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 2006 at $546,689 for all applicable contracts no matter when awarded. The benchmark will apply to contract costs incurred during a contractor's fiscal year 2006 and should be used on all applicable contracts and subcontracts for FY 2006 and beyond until revised by OMB.

The new cap represents a 15.5 percent increase over the FY 2005 amount of $473,318. Contractors can, of course, pay their executives more than $546,689 but the additional compensation will not be allowable under their federal contracts. 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. 26114*).

Bar and Industry Groups Urge Changes to GSA Price Reduction Clause

In separate statements responding to requests for comments on how to improve General Services Administration policies, the American Bar Association Section of Public Contract Law and two industry groups advocated changes to the price reduction clausesif not elimination of the provision entirely. The clause essentially requires that when a contractor subsequently offers more favorable prices or terms to certain commercial customers that were used as the basis for a GSA contract, it must extend the same prices and terms to the government.

According to the ABA comments, there is "considerable misunderstanding" on what the government and industry believe is the "tracking" customer – customer or group of customers that will be monitored for purposes of the price reduction clause. The confusion centers on whether the tracking customer needs to be the "most favored customer" (MFC) i.e. the customer receiving the most favorable terms and conditions from the contractor. ABA says who the tracking customer is must be negotiated and does not necessarily have to be the MFC. The ABA also addressed circumstances triggering the price reduction clause suggesting the rule be changed that would provide: (1) a change in the price/discount relationship should not trigger a change unless the change "results in a less advantageous relationship with the government" (2) only changes to the commercial pricelist that disturbs the established price/discount relationship with the tracking customer will be considered to trigger the clause (3) orders received from any customer not a tracking customer will not trigger the clause and (4) any equivalent price reduction will be applicable only upon modification of the contract and will be available to the government for the same total number of days offered to the tracking customer.

The industry groups, representing companies selling commercial products and services to the government, say the price reduction clause should be eliminated because the GSA schedule is a "commercial item contract type" while the clause is not commercial in nature. The group asserts the clause is often "mishandled" by government contracting officers who often "violate the GSA's own guidance", it is often used as a "punitive tool to punish even the most diligent schedule contractor" rather than a means of securing fair prices for the government and it "is an

anachronism" where the government marketplace is sufficiently competitive to keep prices low.

Industry Groups Issue Their Acquisition Reform Wish List for 2006

The Acquisition Reform Working Group, a coalition of numerous contractor organizations, released its 2006 legislative package which is a wish list of acquisition reforms it sends to various acquisition related committees of the House and Senate. Significant items include:

1. Limit imposing government-unique requirements in contracts for commercial items to only those clauses that implement laws or executive orders.
2. Extend cooperative purchasing authority to allow state and local governments to use all General Services Administration schedules to purchase goods and services designed to defend against terrorism.
3. Improve protection of commercially developed intellectual property rights after submission to the government and change the FAR to limit access to third parties of contractors' proprietary or confidential data.
4. Make permanent the use of simplified acquisition procedures to commercial items valued at up to $5 million.
5. Redefine commercial services to provide that if a service is of a type offered and sold in the commercial marketplace where the contractor can establish a market acceptance then it qualifies as a commercial item.
6. Allow use of sole source awards of time-and-material and labor-hour contracts to acquire commercial services.
7. Encourage greater "prudent" use of waivers to the Truth in Negotiations Act.
8. Establish uniform standards for commercial financing by creating uniform payment terms and working capital requirements.
9. Extend Prompt Payment Act interest payments by eliminating the 12-month cap on government obligations to pay interest on late payments due on proper invoices.
10. Revise the applicability of the statutory cap on allowable executive compensation by eliminating language that allows for retroactive application of the cap and replace a series of caps with a general test of reasonableness.

Suspension of Security Investigations Creates Opposition

On April 25 the Defense Security Service (DSS) stopped forwarding contractor requests for initiation of personnel security investigations to the Office of Personnel Management. The suspension of payment to OPM is due to an "overwhelming" volume of requests causing the exhaustion of FY 2006 available funds used to reimburse OPM for the investigations. Numerous industry groups are requesting DOD change its suspension and ensure sufficient funds are available in 2007 asserting the DOD mission will be "negatively impacted." In response to the shortfall, the House passed an amendment to its National Defense Authorization bill that would bar revocation of security clearances caused by the DSS suspension stating they "cannot put defense contractors in the position of having to choose between firing their employees or granting un-cleared personnel" access to classified material.

Contractors Support, Government Groups Opposes CAS Exemption for T&M and LH Contracts

Contractor groups recently expressed support for the Cost Accounting Standards Board's proposed rule to exempt time-and-material and labor hour contracts for acquiring commercial items from CAS coverage. The Council of Defense and Space Industry Associations (CODSIA) said without the exemption, the T&M and LH contracts would be awarded under FAR Part 12 procedures and would be CAS covered which would be "unacceptable" because it would adversely affect the ability to attract commercial companies to conduct business with the government. CODSIA also recommended changes to the so-called "hybrid contracts" which might otherwise qualify for CAS exemption but do not because a portion of the contract (e.g. a separate line item) requires submission of cost or pricing data or provides payment based on actual costs. Rather, CAS should apply only to those portions of the contract, not the whole thing.

The Project on Government Oversight (POGO) opposed the proposal stating it represents a "concerted effort to effectively undermine and abolish all CAS requirements." Since various indirect costs are loaded into labor rates under T&M and LH contracts, there must be some method to "ensure consistency, avoid double counting, ensure unallowable costs are excluded and a consistent cost accounting period is

used." POGO stated that the proposed rule would allow for CAS exemption of large T&M and LH task and delivery orders issued under an umbrella contract that was awarded using competitive procedures which would allow these large orders to be awarded on what is "effectively a sole source basis without protections afforded by CAS."

DCAA Issues Guidance on Contractors Using Statistical Sampling to Screen Unallowable Costs

The Defense Contract Audit Agency issued guidance to its auditors alluding to the recent changes to FAR 31.201-6, Accounting for Unallowable Costs that allow contractors to use statistical sampling as a method to identify and segregate unallowable costs. The guidance reminds auditors that if the contractor elects to use statistical sampling the revised rule encourages the contractor and cognizant Administrative Contracting Officer to enter into an advanced agreement covering the use of statistical sampling. The rule change requires the ACO to request input from the auditor before entering into such an agreement. When such input is requested, the guidance instructs auditors to contact DCAA Headquarters to obtain advice on a case-by-case basis to ensure there is consistent advice on sampling plans. The guidance also states that any unallowable costs found by DCAA should be considered part of the contractor's projected decrement to its claimed costs (*06-PAC-012(R*).

DOD Rules Finalized

The Department of Defense issued final rules on interim rules it had passed in the last year. Acquisition related final rules include:

1. Designed to reduce non-competitive awards of task and delivery orders, the same approval processes described in FAR 8.405-6 must apply to all orders in excess of $100,000 under Federal Supply Schedule (FSS) and multiple award contracts (MACs). For FSS schedule orders, DOD must solicit either all contractors offering desired services under the applicable schedules or enough contractors to ensure receipt of three offers. If three offers are not received the CO must determine in writing that no additional contractors could be identified despite reasonable efforts to do so. Waivers to these requirements can apply when there is only one source for the service, the work is a follow-on to a previously competed order and there is specific statutory language authorizing purchase from a specific source (*Fed. Reg. 14106*).

2. The final DFARS rule restricts consolidation of two or more separate requirements into a single solicitation and contract with a value exceeding $5 million. Such bundled contracts can be justified only if (a) market research "appropriate to the circumstances" determine whether consolidation is necessary and justified (b) any alternatives involving lesser degree of consolidation are considered and (c) a senior procurement executive determines the consolidation is necessary and justified because the benefits "substantially exceed" those of alternatives considered (*Fed. Reg. 14104*).

3. Citing "systemic problems" with acquiring DOD items under non-DOD contracts, the final rule would prohibit using DOD contract vehicles from acquiring goods and services through a non-DOD contract or task order valued at more than $100,000 unless certain conditions are met. These conditions are (a) it is in the best interest of DOD considering customer requirements, schedule, cost effectiveness and contract administration (b) determine that the tasks or supplies to be provided are within the scope of the contract to be used (c) ensure government funding is governed by appropriate limitations and (d) ensure the contract complies with all applicable statutes, regulations and other requirements unique to DOD (*Fed. Reg. 14102*).

DOE Will Phase Out Reimbursement of Defined Benefit and Certain Medical Plans

Citing rising costs, the Department of Energy April 27 announced a new policy that will phase out reimbursement to contractors for their costs of employees' defined benefit and medical benefit plans that are inconsistent with market based medical plans. DOE will continue to reimburse contractors for current and retired employees but for new employees, it will pay only for defined-contribution pension plans (e.g. 401(k) plans) and medical benefit plans that meet "market-based" benchmark amounts. Though DOE will negotiate with each contractor, the new policy will take effect no later than March 1, 2007.

Industry Urges Selection of CAS Board Chairman

A coalition of defense contractor organizations are urging the head of the Office of Management and Budget to appoint an acting chairman of the Cost

Accounting Standards Board so the Board can proceed with "a much needed comprehensive review" and administration of policies and procedures to implement the standards. The coalition has identified the following "initiatives" that cannot proceed without a CAS Board chairman:

1. finalizing proposed amendments to CAS 412 and CAS 415 concerning recognition of employee stock ownership plans
2. revising CAS Disclosure Statement requirements
3. revising capitalization thresholds and recordkeeping requirements in CAS 403, 404 and 409
4. amending CAS 410 that relates to the transition from a cost of sales or sales base to a total cost input base
5. revising rules regarding calculation of cost impacts when a contractor makes multiple accounting changes on the same date
6. determining where the clauses applying to CAS would apply to foreign concerns
7. exempting time-and-material and labor-hours contracts for acquisition of commercial items from CAS coverage (see article above)
8. resolving conflicts between CAS and FAR regarding what constitutes catastrophic losses
9. addressing pending legislation affecting pension cost accounting.

DOD Finalizes Policy Allowing Incremental Funding of Fixed-Price Contracts

The Defense Department finalized an interim policy in place for more than 12 years that allows incremental funding of fixed price contracts in limited circumstances. The interim rule published September 1993 stated that while full funding of fixed price contracts are preferable incremental funding was permitted on contracts funding research and development, those Congress chose to incrementally fund or when the head of the contracting activity approved it. The final rule (1) requires funding be placed on the contract as soon as possible (2) states the contractor is not authorized to perform work beyond the available funds allotted to the contract (3) requires the contractor to notify the CO at least 90 days prior to the date when, in the contractor's best judgment, work under the contract will reach the point at which the total amount payable by the government will approximate 85 percent of the total amount allotted for the contract and (4) requires the contractor, at the same time, to provide information regarding additional funding needed to continue performance (*Fed. Reg. 18671*).

DOD Allows Streamlined Procedures For Work Following OTAs

The Defense Department issued a final rule for a pilot program under which it may use streamlined contracting procedures for producing items or processes begun as prototype projects under "other transaction agreements" (OTAs). Under the new rule, contracts and subcontracts awarded under the pilot program may be treated as those for acquisition of commercial items and items or processes acquired may be treated as developed in part with federal funds and in part with private funds for purposes of defining rights in technical data. OTAs are non-contractual vehicles not subject to normal acquisition laws and regulations that are used to encourage DOD access to cutting-edge research and development by firms not ordinarily involved in government contracts (*Fed. Reg. 18667*).

CASES/DECISIONS

ASBCA Rejects Modified Total Cost Claim

(Editor's Note. Though claims should normally be based on incurred costs, it is not always possible to quantify entitlement this way. The following demonstrates when other methods may be used.)

In its claim for $65 million, Grumman used a "modified total cost method" (MTCM) because it was not able to use its otherwise acceptable cost accounting system to quantify its claim. The MTCM used was to compute the variance between the contractor's actual cost and the contract target costs, adjusting the amount for the difference between the additional costs resulting from the government's actions and those not caused by the government's action. The Appeals judge pointed out that Propellex had established that the MTCM can be acceptable when the claimant can prove four key elements in addition to the adjustment: (1) impracticality of proving its actual losses directly (2) the reasonableness of its bid (3) reasonableness of its actual costs and (4) lack of responsibility for the added costs. While Grumman satisfied the first element, the Board ruled it had failed to satisfy the other three and accordingly awarded it only $387,067 plus interest (*Grumman Aerospace Corp., ASBCA No. 48006*).

Payment for Guaranteed Minimum Must Be Offset by Costs Firm Would Have Incurred

Since the government failed to order the minimum guaranteed quantity in its indefinite delivery/ indefinite quantity contract, Bannum sought recovery of the shortfall by multiplying the contracted fixed daily rate times the shorted amount of days.

While the Board agreed there was a shortfall and hence a breach of contract, it cited *White v Delta* which states the objective in awarding damages for breach of contract is to place the contractor in as good a position monetarily as it would have been by performance of the contract. Hence, the proper basis would not be to award the total amount it would have received without the breach but rather that amount minus the variable costs that would have been incurred had the minimum amount been ordered. To do otherwise would be to place the contractor in a better position, not as good a position (*Bannum Inc., DOTBCA No. 4452*).

No Relief for Lost Proposal Because of No "Systematic Failure"

A protester whose proposal for environmental remediation services was lost by the Army Corps of Engineers was not given relief by the GAO claiming it was an isolated incident. The GAO stated relief may be appropriate when the loss of a proposal is not an isolated act of negligence but was caused by a "systematic failure" resulting in multiple or repetitive instances. Since no such systematic failure was proven in this case, the protester came away empty handed (*Project Resources Inc., GAO B-297968*).

Can Offset CAS 418 Noncompliance Increased Costs Against Decreased Costs on Fixed Price Contracts

Lockheed allocated the costs of two Cray supercomputers used for government work to two government business segments based upon an estimate of usage for the year where the variance between estimated and actual use was not allocated to the business units. The government asserted Lockheed had violated CAS 418 that addresses indirect cost allocations noting if forecasted rather than actual costs are used then contractors need to at least annually revise the estimated amounts to reflect anticipated conditions. The government claimed though the actual use of the computers changed significantly, Lockheed did not adjust the amounts charged to its business units or to affected government contracts to reflect the variance between the pre-established amounts and actual usage rate. The court sided with the government on this issue.

Though the CAS 418 noncompliance increased costs on the relevant cost type contracts, Lockheed asserted that the noncompliance resulted in cost decreases on its fixed price contracts with the result that the decreases offset the increased costs it owed due to the noncompliance. The government contended that CAS Section 306(e) prohibited the offsetting of increases on cost type contracts with decreases on fixed price contracts caused by the same accounting change while Lockheed said that section did not apply. The Court sided with Lockheed saying "there is no hint" in the regulation that requires the contractor to reimburse the government fully for cost increases on cost type contracts if the same CAS violation had the effect of decreasing costs on other fixed price contracts (*Lockheed Martin Corp. v US, Fed. Cl. No. 00-129C*). (*Editor's Note. We will discuss this case in greater detail in the next issue of the GCA DIGEST.*)

SMALL/NEW CONTRACTORS

DCAA Audits: What's Hot Now?

(*Editor's Note. Contract Management asked us several months ago to prepare an article addressing some of the hot issues the Defense Contract Audit Agency is addressing these days when examining the adequacy of contractors' accounting practices. The following is an edited version of that article designed for our readers who are expected to undergo either an accounting system survey or accounting system review.*)

In spite of a great deal of hoopla over commercial pricing in recent years, the government now requires contractors to demonstrate more than ever the adequacy of their contract costing practices. As in the past, government auditors still ask contractors to provide accurate numbers for cost reimbursement contract and subcontract work, verification of time worked and costs for time and material contracts, and cost data for fixed priced work (when price is based on costs). In addition, the government has created other priorities for increased audit scrutiny. During the last year alone, for example, various U.S. Department of Defense agencies issued urgent

memos calling for greater audit attention of contractors' financial capabilities, internal controls, expense and travel reporting, billing practices, timeliness of incurred cost submittals, treatment of uncompensated overtime, and timekeeping practices. Agency officers have also demanded that auditors do a better job of tracing labor charges to source documents, keeping track of time-and-material labor billings, monitoring actual indirect rates and screening unallowable costs.

Though individual companies can expect greater or lesser emphasis, we have identified six areas where you can expect to see heavy audit scrutiny (the original article included seven but we have excluded timekeeping from our list below since we are addressing this area separately in the GCA DIGEST).

1. *Labor Charging*. Labor charging is critical because DCAA is intensely focused on adequate internal controls (e.g., labor charging controls) in the light of recent financial scandals and findings of the President's Council on Integrity and Efficiency. Auditors want to make sure that once the employee enters his or her hours into their timekeeping system, the accounting system can reliably track the labor and costs associated with that time, and then charge the cost of that labor to the correct contract. DCAA will attempt to ensure:

- Clear visibility of labor costs through the accounting system.
- Labor distribution reports (i.e. reports that summarize employee hours by jobs) that reconcile hours entered into the system with a variety of job cost reports.
- Job cost reports that reconcile with financial statements (e.g. direct labor costs reflected in job cost reports are identiable in the general ledger).
- All reports generated by the system are consistent.

2. *Uncompensated Overtime*. Over the last five years, inspector generals in all government departments have become highly concerned about the way contractors treat uncompensated overtime (UOT). The government's concern with UOT applies to employees who are exempt from the Fair Labor Standards Act and who, therefore, are paid a set salary regardless of hours worked. It becomes relevant to the government when these employees work overtime. An exempt employee, for example, paid a salary of $1,000 per week earns $25 per hour on a 40-hour week ($1,000 divided by 40 hours). When that employee works 50 hours per week, his effective rate is lowered to $20 per hour ($1,000 divided by 50 hours).

Buying agencies of the government often have conflicting assessments over the use of UOT. On one hand, government agencies want to realize the cost savings when charged the lower dollar amount per hour worked. On the other hand, they fear that encouraging contractors to aggressively bid lower hourly rates for proposed work using UOT will result in exhausted employees who are unable to perform at peak levels. DCAA is equally concerned about costing issues related to UOT. They worry about contractors "gaming the system." For example, if the same employee works overtime, they worry that cost-type work will be charged the full $25 per hour for all hours worked, while commercial or government fixed-price work will be charged lesser amounts. In addition to determining whether contractors do or should report all hours worked, DCAA will want to make sure opportunities for gaming are minimized by allowing only three acceptable approaches for charging hourly rates to contracts and they will want to make sure that one of the following are used:

- Compute an average labor rate for each labor period based on the salary paid, divided by the total number of hours worked during the period. For example, if an employee is paid $1,000/week and works 40 hours, you charge the contract $25/hour. If he works 50 hours, you charge the contract $20/hour.
- Prorate the salary according to the number of hours worked on each contract. For example, if an employee earning $1,000/week works half her time on Contract A and half her time on Contract B, you charge $500 to Contract A and $500 to Contract B.
- Compute an estimated hourly rate for the entire year, based on the total hours the employee is expected to work. Any variance between actual salary and the amount distributed to jobs is credited to overhead. For example, if the employee earns $1000/week with no overtime, you would expect him to earn $52,000/year for 2080 hours at $25/hour. If that employee actually works 2500 hours, however, and you've charged $25/hour to the contract, more dollars have been charged than the employee has received. In that case, DCAA requires you to credit the overcharge to overhead (in effect reducing the overhead rate charged to all contracts).

3. *Indirect Rate Computations*. The government provides for full costing of contracts, including both direct and

indirect costs. DCAA, in practice, allows only certain methods for computing and allocating those indirect costs, and the agency imposes rules on how to apply rates. You can utilize a variety of indirect costing approaches. The specific decisions are usually based on such considerations as maximizing or minimizing proposed prices, administrative ease, and so forth. Auditors will examine what indirect cost structure you adopt and will make sure that it generates equitable allocations to government contracts. Common rates include:

- Overhead – one, several by location, on-site/off-site
- General and Administrative
- Service Centers
- Company-wide fringe benefit
- Material/Subcontract handling

For those contractors having cost type contracts, there is considerable emphasis these days on whether contractors have adequate procedures to "monitor" their rates - compare actual to build rates.

4. *Tracking Costs by Final Cost Objectives*. The DCAA requirement regarding what constitutes a "final cost objective" has expanded significantly in recent years. Once limited to prime and subcontracts, it has evolved to include complex teaming arrangements, task and delivery orders under contract vehicles like ID/IQ and the Federal Supply Schedule (FSS) and cost sharing arrangements. Under one contract vehicle, individual task orders may be cost reimbursable, time-and-material, labor hour, fixed price, or a hybrid mix. Cost accumulation requirements for final cost objectives are found at both the federal level and, increasingly, at state and local government levels. In order for your accounting system to receive the DCAA's highest rating of "adequate," auditors will insist that your system allow you to accomplish the following:

- Segregate, identify, and report all costs by final cost objectives.
- Isolate separately funded contract vehicles
- Report unique requirements for different pricing and costing arrangements, e.g., funding limitations on cost-type contracts (identify not only monthly but cum-to-date totals), milestones on fixed-price contracts and contract specific billing rates on T & M contracts.

5. *Screening Unallowable Costs*. With numerous legislative and inspector general offices quick to assert contractors are charging taxpayers inappropriate expenses, auditors are looking more closely than ever for unallowable costs, even if they are insignificant in amount. Now state and local governments are beginning to apply this same level of scrutiny. Demonstration of adequate screening requires you to:

- Identify and record an unallowable cost at the time it is first recorded
- Ensure unallowable costs are excluded from bids, billings, claim and termination proposals, incurred cost submittals, etc.
- Assign unallowable costs to the appropriate accounts
- Provide visibility of all transactions in accounts for scrubbing purposes
- Have the ability to provide percentage adjustments to selected accounts so only a portion of costs included in an account is screened
- Since statistical sampling techniques are now officially sanctioned by the government, use of the technique will invite scrutiny in how the methodology is used.

6. *Travel and Expense Reporting*. Next to timesheets, travel and expense reports are most critically scrutinized by DCAA. Auditors examine expense reports for unallowable costs, and in these times they give special attention to relocation and travel expenses. In striving for audit compliance, your accounting system should detail the following kinds of items:

- Identified unallowable costs (e.g., excess per diem, entertainment, first class travel) are identifiable in expense report forms and accounting system
- Proper approval of expense reports are made
- Show that individual contract limitations are followed.

QUESTIONS & ANSWERS

Q. My wife and I are owners of our company. It provides supplies and services to both the government and commercial markets and is very successful. We took very little salary in earlier years but paid ourselves a higher salary the last two years where the government is now questioning over half of our compensation as "unreasonable." They indicated that they benchmarked our salary against a survey that targeted comparable firms and questioned the difference. Can we challenge them?

A. For non-major companies (the OFPP salary cap discussed above applies to larger companies), auditors will normally consider "reasonable" compensation

GCA REPORT
P.O. Box 1235
Alamo, CA 94507

to be what an adequate survey (or average of more than one survey) says is the "average" compensation, usually measured as the mean point (or 50 percentile) of the survey(s) plus ten percent. The two most common ways of challenging their assertion is to show (1) the benchmark survey is not representative of your firm (e.g. differences in industry, location, etc.) or (2) a higher percentile is justifiable. Since you indicate the survey benchmarked appropriate firms, your best basis is to justify use of a higher percentile.

The FAR does recognize a higher compensation can be justified and interestingly, DCAA's Contract Audit Manual addresses this in Chapter 6-414(h). Here it says that a higher quartile (up to 75%) can be used if it is "justified by clearly superior performance as documented by financial performance that significantly exceeds the particular industry's average." The section goes on to list examples of what could be considered financial performance measurements such as (1) revenue growth (2) net income (3) return on investment (4) return on assets (5) earnings per share (6) return on capital (7) cost savings and (8) market share. Of course, not all of these must be chosen but one or more can be chosen where the Manual says the contractor "must show that the measure chosen is representative of the executive's performance." Two or more measurements are better where an example is provided that says higher sales but lower profit should not be considered superior performance. Justification for a higher quartile should be based on "the competitive environment in which the contractor operates." The superior performance must be based on the executive's performance and the criteria states "there should certainly be no extra compensation due to performance which results primarily from the contractor's status as a Government contractor." Also, the measure chosen to justify a higher average compensation "should be applied consistently" over several years where both increases and decreases in performance would be reflected in what is considered "reasonable" compensation.

So, the bottom line is DCAA does recognize justification for higher than average compensation and if you can show your financial performance exceeds the average of other firms in comparable businesses you could justify up to a 75 percentile. Also, your lower compensation in earlier years can show less than great performance in those years but higher compensation being justified in years where performance was better than the norm.

Q. I am being told there is a big push for the government to look for defective pricing on both prime contracts and subcontracts. How do I know if my contracts are subject to defective pricing audits.

A. Yes, you are right – there is a significant emphasis being put on defective pricing audits (they are usually called post award audits). Only those contracts and subcontracts subject to the Truth in Negotiations Act (TINA) are candidates for such review. If the dollar value of the negotiated contract/subcontract or any modification exceeded $500,000 (recently changed to $550,000), you submitted *certified* cost or pricing data and the clauses covering TINA (FAR 52.215-10, 11, 12 or 13) were included in the contract, then that contract is probably subject to TINA.

GCA REPORT · P.O. Box 1235 · Alamo, CA 94507 · (tel) 925-362-0712 · (fax) 925-362-0806 · Email: gcaconsult@earthlink.net
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