GCA REPORT
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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 2005 at $473,318 for all applicable contracts no matter when awarded. The benchmark will apply to contract costs incurred after January 1, 2005 and should be used on all applicable contracts and subcontracts for FY 2005 and beyond until revised by OMB.

The new cap represents an 8.5 percent increase over the FY 2004 amount of $432,851. Contractors can, of course, pay their executives more than $473,318 but the additional compensation will not be allowable under their federal contracts. Recent DCAA guidance stresses 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 (or 50 percentile) amount of compensation for senior executives of all surveyed corporations for the most recent year data is available. Since the surveyed companies include the top five highest paid executives of public-traded companies with annual sales over $50 million be aware that lower caps are likely to apply to smaller companies (Fed. Reg. 23888).

Air Force Notice on Defective Pricing Creates a Stir

An unsigned Air Force "Defective Pricing Notice" focusing on pricing issues related to litigation of defective pricing allegations against Science Applications International Corp. has created quite a stir in industry and government circles. The February 11 document described itself as an explanation of FAR Table 15-2 and states contractors in support of their proposed contract pricing should be required to (1) identify and provide copies of any quantitative risk analysis it conducted or any other written analysis of the risks involved in performing the anticipated work (2) identify and provide copies of minutes, briefings or reports from meeting or panels convened to review the price proposal (3) identify the nature and amount of any management reserve, risk reserve, minimum required and variance labor hours or any other contingency included in the proposed price and (4) explain the effective fee calculation or similar calculation. For contracts covered by the Truth and Negotiations Act contractors must submit to the government certain "cost or pricing data" to support negotiations regarding the contract price and they must certify the cost data submitted are current, accurate and complete. Defective pricing allegations under TINA apply only to "cost or pricing data" not management judgments and there is a long history of controversy as to what is "cost or pricing data" and what is not.

Two influential industry groups issued follow up letters March 29 and April 4 to Air Force official Charlie Williams stating the February 11 notice inappropriately "expands the definition of cost or pricing data" found in FAR 2.101 by including management judgments rather than factual information in determining whether defective pricing under TINA has occurred. The letters indicated the expanded definition of cost or pricing data constitutes a significant change and if the letter is applied to other contractors the government must follow notification and commentary procedures for changing the law. Mr. Williams responded April 13 saying the "Defective Pricing Notice" was developed to assist Air Force officials in negotiations with SAIC's ongoing litigation and had not "broader application" and did not "reflect a change in pricing policy." However a few weeks later Steven Shaw, deputy general counsel of the Air Force issued an internal memo that seemed to contradict Mr. Williams' assurances emphasizing the February 11 Notice should "apply to all TINA-covered contract actions with all contractors, not just SAIC."

GAO Report Faults Lack of Audits as Cause of Excessive MAS Pricing

(*Editor's Note. The following report is often the precursor of proposed rules to increase audit surveillance.*) A report by the General Accounting Office concluded that the General Services Administration could do a lot better job at negotiating multiple award schedules (MAS) and would save hundreds of millions by conducting pre and post-award audits of its contracts. In spite of a ten fold increase over the last ten years of MAS sales – a major component of the government's federal supply schedules program intended to use the government's purchasing power to obtain "most favored customer" pricing - reviews of contract files indicate that contract negotiators are failing to obtain such favored pricing. The GAO concludes efforts to obtain most favored customer pricing is caused by "the significant decline in the use of pre-award and postaward audits of pre-award pricing information." The report said earlier pre- and post-award audits had helped GSA negotiate and recover millions of dollars in excess pricing in the past but as the audits decreased, so did the cost savings. The report stated that pre-award audits enable contract negotiators to verify that vendor pricing information is accurate, complete and current before a contract is awarded. Post-award audits were discontinued in 1997 but the expected increase in pre-award audits did not offset the cessation as expected. The report recommended there be assurance that pre-award audits be conducted when thresholds are met for new contracts and extensions and there be guidance helping contracting officers determine when post-award audits are needed. A copy of the report is available at www.gao.gov/new.items/d05229.pdf.

In letters to the GSA, contractor and bar groups May 10 disagreed with the findings of the GAO Report and vehemently disagreed with the need to have post-award audits. They stated that findings of inadequate price analysis and documentation did not amount to a finding that resulting prices were unreasonable. Further, numerous recent improvements to the MAS program – e.g. increased competition at the order level and establishing subordinate blanket purchase agreements – were not taken into account and the GSA post-award audits under the Price Reductions clause of MAS contracts adequately protected the government's interest by providing retroactive cost recovery if price reduction to certain other customers is identified. Instituting other post-award audit rights would be inconsistent with commercial practices and would violate the intent of Congress.

OMB Says Agencies Must Publish Justifications for Use of Brand Names

The Office of Management and Budget April 11 issued a memo reminding federal agencies of the need "to maintain vendor and technology neutral specifications" and to comply with government-wide rules limiting the use of brand name specifications. Effective immediately, federal agencies must publish a justification for any use of brand name specifications when posting a solicitation. If publication of the justification is inappropriate because of national security, trade secrets or other concerns agencies should provide a copy of the written justification to the Office of Federal Procurement Policy.

The memo alludes to FAR 11.105 that states an agency may not require a particular brand name, product or feature of a product that is peculiar to one manufacturer that thereby precludes consideration by another. The only exception to this rule is if there is written justification and a particular brand name is essential to government requirements and market research indicates other similar products cannot meet agency needs or at least be modified to do so. The memo concludes that as a rule, contract specifications should emphasize the necessary physical, functional and performance characteristics of a product, not brand names.

New Study Says Outsourcing Experiences Have Been Negative

In what some commentators say can affect controversial outsourcing actions by government agencies, a new study indicates that large companies that have outsourced information technology and business process operations have been disappointed and are choosing to bring them back in-house and explore other alternatives. According to a study released April 19 by Deloitte Consulting, 79 percent of respondents indicated they have had significant negative experiences with outsourcing projects, citing increased costs and complexity as the culprits. The study participants reported that cost savings failed to materialize and unexpected complexity (e.g. 10,000 page contracts) required extensive senior management attention. In addition there were violations of intellectual property rights, employee backlash over loss of operations, diminished flexibility due to multi-year contracts and over dependence on a single vendor's services. The report identified limited circumstances where outsourcing can continue to provide useful solutions such as in rapidly changing industries where one transformed operation can be temporarily outsourced, outsourcing "commodity" functions (e.g. webhosting, mailroom operations) that are non-core to the business, and helping to spread high risk operational and financial functions (e.g. disaster recovery) but predicted outsourcing will soon lose its status as a management fad. The survey is available online at "www.deloitte.com/dtt/research".

Contractor and Bar Groups Call for Broad Consequential Damages Waiver

Contractor and industry groups expressed support for a new proposal by the General Services Administration to amend the GSA Acquisition Regulation to supplement and expand the limited waiver of consequential damages currently provided in FAR 52.212-4, Contract Terms and Conditions – Commercial Items. The proposed provisions are intended to promote commercial acquisition practices by limiting liability for commercial items that may be defective or deficient but have been accepted by the government. The contractor and industry groups hope to go further and protect contractors from consequential damages for items that have or have not been accepted. The groups encourage the change but advocate a broadening of the FAR 52.212 clause to protect companies from open-ended and unlimited liability of consequential damages that may arise from the performance of commercial services or products. They state that currently contractors include a "risk premium" in the contract price to account for potential harm for consequential damages and the government can avoid such increased costs if the contract terms completely protected contractors.

CCR is Revamped to Ensure Accuracy of Small Business Data

Businesses seeking public contracts through the Central Contractor Registration (CCR) database will no longer be able to self-certify themselves as a small disadvantaged business, 8(a) certified or HUBZone-certified business. Under a new policy issued April 22, the Small Business Administration will monitor and confirm the federal certification status of each small business listed on the CCR database. The move to increase oversight by the SBA follows a recent report by the SBA Inspector General that states of the top 1,000 federal small business contractors by dollar value, 44 were ineligible for small business contract awards resulting in $2 Billion of small business targeted contracts going to large businesses. The errors were primarily because the SBA utilized multiple award contracts which do not require agencies to obtain current size certifications where contractors self-certified their size at the time a solicitation was issued and the certification remained effective throughout the multi-year period.

Attorneys Offer Advice on Contracting with the DHS

At the third annual Homeland Securities Contracting Opportunities Conference held by the Bureau of National Affairs, several attorneys specializing in federal contracts put forth some useful insights into cost and pricing issues of doing business with the new Department of Homeland Security. Kenneth Weckstein of Epstein Becker & Green, P.C. advised once an award is made contractors should always obtain written direction from the appropriate person for all changed work that will increase the cost of performance and they should monitor all costs charged to a contract no matter what the contract type. Wechstein also reminded contractors of the two legal protections they have to minimize risk: (1) the "government contractor defense" that provides qualified immunity from tort actions arising from government contract performance where the government approved reasonably precise specifications, the contractor's equipment performed to those specifications and the contractor warned about hidden dangers in the use of the equipment and (2) the SAFETY Act of 2002 that limits liability of companies that invent "qualified anti-terrorism technologies" which bar joint and several liability for noneconomic damages and on punitive damage awards as well as a cap on liabilities.

Stephen Knight of Smith Pachter McWhorter & Allen P.C. explained that many cost and pricing issues remain unsettled and hence pose a risk to contractors. For example, DHS is placing contractors under intense audit scrutiny in handling independent research and development (IR&D) costs where the government now pursues mischarging of IR&D as fraud. He recommends that contractors establish clear IR&D cost charging principles and disclose them upfront to avoid assertions of fraud.

Wynn Revised Earned Value Management Policy to Focus on High Risk Contracts

Acting Under Secretary of Defense Michael Wynne revised thresholds of government requirements for earned value management systems – management tools which track variances in work, schedule and resources. In an internal memo to heads of the services, Wynn directed that all cost or incentive contracts, subcontracts, intra-government work agreements and other agreements valued at $20 million or more must implement the American National Standard 748, Earned Value Management Systems (ANSI/EIA-748). The effect is to lower the threshold for EVM compliance from $73 million for research, development, test and evaluation contracts and $315 million for procurement contracts to $20 million for all cost or incentive type contracts. Wynn also lowered the threshold above which a contractor's EVM system must be formally validated to $50 million. The memo states the $20 million threshold is "consistent with how industry does business." At the same time, EVM use is discouraged on firm-fixed price, level of effort and time and material contracts, regardless of dollar value. While the majority of prime contractors with the Defense Department already have validated EVM systems, the lower threshold will increase the number of subcontractors that require validated systems.

In a separate action, the FAR Council has proposed April 8 that an EVMS be used in all major federal acquisition programs government wide, using the same thresholds and ANSI/EIA 7-48 requirements discussed above.

Air Force Releases Performance/Price Tradeoff Guide

The Air Force has issued a new general guidance on the "Performance Price Tradeoff (PPT)" technique for source selection. The 15-page guide explains how and when to use PPT and provides an appendix with sample documents. The guide defines PPT as a "simplified best value source selection strategy that permits a tradeoff between price and performance in reaching an award decision." It is intended to provide discretion to source selection officials to award to higher-rated performers if a price differential is warranted by "weeding out marginal to unsatisfactory performers in favor of offerors with proven records of providing quality products and/or services on time and at affordable prices." The guide is available at www.safaq.hq.af.mil/.

Travel…

Agencies Can't Pay for Fatherly Help

(*Editor's Note. It is long established that when an employee is transferred to a new permanent duty station (PDY) it is in essence transferring the employee's entire family so travel expenses of the immediate family is reimbursable. The following identifies the reach of who is entitled to reimbursement.*)

Angela was transferred from Dallas, TX to Herndon, VA and asked her father, who did not live with her, to accompany her on the trip since she would be alone with her son in the middle of winter. Her father drove with her and flew back to Dallas where Angela submitted a request for reimbursement for travel expenses for her and her father, including his airfare back to Dallas. The government refused to pay her father's expenses. The Board ruled against Angela, noting the Federal Travel Regulation authorizes payment of travel costs to an employee's immediate family. FTR 300-3.1 defines "immediate family" as (1) spouse (2) children of the employee or spouse under 21 years of age or, regardless of age, are physically or mentally incapable of self-support (3) dependent parents (including step and legally adoptive parents) and (4) dependent brothers and sisters who are unmarried and under 21 or, regardless of age, are physically or mentally incapable of self-support. Since Angela's father was not a "dependent parent" the Board ruled he did not qualify as her immediate family (*Angela Hicks, GSBCA 16586-RELO*).

Agencies Can Pay for Food at Sponsored Conferences

(Editor's Note. Though the following circumstances apply to a government sponsored conference, we see no reason why the principles should not apply to all conferences.)

The National Institutes of Health planned on hosting a conference on latest scientific advances in treating Parkinson's disease where federal employees, grantees, contractors and private individuals would be attending. The NIH wanted to provide meals and refreshments at the event and asked the General Accounting Office for an opinion whether it could use appropriated funds to provide the food. The GAO recognized it had previously developed a test to determine allowability of appropriated funds for privately sponsored meeting where agencies may pay the costs of providing if (1) the food is part of a formal conference (2) the food is incidental to the conference (3) attendance at the time food is served is required to ensure attendee' full participation and (4) the conference includes discussions, speeches, lectures or other business that is conducted at times other than just when food is available. The GAO said all conditions were met, namely (1) the event was a "formal conference" because the event related to the agency's mission (2) the event is not organized only to accommodate the provision of food (3) meals and light refreshments will be served during essential discussions, panels and speeches and (4) substantive sessions would be scheduled when meals and refreshments will not be served (*National Institutes of Health – Food at Government-Sponsored Conferences, B-300826*).

CASES/DECSIONS

Cost Reimbursement Rules Don't Apply to Fixed-Price Contracts

ISN, a Subchapter S Corporation, had in 2000 won a claim on its cost type contract to be reimbursed for state sales income tax its shareholder rather than company had paid where the Court ruled the tax liability was merely shifted to the shareholder and did not represent an exemption that relieved the tax liability. As a result of the decision, INS submitted a claim that sought reimbursement for the tax on its firm-fixed price contracts and additional profit on its cost type contracts since the original fixed fee was based on costs that did not include the tax it had coming to it. The Court rejected ISN's claim ruling that according to FAR 16.202-1, under a fixed price contract the contractor must perform for a fixed amount of compensation, regardless of costs incurred. The Court stated "there is no such thing as 'reimbursement' of any costs in a fixed price undertaking (Otherwise, why would they call it a 'fixed-price' contract?)." The Court also rejected the claim for a greater fee because it violates the express prohibition against cost-plus-percentage-of-cost contracts. Under ISN's request, its recovery would have been based on a corresponding cost increase which is a violation of the statute (*Information Sys. Networks Corp. v US, 2005 WL 741855*).

Assessment Year Not Payment Year Governs Tax Liability

(*Editor' Note. The controversy over when accrued versus paid costs should be recognized is on-going. The following addresses taxes.*)

A property lease to the General Services Administration had a tax-adjustment clause requiring the GSA to "make annual lump sum payments to cover its share of increases in real estate taxes over taxed paid for the calendar year in which its lease commences (base year)." The real estate taxes assessed for 2000 and actually paid in 2001 had increased substantially over taxes assessed in 1999 and paid in 2000. In 2001 the landlord demanded GSA pay the increase asserting the phrase "taxes paid for the calendar year" meant taxes paid during that year, regardless of the assessment year. That interpretation maximized the landlord's recovery since it compared the lower 1999 assessment paid in 2000 with the higher payment in 2001. The government responded the phrase "taxes paid for the calendar year" meant taxes assessed for that year, not paid during the year and hence it was responsible only for the assessed taxes between 2000 and 2001.

On appeal the landlord argued the phrase "taxes paid for" was ambiguous and the ambiguity dictated the phrase be construed against the government. Further, the government's interpretation was unreasonable because it would make GSA responsible for tax adjustments the year after it vacates the leased property, leaving the landlord without leverage. The Appeals Court disagreed saying the phrase "taxes paid for" is unambiguous where in tax parlance, the phrase refers to taxes accrued during the year, regardless of when paid. As for whether the Court's interpretation would preclude recovery in the last year, the landlord has not lost its right to recover any real estate tax increase in the final year even though these taxes are paid after GSA vacates the property (*Greenwood Assocs. V. Perry, 2005 WL 407721*).

Small Business May Have More Than One Office for HUBZone Purposes

(*Editor's Note. The following ruling provides opportunities to move employees around to qualify as a HUBZone company.*)

Si-Nor claimed it was an Historically Underutilized Business Zone (HUBZone) small business because its principle office where the majority of its employees worked was located in a HUBZone location. The Government disagreed stating its headquarters, which was listed on its letterhead, was located in a non-HUBZone location and hence Si-Nor was not entitled to a price preference. The Appeals Court sided with Si-Nor ruling a company may have headquarters in a non-HUBZone location, establish a principle office – where a greater number of the firm's employees perform their duties – within a HUBZone locality and still qualify for participation in the HUBZone program (*Mark Dunning Industries Inc. v. U.S., Fed. Cl., No. 03-465(C)*.

Service Contract Act Doesn't Allow Contractor to Get Increased Costs of its Defined Benefit Plan

Rather than pay its employees the costs of equivalent benefits resulting from a change in its health insurance costs, LSI decided to provide its employees with a defined benefit plan. Under the price adjustment clause of its contract, LSI is entitled to a price adjustment only if increased costs of fringe benefits result from compliance with a Labor Department wage determination, which in this case is incorporated in the fringe benefits set forth in the collective bargaining agreement (CBA) with LSI. The CBA, which was inherited from a prior contractor that was purchased by LSI, states in detail the benefits that must be provided to workers but does not state a minimum cost contribution to be paid by the employer for defined benefit plans and hence these costs are not part of the collective bargaining process. Although the Service Contract Act provides that employees of successor contractors must receive no less than the wages and fringe benefits they were entitled to under the predecessor's CBA, the Labor Department has interpreted this requirement to be satisfied if the successor contractor provides "equivalent fringe benefits" meaning equal in terms of monetary cost to the contractor. Where the CBA does not include provision for the costs of the benefits, compliance with an applicable wage determination does not compel the contractor to incur increased costs. Since the increased costs of the defined benefit provision is not covered by the contract's price adjustment clause, the appeals board concluded LSI is not entitled to the price adjustment (*Lear Siegler Services, Inc. ASBCA No. 54449*).

Bid Protest Clock Does Not Begin on Non-Business Day

Though its work week is Monday through Friday, a clerk picked up the agency's award decision notice on Saturday, even though it was not opened until Monday. Since the bid protest rules require a protest filing within ten days of receipt or knowledge of the adverse decision, the government claimed the bid protest was untimely when measured from the Saturday the company received the notice. The Comp. General office disagreed, ruling the protester did not receive constructive or actual knowledge of the decision until the following Monday which would have made the protest timely. The Comp. Gen. stated the Saturday receipt should be considered to have been received on the next day of business or Monday (*Supreme Edgelight Devices, Inc., Comp. Gen. Dec. B-295574*).

NEW/SMALL CONTRACTORS

Gift Rule Guidelines

Government contractors are bound to strict rules surrounding gift giving to government employees where failure to abide can lead to heavy fines and penalties, periods of suspension and debarment and even criminal liability. The rules can be quite confusing due mostly to the fact that some laws focus on contractor actions while others focus on the government official's ability to accept gifts. We decided it would be a good idea to summarize the basic current rules and we have relied on an article in the February 2, 2005 edition of The Government Contractor written by Galye Firod and Lorraine Campos of Reed Smith. We recommend that business development, project managers and other relevant personnel receive copies of this article.

Laws Governing Contractor's Actions

Under the Bribery Statute (18 USCA 201(b), it is a crime to directly or indirectly give or promise anything of value to any public official with the intent to influence any official act. To find the required intent, there must be the expectation of a favorable official act in return for the gift or favor. Even if the intent is to simply generate goodwill, there is a strong presumption of ill intent. The Gratuity Statute (18 USCA 201(c) is similar to the Bribery Statute but requires a lesser degree of intent. Under the Gratuity Statute it is a crime to directly or indirectly give, offer or promise anything of value to a public official or former public official for any act performed by that official. For example, the Gratuity Statute is violated by sending an official a gift for that individual's handling of a procurement action. The act is violated where there is a "link" between the thing of value given to the official and a specific "official act" for which it is given.

The critical element of both acts is the intent of the giver of the bribe or illegal gratuity. *US v. Sun-Diamond Growers* clarified that a conviction under the Gratuity Act was improper by merely showing the donor gave the recipient a gift because of their official position. The Court adopted a more narrow interpretation holding the government must provide a link between the gift and the "specific act" for which it was given. The court based its conclusion on two grounds: (1) under the government's contention the contractor could be guilty of criminal violations by giving token gifts (e.g. a school baseball cap to the Sec. Of Education) (2) if Congress had intended to adopt a broad criminal prohibition, the statute would have explicitly said so.

Penalties for both statutes are serious for both acts - \$500,000 per organization, \$250,000 per individual or three times the amount given while the Bribery Act carries up to 15 years in prison and the Gratuity up to two years in prison. In addition, indictment or conviction can lead to suspension or debarment from government contracting and a contract may be terminated with damages of 3-10 times the gratuity cost.

Laws Governing Government Officials

Government employees are prohibited from soliciting or accepting any gift or gratuity from a "prohibited source" – does or seeks business with employee's agency, conducts activities that are regulated by the employee's agency, seeks any official action by the agency or has interests that the employee may substantially affect. The term "gift" includes any item having monetary value. It does not include modest items of food, refreshments, greeting cards, items of "little intrinsic value" (i.e. plaques, certificates, trophies) and prizes in events open to the public. There are exceptions to the rules when a gift can be accepted by a government employee and significant ones include:

Gifts of $20 or less. Under the $20/$50 rule, government employees can accept gifts on any one occasion worth $20 or less where total value of the gift from any single source cannot exceed $50 per calendar year. The gift exception does not apply to cash or investment interests (e.g. stocks, bonds) which are prohibited regardless of amount.

Gifts Based on Bona-fide Personal Relationships. Gifts based on family relationships or personal friendships are exempt from gift-giving prohibitions. If the government and contractor employee develop a relationship, it cannot convert a gift based on personal relationship. Generally, if a relationship predated the business-related contacts, gifts would be subject to less scrutiny. Also, if a contractor employee seeks reimbursement from his company it is safe to assume the gift is not based on a personal relationship.

Discounts and Similar Benefits. Government employees may accept reduced membership or other fees offered to all government employees or uniformed military personnel. The exemption only applies if the discount is offered to all employees and would not apply if there was discrimination based on rank or position. For example discounts on country club members offered to department secretaries would not apply because it discriminates in favor of high ranking officials while an employee of the Consumer Product Safety Commission may accept a $50 discount on microwave ovens offered to many organizations even if the Commission is conducting studies of the oven's safety since the discount is offered broadly.

Awards and Honorary Degrees. An employee may accept gifts, other than cash or investments, with an aggregate market value of $200 or less if the gift is given for meritorious services. However, the gift must be given from a person or organization not having interests that may be substantially affected by the employee's official duty. Gifts with a value over $200 and awards of cash or investments can be given with written permission from the ethics official of the agency (e.g. Nobel Prize for Medicine for an employee of the National Institute of Health).

Gifts Based on Outside Relationships. Employees may accept meals, lodging, transportation and other benefits based on outside relationships such as business activities of employee's spouse.

Gifts in Connection with Political Activities. Under the Hatch Act Reform Amendment, government employees may take an active part in political management or campaigns. They may accept meals, lodging, transportation and other benefits in connection with the campaign. For example, the Secretary of Interior may accept airline tickets and hotel accommodations to give a speech for a Congressional candidate.

Widely Attended Gatherings. Government employees and spouses may attend widely attended gatherings free of charge provided other attendees are also invited free of charge. "Widely attended" describes an event that is open to members from a given industry or profession or from a diverse group that is interested in the subject at hand.

Social Invitations from Other the Prohibited Sources. An employee may accept food, refreshments and entertainment, not including travel or lodging, at a social event attended by others as long as the invitation is from a person not a prohibited source and no fees are charged. For example, a DOD press official may accept an invitation to a cocktail party given by a Washington hostess who is not a prohibited source. The employee may attend even though it believes the invitation was extended because of his official position.

It should be remembered that the laws governing the government employee's acceptance of a gift covers only the government employee's acceptance of gifts not the government contractor's giving. None of the gift exceptions shield a contractor from improper bribe or gratuity giving.

QUESTION AND ANSWERS

Q. We frequently receive intra-company transfers from other affiliated business units. The transfer price is fully loaded which includes direct, overhead and G&A costs

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(but no profit) and we then add our own G&A rate when we bill the government (our G&A base includes all costs). DCAA and our contracting officer are telling us we cannot add G&A to both costs transferred into our company and transferred out to the government. What do you think?

A. They may be confusing G&A with profit. Whereas pyramiding of profits is usually prohibited, pyramiding of costs is not. We reviewed both the FAR and even the DCAA Contract Audit Manual and found no mention of G&A being prohibited to either transferred in or out prices as long as the costs that are charged G&A are included in the G&A bases of both business units. It also seems logical to allow for all allowable costs since non-intra-company prices (e.g. normal subcontracts) presumably include all costs plus a fee and there is no expectation that intra-company prices should be lower than subcontractor prices.

Q. We submitted our incurred cost proposal to DCAA and they are calling us to ask what we plan to do with our subcontracts. Are we supposed to audit them? How much effort are we expected to expend?

A. It is the prime or upper-tier subcontractor's responsibility to verify subcontractor charges on cost type or time and material contracts. The decision to audit your subcontractors or have DCAA audit them has tradeoffs to consider. If DCAA audits them, you avoid the effort and expense and your subcontractors may be more comfortable not having a potential competitor auditing their books. However, some subcontractors, especially those inexperienced in the government arena, may be intimidated by a DCAA audit. If they have questionable contract accounting practices and even weak internal controls – which is very common with newer contractors – DCAA may conclude their accounting practices are inadequate which can have a negative impact on both them as well as your ability to use them in the future.

There is really no dollar value threshold to decide who you should audit. We generally use a rule of thumb threshold value of $100,000 of subcontract costs on a $5-20 million contract where this can be adjusted for higher or lower value contracts. The most extensive audit work involves cost type subcontractors where you need to verify labor rates charged, indirect cost rates and selected other direct costs. (You may also want to look at their accounting practices to make sure they would not receive an "inadequate" accounting system opinion and alert them to significant problems.) For time and material and labor-hour subcontracts, you will want to carefully examine the subcontract to ensure correct labor rates and appropriate labor categories were charged, select high dollar material and ODC items are traceable to invoices and the total dollar value of the subcontract was not exceeded.

If you use outside help, make sure the reviewer knows something about contract auditing, which is quite different than financial auditing. If you have a good relationship with DCAA, you may want to discuss your audit plans with them since they will likely review your work and they have the authority to request additional audit investigations if they believe your efforts were not adequate.