GCA REPORT
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NEW DEVELOPMENTS

DCAA Issues Several Guidelines and Alerts

The Defense Contract Audit Agency has issued several communications. The most significant ones are:

♦ **DCAA's Recent Response on Recent Compensation Cases**

(*Editor's Note. We have been waiting, so far in vain, to see DCAA revamp its approaches for reviewing compensation, especially executive compensation, in the light of two recent cases – JF Taylor (ASBCA 56105) and Metron (ASBCA 56624) - that found DCAA's approach to be "statistically flawed". The following "rejoinder" by DCAA provides a pretty good indication of what their current position is on the cases.*)

A contractor was challenging a DCAA finding of excess compensation and alluded to the two cases where, as reported in Darryl Oyer's May 10 newsletter, DCAA responded by making the following points:

1. Use of a 10% range of reasonableness is an accepted method in the field. (The JA Taylor case found such a range "statistically fatally flawed" arguing a range should be based on a dispersion of data and a standard deviation applicable to each circumstance, not an arbitrary 10 %.)

2. Merely alluding to the JF Taylor case is inappropriate because the findings are relevant to only the one case and not "precedent findings."

3. The contractor's expert witness had no experience in compensation but was "only" a statistics expert. His approach is not one used by compensation professionals.

4. The Government's expert witness was deemed not credible and the contractor's expert witness testimony went "unrebutted." Had the government a credible expert witness the response states "we strongly believe the court would have ruled in the government's favor."

Of note, DCAA did not mention the Metron case strongly supported the JA Taylor findings and found that one survey, Radford, was superior over the multiple surveys used by DCAA.

(*Editor's Note. In two recent appeals our clients have brought in response to DCAA assertions of excess compensation, early negotiations with DCMA attorneys indicate they are taking the cases seriously where, for example, they seem to agree with the Metron case finding that the Radford survey should be used for professional firms. It is too soon to see how these two appeals and others will be played out.*)

♦ **Developing a Finding on a Price Proposal Audit**

When it is determined that the underlying cost data is insufficient or there is significant fault with its estimating method, DCAA usually issues a report stating the relevant costs are *unsupported*. Apparently in response to wide-spread criticism of excessive determinations of costs being unsupported, the new guidance now encourages the audit team conducting the proposal audit to gather evidence, even if they must find it on their own or use 3rd party sources, and take necessary steps to quantify the effect of the relevant costs and report the differences as *questioned* costs. For example, such evidence might include a vendor quote that contains quantity discounts where the proposal does not reflect these. If after taking steps to determine the dollar impact of not applying the discounts auditors still cannot determine the impact then an audit report may say the costs are unsupported.

The Q&A section of the memo provides several examples of costs that are usually reported as unsupported that now should be further reviewed:

1. The basis of estimate states competitive prices are used where during the audit it is found that a significant amount of proposed material costs use single quotes. Auditors should conduct discussions with the contractor and review purchase files for follow up actions to ensure competition is made.

2. The prime contractor has not yet conducted cost/price analysis on a subcontract valued over $700K. Available evidence should be sought such as historical purchases where negotiation memos allow computation of a decrement factor or price analysis conducted to demonstrate price reasonableness. If the cost/price analysis is still not complete by the end of the audit the costs should be reported as unsupported and issuance of an estimating deficiency should be considered.

3. Contractor is using engineering estimates on a follow-on contract asserting historical hours are not representative due to design changes. Gather evidence to see if historical hours can be adjusted for the design change. The guidance denies anticipated assertions that DCAA is trying to "fix" the proposal and thereby impeding auditor independence.

4. A fixed price proposal with a four year performance period used indirect cost rates where the first year was based on budget data, the second year was based on cost adjustments to Year 1 and years 3 and 4 used Year 2 data where there was no narrative provided supporting the flat line rates. Ask the contractor for support of the last two years and/or develop historical trend lines using regression analysis before putting forth an unsupported opinion (*13-PSP-003(R*).

- **Unallowable Costs for Ineligible Dependent Health Care**

The new DCAA guidance alludes to a Feb 17, 2012 Memorandum from the DOD Director of Defense Pricing (DPP) that states costs incurred for ineligible dependent health care benefits are unallowable under FAR 31.203-3 and 31. 205-6(m) where though unallowable should not be subject to penalties. The new guidance revises two earlier DCAA guidelines that stated such unallowable costs are expressly unallowable and hence subject to penalties under FAR 42.709. The new guidance states penalties will not apply both going forward and in prior audits and if penalties were recommended supplemental reports should be issued (*13-PAC-004(R*).

- **Audit Alert on Allowability of Travel Costs**

The guidance alludes to FAR 31.205-46(a)(2) that states allowable lodging, meals and incidental expenses (IEs) are limited on a daily basis to "maximum per diem" rates set forth in government regulations such as the Federal Travel Regulations, Joint Travel Regulations, etc. The guidance reminds auditors that though travel regs provide for two ceiling amounts which apply to government employees' travel costs – one for lodging and another for meals and IEs – contractors are subject to only one ceiling, a total of lodging, meals and IEs per the DCAA Contract Audit Manual 7-1002.3.e(2) (*13-PAC-002(R*).

- **Alert on Supervisory Involvement in Design of Sampling Plans**

The alert emphasizes the importance of supervisory involvement in the design of sampling and judgment selection plans where auditors are encouraged to discuss and review plans with their supervisors and obtain their approval prior to selecting transactions. The guidance states sampling is considered an important tool that saves time and improves audit efficiency by allowing an auditor to gain sufficient, objective evidence to draw a conclusion about a population without examining the entire population. The alert states statistical sampling is useful in either testing for errors or assuring an error rate is not excessive (attribute sampling) or to estimate an amount such as questioned costs (variable sampling) (*12-PPS-033(R*).

- **Audit Alert on Conducting Concurrent Review**

We are seeing DCAA increasingly auditing multiple years of incurred cost proposals at the same time. DCAA has issued an alert encouraging use of concurred reviews touting the advantages as (1) saving time and reducing the audit cycle and (2) expanding professional development by allowing auditors, often for the first time, to be involved in the management review process (*12-PPS-031(R*).

Proposed Rule on Unallowable Fringe Benefit Costs

The Defense Department is proposing to amend the DFARS to state explicitly that fringe benefit costs contained either in an incurred cost or forward pricing proposal are unallowable if they are contrary to law, employer-employee agreement or an established policy of the contractor. Unlike the DCAA guidance described above that states unallowable employee health care costs of ineligible dependents are not subject to penalties under FAR 42.709-1 the proposed rule intends to make unallowable fringe benefit costs expressly unallowable and hence subject to penalties (*Fed. Reg. 13606*).

FAR Council Issues FAR Changes

The FAR Council issued changes to the FAR in the form of FAC 2005-66. Two items of interest to contractors are (1) a final rule that provides guidance when a time-and-material or labor hour contract or task/delivery order ceiling is either raised or changed where now the CO must conduct a price or other analysis and document the file to ensure it is in the best interests of the government (*Fed. Reg. 13766*) and (2) extension of authority to use simplified acquisition procedures for acquisition of what the CO reasonably expects will be commercial items not exceeding $6.5 million, including options ($12 million for items identified in FAR 13.500(e) (*Fed. Reg. 13767*).

OFCCP Changes Rules on Investigating Pay Discrimination

The Labor Department's Office of Federal Contract Compliance Programs has rescinded two Bush-era enforcement guidance documents – "Compensation Standards" and "Voluntary Compliance" – stating they make it hard for OFCCP to exercise its role of monitoring contractor pay practices by providing an excessively "narrow focus" on what to examine. OFCCP states the old guidance addressed only one type of pay disparity – pay differences among pools of workers in one category - and did address more difficult to find and prove things such as discrimination in job assignments, promotion opportunities and access to overtime where the old guidance allowed contractors to review their own compensation system and then be shielded from enforcement action based on one statistical model. New procedures now allow OFCCP to "cast a wider net" to find other forms of pay discrimination such as hiring, promotion and termination and investigations will now be carried out on a case by case basis which may include a review of contractors' policies and procedures, statistical and non-statistical analyses and consultations with labor economists and other experts. In addition, unlike earlier guidance that required anecdotal evidence by employees, OFCCP will no longer need that evidence where now they may seek remedies of discrimination whether or not workers realize they are underpaid. (*Fed. Reg. 13508*).

Controversy Over Executive Pay Continues

Despite several proposals to lower executive pay to $400,000 and another to $230,700, the final version of the 2013 National Defense Authorization Act rejected such proposals, instead calling for study of contractor compensation. Practically before the ink was dry three senators – Barbara Boxer (D-CA), Chuck Grassley (R-IA) and Joe Manchin (D-WVA) – are calling for "commonsense" limits on the compensation of government contractors. Under current law government contractors may charge the government up to $763,951 where the senators state such a limit has more than doubled since 2000 and has grown 55 per cent faster than inflation. Boxer and Grassley succeeded in 2012 to expand the cap to all contractor employees rather than just the top five executives.

The next day the Professional Services Council expressed "strong opposition" to such "arbitrary reductions." The PSC argued the imposition of limits undermines long term policy, decreases the ability of the government to attract the kind of high-end skills needed to perform more complex missions and stated arbitrary caps and salary freezes are not the answer and would cause more harm than good.

Meanwhile Senate and House panels beginning to work up new spending bills for 2014 are already putting forth compensation caps.

DOD Issues Final Rule on Proposal Checklist

The Defense Department published a final rule amending the Defense Federal Acquisition Supplement (DFARS) to add a 12 page checklist contractors must complete when submitting proposals to solicitations that require certified cost or pricing data. The preamble said the purpose of the rule is to ensure accurate, thorough and complete proposals where contractors would be able to self-validate them. The final rule replaces an interim rule issued in Dec 2011 where the items were reduced from 47 to 36 after comments were received where most of the reduction was due to either duplication or the fact the FAR already requires COs to comply. Some of the changes included: (1) modify Item No. 20 to ask if the proposal includes subcontractor certified cost or pricing data or just a proposal (2) modify Item No. 19 to require offers to identify those subcontractors that will require assist audits (3) modify Item No. 27 to ask if the price proposal includes a price analysis for commercial items that are not available to the general public and (4) add to the checklist instructions that offerors may choose to have prospective subcontractors use the same checklist or a similar one, Comments we have seen indicate the checklist does not add much value to already expensive proposal preparation costs and are not much different from DCAA's own checklist. The final rule will be incorporated into the DFARS section 215.408 and can be found at www.ofr.gov/OFRUpload/OFRData/2013-07106_PI.pdf).

DCAA Slammed for Poor Quality Audits

After examining a sample of reports across the agency, the Defense Department Inspector General issued a report stating the Defense Contract Audit Agency had "significant quality problems" including external impairments to independence, inadequate planning, poor communications with contractors, audit opinions with insufficient evidence, unsupported or untimely reports and ineffective supervision and quality control. The IG report recommended DCAA consider either

rescinding or issuing supplemental reports for the 37 sampled reports that were reviewed.

In a letter to the IG DCAA Director Patrick Fitzgerald objected to the value of the IG report stating it was of "minimal value" since it based its findings on old data and did not reflect the improvements DCAA has made since highly critical GAO and other reports and senate investigations were conducted in 2009. Fitzgerald's letter states IG's review focused on reports completed before or just after the 2009 critical reports and does not reflect "major changes" made by DCAA to correct the reported problems. Many comments on the report and DCAA response seem to agree that things are being done differently but "is not what it should be."

Air Force is Lax in Enforcing New Cost Type Contract Rules

(*Editor's Note. The following may indicate why we are seeing less cost type contracts and task orders being issued, even when prior contracts were cost type.*)

A DOD IG report stated that the Air Force failed to follow an interim rule issued March 21, 2011 in close to half of the 156 contracts it reviewed. The rule addresses documentation of decisions to award cost type contracts and approvals which include: (1) approval of letting a cost type contract at least one level above the CO (2) a written justification for the decision (3) how the contract requirements can transition into a fixed price vehicle (4) federal resources are available to monitor the contract and (5) the contractor has an adequate accounting system in place. DOD's position on cost type contracts is they pose increased risk because contractors are less apt to control costs. DOD personnel told the IG they were unaware of the rule, assumed it did not apply to task or delivery orders or followed the rule but failed to provide documentation (*the IG Report can be found at http://www.dodig./mil/pubs/documents/DODOG-2013-059.pdf.*).

ABA Is Critical of Recent Strategic Sourcing Proposals

The American Bar Association during its midyear conference came out against recent "strategic sourcing" initiatives that would supposedly apply the vast spending power of the federal government to obtain lower pricing. An ABA representative stated such actions would make agencies "less agile" to buy items they really need, works well for simple commodities but not more complicated purchases like computers, it solves six to eight year old problems where technology has leapfrogged where actual purchases are several years later than when requirements were established and government mistakenly believes centralization is best where decentralization is actually more efficient.

CASES/DECISIONS

Court Rejects CAS Noncompliance Assertion and Rules SOL is not Violated

Effective Jan 1999, Sikorsky adopted an indirect cost structure that allocated indirect material costs on a direct labor base. DCAA said in its final audit report for 1999 that the change complied with the cost accounting standards (e.g. CAS 418) but in 2004 DCAA reported the accounting practices were noncompliant with CAS 418 during the fiscal year 2003 where the ACO issued a decision in 2008 saying Sikorsky owed the government $80 million for the CAS noncompliance. Sikorsky asserted not only was the accounting practice compliant with CAS 418 but the government's claim had exceeded the Contract Disputes Act's six year statute of limitations (SOL). The Court first ruled the claim satisfied the SOL because Sikorsky failed to show the government had actual or constructive knowledge of a potential claim prior to Dec 2002 when the FY 2003 Incurred Cost Proposal was submitted. As for the noncompliance itself, the Court ruled the government failed to show a direct labor base was inappropriate to apply indirect material costs. On the contrary, evidence during the trial proved compliance with CAS 418-50(e) because direct labor varied proportionately to material costs from 1999-2005 and therefore was an acceptable means of measuring resources consumed in connection with pool activities (*Sikorsky Aircraft Corp. v , Fed. Cl. No. 09-844C*).

What Does it Mean to Question Staffing Levels

(*Editor's Note. Ralph Nash in the Nash and Cibinic Report addresses fairly typical circumstances where the government questions staffing proposals during discussions that result in the contractor adding staff to their proposals after which they lose the competition because their proposed costs are too high. Several recent cases address protests that were made under these circumstances.)*

Under most of the cases Prof. Nash alludes to, the GAO has denied the protests concluding the protestors misconstrued the government's comments by not recognizing that if they believed the proposed staffing

levels were attainable they could have submitted justification for that level of staffing rather than adding staff. For example, in *Unisys Corp. (Comp. Gen. B-496326*) the government asserted during discussions the staffing levels were "insufficient" or in *AdvanceMed Corp (B-404919*) where the government stated "please provide rationale for not proposing FTE for the following labor categories" or in *Logmett LLC (B-404984*) the government said it was concerned that only one heating and air conditioning unit was being proposed. The GAO rejected protesters' contention that concerns and questions raised led them to believe more hours and HUAC units had to be added stating they were wrong because such questions and concerns did not preclude the protesters from explaining a technical approach that did not require additions staff or units. Prof. Nash states contractors should learn that when an agency raises a concern or issue, the GAO will not take this as directing an increase in staffing but offerors should treat such concerns as an invitation to explain their seemingly low support staff levels.

Court Upholds $12 Million Company Debt Against the President

Under its dredging contract, the contracting officer rejected Renda's claims against the government but sustained several claims the government pressed against Renda. An attorney incorrectly told Oscar Renda, the president and majority stockholder of Renda, the claims were invalid and so it appealed the claims it put forth but not the government claims. While the appeal was pending, Renda transferred all the $8.5 million worth of assets of the company, which was insolvent at the time, to unsecured creditors. After the district court ruled against Renda, the government commenced action against Oscar seeking to hold him personally liable under the "Priority Statute." The Priority statute, which the court states is as old as the constitution, makes a corporate officer personally liable for a company's debt if he (1) pays a nonfederal debt (2) before paying a claim of the US government (3) at a time the company is insolvent (4) if he had knowledge of the debt. The court said all these conditions were met and ruled Oscar was personally liable for $22 million of government claims.(*United States v Renda, 5th Cir., No 11-41203*).

Affiliation Exception Applies to Joint Ventures Not Prime-Subcontract Relationships

InGenesis, a small business 8(a) protégé under the mentor protégé program proposed its mentor STG as its subcontractor. Distinctive filed a size standard protest alleging InGenesis exceeded the size standard by itself. InGenesis argued that SBA regulations permit a joint venture of mentor-protégé firms to bid as a small business, assistance provided under a mentor-protégé relationship does not create an affiliation where both firms together must not exceed small business levels and assistance can apply to either joint venture partners or subcontractors. The SBA ruled that their regulations contemplate an exception to the affiliation rules only for formal joint ventures which is not the case here arguing mentor firms are supposed to provide assistance to-protégés not the other way around where a protégé provides subcontracts and other assistance to mentors (*InGenesis, Inc. SBA No. SIZ-5436*)..

No Compensation for Contractor Who Assumed Price Risks

Lakeshore performed 79 delivery orders under its Army construction services contracts where under each order it provided an estimate of costs based on unit prices under a Universal Unit Price Book (UUPB). Lakeshore subsequently sought a $2 million equitable adjustment for losses incurred by being forced to follow the UUPB where the government breached its contract by not using a price index accurately reflecting its local rates for labor, material and equipment and inflation. Lakeshore also asserted a reformation of the contract was appropriate due to mutual and unilateral mistakes about the price list. The Court sided with the government because the Army did not promise to provide prices or information on what economic consequences would occur if the price guide was incorrect. It stated Lakeshore should have known it bore the risks of the UUPB prices being too low or inflation being too high. It also rejected the mutual mistake argument asserting no mistakes of fact had occurred because Lakeshore had failed to show most of the prices were inaccurate and that no unilateral mistake occurred because mistakes in judgment are not recoverable (*Lakeshore Engrg Services v US, Fed. Cl. No. 09-865C*).

Negotiated Settlement of Backpay is Allowable

(*Editor's Note. Darryl Walker wrote in the April edition of the Beason & Nalley newsletter on a case where back-pay under some scenarios may be allowable where under others they are not.*)

An investigation by the Labor Department found that CH had violated the Service Contract Act by failing to

pay part time employees $3.59 for stipulated fringe benefits and overtime resulting in the Wage and Hour Division (WHD) of DOL ruling CH had to pay employees $268,899. CH paid its employees in the form of retroactive adjustments to prior periods where the government believed such payments were not allowable contractor costs per FAR 31.205-6(h) which makes back-pay payments expressly unallowable. CH asserted the back-pay payments made here are allowable under the exception rule of section (h) when they are required by a "negotiated settlement, order or court decree" and the underpayment is tied to "actual work performed." The scenario here for the payment was consistent with the exception where a government agency, through an investigation, found CH liable under two federal statutes and accompanying contract clauses resulting in a settlement. Comments on this case have stated auditors and ACOs will differ in their views on unallowable back-pay where they will determine costs stemming from an investigation and settlement are allowable while costs resulting from a contractor initiated determination that back-pay is justified where there is no negotiated settlement, order or court decrees would be considered unallowable and because they are "expressly unallowable" subject to penalties.

NEW/SMALL CONTRACTORS

Internal Controls and Written Policies

(*Editor's Note. With the transfer of certain traditional audit responsibilities from DCAA to the Defense Contract Management Agency (e.g. smaller proposals) DCAA is taking other audits even more seriously such as incurred cost proposals, invoice audits and accounting systems. One of the critical subparts of an evaluation of a contractor's accounting system is a determination of whether they have adequate "internal controls" and written policies. DCAA's scope of review of these two areas and what they consider to be adequate has changed considerably recently where the absence of detailed guidance leaves determinations of adequacy left to the individual auditor. Since a significant amount of our consulting work relates to ensuring contractors' accounting systems will be considered adequate much of our work revolves around these two areas so we have used both our experiences and the text Pricing and Cost Accounting to identify the critical areas.*).

Good internal controls and written policies are the cornerstone of a good accounting system. The government accounting regulations do not prescribe specific internal controls or written policies must be where auditors have wide discretion in determining strengths and weaknesses. The internal controls of most commercial companies will focus on control of cash and payables where written policies often do not exist. However, government auditors will largely focus on written policies in evaluating internal controls – whether they exist and are they adhered to. Auditors are increasingly reviewing written policies to determine whether adequate internal controls exist.

In addition to written policies addressed below, the author has identified eight internal controls that are considered essential for an adequate accounting system for government costing purposes:

1. Separation of authority between key accounting functions (e.g. payroll vs. timekeeping, requisition of materials and services vs. purchasing them, purchasing vs. accounts payable functions, billing vs. accounts receivable functions).

2. Internal reviews by management to ascertain employee compliance with its essential policies and procedures.

3. Periodic reconciliations of cost control records from the point of original entry through cost accumulation summaries to billings records and accounts receivable

4. Management authorization of critical accounting activities like issuing payroll checks, signing timesheets and requisitioning/purchasing materials and services.

5. Budget controls procedures for comparing actual costs to budgets.

6. Productivity measurements techniques to allow management to focus on problem areas and improve overall efficiencies.

7. Organizational charts to determine authority and responsibility and to provide for division of responsibilities.

8. In-house suggestion boxes and hot lines to encourage employees to make recommendations and ask questions about proper procedures or to inform management of possible areas of wrongdoing and fraud.

♦ **Written Policies and Procedures**

The focus of auditors on written policies and procedures are more pronounced now than ever. In our experience as both DCAA auditors and consultants, there used to be 5-6 policies that were considered to be essential at small to mid-sized contractors whereas additional ones may have been expected at larger companies such as majors or CAS covered firms. The essential policies covered timekeeping, expense reporting, screening unallowable costs, accumulation and allocation of indirect costs (including monitoring indirect rates during the year), basic contract costing like distinguishing direct versus indirect costs and maybe one on estimating and pricing. All companies should have written policies covering, at a minimum, these areas.

However, increasingly we are finding auditors writing up contractors for having inadequate internal controls which generally translates into having inadequate written policies addressing numerous areas. Unfortunately, there are neither regulations nor even auditor guidelines on what constitutes an adequate number of such policies and what they should cover. To complicate things more, we find individual auditors will have their own "pet" policies they consider essential for any system of adequate internal controls. The above mentioned text has identified 24 policies, which include the 5-6 discussed above, that advises contractors to have in place where we are in substantial agreement in as much as we have found numerous instances of auditors citing their absence as grounds for asserting weak internal controls . These 24 policies include:

- Definition of direct costs
- Description of indirect cost structure
- Job cost accumulation process
- Labor recording (e.g. timekeeping)
- Cost transfer between segments, if applicable
- Interim invoicing
- Preparation of incurred cost submission
- Final invoicing
- Asset capitalization
- Contract briefing
- Documentation of expenses
- Incentive compensation plans
- Paid time off
- Consultant costs
- Employee travel expenses
- Monitoring indirect cost rates
- Employee benefits
- Limitation of cost clause requirements
- Segregation of unallowable costs
- Adjustment vouchers
- Cash discounts
- Severance pay
- Closing statements
- Uncompensated overtime

Though the list would appear to be excessive for any mid-sized or even small contractor, we are finding auditors increasingly requiring such policies at more and even smaller contractors. Adequate practices in these areas are not considered sufficient – increasingly, contractors are expected to have actual written policies in the areas the auditor deems essential if they are to issue an adequate opinion on the contractor's accounting system. In fact, we have a couple more to add to the list such as prime contractors' review of requirements of subcontractors and estimating and pricing.

QUESTIONS AND ANSWERS

Q. In our Afghanistan contract there was an original CLIN through March 2012 for vehicles and then an additional CLIN was added in July 2012 for additional vehicles. We purchased some vehicles in April which leaves the question of how to treat the costs from April to July.

A. There are clear rules in the FAR addressing consistency of treating costs – "like costs in like circumstances" must be treated either direct or indirectly, not both ways. So if vehicle costs are always treated directly, then they should all be direct. If you anticipate problems being able to recover the April-August costs as a direct charge (remember, you are always allowed to make an adjustment for prior billings and claim the cost later) then you should be prepared to assert they are "like costs incurred under unlike circumstances." Your written policies should, ideally, provide that certain costs are treated sometimes as direct and sometimes as indirect where an example similar to the vehicles would be provided. If you don't feel the government will accept the costs as direct and if you don't have a policy now, I would take the chance of treating it as an overhead item. Questioned costs due to allocation issues, as opposed to allowability, do not attract penalties because they are not "expressly unallowable" so you can be more liberal in your treatment of these costs.

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Q. Can you tell me what activities related to acquiring another organization are allowable. Some activities are very clear but our staff is having difficulty with small dollar transactions.

A. Most transactions are judgmental. For example, though outside services as well as significant in-house activity related to the acquisition are unallowable, if an "immaterial" amount of staff time worked on the acquisition it is usually not unallowable. Also, though external reorganization activities are unallowable "internal reorganization activities" related to improving economies and efficiencies are allowable even if they are generated as a result of an acquisition.

Q. My company wants to implement a comp time policy for its exempt employees where if they work a lot of hours in a particular pay period we will bill the client for all hours worked but pay them their regular salary. The employee can bank his overtime and use it to take time off during less busy times. Is that OK? What happens if they terminate their employment or never use the comp time? Do I credit the labor costs of cost type contracts? What about time and material contracts?

A. As for your first question, yes your approach is sound provided employees are paid for the comp time. You probably want to establish a policy that if comp time is not used, the employee is paid for the accumulated amount say at the end of the year or at time of severance where perhaps a certain maximum amount may be transferred to the following year. Yes you could credit the cost type contracts they worked or alternatively credit the relevant indirect cost pool for the payment. As for owing anything on the T&M contracts we addressed this question in a case discussed in the last issue of the REPORT that established you would not owe the client anything on the T&M contracts.

Q. Recently one of our company vehicles met with an accident and we paid some insurance claim because of the property damage. Are costs unallowable or could we charge them where the company car was initially charged (overhead)

A. Those costs, if reasonable in amount, should be allowable. The only prohibition might be if the car is primarily for personal use or the related accident had nothing to do with business purposes. As for where to charge the cost, you could interpret it as either an insurance related cost or an auto expense cost in which case you should be consistent with how you charge those two categories of costs.

Q. I hear that bonuses or incentive compensations that are more than a certain percentage of total compensation (say over 10% but less than 20%) per employee may be deemed unreasonable without putting into consideration the reasonableness of the overall total compensation (base plus bonus).

A. I have never heard of guidance establishing a specific percentage of salary limitation as being reasonable unless a contractor has such a policy. As for questioning either the bonus or the totality of compensation that is true – the government gets "gets two bites of the apple" when reviewing bonus costs. It can determine whether the bonus itself is allowable (e.g. part of an agreement between the company and employee) and if there is no problem there it can still question some or all of it when the amount is added to the other compensation elements and if the total exceeds benchmarked survey results or OFPP caps, any excess can be disallowed.

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