GCA Report

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NEW DEVELOPMENTS

Industry Group Criticizes Proposed Rule Change to Training and Education Costs

An influential industry group has strongly criticized a December 3 proposed rule to change the cost principle on training and education (FAR 31.205-40). The proposed change will disallow costs of training and education "for the sole purpose of providing an employee an opportunity to obtain an academic degree or to qualify for appointment to a particular position for which the academic degree is a basis for requirement." The National Defense Industrial Association stated in a March 26 memo the change (1) erroneously applies tests applicable to federal employees where education expenses are not reimbursable rather than commercial practices that encourage continued training and education of the workforce and (2) contradicts the intent of the changes to simplify and clarify the cost principle by imposing "burdensome and costly" distinctions about allowable and unallowable costs in determining which costs are related *solely* to obtaining an academic degree or related specifically to a particular position. Further the proposed rule would undermine efforts to encourage upward mobility to disadvantaged groups working for contractors.

DCAA Issues Audit Guidance on Recent Cost Principles Changes and Components of Executive Compensation Caps

The Defense Contract Audit Agency issued several audit guidelines on recent FAR changes to depreciation costs, selling costs and pension and insurance costs as well as what components of compensation are included in executive compensation caps. The guidance on the FAR changes include reproductions of the pre-changed regulations which show what was deleted and added.

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

2. *Selling Costs*. The change to FAR 31.205-18, Selling costs, effective on contracts awarded after August 26 has one substantive change. The change to subparagraph (c)(2) eliminates the prior requirement that for foreign direct selling costs to be allowable they had to be related to sales of products normally sold to the U.S. government. The new rule allows costs of all "direct selling" efforts, regardless of domestic or foreign selling activities (MRD -4-PAC-014(R).

3. *Pension Costs and Insurance and Indemnification*. The changes to FAR 31.205-6(j), Pension costs and FAR 31.205-19, Insurance Costs, effective January 12, 2004 include some "substantive changes". The language on early retirement incentive benefits has been revised to clarify the provisions apply to early retirement benefits provided from within as well as outside the pension trust, whether applied for life or a lump-sum payment. Also, the present value of the early retirement incentives must be computed in accordance with the contractor's practices for computing pension costs so that any amount of costs that exceed the employee's annual salary for the fiscal year immediately preceding retirement is unallowable.

The provisions on Employee Stock Ownership Plans (ESOPs) were transferred from the section addressing pension costs to a new (q) section, whether the benefits are payable for life (pension) or not (non-pension). If the ESOPs meet the FAR definition of a pension plan then CAS 412, Pension Costs apply while all other ESOPs must be measured by CAS 415, Deferred Compensation whether or not the contractor is CAS covered.

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

4. *Components of Compensation*. In addition, DCAA issued guidance that reminds auditors what components of compensation are included in executive compensation caps – wages, salary, bonuses, deferred compensation and employer contributions to defined contribution pension plans whether paid, earned or accrued. It also states all other components of compensation such as severance pay and early retirement incentive pay should be separately evaluated for reasonableness (MRD 04-PAC-020(R).

SBA Proposes New Employee-Based Size Standards

Currently the Small Business Administration's size standards – used to determine small business status to be eligible for business set-asides – has two different measures, number of employees or annual average receipts. March 19th, the SBA issued a proposed rule that would restrict measurement to "number of employees" and would also reduce size standards from 37 to 10. Under the proposed rule, size standards will range between 50 and 1,500 employees depending on the industry or SBA program. Of the current 37 size standards covering 1,151 industries, 30 are based on annual receipts while five are employee based (two use other measures). Under the proposed rule, each industry will have an employee-based size standard of 50, 100, 150, 200, 300, 400, 500, 750, 1,000 or 1,500 (50 and 400 are new). "Number of employees" is defined as the firm's average number of persons employed for each pay period over the latest 12 months including employees of affiliates.

Thirty one industries will still have a receipts cap to "prevent businesses from creatively manipulating their employment levels to remain small" by, for example, keeping work in-house or subcontracting out. Without the receipt cap the SBA is concerned that those business might purposely subcontract an "unusual amount of work" solely to retain small business status. These capped industries primarily are construction, information technology-related, dredging, data processing, computer systems design, facilities support, computer related services and logistics consulting services (Fed. Reg. 13129).

DOD Limits TO and DO Contracts to 5 Years; Limits Multiyear Contracting

The Department of Defense issued an interim rule, effective March 23, that amends the Defense Federal Acquisition Regulation Supplement and provides the contract period of a task or delivery order contract may not exceed five years. The five year limit includes all options or modifications. In addition, DOD has issued a final rule that restricts use of multiyear contracts for supplies to only those long-lead time items necessary to meet a planned delivery schedule to complete major end items (Fed. Reg. 13478).

Comments on Proposed Rule Changes to COTS Items

Many commentators have weighed in on a recent January 15 proposed rule to add a definition of commercial off-the-shelf (COTS) items to the FAR and make 20 statutes inapplicable to contracts and subcontracts for COTS items. The following points made by Dave Burgett and Gary Campbell of the law firm Hogan & Hartson LLP written in the February 11 issue of Government Contractor is illustrative.

COTS are really a subset of commercial items covered by FAR Part 12. The proposed rule defines COTS as "any item of supply" that meets the definition of commercial item found at FAR 2.101 and (1) "is sold in substantial quantities in the commercial marketplace" and (2) is "offered to the Government, without modification, in the same form in which it is sold in the commercial marketplace." The authors note this definition is narrower than "commercial items" in three respects. First, it is limited to supply items and not commercial services. Second, a commercial item need only be offered for sale to the general public while a COTS item must be sold in substantial quantities. Third, items undergoing "minor" modification can qualify as commercial items but not as COTS. Despite these three limitations, the majority of commercial supply items should qualify as COTS.

Though five procurement laws are already inapplicable to commercial items the proposal adds 15 more laws inapplicable to those commercial items that meet the proposed COTS definition. Most significantly:

1. *Buy American and Trade Agreement Act (TAA)*. The Buy America Act, which applies to contracts valued at less than $175,000, establishes a price evaluation preference for products manufactured in the US and where costs of components is over 50% attributed to U.S. manufactured components. The TAA, which applies to all sized contracts including Federal Supply Schedule orders, envisions equal treatment of domestic products and those produced in countries that have entered into recent trade agreements such as NAFTA, ALP, Caribbean Basin Initiative and the Israeli Trade Act. It generally prohibits acquisition of end products produced in other countries such as Malaysia, India and China so choice of manufacturing site can affect the marketability of products sold to the U.S. government.

2. *Equal Opportunity and Affirmative Action*. The proposed rule would exempt COTS contracts from the many equal opportunity laws. Of course, these laws are probably applicable to other contracts.

3. *Advanced Payment*. In accordance with the Anti-Deficiency Act, a basic premise of appropriations is the Federal Government not pay for goods and services before they are delivered. This Act would be inapplicable, allowing advanced payment common, for example, under maintenance agreements.

4. *Rights in Technical Data*. Two statutes would be inapplicable – Rights in technical Data (FAR 12.211) for Commercial Items and Validation of Proprietary Data Restrictions. Though proprietary technical data is not normally delivered in connection with commercial items, when it is the FAR clause will no longer apply to COTS contracts, resulting in use of vendors' usual commercial provisions.

5. *Audits*. COTS contractors and subcontractors will no longer be subject to the Examination of Records of Contractor laws which reserve the right for the Comptroller General to examine any records pertaining to federal acquisitions up to three years after final payment. However, COTS contractors can still be required to disclose information under other authority such as those provisions related to pricing Federal Supply Schedule contracts.

100 Top Contractors for FY2003 Announced

The Department of Defense has issued its annual "100 Companies Receiving the Largest Dollar Volume of Prime Contract Awards" list. It is accessible at "http:www.dior.whs.mil/peidhome/procstat/p01/fy2003/top100.htm."

ARWG Seeks Streamlined Commercial Buying by Government

An umbrella group of major industry trade associations has issued a shorter, but hopefully more realistic wish-list of items intended to help the government do a better job of transitioning to commercial acquisition practices, streamline its procurement processes and boost access to commercial technologies. We thought it would be helpful to present their recommendations to identify improvements industry will likely be trying to implement.

The package issued March 13 by the Acquisition Reform Working Group is divided into four categories: commercial acquisition practices, business process streamlining, limitations on global competitions and clarifying socioeconomic requirements. Legislative priority for improved commercial acquisition practices include: (1) limit the imposition of unique government clauses (2) make certain temporary simplified acquisition procedures applicable for buying items up to $5 million permanent (3) give agencies "adequate" funds to conduct public-private competitions and (4) waive government rights to commercially developed intellectual property.

To streamline government processes and expand government access to commercial technology the ARWG recommends (1) repeal limitations on DOD's ability to grant Truth in Negotiations Act waivers (2) override the one-year regulatory cap on agencies obligation to pay interest on overdue invoices (3) revise the FAR to create more cost-effective, commercial-like payment processes for service contracts (4) loosen language that recently slapped a blanket five-year total limit on new task and delivery order contracts and (5) treat sales to foreign, state and local governments as commercial sales.

EO Redirects SBIR and STTR Funding to Manufacturing R&D

In a move to "beef up the small manufacturers who create breakthrough technologies" President Bush issued an executive order February 24 requiring federal agencies who award grants to small businesses to give priority to manufacturing-related research and development funding proposals. "Manufacturing-related" means (a) manufacturing processes, equipment and systems and (b) manufacturing workforce skills and protection. The two programs affected are the Small Business Innovation Research (SBIR) and the Small Business Technology

Transfer (STTR) programs that are used by 10 federal agencies and are coordinated by the Small Business Administration. Congress has appropriated about $2 billion for the two programs this year and the executive order does not create additional funding but rather redirects existing funding toward manufacturing R&D proposals under the SBIR and STTR programs (Executive Order 13,329 published in the Fed. Reg. Feb. 26).

DOD Suspends Price Evaluation Adjustment for SDBs

Effective February 24, the Defense Department has suspended for one year the price evaluation adjustment for small disadvantaged businesses since DOD has exceeded its 5% goal for SDB awards in fiscal year 2003. The price evaluation adjustment allows DOD to enter into a contract with a SDB for a price exceeding (typically 10%) "fair market value." Following a 2003 rule, it will suspend the price adjustment if DOD exceeds its 5% goal of contract awards to SDBs in the previous year (Fed. Reg. 7911).

GAO Wants To Collect Delinquent Taxes from Contractors

The General Accounting Office issued a report on February 12 indicating that over 27,000 federal contractors owe about $3 billion in unpaid taxes as of September 2002. It reported the DOD has not implemented the Debt Collection Improvement Act provisions allowing the IRS to levy 15% of each contract payment owed to offset contractors' federal tax debt, including payroll taxes. The GAO recommended the Defense Department utilize the IRS levy program and suspend/bar delinquent contractors from further awards. The report is available at 'http://gao.gov/cgi-bin/getrpt?GAO-04-95".

Industry and Congress Set to Spar on Overseas Job Outsourcing

During the heat of an election year and a disappointing employment situation, Congress has proposed a raft of bills intended to discourage the private sector, particularly government contractors, from relocating domestic jobs offshore. Reps. Rosa DeLauro and John Dingell have introduced bills that would prohibit federal agencies and state agencies using federal funds to award contracts for goods and services to companies that propose to tap labor outside the U.S. Sen. Norm Coleman has proposed a similar bill in the Senate. Key business groups have banded together under the Coalition for Economic Growth and American Jobs to lobby hard against efforts to inhibit outsourcing of jobs internationally. They state it is improper to use the federal procurement system of the largest U.S. customer to achieve certain ends. They maintain there are lots of reasons why an economy as massive as the U.S. economy would move a job offshore and they want to "balance" economic and trade growth with job protection, avoiding the "blunt instrument" of the government.

Travel…

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

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

Can Reimburse TQSE Even After Buying a House

Before relocating, Reinhold bought a house in June at his new location and reported for duty in mid-July but had to take temporary lodging through the end of August until the renovations were complete. The Department of Agriculture refused to reimburse Reinhold for the "temporary quarters subsistence expenses" (TQSE) but the appeals board ruled he was entitled to the reimbursement. The Board noted that Part 302-6 of the Federal Travel Regulation provides certain conditions for reimbursement but does not expressly prohibit paying TQSE when a house is purchased before relocation. The Board stated the FTR authorized payment for TQSE until an employee can move into a permanent residence and here TQSE was appropriate because Reinhold could not move in. If he had been able to move in but had chosen not to, then the government could have legitimately withheld payment (GSBCA 16344-RELO).

CASES/DECISIONS

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

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

OCC was awarded a $167 Million contract to construct a dam where its bid was $30 Million lower than the next low bidder and $35 Million below the government's estimate. Modifications issued after work began totaled more than $100 Million. An employee asserted OCC intentionally underbid the work and planned to recover lost revenue through change orders and charged OCC violated the False Claims Act by fraudulently inducing the government to execute the contract with the intent to seek later adjustments to the price. The Court rejected those arguments stating only claims intended to cause the government to pay money not otherwise due are actionable under the FCA. The mere submission of a low bid fails to make the government pay funds not otherwise due under the contract. Change requests are commonplace in government contracts and the intent to defraud test is not met because the contractor obtained additional funds under the contract (*US. Ex rel Bettis v. Oderbrecht Contractors of California, 2004 WL 161326*).

Navy Need Not Investigate Whether a Proposed Item is Commercial

Before issuing a solicitation the Navy conducted market research to determine if explosive ordnance disposal containment vessels it wanted to purchase were commercial items and concluded they were since the vessels were sold in the commercial marketplace. Both offerors represented in their proposals that the proposed vessels were commercial items. NAPCO protested the award to UXB arguing (1) UXB's proposal for a "swing out" door rather than "slide out" door represented a "custom" modification and (2) the Air Force did not conduct an investigation to determine whether UXB's vessel was a commercial item. The Comp. Gen. denied the protest, ruling a pre-award commercial item "analysis" was not required by the FAR or any other authority and stated the pre-award market research and the offerors' representation that their proposals were commercial items made it reasonable for the agency to make the award. Regarding the door modification, the Comp. Gen. ruled the door redesign is a "minor modification" that is authorized by FAR 52.202-1 because it does not alter the vessels primary purpose which is to contain a blast (*NABCO Inc., Comp. Gen. Dec. B-293027*).

FAR "Rights in Data" Clause Get its First Interpretation

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

Secret Joint Venture Agreement Does Not Violate Anti-Assignment Act

(Editor's Note. The following demonstrates that though companies may choose to form a variety of cooperative arrangements during performance of a contract, they need to make sure the original contracting arrangement with the government is in tact.)

Great Lakes was awarded a $58 million contract after which its principle subcontractor executed a joint venture agreement concerning the work. Though there were "assignment-like" provisions in the joint agreement (e.g. telling the government to make payments to a joint venture account) these were not implemented. In a subsequent claims dispute, the government sought to dismiss the claim contending that the contract was void because the joint venture violated the Anti-Assignment Act that prohibits transferring any contract or interest. The Appeals Board rejected the government's position stating since Great Lakes remained the sole contact for all performance related matters and all contract related documents were executed in the contractor's name they were still in a contractor-subcontractor role vis-à-vis the government even though they may have acted as joint venture partners in their own business dealings (*Great Lakes Dredge & Dock Co., ASBCA 53929*).

Court Rejects Equitable Price Adjustment on a Breached Contract

(Editor's Note. The following demonstrates you can not always count on methods used to quantify entitlement in one case to be applicable to another.)

Hi Shear asserted the government breached its contract by not considering all relevant facts when it significantly underestimated parts it would buy in a requirements contract. It sought lost profit and an equitable price adjustment because the lower quantity of parts ordered resulted in higher unit costs than it had bid over the length of the contract. It based the later claim on a prior case (*Rumsfeld v. Applied Cos.*) where the contractor received a price adjustment based on higher unit costs incurred due to lower volume ordered.

The Court agreed that the government breached the contract but rejected the lost profits and most of the equitable price adjustment claim of $438,000. The contractor was not entitled to an adjustment covering the period of its unexercised options since the government was not obliged to exercise the options. Next, the Court rejected the lost profit claims based on the Army's unordered quantities because to establish lost anticipated profits contractors must "definitely establish" that without the government's breach there would have been profit. Here, since the breach resulted in an overestimate Hi Shear could not contend those quantities would have been ordered had the breach not occurred and to allow lost profits would have violated the "well established" rule that damage awards cannot put the contractor in a better position than they would have been had the government not breached the contract. As for the equitable adjustment due to higher unit costs, though it spoke approvingly of Allied, that method is not the only method to compute a claim when other reasonable methods exist. Here the lower Court ruled the contractor was entitled only to $17,000 that was based on the requirements the government should have estimated but for its negligence not on the total difference between the government's actual orders and the overestimated quantities in the contract. To require use of the Allied method would deprive the Courts of the "flexibility" the law recognizes as appropriate when computing damages (*Hi-Shear Tech. Corp. v. US 2004 Wl 197144*).

CAS 415 Not Violated by Contractor's Funding of Its 401(k) Plan

(Editor's Note. Since CAS 415 is the accepted method of computing deferred compensation for all contractors – not just those covered by the cost accounting standards – this case has wide applicability.)

Tenneco Corporation funded its "matching" 401(k) contributions by transferring its stock form the parent to a holding company where it later distributed funds to each subsidiary. During this interval the value of the stock increased and when one of the subsidiary companies, Newport News, claimed the 401(k) contribution at the increased value on its incurred cost submission, the government rejected $19.5 million of the increased value. The government claimed Newport News violated CAS 415, Deferred compensation, by inflating the amount claimed and stated that the cost accounting standard requires the value of stock be measured on the date "the number of shares awarded is known" which occurred when the stock was transferred to the holding company.

The Appeals Court disagreed, stating that CAS 415 did not apply for two reasons: (1) CAS 415 defines deferred compensation as compensation made by an employer to an employee for services performed before the deferred comp is made and since the transfer to the holding fund occurred before the employee performed its services the stock transfer was not deferred comp and (2) the holding company was essentially a "bin" used to fund a number of Tenneco employee programs and thus the cost of stocks awarded to Newport News under the corporate thrift plan could not be known at the time of the transfer to the holding company. Hence the transfer to the "bin" could not be considered an "award" and hence it was not possible to measure the cost of the stock on that date. Rather, the award date was when the stock was deposited by Newport into its 401(k) plan as deferred compensation for services performed by its employees. Beside, the Court concluded, its interpretation did not expose the government to the risk that the stock's value would increase over time because the 401(k) recipients received stock awards from the holding company purely in terms of the cash value the stock represented rather than as stock "per se" (*Newport News Shipbuilding and Dry Dock Co. v. U.S. 2003 WL 22357733*).

NEW/SMALL CONTRACTORS

Special Allocations of Indirect Costs

(We frequently receive questions about whether established methods for allocating indirect costs can be altered under a new type of

contract. Though circumstances can change requiring the adoption of a new indirect cost allocation method, the government provides another option when circumstances are unique to one contract without having to change the method of indirect cost allocations to other contracts. This issue was addressed in an article we wrote about five years ago so the following is an adaptation of that article.)

Consider: Contractor A's practice is to recoup its general and administrative expenses by applying a G&A rate to total costs that normally include little material or subcontractor costs. It is now bidding on a Government contract requiring a significant portion of material and subcontractor costs. Contractor A fears that if it follows its normal G&A allocation practice it will (1) allocate too much G&A expense to the bid, resulting in a non-competitive bid price and (2) expose itself to allegations of cost distortion. Contractor B's practice is to include its research and development costs in its G&A pool. The contractor it is now bidding on a contract that exclusively uses the product it spends its R&D costs to develop. It now wants to recover its R&D costs on this contract. Use of a *special allocation* of indirect costs may be the answer for the two contractors. A special allocation of indirect costs is one method available to alter the indirect costs assigned to one contract or class of contracts without having to change the method of allocating indirect costs to all contracts. We will summarize the rules covering special allocations and briefly mention some of the administrative considerations in choosing this option.

The effect of a special allocation is to alter the amount of indirect costs allocated to a contract or group of contracts over the normal method of indirect cost allocation. A special allocation is, in effect, charged directly to a "cost objective" (e.g. usually synonymous with a contract but it could apply to other items such as a delivery order or product line). Once charged direct, the costs associated with that cost objective is subtracted from the normal indirect cost pool and the amount of the allocation base is subtracted from the normal indirect cost allocation base.

Basic Rules

Cost Accounting Standards (CAS) 403, 410, 418 and 420 address special allocations. While these standards apply to "fully" CAS covered contracts, the Courts and agency boards of contract appeals have looked to the CAS to resolve indirect cost allocation disputes under those contracts not covered by CAS. Government auditors also tend to apply the same indirect cost allocation principles to all contractors, whether CAS covered or not

CAS 403 permits a contractor and CO to agree to a special allocation of residual home office expenses when a particular segment receives more or less benefit than would result if its normal methods applied. This might occur, for example, when a segment provides much of its own executive type functions or is part of a joint venture, receiving home office support from both firms. **CAS 410** *requires* the contractor to use a special allocation for general and administrative costs when a particular cost objective receives a significantly different benefit than other cost objectives. The examples provided above would likely qualify. **CAS 418** permits a special allocation for all indirect cost pools not covered by the other three standards. FAR 31.203(d) cites numerous examples when a special allocation might be appropriate such as a change in manufacturing process, different amount of products or services required, etc. **CAS 420** permits a special allocation of research and development and bid and proposal costs. Since IR&D/B&P costs are usually part of G&A, CAS 410 would generally apply.

Administrative Considerations

When Should You Implement a Special Allocation? A special allocation is most often necessary for a particular contract and should be negotiated before agreement is reached on price. While the need for a special allocation may not be apparent until later, retroactive changes to cost accounting practices are rarely allowed.

With the exception of CAS 410, special allocations require mutual agreement between the contractor and the Government. Taking unilateral action to implement a special allocation makes the contractor susceptible to accusations of CAS noncompliance. On the other hand, a failure to implement a special allocation when the circumstances warrant it also expose the contractor to the same accusations. Proper timing of introducing a special allocation is an important consideration - ensure its acceptance before allegations of improper cost allocation interrupt the proposal evaluation and contracting process.

Has an Accounting Change Occurred? The government is touchy about changing accounting practices – if a change occurs, written disclosed practices often need to be changed, cost impact on contracts may need to be identified and contract repricing may be necessary. Unfortunately, it is not clear whether a change has occurred when a special allocation is made. A special allocation removes certain costs from the indirect pool and the pool's allocation base. Since the same

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proportionate method is used to allocate the net indirect cost, many experts claim a change to a cost accounting practice has not occurred. On the other hand, a special allocation results in the direct allocation of certain costs that are otherwise treated as indirect and some government auditors might claim a change has occurred. The answer at this time is not definitive.

Is the Consistency Principle Violated? CAS 402 and FAR 31.201.3 require contractors to treat similar costs incurred under similar circumstances consistently. Some contractors may fear that the change from an indirect allocation to a direct allocation may violate the consistency concept. The *Aydin, Corp* case settled a few years ago lessened the influence of CAS 402 on questions of special allocations, resulting in CAS 402 not preventing a special allocation when one is needed to ensure proper allocation.

If you think a special allocation will benefit your organization, you may want to obtain a second expert opinion.

QUESTIONS AND ANSWERS

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

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

Q. What are the sources of information in your newsletters?

A. We try to review as much relevant information as possible. We subscribe to and read just about all periodicals that might address contracting and cost/pricing issues. In spite of some interesting articles, only about 2% of the information contained in the periodicals are possibly relevant to our subscribers. We also review the Federal Register and read all guidance issued by the DCMA and DCAA as well as other government agencies. In addition, our large network of contractors and professionals often provides us private opinions and "white papers" that are particularly relevant to our readers. Lastly, consulting engagements and questions we receive from clients and subscribers quite frequently stimulate us to independently research and write on given topics.

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