not necessarily refer to the accounting software or lack of it a contractor chooses to use. A contractor is free to use whatever software program they choose (even manual “show box” systems can be approved) and they can use actual or standard costing methods. Rather it is considered to be a combination of records, internal controls and written policies and procedures that together form the basis of estimating, accumulating and reporting financial data. Though an adequate accounting system is important for all companies, it is especially important for government contractors where they must establish an accounting system not only consistent with generally accepted accounting principles (GAAP) but also a variety of unique government accounting requirements.

Though some auditors may forget this lesson, the size of the firm and the extent of government contracts should dictate the depth and breadth of the accounting system. Small companies with relatively few contracts can probably generate all the necessary cost data using manual or spreadsheet systems. Large contractors with several segments or complex manufacturing will require much more. Accounting software that does not accommodate government accounting requirements (e.g. job costing) can be supplemented by spreadsheets as long as they are reconcilable with official books and records. If a contractor wishes to obtain government contracts over a relatively long period we recommend it obtain government-compliant accounting software that will interface with its corporate accounting transactions. The software obtained should emphasize government cost accounting and reporting of government projects, timekeeping, labor distribution, revenue recognition and contract management capabilities. The system should also have billing capability to invoice costs, pre-established labor billing rates for T&M contracts, unit pricing, indirect costs and fees billed on top of appropriate costs (e.g. overhead billing on direct labor, general and administrative billed on total costs, fees on top of all or certain costs).

Basic Record Keeping

The types of books and records used in an accounting system vary widely where they need to be suitable for individual companies. For government contract purposes, the main requirement is that record keeping must provide sufficiently detailed contract costs so that they can be identified at interim levels for purposes of repricing contract work, negotiating revised targets, billings, and determination of when contract costs have hit 75% or 85% of approved funding levels. The record keeping system must include, at a minimum, a general ledger, a job cost ledger that tracks all direct costs, labor distribution records (e.g. hours and costs attributed to specific contracts), time records, subsidiary journals, a chart of accounts and financial statements such as Profit and Loss and Balance Sheet.

Several functions are considered essential to the adequacy of any basic record keeping system for government contractors:

1. Segregate direct costs by contract or job and then identify direct costs by cost element such as labor, material, subcontracts, travel, and other direct costs. Government accounting jargon for contracts or jobs goes by final cost objectives (FCOs) and may differ widely. Sometimes FCOs may be a contract or subcontract, task or delivery order, CLIN, out-of-scope

work in anticipation of a request for equitable adjustment, terminated and non-terminated portion of a contract, etc.. In addition, significant IR&D and bid and proposal projects will need to be considered a FCO.

2. Segregate indirect costs by account and title depending on the indirect cost rates that will be applied for pricing and costing purposes. Common indirect costs include fringe benefits, labor-oriented overhead, material/subcontract related handling costs, G&A costs and service centers so these costs need to be readily identifiable. Also, be able to demonstrate that actual annualized indirect cost rates are monitored during the year.

3. Accumulate costs on both a current and cumulative basis such as year-to-date and cumulative-cost-to-date.

4. Establish the accounting period and reconcile time sheets to labor costs identified in job cost ledgers and ensure these costs are identifiable in the company's general ledger.

5. Enter costs to the books of account on a current basis e.g. at least monthly.

6. Separately identify unallowable costs in either the books of accounts (i.e. separate unallowable cost accounts) or less formal costs accounting techniques may be acceptable. For example, a contractor may elect to review all or a sample of accounts in certain risky accounts and identify a percentage of costs in that account that are unallowable. Though such after the fact screening methods were considered acceptable in the past some auditors are challenging such approaches asserting determinations of allowability should be made when the costs are either incurred or entered into the books of account and not later.

Special Emphasis on Treating Labor Costs

Verification of labor costs, because they are usually the highest cost element, attract indirect cost dollars and are vulnerable to inaccuracies because there is no third party verification (e.g. vendor invoices), is of paramount importance to the government. The key document in accounting for labor is the timesheet or timecard. Since timesheets can be easily altered by others, government contract employees must be made aware of their responsibility and the importance of accurate timesheet preparation. The government relies on the accuracy of timesheets and related internal controls to ensure the accuracy of labor costs presented for payment, contract costing and estimating. It is essential that the internal controls over labor reporting be clearly established and

that they be reviewed by management periodically. Adequate timesheets must include the following information: employee name, employee identification number, time period, employee and supervisor signature, daily entries, project name, project number, daily totals, project totals and room to insert comments on changes or other matters. Electronic systems are acceptable provided they have such internal controls as only the employee may make entries or make changes or changes made after initial entry are visible to provide an audit trail. (*Editor's Note. For more detail see past articles on proper timekeeping and floorchecks – use our keyword function at our website to access these articles.*)

QUESTIONS AND ANSWERS

Q. I am a contracting officer in the Dept of Interior and have a question about material and subcontract (M&S) fees. I have a prime contractor who is charging M&S fees for them to process subcontractor timesheets, payroll and travel vouchers. I cannot find anything where the prime can charge M&S fee on these costs. Is it legitimate?

A. Part of the problem is the meaning of M&S fees. Sometimes that term may really be an indirect cost rate that is applied to certain costs identified in the indirect cost base. So in that case, the fees are really an add-on cost like overhead or G&A that may be applied to the costs identified in the indirect cost base. Other times M&S fee is a contract arrangement between the prime and the government customer where there is a set fee or profit rate that may be charged to specific types of

costs that are incurred.

As for what costs the fee applies to (whatever it is) there is no one “should” answer. If it is a profit rate, it depends on what costs are identified in the contract (or if silent, in the proposal). If it is an indirect cost rate, then if payroll and travel related costs are included in the M&S base then yes the M&S fee can apply; if those costs are not included in the M&S base but rather in one of the other indirect cost pools or even the M&S cost pool then it should not apply to those costs.

Q. You recently wrote “There have also been changes to employee release agreements where employees are given more severance pay than they would otherwise receive in exchange for releasing the contractor from potential liability for wrongful termination. DCAA initially took the position such costs were unallowable because they represented payment for work not performed. DOD firmly rejected DCAA’s position, forcing DCAA to issue guidance prohibiting auditors from questioning such payments because they are unallowable backpay for work not performed and directed auditors to examine such payments on a case-by-case basis for reasonableness.” Can you tell me where I can find this DCAA guidance.

A. The reference is in Chapter 7-2107.7 in the DCAA Contract Audit Manual.

Q. Is key man insurance allowable when the company is the beneficiary? If not, can we change incurred cost proposals that made it allowable?

A. No. The key man insurance you described is unallowable. However, insurance costs whose beneficiary is the family are allowable. Yes, the ICP can be rescinded and changed before an audit is begun.