
GCA REPORT

(A publication of Government Contract Associates)

March - April 2012

Vol 18, No. 2

NEW DEVELOPMENTS

OFPP Finally Increases Compensation Ceiling Despite Political Controversy Over Compensation Limits

The Office of Procurement Policy set the maximum “benchmark” compensation allowable for the top five executives at \$763,029, effective January 2011 for all applicable contracts no matter when awarded. The benchmark will apply to contract costs incurred after January 1, 2011 and should be used on all applicable contracts and subcontracts for FYs 2011, 2012 and thereafter until revised by OFPP. Due to recent changes expanding the cap from only the five highest paid executives to all employees, the cap will apply to all employees starting in 2012 (payments to scientists and engineers may be exempted from the caps on a case-by-case basis “to ensure access to needed skills”). The cap applies to employees of a company as well as subsidiary business segments directly reporting to the corporate headquarters and home office employees if their costs are allocated to government contracts.

The new cap represents an 11.5 percent increase over the \$684,181 that was in effect for FYs 2009 and 2010. Contractors can, of course, pay their executives and other employees more than \$763,029 but the additional compensation will not be allowable under their federal contracts. The cap covered compensation includes the total amounts of salary, bonuses, deferred compensation and employer contributions to defined contribution pension plans. The cap covered compensation does not apply to fringe benefits like health benefits and 401(k) employer contributions where if they are reasonable they are allowed irrespective of the cap. The benchmark compensation amount reflects the median amount of compensation for senior executives of all surveyed corporations for the most recent year data is available. Since the benchmarked companies represent large publicly traded companies with revenue exceeding \$50 million, it should be stressed that significantly lower caps will apply to smaller companies.

Whereas the caps were issued annually in the past, OFPP deliberately failed to issue the cap in FY 2011 due to the current administration and certain congress

members’ desire to significantly lower the caps below the formula-based benchmark compensation approach. This controversy has been continuing recently. For example, Senators Barbara Boxer (D-CA) and Charles Grassley (R-IA) have introduced a bill to lower the cap to approximately \$400,000, the level of pay to the President, to stem the “exorbitant taxpayer funded salaries for contractors” while the Obama Administration and Congressman Paul Tonko (D-NY) would set the limit at \$200,000 for all contractor and subcontractor employees. Recognizing the controversy, an attachment to the OFPP notification denounced the current OFPP formula for changing the pay cap stating taxpayers are being forced to reimburse contractors “for levels of executive compensation that cannot be justified for federal contract work.”

DCAA Issues Guidance on Multi-Year Auditing of Incurred Cost Proposals

Reflecting recent practices, the Defense Contract Audit Agency has issued guidance on utilizing multi-year techniques for incurred cost estimate proposals (ICEs). The intention is to improve efficiencies that will allow one set of working papers and one audit. Multi-year auditing will not occur at contractor locations having more than \$250 million in auditable costs and is considered most effective at small contractor locations. The multiyear audits will occur only where the “contractor’s structure is relatively stable and consistent” when, for example, there were (1) similar type contracts being performed during the years (2) no significant changes in the business systems or internal controls or (3) no significant changes in organization structure or operations.

The guidance provides for a wide range of flexible approaches to audit the direct and indirect costs for each year. Though costs in each year are to be reviewed auditors may review a specific expense account for the first year and based on those results, adjust the level of testing for the subsequent period. Or testing of a “homogeneous population of like transactions across all years” may be made. Auditors are also given flexibility in what sampling techniques to use to accomplish their objectives such as statistical or judgmental sampling techniques where the later must be justified for giving adequate audit coverage for the

universe. Projection of audit findings to the universe is acceptable but the findings must be evaluated before projections are made.

More detailed information is provided in a Q&A section of the guidance. There it states (1) the DCAA Contract Audit Manual 6-603.6 is being revised to allow for multiple rather than single year findings (2) only one audit report will be issued for all years (3) multiple years can be from two to five years (4) prior year findings of questioned costs or accounting system inadequacies do not preclude use of multi-year auditing but will be considered during the risk assessment conducted before an audit (5) if the auditor wishes to test an indirect cost account for all years, “homogeneity” of the costs must be considered (e.g. amount of costs roughly equal, no changes to accounting system, internal controls or policies.) while for direct costs, the terms and conditions and policies affecting direct costs must be similar. As for projecting questioned costs to the sample universe, auditors must evaluate the basis for the questioned costs and whether it is unique to a particular year where non-recurring costs or non-systemic errors are not to be projected. When the projected universe combines pools or years, the auditor must decide the appropriate method to apply questioned costs to the individual pools and/or fiscal year where the determination is considered to be an auditor judgment and not presented as a statistical projection (12-PPD-006(R)).

DCAA and DCMA Review Their Approach to Implementing Business Systems Rule

Officials from DCAA and DCMA outlined their approach to how they will review contractors’ business systems in a symposium held March 22. The speakers addressed the Defense Department’s new business systems rule finalized Feb. 24 that would impose a percentage of withhold if contractors’ business systems contain “significant” deficiencies. DCAA Director Patrick Fitzgerald stated the two organizations have clear lines of jurisdiction over technical oversight of business systems where DCAA will review accounting, billing, estimating and material management accounting systems (MMAS) while DCMA will review purchasing and government property management systems.

Prior to auditing an accounting system DCAA will ask the contractor (personnel responsible for performing the processes since they know most about the system) to “walk through” with them to demonstrate how its policies, procedures, practices and processes comply with applicable criteria. If there is a withholding of funds, DCAA will reevaluate the system after a contractor fixes the problems. Fitzgerald anticipated

many issues will arise over whether a deficiency is significant where he stated the rule defines a significant deficiency as a “shortcoming that materially affects the ability of DOD officials to rely on information from the system to manage it.” DCAA is in the process of revising its audit programs to meet the new rules where he said the billing audit program is finished while the accounting programs will be finished “in the near future.” DCMA’s Executive Director of Contracts Tim Callahan promised the agency will foster a dialogue with contractors during reviews and share information to avoid “surprises.” DCMA is establishing a Contractor Business Systems Panel devoted to making final decisions on compliance where the panel will have various levels of expertise contributing to decisions.

An industry representative Greg Bingham expressed some potential issues related to the rule’s implementation. For example, the definition of a “significant deficiency” that “materially affects” whether an agency may rely on the information is too vague. Many industries such as aerospace cannot agree on what this means so its going to be quite difficult for an auditor to make this judgment. In addition, federal auditors often lack private industry experience to make judgments about business systems where “classroom training may not be sufficient.” Another concern expressed is in the rule’s definition of a “subcontract” and “purchasing order” that will include agreements with contractor vendors that would normally be applied to a contractors indirect cost pool where now auditors are likely to review relatively small items. Also, Mr. Bingham expressed concern if the federal government has enough personnel to perform timely follow up audits to remove withholdings or whether such audits would be accorded sufficient priority.

Comments Proliferate Following the JA Taylor Executive Compensation Case

In addition to our detailed coverage in the last issue of the GCA DIGEST of the important case finding that DCAA’s normal methodology of evaluating executive compensation was “statistically fatally flawed” we have found wide coverage of the case and some comments on what it means going forward. Of particular interest, DCAA has not issued any comments on the results of the case nor has it changed its methodology in recent compensation reviews we have encountered since the case was decided. Some of the comments we have seen include:

1. The government has until May 21 to appeal the decision where some commentators predict it will be appealed while other state it probably will not be.

2. Members of the Obama administration and legislators committed to lowering executive compensation levels (see story above) have expressed disappointment with the case but state it is more of a setback rather than a defeat for them.

3. Other commentators have stressed that the case provides a clear criticism to DCAA's approach to evaluating executive compensation where until it adopts steps to address the errors found in the case, contractors have a strong basis to challenge DCAA's findings both in the past and going forward.

4. Responding to a seminal finding in the case that DCAA's approach of allowing only a 10% "range of reasonableness" (ROR) factor on the levels of compensation its surveys indicate are reasonable, one commentator stresses the case provides a rather simple process to evaluate executive compensation where "anyone with a freshman statistics book" can compute a 95 percent confidence level associated with the data being used which would normally provide for a much higher ROR factor. Contractors with outstanding incurred cost proposals may want to review and recalculate their compensation calculations to determine whether to make adjustments, dispute DCAA assertions if made or provide additional justification for amounts claimed.

5. Another commentator has suggested steps to be taken to apply the lessons of the case including (a) develop and maintain written compensation policies that are consistently followed (b) create and maintain detailed compensation records and rationales for compensation to have handy if a dispute occurs (c) develop and maintain job descriptions that justify benchmarking to specific job categories (d) show that positions are responsible for total company revenue so as to avoid benchmarking certain executives to lower revenue comparables based upon assertions they are responsible for only a portion of company revenues (a position DCAA took that the board did not dispute) (e) ensure DCAA has all relevant information so auditors benchmark your company to relevant industry, geographic area, security clearances, relevant skills, etc. and (e) engage the CO early so if auditors are applying incorrect statistical techniques or are using incorrect surveys notify the CO early on in the process.

New Final FAR Rule on Awarding Cost Type Contracts; Criticisms of Agency Compliance with Cost Type Rules

A final FAR rule was issued on use and management of cost reimbursable contracts which does not differ significantly from an earlier interim rule we reported

on. The rule does not interfere with the discretion of the contracting officer to decide what contract type to award but rather clarifies when cost-reimbursement contracts are appropriate and requires COs to document the rationale for awarding such contracts. The final rule identifies circumstances when cost type contracts are appropriate (e.g. uncertain estimate of costs), acquisition plan findings to support the selection decision (or when the plan is not required the CO must still document the decision in the contract file) and there is adequate resources available to award and manage the cost type contract (*Fed. Reg. 12925*).

There have been numerous Inspector General reports criticizing agencies' awarding of cost reimbursable contracts indicating there may be some pressure to lessen such awards. For example, the General Services Administration was criticized for not using acquisition plans to document and justify using cost reimbursable contracts while the Environmental Protection Agency was criticized for not having discussions minimizing the use of other than firm fixed price contracts and not considering the use of such contracts as portions of cost type contracts as well as not having written acquisition plans.

New FAR Rules Finalizes Parity of Small Business Programs

Final changes to the FAR were made to clarify there is no order of priority among small business socioeconomic contracting programs. The rule is meant to clear up confusions over the statutory relationship between the HUBZone program and others such as 8(a), Service Disabled Veteran-Owned Small Business (SDVOSB) and women-owned small business (WOSB) programs. The confusions stem from two GAO decisions that ruled a federal agency must use a HUBZone small business for an acquisition if it reasonably expects at least two HUBZone firms will submit fair market based prices before it uses any other firms qualifying under other programs. These decisions conflicted with the Small Business Administration parity requirements designed to ensure small businesses have a fair shot at federal contracts regardless of what small business program they are a part of and FAR 19.203 which states there should be no order of precedence.

Proposed DOD Rule to Have Some Interim Vouchers Audited

The proposed rule would revise requirements for approving interim vouchers for those contractors that are entitled to direct billing. DCAA auditors would use sampling techniques to select vouchers which would

be reviewed by contract auditors and would need to be approved before they are sent to disbursing offices for payment. If questions costs are found, DCAA may issue a Form 1, Notice of Contract Costs Suspended and/or Disapproved. Vouchers not selected for review will be considered to be provisionally approved and sent directly to the disbursing office. The proposal also states that all provisionally approved vouchers will still be subject to a later audit of actual cost incurred (*Fed. Reg. 2682*).

DOD Memo Addresses Whether Unallowable Dependent Health Costs are Subject to Penalties

The Director of Defense Pricing has issued a memo that reversed DCAA's position that costs incurred in providing health benefits to ineligible dependents such as divorced spouses or children too old to qualify are expressly unallowable and hence subject to penalties. The memo states DOD will continue to disallow the costs but will not pursue penalties under FAR 42.709 provisions. However, the memo states DOD intends to amend the DFARS to make future unallowable dependent health care benefit costs expressly unallowable and subject to penalties.

DCAA Guidance on B&P Costs

Following a DOD directive on establishing criteria for charging bid and proposal costs as either direct or indirect, DCAA has issued guidance to its auditors implementing the directive. It states that proposal preparation costs not funded by a grant or required under a contract is "by definition" indirect while such costs should be charged direct only when there is a "specific contractual requirement for the contractor to submit a proposal." For indirect costs, the guidance states the allocation of costs should be consistent with CAS 420 (which applies, in most parts, to non-CAS covered contracts and contractors). Auditors are told to be alert to disclosed practices that may be "vague and misleading" (*12-PAC-008(R)*).

DCAA Issues Its First Annual Report

(Editor's Note. DCAA has long submitted reports to congress providing statistics on its accomplishments (one of us used to help prepare these reports when we were with DCAA) where the most important statistic was showing the amount of questioned costs found and sustained as a percentage of costs of the agency where high ratios were used to justify higher budgets for the agency even in times of steep defense cuts. The following article addresses the first report required under the National Defense Authorization Act of 2012 which is more publicly available. We find it interesting because the metrics it shows tell interesting stories.)

The report highlighting DCAA's accomplishments showed it audited \$128 billion in defense contract costs, issued 7,390 reports, finding \$11.9 billion of questioned costs of which \$3.5 billion was "documented savings" resulting in \$5.80 of savings for each dollar invested. Of note, the report shows a significantly higher level of costs questioned to costs examined – 9.25% compared to prior years ranging from 2.19%-6.75%. One commentator indicates the increase may be a result of a higher shift to forward pricing proposal audits which historically has been associated with a higher percent than other audits. As budget cuts occur it may mean less proposals and new emphasis on catching up on backlogged incurred cost audits occurs will mean the "hit rate" will likely decrease, putting additional pressure on finding more questioned costs.

Another group of statistics addressing its productivity is also notable. The number of audit reports has fallen significantly, from 21,176 in 2009 (and a lot more in earlier years) to 7,390 reports in 2011 in spite of the fact DCAA had 16% more auditors. Also, the elapsed time for all audits has also increased 400% compared to 2008 and earlier statistics. In addition, a high percentage of time is spent on non-field audit work – e.g. out of 120 days to audit a forward pricing proposal, only 20 days were spent on field work while the remaining time was spent on time consuming "risk assessments," group meetings to reach consensus and a lengthy review process. In response to questions about such low productivity measurements, DCAA's responses are it has no mandatory dates where it states meeting high quality and audit standards are more important than meeting "arbitrary due dates." (We believe the audit "clients", the government, would have a different take on such slow responses.)

Forecast of Likely Hot Procurement Issues

In an uncertain environment of budget cuts, sequestration and congressional uncertainty the President of the influential Professional Services Council Stan Soloway put forth some interesting procurement related comments at a March 27 conference. He said tough times are likely but some industries should survive and even thrive. His comments included:

1. An election year means contractors will need to live with uncertainty where budget wars are expected. Politics will preclude budget deals resulting in use of continuing resolution funding in September so legislators can go home to campaign that will last either through February 2013 or perhaps a shorter one that forces a lame duck session.

2. Soloway predicts a 50-50 chance that some form of sequestration will occur where not planning for it would be “a big mistake.” (Sequestration is the large reductions in spending that were promised if legislators could not agree to a deficit reduction program last year which did not happen.) Contractors should plan on agencies making across-the-board cuts to all programs, agencies will not receive authorization instructions until possibly December where then they will rush purchases and it should be remembered that budget cuts in many areas will not be actual spending reductions but rather slowdowns in spending growth. He also predicts there will be some winners such as cybersecurity, operations and maintenance and special operations.

3. Agencies will feel pressure to use lowest price, technically acceptable contracts rather than “best value”.

4. Soloway alludes to proposals affecting executive compensation (see article above) where he states they are unlikely to pass.

5. Cloud computing will become more important.

6. Alluding to increased emphasis on small business contracting. Soloway pointed to several recent small business related proposals such as raising small business set-aside goals, promoting Office of Small and Disadvantaged Directors to senior acquisition officials, increased oversight of subcontracting plans, getting small business advocates active earlier in the acquisition process, greater emphasis on helping small businesses receive more multiple contract awards and helping early stage small businesses (15 or less employees and less than \$1 million in revenue) receive more government contracts.

CASES/DECISIONS

Board Denies Payment for Federal Excise Tax

Hillcrest’s contract to provide helicopter fire fighting services was designed as a commercial item procurement. It sought payment for federal excise taxes it paid during contract performance, citing FAR 52.229-3(b) that provides a contract price shall be increased by the amount of any after-imposed federal tax if the contractor warrants that a new tax amount was not included in its contract price. The Board disagreed stating the tax clause is not a mandatory clause for commercial item contracts but stated the contract was clearly subject to the commercial item tax clause at FAR 52.212-4(k) which provides that the contract price includes all applicable federal, state and local taxes and

duties which controls here (*Hillcrest Aircraft Co., v Dept of Agriculture, CBCA, No. 2317*).

Contractor Entitled to Payments Made for Accrued Sick Leave Hours

In its NASA contract to provide operations and support services SGS’s contract was subject to the Service Contract Act which requires it to pay employees wages and fringe benefits established in its 23 separate collective bargaining agreements (CBAs). SGS believed the contract called for it to pay employees for benefits remaining when they cashed out at termination and allowed it to bill the government for the costs. The contracting office determined that costs paid out by SGS for unused reserve sick leave were unallowable where SGS appealed after its claim seeking \$2.9 million reimbursement was denied. The Board said the dispute focused on a contract provision, article B-5F, that required SGS to accept transfer of accrued sick leave hours of personnel hired by the previous contractor where the government would nonetheless not pay the costs of these carry-over hours unless they were used. The Board ruled this meant the government would pay the costs associated with permissible use of the carry-over accrued sick leave hours. If those hours are used, whether they be regular or reserve sick leave hours covered by the specific CBAs both types of hours may be used and the costs are payable by the government. The board added the reserve sick leave payments are allowable as fringe benefit costs under FAR 31.205-6(m)(1) (*Space Gateway Support, LLC, ASBCA No. 56592*).

Claim Language Does Constitute Sum Certain

Zafer submitted a request for equitable adjustment seeking an additional \$4.9 million. Its REA included language “Zafer reserves the right to revisit these and other matters until a release of claim is executed” where the government claimed such language negated the requirement to propose a sum certain in its REA. The Board sided with Zafer stating the REA properly requested an unqualified determinable amount where the reservation of rights language did not disturb or question the exact amount in the claim. The Board added that a contractor submitting a valid claim may later amend it or separately assert a new one based on different facts (*Zafer Taabut Insaat vs. Ticaret AS, ASBCA No. 56770*).

Case Clarifies Basis to Challenge a Task Order Award

In its task order to provide services to the Navy, Solute challenged the award contending the Navy failed to

evaluate the task order proposals in accordance with solicitation requirements. The Court stated it did not have jurisdiction to address the challenge since prior cases ruled it may not address a protest of a task order unless it challenges an increase in scope, period or maximum value of an underlying contract where here Solute’s challenge was a disagreement with the manner in which the government evaluated task orders (*Solute Consulting V US, Fed. Cl. No 12-37C*).

Government Control Exception Requires Reinstating Late Proposal

(Editor’s Note. The following case provides some conditions for waiving late proposal delivery penalties.)

The RFQ specified that the Defense Intelligence Agency (DIA) proposal be accepted on Sept. 12, 2011 at 11:00 AM by email and that paper and compact disc versions be delivered at an address within the Bolling Air Force Base. On Sept. 12, EOR sent its proposal via email at 10:00 AM to DIA and told DIA it had dispatched a courier to delivery a hard copy and disc versions. The courier arrived at the base visitor’s center at 10:25 AM but could not make the delivery because it lacked a valid ID where due to miscommunications DIA did not meet the courier until 12:55. The contracting officer said EOR’s proposal was not timely and would not be considered where EOR pursued action contending it had satisfied the government control exception at FAR 15.208(b)(1)(ii) (i.e. received at place designated for receipt and under government control prior to receipt deadline). The court sided with EOR stating (1) it satisfied this exception because DIA received EOR’s paper proposal at the installation designated for receipt prior to the deadline (2) the paper was under government control because EOR had relinquished control and could not make any modifications (3) DIA should have waived the late delivery of the paper copy as a minor informality due to EOR’s timely email submission and (4) EOR did not gain a competitive advantage by taking more time to complete the paper proposal than other offerors (*The Electronic On-Ramp Inc. v. US, Fed. Cl. No. 12-22*).

Agency Improperly Conducted Discussions

The Air Force received several proposals for a mobile concrete plant where RexCon’s rating was “unacceptable” due to its failure to meet the electrical system requirements and not providing 24 hour/7 days a week technical support. The agency conducted what it called “clarifications” with RexCon on “discrepancies” in its proposal where the Air Force followed with written questions and received responses from RexCon resulting

in changing its evaluation to “acceptable.” The Air Force evaluated ERIE’s proposal, which had a lower price than RexCon as “unacceptable” also but did not conduct “clarifications” with it. After awarding RexCon the contract ERIE filed a protest stating the agency should have conducted “clarifications” with it. The Comp. Gen. sided with ERIE noting that clarifications are “limited exchanges” meant to resolve “minor uncertainties” or irregularities which do not give an offeror the opportunity to modify its proposal. “Discussions” on the other hand occur when an agency communicates with the offeror for the purpose of obtaining information essential to determining the acceptability of an offer or provides the opportunity to revise or modify a proposal where all offerors are to be given the opportunity to revise their proposal. The Comp. Gen. disagreed that the Air Force’s exchanges constituted “clarifications” rather than “discussions” because before the exchange RexCon’s proposal was unacceptable and after, it was acceptable (e.g. during questioning it asserted it would be “on call”). Finding the exchanges to be discussions, the Comp. Gen. concluded the Air Force was required to present ERIE with the opportunity to address the agency’s concerns through discussions as well (*ERIE Strayer Co., Comp. Gen. Dec. B-406131*).

Government Did Not Properly Consider Low Price

Protester NikiSoft proposed the lowest price but the award for services went to LS3 on grounds it offered the best value where NikiSoft asserted the government did not consider its low price in making its determination. On examining the record, the GAO agreed with Nikisoft saying the government did not consider its lower price in spite of the requirement under FAR part 8.4 to conduct a price/technical tradeoff to determine whether a technical superiority is worth a higher price. (*Nikisoft Systems Corp., GAO B-406179*).

NEW/SMALL CONTRACTORS

New Areas of DCAA Audit Scrutiny

In addition to our consulting experience and hearing from subscribers we have taken the plunge to observing blogs where we are finding useful experiences from others. In addition to priority audit areas we reported on in our summary of the Grant Thornton Survey in the last issue of the GCA DIGEST (e.g. executive

compensation, consulting, legal, employee morale, labor charging costs) we were pleased to find other audit areas reported in blogs that we find corresponds to our experience. Some of the topics the blogs indicate are “hot” areas include:

1. Increased focus on marketing costs where there will be more detailed examination of expense reports to ascertain the purpose of the trips and expenses as well as proper completion of expense reports. *(Editor’s Note. Though the observation is quite valid, we do find certain assertions by bloggers that, for example, marketing costs are “unallowable” while bid and proposal or business development costs are “allowable” as questionable. Such assertions need to be looked at with a critical eye.)*

2. There is increased scrutiny over per diem rates, including those expended by consultants and subcontractors. You can expect a large sample of expense reports to be examined *(in line with new guidance on statistical sampling DCAA auditors are told to follow)*.

3. Auditors are expected to be checking on projects to ascertain whether they are in an overrun or loss position. They will be examining whether such costs are inappropriately being billed to the government. *(Editor’s Note. As an example of mixing useful and incorrect information, we saw one blogger indicate incorrectly that such overrun costs may not be included in either G&A pool or base expenses.)*

4. Auditors are making sure that claimed depreciation costs are consistent with the way they account (or are supposed to account) for them using generally accepted accounting principles as opposed to those used for federal tax purposes. For example, accelerated depreciation or IRS Section 179 deductions (write off of capital costs in one year) used for government costing purposes are usually disallowed unless contractors can demonstrate such treatments are consistent with actual usage (e.g. one year of contract performance).

5. Auditors will be examining whether contractors have and are following adequate purchasing and estimating system procedures. They will be asking to examine such procedures and will be selecting samples of proposals and purchases to see whether procedures are being followed. *(Editor’s Note. Full blown contractor purchasing system reviews (CPSRs) are now the explicit responsibility of the Defense Contract Management Agency so we have not seen much emphasis on purchasing system practices but yes, we have seen increases in audits of purchases during increased invoice audits and we are expecting DCMA to request DCAA assistance in their CPSR reviews in the future. We are also seeing more emphasis on adequate estimating procedures and practices.)*

6. Though many blogs correctly emphasize that DCAA’s role in auditing forward pricing rates have been reduced (only >\$10 Million fixed price and >\$100 Million cost type contracts) they are stating that DCMA is asking cognizant DCAA offices to review detailed budgeted costs that form the basis of many forward pricing rates. We are also seeing that proposed provisional billing rates used for billing cost type work as opposed to forward pricing rates is still considered the responsibility of DCAA where due to their backlog of incurred cost audits, these provisional billing rates are being audited in detail where prior year actuals used for projecting future costs are being audited as if they were incurred cost audits.

7. Bonus plans are being audited carefully where the absence of written bonus plans are being cited as grounds for disallowing the costs. In the past, a written bonus plan was usually not considered a requirement to allow bonus costs – FAR 31.205-6(f) states “an agreement” or an established plan or policy are in place to mean “in effect, an agreement” – whereas now an increased number of auditors are requiring a written bonus plan to exist for bonus costs to be considered allowable. That issue will need to be resolved.

8. Increased emphases on original paperwork being in place. Many contractors have often met with auditors to describe their scanning technologies to inform them of their practices. However, the absence of clear audit guidelines in this area and lack of clear “acceptances” of most systems lead many auditors to insist that original documents be in place following FAR record retention requirements.

9. Personal use of cell phones are being examined. Auditors will generally be looking for written policies to either identify personal use of cell phones or the practices to make cell phones a form of compensation so no tracking of personal use is needed.

QUESTIONS AND ANSWERS

Q. What are the typical profit rates realized on different government contracts?

A. We reported on the Grant Thornton survey in the last issue of the GCA DIGEST where it states typical rates are 6-7 percent for cost reimbursable, 8-9 percent for time and material/labor hour and 9-10 percent for fixed price contracts. In our experience, the range is

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generally larger - 6-10 percent, 8-12 and 8-15 percent (as high as 25%), respectively.

Q. We have some info that will affect our proposed price. Do we need to submit a new proposal?

A. The requirement under TINA is to update cost or pricing data disclosure not to reprice the proposal itself. However you should explain how the updated data relate to the price proposal. To minimize risk of defective pricing, it is best to conduct a sweep prior to price negotiations and divulge any new facts.

Q. Can a company provide an individual a company paid automobile in lieu of compensation. All of the lease payments, taxes and repairs would be imputed to the individual as compensation on their W2s. In this case, would the lease payments, taxes and repairs be allowable expenses to the company?

A. Its a tricky question. "Compensation" is allowable to the extent it is considered reasonable while only the business related expenses of "autos" are allowable where you are required to keep track of the business versus personal use. Most likely you would assert it is compensation and hence allowable but an auditor would likely assert the expenses you describe are "auto" expenses and hence only the business use is allowable (if you didn't keep track the entire amount may be questioned). Though you have good grounds for asserting they are compensation expenses, the auditor and his supervisors would likely not agree where you would be stuck challenging the "finding" with either the ACO or even some form of litigation. Though an auditor still could assert it is auto expenses, if the company simply provided a fixed amount as compensation that is supposed to be compensation in lieu of providing a car that would more likely be

accepted where then the individual has the freedom to do what they like with the compensation.

Q. For GAAP purposes, we add a 24% figure to direct labor for computing burdened labor but for government costing purposes the 24% figure is way too low to capture all of our indirect costs. What should we do?

A. For government costing purposes you should be fully burdening your labor costs. There is no requirement that your government costing must be consistent with your GAAP accounting in this area so you can either keep your GAAP accounting the same or raise the 24% to reflect more accurate costing.

Q. We are changing to a flexible timekeeping practices where, for example, employees may work in the morning, take 5 hours off and work late into evening. Will this be a problem with auditors?

A. I don't see why unless a specific contract or client objects but make sure you revise your written policies to reflect the new policy.

Q. Though I stayed with relatives at my temporary duty assignment may I still claim the lodging rate I would have been entitled to had I not stayed with them.

A. No. Section 301-11.12(3) of the FTR states you will not be reimbursed the cost of comparable conventional lodging in the area or a flat "token" amount. You may be reimbursed for additional costs your host incurs in accommodating you providing you can substantiate the costs and they are reasonable. The exception to this is if the friend or relative are in the business of operating a hotel or apartment house business.