NEW DEVELOPMENTS

OMB Increases Executive Compensation Ceiling

The Office of Management and Budget has set the maximum “benchmark” compensation allowable for contractor executives in Fiscal Year 2002 at $387,783. The benchmark will apply to contract costs incurred after January 1, 2002 until revised by OMB and should be used on all applicable contracts and subcontracts no matter when they were awarded.

The new cap represents a 3.6 percent increase over the FY 2001 amount of $374,228. Contractors can, of course, pay their executives more than $387,783 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 employer contributions to defined benefit plans where if they are reasonable they are allowed irrespective of the cap. The cap covers the five senior managers of a company as well as subsidiary business segments directly reporting to the corporate headquarters. 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, lower caps are likely to apply to smaller companies.

DOD Needs to Demonstrate Agreed-To Prices are Reasonable

The Director of Defense Procurement Deidre Lee issued a memo giving its acquisition officials clear marching orders to conduct thorough price analyses and reasonable price determinations when cost of pricing data is not obtained. The memo is in response to a highly critical report issued by the DOD Office of Inspector General last year asserting the Defense Department is failing to adequately ascertain whether the prices it is paying are reasonable and that the resulting prices represent overpricing of items being purchased. The memo is considered a follow-on to an earlier Commercial Item Handbook describing the range of price reasonableness tools available (at “www.acq.osd/mil/ar”). The memo reminds its audience that FAR 15.403-3 requires COs to evaluate price reasonableness and emphasizes the following:

• COs should require contractors to provide information needed to make price comparisons and analyze pricing trends, including information regarding prior prices at which the item was sold, quantities sold and other pertinent facts.

• It may be appropriate to obtain cost information to explain price increases not otherwise obtainable from market research.

• A contractor that refuses to provide information may be ineligible for award unless the head of the contracting activity determines otherwise. COs need to document the extent of their efforts to obtain needed information.

• Price analysis must be fully documented in the contract file. If circumstances require the Government to agree to a price that cannot be justified, those circumstances must also be documented so the price will not be used as a basis for future buys.

The memo also identified the major buying commands and stated they will be required to monitor their CO’s activities to assure price reasonableness.

Though the memo addresses actions for COs to take, some commentaries have stressed that contractors are in the best position to help the government meet their requirements to document price reasonableness. One commentator, Joseph Barcelona of PricewaterhouseCoopers LLP, has suggested several steps contractors can take to help COs demonstrate reasonableness:

1. Don’t claim a “commercial item” exception from submitting cost or pricing data when the government is the only customer and the product or service is not sold in substantial quantities to other federal agencies.
Rather, price history or market analysis may be made available to support a cost or pricing data exception.

2. When using a catalog price as a basis for the cost or pricing exception the contractor can supply additional information and a detailed rationale for why its price is reasonable. A contractor may want to supply sales data history and offer an explanation if its price deviates from previous sales of similar quantities under similar terms and conditions.

3. Where historical prices support an exception, the contractor may want to supply all appropriate history including historical cost and pricing data, a detailed rationale for price proposed and a detailed explanation for any price variation.

4. If the contractor has conducted market analysis, consider providing the results to the CO. For example, a price versus value analysis comparing prices to a competitor's could establish price reasonableness data even if the proposed price is higher than competitors' prices.

DCAA Issues Guidance on Consulting Costs

In response to numerous inquiries into documentation requirements establishing allowability of consultant costs under FAR 31.205-33(f), new guidance issued May 9th by the Defense Contract Audit Agency emphasizes that consulting and professional service costs are allowable only when supported in each of three categories:

1. Evidence of what work was planned;
2. Evidence supporting the invoice and;
3. Evidence of what work was performed.

In response to often excessive demands for evidence of work product, the guidance suggests the last category's requirement for evidence be moderated. “The auditor should not insist on a work product if other evidence provided is sufficient to determine the nature and scope of the actual work performed by the consultant.”

The guidance also responded to (1) assertions that only one of the three categories are required and (2) work of lawyers and CPAs under “attorney-client privilege” should be excepted. DCAA rejected both positions. In reviewing the history of the cost principle, DCAA asserts the FAR Council modification of the principle in 1989 made the three categories mandatory, not optional or alternative. It quoted the Cost Principle Committee statement “one has to check the agreement, the billings and the output and compare them against each other.”

In rejecting recommendations to exclude evidence related to attorney-client privilege, DCAA alluded to the Committee's statement that “with lawyers now involved in many areas of consulting, lobbying and other non-traditional activities such an exception could be used by contractors to avoid providing documentation for consulting costs leading to abuses.”

DCAA Guidance on Monitoring Direct Billing Vouchers

DCAA has established an audit program to monitor contractors' vouchers in order to continue participation in the direct billing program. The direct billing program allows contractors to by-pass DCAA and direct bill the agency they are doing business with. The new audit program is intended to meet DCAA's requirement to provide ongoing surveillance of direct billing contractors' paid vouchers to ensure the government can rely on the contractors' procedures for preparing invoices. A sample of vouchers submitted by large contractors will be examined each year while non-majors will be selected on a random basis each year.

The new guidance issued April 15th will be incorporated in Chapter 6-1007 of the DCAA Contract Audit Manual. The new 25 page audit program seeks to assure vouchers accurately reflect job cost reports, billing rates mirror either approved provisional rates or contract rate ceilings, vouchers include current and cumulative amounts, billing rates are adjusted to reflect actual year end allowable rates, contractors are up to date in their incurred cost submittals, fee withholds are taken when appropriate and 5% of billable costs for T&M/Labor hour contracts are withheld up to $50,000 per contract.

Proposed FAR Rule on Training and Education Costs

Under a May 15 proposed change to FAR 31.205-44 (Training), reasonable contractor costs associated with training and education will be allowable subject to the current five exceptions. The current rule is considered to be “somewhat restrictive” in that it (1) differentiates and imposes limitations on part-time college level programs, full time education and specialized programs and (2) requires full time education courses or degrees to be related to fields the employee is working in. The job relationship requirement will be eliminated since there is “minimal risk” to the government and the standard is counter to the government's initiatives supporting upward mobility, job retraining and educational advancement.
The remaining five exceptions are: (a) overtime compensation for training and education (b) costs of full-time or part-time college-level education at the undergraduate and graduate level with certain exceptions (c) grants to educational or training institutions including donation of facilities or other property, scholarships and fellowships (d) training and education costs for other than bona fide employees (except for employee dependents overseas where suitable public education is unavailable) and (e) costs of college plans for employee dependents.

Proposed FAR Changes to Miscellaneous Cost Principles

The FAR Council has proposed a variety of changes to several cost principles:

1. FAR 31.205-45 (Transportation Costs) would be deleted entirely because (1) there is no need to affirm a statement of allowability and (2) allocation questions are covered by FAR 31.201-4 (Determining allocability), FAR 31.202 (Direct costs) and FAR 31.203 (Indirect costs).

2. Sections of FAR 31.205-10 (Cost of Money) would be revised by deleting portions that either duplicate CAS 414 (Cost of Money as an Element of Cost of Facilities Capital) or record-keeping requirements at FAR 31.202-2.

3. FAR 31.205-48 (Deferred research and development) would be changed to delete the word “deferred” from the title. The rationale for the change is that costs that are unallowable under this cost principle are unallowable regardless of whether or not they are charged in the current accounting period or deferred to another period.

BRIEFLY…

House Passes Telecommuting Allowability Rule

A bill designed to support use of telecommuting by federal contractors passed the House. The bill does not require contractors to allow employees to telecommute but rather says federal agencies may not prohibit contractors from having telecommuting policies unless there is specific justification. In addition, the bill would prohibit agencies from issuing solicitations that would disqualify an offeror that utilizes telecommuting and from down-grading an offeror's proposal if it allows telecommuting. (Editor's Note. Contractors will need to factor in this green light to telecommuting when anticipating competitors' bids and whether to offer telecommuting employees in their bids.)

Protest, Claims and ADR Actions Can’t be Used to Downgrade Offers

In an April 1 memo to all federal agency senior procurement executives, Office of Federal Procurement head Angela Styles said “filing of protests, filing of claims or the uses (or non-use) of Alternative Dispute Resolution must not be considered by an agency in either past performance evaluations or source selection decisions.” The memo is in response to concerns that some source selection officials are downgrading contractors based on their protest or claims history where, for example, the Air Force has started taking into account a contractor's cooperation in resolving issues without litigation when evaluating contractors' performance. The memo further states contractors should not (1) be given “downgrades” for availing themselves of protests, claims or litigation or (2) given more positive past performance scores because they refrained from filing protests or claims or elected to use ADR procedures.

Proposed Change to FAR Compensation Cost Principle

The FAR Council has proposed changes that will amend certain sections of FAR 31.205-6, “Compensation for personal services”. None of the changes address pension costs, deferred compensation or post-retirement benefits which the FAR Council says will be addressed later. The proposed changes (1) adds a definition of “compensation for personal services” to FAR 31.2001 that mirrors some of the existing definitions of FAR 31.205-6(a) that defines it as “all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor” but deletes as unnecessary specific examples of “compensation” such as salaries, wages, fringe benefits and stock ownership plans. The change also adds (2) “limited liability companies” to the list of business owners that COs need to be concerned that compensation is not actually an unallowable profit distribution. In addition, the proposed rule (3) deletes language of FAR 31.203-3(a) that places the burden of proving reasonableness on the contractor. The FAR Council stresses the change is not intended to shift the burden to the government but the deletion is made only because it duplicates language
already found in FAR 31.201-3(a). Finally (4) paragraph h, “Backpay” is now proposed as a new paragraph (g) to emphasize that backpay for underpaid work is the only allowable retroactive adjustment except as otherwise provided in the FAR (Fed. Reg., 19952, April 23).

**Army Reinstates Contract Work Force Reporting Requirement**

After halting the often cumbersome requirements last year, the Army has reinstated the reporting requirements for tracking contractor employee hours and costs. Since recent reductions in the Army’s workforce has caused greater reliance on use of contractors’ services, Secretary of the Army Thomas White states the Army needs “credible” information to determine whether better use of outside rather than in-house support is justified. The effort will be similar to last years’ “Contractor Man-Year Equivalents”. To take some of the sting out, Secretary White has ordered that a separately priced line item in new contracts be included to recover the costs of the effort to obtain and report the data.

**DOD Withdraws Teaming Proposal**

The Defense Department withdrew its proposed rule on exclusive teaming arrangements saying the public comments received indicated there was no need for the rule. In response to criticism that certain teaming arrangements between contractors could result in anticompetitive effects, the proposal specified that certain teaming arrangements might evidence violation of antitrust laws and should be reported to the Attorney General. The comments warned the rule would delay the acquisition process and would deter contractors from entering into teaming arrangements that would otherwise benefit the government.

**CASES/DECISIONS**

**New Damage Calculation When Minimum Order is Not Made**

(Editor’s Note. Since some recent cases have ruled the minimum order quantity on ID/IQ contracts must no longer be a trivial amount but more “realistic” the following becomes more relevant in determining damages when the minimum quantity is not ordered.)

The contractor’s Army contract required the government to order at least $200,000 in supplies or services and to maintain the capability to perform work at $3,000 per day. When the government ordered and paid nothing the contractor appealed and the Board ruled, based on a prior case, that the contractor was entitled to the difference between the minimum guarantee and what the government ordered, which in this case was $200,000. The Federal Circuit court rejected the Board’s interpretation of the cited case (Maxima Corp. vs. US) and ordered the contractor was entitled to the difference of minimum amount and actual amount minus the cost of offering the minimum quantity. The Court stated the non-breaching party should be in as good a position as it would have been had it performed the contract but “should on no account get more than would have accrued if its contract had been performed.”

If the government had given the contractor the $200,000 it had contracted for it would have incurred certain costs to provide it; if the board’s formula held, the contractor would have earned an unjustified windfall (Secretary of the Army v. Delta Constr. Int’l Inc., Fed. Cir., No. 01-1253).

**“Settling-In Allowance” is Subject to $1,000 Relocation Cap**

(Editor’s Note. We frequently encounter circumstances when several types of costs can reasonably be classified in different ways. The following demonstrates how contractors treat these costs and describe them in written procedures can often lead to different conclusions.)

From 1984 through at least 1991 Contractor had provided its employees a “settling-in allowance” (SIA) in the amount of one month’s salary when they relocated and the government never challenged them. During a review of CAS 405 (Treatment of unallowable costs) in 1994 DCAA focused on the costs and asserted they should come under FAR 31.205-35(b) through (f) (Relocation costs) that considered them miscellaneous relocation costs subject to a not-to-exceed amount of $1,000 in lieu of actual costs. The contractor characterized the SIA as a kind of incentive to relocate, qualifying them as a “bonus” or “other related expenses” under the compensation cost principle of FAR 31.206-6.

The Board sided with the government. The Board stated the contractor’s Industrial Relations handbook, in its discussions of SIA, included such expenses as “installation of telephones, conversions of electrical appliances”, etc. which are similar or identical to those enumerated in the relocation cost principle of FAR 31.205-35(a)(5). Hence they should be subject to the $1,000 limit. In responding to the contractor’s assertion
they are compensation costs, the board ruled (1) the fact the contractor's SIA serves as an inducement to get its people to relocate does not disqualify them from being relocation expenses (2) the fact employees can spend the $1,000 any way they want does not mean they are not relocation costs and (3) characterizing SIA as compensation does not make them allowable if the costs over $1,000 are unallowable because the compensation cost principle states that if costs are unallowable under other principles they “shall not be allowable under this subsection solely on the basis they constitute compensation.” The Board rejected the government's attempt to disallow the costs before the 1994 audit stating “it is well established that where the government has consistently accepted and allowed a cost in the past, the Government may not retroactively disallow the cost” (Lockheed Martin Western Div. Lab., ASBCA, No. 51452).

Can’t Use Affiliate for Improving Corporate Experience Rating if its Resources are Not Committed to the Contract

Brown & Root (B&R) Services was awarded a worldwide emergency construction services contract where the request for proposal listed “corporate experience” as one of the three evaluation factors. During its evaluation the agency independently obtained information about one of B&R’s affiliated companies that had the effect of raising its corporate experience rating from “superior” to “superior plus” helping its low cost proposal win. Perini/Jones (PI) protested complaining the agency misevaluated B&R’s proposal by considering its affiliates while the government responded it was correct to include the affiliate’s experiences and for purposes of evaluation, B&R and its affiliate were the same legal entity.

The Comp. Gen. sided with PI noting an agency may attribute to an offeror the past performance or experience of a parent or affiliate only if the offeror's proposal demonstrates the resources of the affiliate will affect the offeror's performance. In this case, B&R's proposal was submitted solely in its own name and the affiliate's resources were not referenced in the proposal. Further, since B&R and the affiliate had different entity and DUNS numbers they were discrete legal entities. Since the increased rating prejudiced (i.e. harmed) PI and the price differences were not substantial, PI had a good chance of winning the award and hence prevailed in the protest (Perini/Jones, Joint Venture, Comp. Gen. Div. B-285906).

Contractor Can Recover Cost Overrun Caused by Unexpected Overhead Increase

Contractor had a five year cost plus fixed fee contract to supply support services to the Department of Health and Human Services. The contract provided for billing provisional rates and negotiating final fixed cost rates following each fiscal year. It also included the Limitation of Funds (LOF) clause that required it to give notice when it had reason to believe its expected contract costs would exceed 75 percent of allocated funds within 60 days. Eighteen months after the end of performance Contractor requested approval of final indirect cost rates for the final four months of the contract which was four months into 1997. After negotiations, Contractor submitted a voucher for $186,000 which included indirect actual negotiated overhead rates for 1997. The government returned the voucher because it represented a cost overrun. Contractor explained its unexpected high overhead rate was a result of not receiving an expected contract until the next fiscal year making its direct costs lower and its indirect rate higher. The government said its hoped-for business did not excuse its obligation to provide notice.

The Board sided with the Contractor. It relied on a “landmark decision” of General Electric which ruled the key issue is whether the overrun was foreseeable. The burden of providing it was not foreseeable rests on the contractor which must maintain an accounting and financial reporting system able to provide knowledge of probable overruns. (Editor's Note. Note that the prerequisite is an adequate accounting system – no such system and all bets are off.) In this case, Contractor did have an adequate accounting system and had it billed at actual rates for the first four months rather than at provisional rates, it still would not have had an overrun. The Board ruled the Contractor could not have reasonably foreseen at the end of four months that its overhead rate for the year would have increased so high and hence no LOF notification was required (Moshman Associates Inc., ASBCA, No. 52868).

A “Mutual Mistake” is Grounds for Recovery After a General Release

The contractor submitted a cost plus fixed fee proposal for a feasibility study that included facilities cost of capital as part of the contract cost. The contractor completed the contract and submitted a close-out proposal which mistakenly failed to include FCCOM in its actual costs. In agreeing to a modification establishing the final costs and fee, neither party was aware the total price excluded FCCOM even though
the mod included a provision releasing the government from further liability. When the contract put forth a claim for the FCCOM amount, the CO denied it (1) citing the release (2) rejecting the contractor’s claim a mutual mistake had occurred and (3) asserting the contractor was negligent in failing to include FCCOM.

The Board sided with the contractor and rejected all the government’s arguments. First, it ruled the contractor satisfied four elements needed to establish a mutual mistake: (1) no dispute that FCCOM is an allowable cost and both parties were mistaken that the total price reflected in the mod represented total actual costs (2) the mistaken belief the mod represented the total cost was the basis for the agreement (3) the mistake had a material impact on the effect of the agreement (at least $690,000) and (4) the release did not put the risk on the contractor. Second, the Court stated a mutual mistake, along with economic duress and fraud, are the limited circumstances when a claim can be prosecuted despite a general release. Finally, negligence alone was not sufficient, especially when the other party (i.e. the government) would become an unintended beneficiary (The Boeing Co. ASBCA, No. 52256).

NEW/SMALL CONTRACTORS

Basics of Uncompensated Overtime

We have been receiving frequent inquiries by our readers into what is uncompensated overtime and how it should be treated. Rather than refer readers to old articles, some more than five years, we thought it would be a good idea to update the subject incorporating new guidance and provide some of the basics of the issue.

Definition. Under the Fair Labor Standards Act overtime must be paid to hourly employees whenever they work more than 40 hours in a week but not to salaried executive, administrative or professional employees even though they often work more than forty hours per week. The Act refers to hourly employees as “non-exempt” and salaried employees (those not paid overtime) as “exempt. Uncompensated overtime (UOT) then refers to the work exempt employees perform above and beyond forty hours per week.

Worry About “Gaming.” Both the government and contractors competing for awards have reason to be concerned. The government has long been worried that improper treatment of uncompensated overtime provides the potential for “gaming” the system. Let’s consider an exempt employee who earns $1,000 per week and worked 50% of their time on cost type federal contracts and 50% on commercial work. During a normal 40 hour work week the exempt employee would likely charge $25 per hour to both projects ($1,000 divided by 40 hours equals $25 per hour).

Now consider the same exempt employee who works 50 hours during the week, 25 hours on the cost type job and 25 hours on the commercial job. The contractor may intentionally or unintentionally charge the same $25 per hour to both jobs resulting in $1,250 being allocated to direct projects while the exempt employee receives only $1,000. Alternatively, if the contractor charges only eight hours per day to projects no matter how many hours its employees work, the firm may allocate all five hours worked to the cost type contract and only three hours to the commercial contract.

Contractors also need to be concerned if some of its competitors are likely to have their employees work ten hours per day and hence bid and pay them at $20 per hour. Your firm may need to match this ten hours or continue the eight hour day and either lower benefits or risk offering a non-competitive price.

“Forty-Hour” Versus “Total Time Approach.” Numerous companies require their employees to record a maximum of eight hours per day or forty hours per week. Such “forty hour” companies have employees charge only the first 8 hours to jobs or indirect functions while others permit exempt employees to select where to assign their 8 hours. Alternatively, “total time” companies have their employees identify all hours worked and assign these hours to all cost objectives (e.g. contracts, tasks, etc.) or indirect functions.

Responding to the first “gaming” potential of allocating more costs to projects than employees are paid, many government bodies have called for mandatory total time reporting. Responding to the second “gaming” potential of evaluating offerors’ hourly rates using different UOT computations that may result in overworking employees and hence risking non-performance, other government bodies have called for mandatory eight hour recording or, at least, explicitly divulging UOT practices.

DCAA Guidance. In practice, it is generally the judgement of the Defense Contract Audit Agency that determine whether “the government” accepts or rejects the contractor’s handling of uncompensated overtime in both bidding and costing circumstances. It is important to understand DCAA’s guidance because (1)
it is, by far, the most comprehensive and (2) is, by default, the primary basis of determining proper treatment of UOT.

DCAA's Contract Audit Manual (DCAM) Part 6-410 addresses UOT. Its stated goal is to determine (1) whether a contractor accounts for all hours worked and if not, whether the government materially suffers (2) whether the contractor is allocating an "equitable share" of labor costs to government contracts (e.g. is not "gaming" the system) and (3) whether all work such as UOT is included in the base for purposes of calculating indirect cost rates.

Though some agencies have advocated it, DCAA, surprisingly, does not require total time reporting unless there is a "material" inequity from the contractor's failure to record total time. DCAM instructs its auditors to request a copy of the contractor's policy addressing UOT and make sure that the contractor's method of bidding UOT is consistent with the way it accounts for UOT. If the contractor records only forty hours per week, the auditor is to conduct a floorcheck and/or interview exempt employees to determine whether they work more than 40 hours. If there is UOT, the auditor is to suggest that full time recording is preferable. If the contractor refuses, the auditor is then encouraged to expand the floorcheck/interviews to determine whether the failure to record all hours results in a "material" difference in cost allocations to contracts. If they determine that the absence of total time reporting results in material overcharging the government, auditors are told to cite contractors for noncompliance with FAR 31.201-4 and when covered by cost accounting standards, also CAS 418.

Both FAR 31.201-4 (Determining allocability) and CAS 418 require that indirect costs bear a beneficial, causal relationship to the cost objectives to which they are allocated. In addition, the allocation base selected (i.e. direct labor, total cost, value added, etc.) must be representative of the total cost activity performed by the contractor. Since direct labor is usually at least one of the factors in the base, DCAA claims that failure to record all hours worked results in the exclusion of UOT hours from the base and thus the remaining hours in the base would not "bear its fair share of indirect costs."

DCAA has recently emphasized that materiality must be considered when citing either a CAS 418 or FAR 31.201-4 noncompliance. Materiality, however, is not defined but is left to the auditor's individual judgement. If materiality is asserted, DCAA is instructed to not only cite the contractor for noncompliance and require it to include all hours in its allocation base(s) but also recommends one of three methods for accounting for UOT:

Method 1. Calculate an average rate for each pay period, based on salary paid divided by total hours worked and allocate costs to cost objectives based on that calculated rate. In the example cited above, if the pay period was bi-weekly and the exempt employee worked 100 hours rather than the standard 80 hours, the rate to be applied to each hour worked would be $20 ($2,000 salary/100 hours).

Method 2. Assign the total hours on a pro rata basis to all cost objectives worked during the pay period. In the example, the 25 hours worked on the government contract (50%) and the 25 hours worked on the commercial contract (50%) would result in applying the same percentages of salary to the respective contracts (50% of $1,000 salary or $500 to each contract).

Method 3. Allocate costs using an estimated annual rate and credit any variance to an indirect account. In our example, if the contractor expects the exempt employee to work 2,600 hours then his hourly rate will be $20 ($52,000 divided by 2,600 hours). If actual hours vary, then the difference is added to the indirect pool if less than 2,600 hours and deducted if more than 2,600 hours.

Two variations are sometimes accepted by DCAA under certain circumstances:

Alternative Method 1. Allocate employee's hourly rate on a standard week and credit the indirect cost pool for excess hours at the same rate. In our example, charge all cost objectives at $25 per hour and if the standard work week is exceeded, credit the indirect account for each hour exceeded times the same $25 per hour.

Alternative Method 2. As a variation of Method 2 above, determine a pro rata allocation of hours worked each day and distribute the daily salary using the pro rata allocation. In the example cited above, if the pay period was bi-weekly and their $200 daily salary would be apportioned 50% to each contract for that day.

In practice, DCAA's reaction to these two alternative methods vary widely. We sometimes see complete acceptance of Alternative Method 1 while other auditors adamantly reject its use at similar type contractors, insisting on adoption of one of the three "acceptable" methods to avoid being cited for noncompliance. Sometimes one of the alternative methods are eventually accepted after DCAA determines a lack of materiality, allocations of the "credit" to all contracts
is not distortive or negotiations have demonstrated the
difficulty and high cost of implementing one of the
“acceptable” methods.

If UOT is material or you plan to bid on competitions
where you or others are likely to compute rates based
on UOT, then it is a good idea to adopt one of DCAA’s
suggested approaches. If not, you should decide on a
how you will record the eight hours (e.g. first 8 hours,
last 8 hours, 9-5 hours) and commit them to writing so
method is established and implemented.

QUESTIONS & ANSWERS

Q. Though we chose not to fight several questioned
costs, we were quite surprised to see that DCAA is also
attempting to impose penalties on many of these. Since
some penalties are triple the amount of the cost, can
you suggest some ways to challenge them?

A. First its not DCAA’s role to impose penalties – their
role is only to recommend when they believe the
conditions are appropriate. It is the contracting officers
decision to do so – they used to rarely impose them but
recent Inspector General reports criticizing the lack of
penalties are resulting in more frequent attempts to
collect penalties. The rules for waiving the penalties
are found in DFARS 231.7002-5, FAR 42.709, CAS
405 and even Chapter 6-608 of the DCAA Contract
Audit Manual.

At the least controversial level, you can avoid the
penalty by demonstrating the allocation of the penalized
costs represent less than $10,000 of costs that are
allocable to covered contracts. Also, if the contracts
are really subcontracts, then the penalty statutes do not
flow down to them even though the prime contract was
covered. Next, you can claim the inclusion of the cost
was an “inadvertent error” – the inadvertence error is a
valid defense when the contractor can establish it has
“appropriate policies, personnel training and an internal
control and review system” in place to screen
unallowable costs. Most difficult to prove but
sometimes effective is to challenge DCAA’s assertion
that the penalized costs are “expressly unallowable.”
DCAA’s interpretation of “expressly unallowable” is if
the cost questioned is clearly covered by one of the
FAR and DFARS cost principles. As we discussed in
an article in the Fourth Quarter 1999 GCA DIGEST,
court cases have ruled that “expressly unallowable”
does not apply if there was either a “reasonable dispute”
or it is not entirely certain a cost principle applies (“clear
beyond cavil”). These later challenges to what is
“expressly unallowable” have not yet been incorporated
into DCAA guidance so you will likely have an uphill
battle with them. If you are challenging some of the
costs, we frequently see the CO attempt to reach a
compromise by waiving the penalties if the questioned
costs are accepted so you may want to challenge more
“gray area” disallowances in the future.

Q. Are your publications an overhead or G&A expense?

A. Like many other costs, you have a wide latitude
unless your established practices limit you (e.g. all
publications are charged to only one indirect cost pool).
Generally, firms’ definitions of overhead and G&A are
sufficiently broad to allow either interpretation. For
example, like many other categories of expense, the
publications could be considered overhead to the extent
they help you manage contracts or G&A because they
help manage the company as a whole.