GCA REPORT

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NEW DEVELOPMENTS

OFPP Issues Clarification of the Recent Pay Cap

The Office of Federal Procurement Policy issued a memo intended to clarify certain aspects of a recent increase in the executive compensation cap to $763,029 which we reported on in the last issue. The new cap applies to FY 2011 costs incurred after Jan. 1, 2011 under defense and civilian contracts. The cap applies only to contractors' five highest paid executives. The memo adds, in conformance with the National Defense Authorization Act for 2012, the cap will be extended to all contractor employees beginning Jan 1, 2012. Contractors may pay both their executives and other employees any amount but the allowable portion will be limited by a formula based on the Securities and Exchange Commission data over a recent 12 month period where the cap is set at the median or 50th percentile of compensation for the five highest paid managers of all publically owned companies with annual sales of at least $50 million. The memo emphasized that the Obama administration has called on Congress to discontinue the formula based approach and rather peg the cap to Level 1 federal executive salaries which are currently $199,700.

New Contract-Related Interest Rate Set for Second Half of 2012

The Treasury Secretary has set a rate of 1.75% for the period July through December through June 2012. The new rate is an increase from the 2.0% rate applicable to the first six months of 2012 and is the lowest rate ever set. The Secretary of the Treasury semiannually establishes an interest rate that is then applied for several government contract-related purposes. Among other things, the rates apply to (1) what a contractor must pay the government under the "Interest" clause at FAR 52.232-17 and (2) what the government must pay a contractor on either a claim decided in its favor under the Contract Disputes Act or payment delays under the Prompt Payment Act. The rate also applies to cost of money calculations under Cost Accounting Standards 414 and 417 as well as FAR 31.205-10 and when a discount factor is used to calculate the present value of future payments (e.g. deferred compensation).

DCAA Issues Guidance to its Auditors

The Defense Contract Agency has issued several guidelines to its auditors in the last couple of months where the most significant are summarized below.

- **Audit Leads**

(*Editor's Note. You can usually expect a prior "audit lead" to result in that area being a priority area during a future audit where the lead has relevance. Though auditor actions on audit leads have been inconsistent the following steps are intended to tighten up the procedures auditors and their supervisors should take to establish the leads and make sure they are eventually addressed.*)

The new guidance provides information on (1) when to prepare audit leads (2) proper supervisory review of them (3) appropriate follow up procedures and (4) final disposition of them. Section 4-403.e of the DCAA Contract Audit Manual will be revised to clarify the responsibilities of auditors and supervisors:

1. Auditors will provide audit leads when an issue arises it believes needs to be addressed but is not in an area of its current audit. Auditors are told to provide a brief description of the lead, identify areas impacted and suggest audit steps to be taken.

2. Supervisors will review the audit lead and provide guidance on either current or follow-up actions. If the lead is part of the scope of an existing audit, the supervisor will design customized audit steps to address the lead. If the lead is not part of the scope of a current audit, the supervisor is instructed to either (a) document the specific place where the lead will be addressed in future audits or (b) immediately establish a new audit. Supervisors are now explicitly responsible for ensuring the audit leads are addressed, appropriately dispositioned and documented.

3. Final approved audit lead sheets are now to be included in the audit workpapers and field office managers will periodically review audit lead sheets to ensure actions are taken (*12-PPS-010R*).

♦ **Determining Risk of Incurred Cost Proposals**

The new guidance states that DCAA is revising its policies and procedures for reviewing and reporting on low risk indirect cost estimate (ICE) proposals. To be prepared to implement the new policies the guidance states that auditors should make every effort to evaluate the adequacy of the proposal using the new "Guide for Determining Adequacy of Incurred Cost Proposal." Once the ICE is deemed adequate auditors are told to make a risk determination using a new form that is attached to the guidance. The new form asks three questions to determine whether a contractor is high risk where a "yes" answer to any question qualifies for high risk: (1) Are there audit leads or other significant risks identified such as known business system deficiencies (e.g. accounting, purchasing, estimating, etc.) that would have a significant impact on the ICE (2) Is the ICE a new "incurred cost" contractor (i.e. no other ICEs submitted) or (3) Were there significant questioned costs in the prior year's audit. Once the procedures are in place for contractors with less than $15 million of auditable dollars, it will be expanded to those with more (*12-PPD-011R*).

♦ **Auditing Accounting System Administration of Majors and Other Large Contractors**

DCAA has issued guidance for evaluating the accounting system for major and large contractors as part of the new DFARS 252.242-7006 section covering evaluating and reporting on business systems. Audit programs for non-majors will be issued "shortly." Topics addressed by the guidance includes: (1) Audit Approach (2) Definitions and Underlying Concepts (3) Evaluating Identified Noncompliances (4) Reporting Results (5) Testing Relevant Data and Cycling of Accounting System Audits (6) Reporting Significant Deficiencies Identified in Other Business System Audits and (7) Business System Follow-Up Audits (*12-PAS-012R*).

♦ **Elimination of Non-Major Incurred Cost Audit Program**

Effective immediately, DCAA will no longer have a separate incurred cost audit program for non-major contractors where now the current major incurred cost audit program will be used to perform all incurred costs audits, whether they be at major or non-major contractors. For in-process ICE audits at non-majors, all major audit steps will be included if audit steps have not been substantially started where if they have been started auditors will determine what steps from the major audit program will need to be added. Though the guidance does not address the reasons for the change, it appears as if a review of both audit programs indicated the major audit program was more consistent with generally accepted government auditing standards (GAGAS) and hence was the preferred program for all audits (12-PPD-014R).

♦ **Performing Sufficient Testing**

DCAA has issued guidance on the testing it has determined to be necessary to comply with GAGAS to provide an adequate basis for its audit conclusions following both internal and external reviews indicating the agency was not complying with the audit standards. In brief the guidance addresses the following topics:

1. Audit Procedures. Three broad categories of procedures are identified including (a) risk assessment procedures (b) testing of relevant controls (c) substantive procedures to test specific costs to detect material unallowable costs. Examples of procedures to be used are inspection of records, observations, inquiries, etc.

2. Sufficient and Appropriate Evidence. Auditors are instructed to determine the amount and type of evidence needed. What is considered to be sufficient and appropriate evidence will depend on the circumstances. The guidance provides a separate attachment of examples of what is considered sufficient when auditing proposed direct costs, proposed indirect rates or when examining a business system.

3. Selecting Items for Testing. Once appropriate accounts or other areas are identified for review, specific items will be selected where, for example, a 100 percent review may be warranted, a judgmental selection of items may be appropriate in some circumstances but it should be accompanied by showing how the results provide adequate coverage of the universe while in other circumstances a statistical sample needs to be conducted.

4. Documenting Requirements. The guidance reminds auditors that GAGAS requires auditors to prepare "attest" documentation in sufficient detail to enable another auditor with no connection to the engagement to understand the work performed and evidence obtained to support the audit conclusion (12-PAS-015(R).

Government Reduces Conference and Travel Costs

(*Editor's Note. Steps initially taken to reduce government expenses are often translated by auditors into being the criteria for what constitutes "reasonableness" for contractors. The following actions to reduce conference and travel costs within the government stands a good chance to be considered the criteria for reasonableness for such costs for contractors.*)

The Senate April 24th passed an amendment to a postal reform bill by voice vote to limit the cost of government-sponsored conferences to $500,000. The amendment, which follows in the wake of a recent scandal over a General Services Administration conference held in Las Vegas, will limit the amount spent on a single conference to $500,000 unless the agency is the primary sponsor. It also reduces the amount an agency may spend on its conferences to 80 percent spent in 2010 and would limit to 50 the number of employees traveling to international conferences. Senior level review of all planned conference expenses over $100,000 will occur.

In a separate but related action, the Office of Management and Budget will require federal agencies starting in FY 2013 to spend 30 percent less on travel expenses than in FY 2010. Agencies will be required to maintain this reduced level of spending each year through FY 2016. A joint review by the Dept. of Defense and the GSA will review travel policies with the intent to lower travel costs where there will be either establishment or clarifications of policies to (1) increase employee sharing of rental cars (2) ensure employees receive per diem reimbursements only for their actual costs and not for costs reimbursed by another party (3) promote the identification and use of non-contract air carries that if used will result in lower total trip costs (4) promote the leverage of government purchasing power to reduce hotel and rental car expenses (5) arrange airfare timing to obtain the lowest possible prices and (6) ensure agencies have controls in place to collect refunds for unused or partially unused airfare tickets (*text of OMB memo is at http://op.bna,com/gr.nsf/r?Open=llbe-8u7pra.*

Lessons Learned From a Recent Booz Allen Office Suspension and Possible Debarment

A recent decision to suspend and possibly debar Booz Allen's San Antonio office has generated considerable commentary where the following lessons learned are put forward by Steven Gordon of Holland & Knight in the April 24 issue of Federal Contracts Report. The assertion is Booz Allen hired a retired Air Force colonel who improperly shared with other employees another contractor's bid and proposal information on the incumbent and source selection information relevant to the upcoming competition. An employee alerted Booze management who investigated the facts, terminated the colonel, decided not to compete for the follow on and reported the matter to the government. Notwithstanding these seemingly prudent actions, the office was nonetheless suspended and faces debarment. Some of the lessons learned are:

1. Beware of the Air Force. The Air Force is the most aggressive agency in initiating suspension and debarment actions. FAR 9-406-2 specifies three causes for debarment: (a) conviction or civil judgment for fraud or dishonest conduct (b) serious violation of a contract's terms or regulations (c) "any other cause" that is serious and compelling that adversely affects the contractor's responsibility. Whereas the first two have traditionally been the basis for debarment actions, the Air Force seems quite willing to use the third catchall provision.

2. All contractors, large and small, should be worried about suspension and debarment these days. Since 2003, single or multiple units within larger companies have been singled out for debarment whereas before, the entire company usually had to be taken into account.

3. Time is of the essence in responding to a problem. Though the employee reported this incident to the legal department between April 12-24, a document hold and retention order on the colonel was not issued until May 27 which the Air Force apparently found an excessive amount of time had elapsed.

4. Make sure you fully investigate and fully report the incident and gather competitive information properly. Whereas terminating the colonel and withdrawing from the competition would have been considered sufficient action in the past, it was considered inadequate now where the Air Force said Booze should have taken action against the four employees who received the information and used it to establish "baseline" business intelligence about the incumbent (e.g. labor rates, FTE hours). This underlies how difficult the critical function of gathering competitive intelligence can be. So, for example, whereas using source information from the Freedom of Information Act is acceptable, information found here was not and employees need to be trained to identify suspect information.

5. Make sure a disclosure to the government is effective. Apparently the disclosure to the customers as opposed to the Inspector General's office was deemed inadequate. (*Editor's Note. Mr. Gordan states, and we agree, that disclosure to an IG office might trigger an extensive investigation that would not otherwise occur if only reported to the customer so considerable judgment needs to be made on who to disclose information to.*)

Proposed Rule to Non-Displacement of Workers Under Service Contracts

The FAR Council May 3 issued a proposed rule to amend the FAR to provide for the non-displacement of qualified workers under federal contracts. The Council stated the rule would implement a prior executive order by President Obama and Labor Department regulations. A new FAR 22.12 section and a new clause will be added stating it is the federal government's policy to require service contractors and their subcontractors to offer employees of predecessor contractors the right of first refusal of employment for positions they are qualified for (*Fed. Reg. 26232*).

SBA Proposed Rule to Have Venture Capital Funded Firms Be Eligible for SBIR and STTR Programs

A proposed rule by the Small Business Administration would make companies that are majority owned by private equity, venture capital operating companies (VCOCs) or hedge funds eligible for awards under the Small Business Innovation Research (SBIR) and the Small Business Technology Research (STTR) programs. The rule will provide definitions of the companies and will require companies to be (a) over 50 percent owned and controlled by US citizens, permanent residence or domestic companies or (b) majority owned by multiple VCOCs, private equity or hedge funds. The proposed rule would also determine an applicant's size and eligibility when applications are submitted as opposed to current rules that apply when the award is made. The move continues prior rule changes that allowed firms owned by these investment companies to be eligible for small business set asides even though the total of all companies may exceed small business thresholds. The 2012 Defense Authorization Act extended the SBIR and STTR programs until September 2017, raised the budgets for the programs and raised the award amounts for Phase I and ll (*Fed. Reg. 28520*).

Controversy Over Changing the Definition of a Commercial Item Heats Up

The Pro-Government Project on Government Oversight (POGO) wrote the Senate Armed Services Committee stating it supported a proposal to narrow the definition of "commercial item or service." The current definition refers to those "of a type" offered for sale where the proposed change would limit the commercial item definition to goods and services that are available to the public in like quantities. The POGO representative stated current definitions lack adequate cost or pricing oversight because many such items are not competitive emphasizing that "billions of dollars are at stake" where companies can bypass requirements to have their price based on cost, resulting in the taxpayer being "gouged." As expected, most industry groups have strongly criticized the proposed change.

DOE Indicates What is Reasonable Lodging Subsidies on Long Term Temp Assignments

(*Editor's Note. The following provides some insight into what the government is likely to accept for lodging subsidies on long term assignments.*)

The Dept. of Energy Inspector General reported that $1 million in lodging subsidies for two employees working at the Princeton Plasma Physics Lab on extended temporary assignments for nine and 14 years was excessive. Recognizing there is no extended duty policy the IG report said two to three years or capping travel per diem at 55 percent of the local per diem rate would be reasonable for contractor employees. The IG recommended the establishment of department wide policies.

Final Rule Issued on Making the CAS threshold $700K

A final rule May 10 was issued in the Federal Register that revises the FAR to make the threshold for applicability of the cost accounting standards be $700,000 to implement an earlier CAS Board rule change. The CAS Board issued a rule change indicating the old threshold of $650,000 would be raised to the "Truth in Negotiations Act threshold, as adjusted for inflation." The TINA threshold is adjusted every five years for inflation. The final rule is intended to clarify that the new threshold is $700K as opposed to the TINA phrase.

DOD Issues Guidance On Pension Rule Changes

For those people who want more detailed information on recent "harmonization" rule changes to CAS 412 and 413 so that there is consistency with the Pension Protection Act the Director of Defense Pricing Shay Azad issued a letter addressing the rule we reported on in the last issue. The letter provides guidance on the relevant dates of the new rules, pension cost changes in CAS, special contract administration issues, needed changes to disclosed practices, subcontractor costs, equitable adjustments and interest rates to use for determining CAS 412 and 413 pension costs.

CASES/DECISIONS

The Government Rejects DCAA's Executive Compensation Approach a Second Time

The Board of Contract Appeals has stunningly issued a second opinion rejecting DCAA's approach to determining reasonableness of executive compensation for companies not large enough to be covered by the OFPP cap on executive compensation. The findings include:

1. The board rejected DCAA's use of multiple surveys that are weighed equally and an average is taken where it stated Metron's use of one single survey was a "best fit. Metron had performed a comprehensive analysis justifying its use of one survey (the Radford Survey).

2. Whereas DCAA rejected use of non-financial considerations in determining what percentile of a survey to use, the Board ruled both financial and non-financial factors should be considered.

3. The Board also rejected DCAA's practice of focusing only on revenue in determining how to use its surveys to benchmark compensation. The Board explicitly ruled other factors should be used such as credentials of executives and security clearances (a high percentage had post graduate degrees and top secret clearances).

4. Where DCAA considered lead engineers as non-executives because they were not designated as vice presidents, the board stated DCAA should have looked beyond their titles to their actual responsibilities and concluded their compensation should be benchmarked to VPs.

5. Whereas DCAA attempted to make adjustments to the one survey accepted by the Board to increase questioned costs, the Board ruled the expert testimony it heard indicated the adjustment were not proper.

(*Editor's Note. As we did for the first case, JA Taylor – Second Quarter 2012 - we will describe in greater detail this second decision in the next issue of the GCA DIGEST.*)

Statute of Limitations Make Government Claims Void

(*Editor's Note. With the long period between submittals of incurred cost proposals and final resolution taking more and more time the six year Statute of Limitation becomes more relevant. Here are three recent cases that are getting a lot of attention these days.*)

Under a 1999 agreement to make up for underpayments of pension costs, Raytheon received $105 million from the government and a 2005 IG audit stated Raytheon was overpaid by $25 million where the contracting officer issued a final opinion during that year. Raytheon asserted the CO's decision was void because it had not been issued within the six year statute of limitation period and the court agreed stating the government was aware of all the information on which it based its $25 million claim nine years before (*Raytheon Co. vs. US, Fed. Cl. No 09-306C*).

In 2000, Boeing submitted a revised disclosure statement stating it had revised its accounting practices and DCAA issued an audit report saying the cost impact of the change on two of its contracts resulted in an overpayment to Boeing for $6.4 million. Boeing refused to pay these costs when the CO requested them in 2003. In October 2010 the government issued a final decision demanding the $6.4 million payment where Boeing appealed saying the government had issued its final opinion over six years ago and hence the payment demand was null. The Court agreed with Boeing ruling the government's claim began to accrue in 2003, the date the CO sent a letter declaring the accounting change to be undesirable and stating the contractor was responsible for the resulting costs so the claim was time barred from collecting since the six years had been exceeded (*The Boeing Co., ASBCA No. 57490*).

Beginning with an audit of Lockheed's incurred cost submittal in 2001, DCAA asserted certain IR&D costs were directly allocable to one contract and hence were unallocable to multiple contracts according to CAS 420 and unallowable as IR&D costs under FAR 31.205-17. DCAA issued a letter to Lockheed and the ACO in 2002 recommending a downward adjustment to its G&A rate as a result of the disallowed IR&D costs and an increase in its G&A base to reflect the increased direct contract costs attributed to the direct R&D costs. It made the same findings and issued similar letters in subsequent years where in Sept. 2005 it issued a draft audit report stating Lockheed was in noncompliance with the CAS and as a result had overbilled the government. In Dec 2010 the ACO issued a demand for $40 million for the noncompliance where Lockheed appealed asserting the six year statute of limitation had been exceeded since the 2002 letters where the appeals board sided with the government saying it was not until DCAA issued its Sept 2005 audit report that the government knew or should have known that the noncompliance had resulted in overbilling to the government which made the elapsed time less than six years (*Lockheed Martin, ASBCA 57525*). (*Editor's Note. An interesting commentary we read on these cases indicate the timing of the start of the six year clock is quite confusing and inconsistent. In Raytheon, the statute of limitation clock started when the government had access to all auditable data because at that point all events and the liability should have been known while in Lockheed the clock does not start until the government determines there was an overbilling on government contracts (i.e. when DCAA informs the ACO that a noncompliance resulted in an overbilling.*)

Improper Price Realism Analysis

(*Editor's Note. The following case addresses common mistakes made when the government uses their own independent estimate – price realism analyses – to evaluate offerors' proposed prices.*)

The RFP for a fixed price contract for computer hardware services provided evaluation of prices based on technical capabilities, past performance and price of offerors. The government received seven proposals where it found DTI and SGS's proposals in the competitive range due to the non-price factors and then compared the prices of the two where its independent estimate concluded DTI's bid was unrealistically low and gave the award to SGS. In its protest, DTI argued the agency should have compared its price to all the offerors as the RFP stated where DTI stated it could offer much lower prices because it teamed with IBM, the original equipment manufacturer, who could offer lower priced spare parts for maintenance. The GAO agreed with DTI stating the government violated the RFP provisions to compare prices of all offerors which if it had, it would have not concluded DTI's price was unrealistic in as much as most of the other offers were comparable to DTI and the only outlier was SGC whose price was 20% higher than the next higher priced offer. The GAO concluded the government's price realism determination did not comport with the RFP evaluation scheme nor did it take into account the unique elements of DTI's proposal (*Digital Tech., Inc., Comp. Gen. Dec. B-406085*).

NEW/SMALL CONTRACTOR

Avoid Bonuses Being Disallowed as "Distribution of Profits"

(*Editor's Note. The following provides some useful insights in how bonuses may be disallowed because they are considered to be a distribution of profit. It is quite common for owners of small companies to forgo some compensation when profits are low or non-existent and to increase their compensation when the company can afford to do so with higher profits. The concern is heightened by a recent decision we reported on where the Board ruled a bonus was unallowable because it was deemed a "distribution of profit." This article is based on some comments on the case made by Professor John Nash in his May issue of the Nash & Cibinic Report where the prescriptions to avoid such assertions come from us.)*

In the SplashNote Systems decision we reported on in the last issue of the GCA DIGEST the CEO had received a relatively modest salary for many years but in 2005 the company made a sufficient profit to pay him a bonus of $36,000 which was added to his $82,000 salary. The contracting officer found the total compensation reasonable but nonetheless asserted the bonus was unallowable in accordance with FAR 31.205-6(a) which in part excludes a "distribution of profits." The appeals board sided with the CO ruling the profit had been paid out of profit and hence was an unallowable distribution of profit.

Professor Nash claims the decision is based on a misinterpretation of the cost principle to bar the allowability of such a bonus if it is paid out of profit resulting is an "unfair" decision that unjustly penalizes a certain class of entrepreneurs. The author makes his point by going back to communications made during consideration of the current FAR cost principle. After providing a lengthy discussion of the communication, Prof. Nash concludes the intent of the rule was to disallow bonuses only if they were not deductible under the tax law. The apparent tax rule is intended to prevent closely held companies from paying dividends through the guise of a deductible bonus business expense where the test should not be whether the bonus was paid out of profits but rather whether it was a disguised dividend.

In the SlashNote case the company called the bonus it paid a "profit sharing performance bonus." The bonus was paid to three company employees based on company performance, employee performance, the importance of the employees' contribution to company profits and the likely impact of the employee on the company's future. There was no finding in the case as to the company's ownership nor whether the bonus was a disguised distribution of a dividend where the fact it was paid to two other non-owner employees would indicate it was not a dividend which is reserved only for owners.

Prof. Nash states that in his opinion, the FAR is punishing the executives of small companies because they agree to earn a part of their compensation only when the company earns a profit. If their total compensation is reasonable, their bonuses should be disallowed only if it is clear the Internal Revenue Service had disallowed them as disguised dividends. He concludes the language in the cost principle unfortunately makes it too easy to disallow bonuses just because they are paid out of profit. This results in an unequal treatment of executives of small companies compared to executives of larger businesses.

In our consulting practice, we have found, so far, an effective protection against auditors ruling bonuses are unallowable, especially as a distribution of profits, is to clarify the practices in a written policy addressing bonuses. In that policy, you should specify conditions for having a bonus pool which commonly include the company achieving profit objectives. The policy would then describe the basis for computing the bonus pool and how it is distributed. In the policy, you will need to explicitly state it is not considered a distribution of profit or in any way a disguised dividend.

QUESTIONS AND ANSWERS

Q. (*Editor's Note. We believe the following real life situation illustrates one effective way of resolving assertions of costs unallowability and attempts to impose penalties on those costs.*) We appealed the government's final decision that a certain category of costs were unallowable and that penalties applied to those costs. After we appealed, we stopped the appeals process and agreed to a settlement that reduced our overhead rate without agreeing that the costs in question were unallowable and stipulated the agreement could not be applied in future years to assess penalties. However, I am worried that the same category of expenses, if disallowed in future incurred cost audits, will result in the three times penalty amount that are supposed to apply under certain circumstances.

A. Our client put the question to the notable attorney handling the appeal who responded that "heighted penalty provisions" found at FAR 42.709-3(b) are unlikely to occur for a few reasons. First, they apply only "when the submitted cost was determined to be unallowable for that contractor prior to submission of the proposal." This means, at the very least, that all incurred cost submissions submitted before the effective date of the settlement agreement (i.e., June 2012), should not be subject to increased penalties because you submitted those proposals and claimed these costs before the settlement agreement. Second, the FAR provides that heightened penalties occur in the following circumstances: (1) DCAA Form 1, Notice of Contract Costs Suspended and/or Disapproved or any similar notice which the contractor elected not to appeal and was not withdrawn by the cognizant Government agency; (2) a contracting officer final decision which was not appealed ; (3) a prior executive agency Board of Contract Appeals or court decision involving the contractor which upheld the cost disallowance; or (4) a determination or agreement of unallowability under FAR 31.201-6. These triggers for heightened penalties all apply in cases where there is some contractor admission or formal finding that the costs were unallowable prior to their inclusion in an incurred cost proposal.

In your case, none of the categories apply. The first two categories relate to circumstances where the contractor effectively admits, by not appealing, the government's finding of unallowability, which is not

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applicable here and the third category applies to a final decision upholding the cost disallowance, which is also not implicated here since a settlement was negotiated in lieu of a court or board decision. The fourth category relates to "mutually agreed-to unallowable costs" under FAR 31.201-6, which is also inapplicable here. The DCAA Contract Audit Manual addresses this nebulous term as specifically designated as unallowable by an agreement between the Government and the contractor and explicitly states a "mere agreement or concession by the contractor to a reduced overhead rate in the settlement process does not constitute agreement on the treatment of specific elements of cost, unless those elements of cost are specifically identified in the agreement and determined to be unallowable costs." Therefore, your settlement agreement should not be considered such an agreement where it never admits fault on your part and never admits to the unallowability of costs. Finally the prohibition of using the settlement in future years clearly shows it cannot be used to assess penalties after 2005.

Q. We are preparing an RFP and will have a related sister company as a subcontractor. We are both independent of each other and have separate tax ID numbers though owned by the same parent company. Can both companies charge fee on the contract? Our sister company would charge fee to us and we, in turn, would take their costs and add our G&A and fee to the prime contract.

A. By "fee" I assume you mean profit as opposed to a G&A cost which is sometimes also referred to as a "fee". Only one related company may add a fee on a government contract. I am unaware of any requirement saying which related company can charge the fee but it is customary (and results in more fee) that the prime or higher level company adds the fee. Of course, profit can be realized by both entities if the transfer price is based on commercial item pricing which presumably includes profit.

Q. We have a cost share agreement where we are reimbursed for training interns but not for their salaries. Are these salaries reimbursable?

A. It does not appear to be a reimbursable direct cost of the cost share agreement since it explicitly excludes salaries. However, if you can demonstrate the interns benefit other projects, it could be considered an indirect cost which is applicable to your other contracts and possibly to your current contract.

Q. We are undergoing a CAS 409 audit (Depreciation) whereas we use a 5-7 year useful life for most categories of assets (computers, software, shop equipment) while DCAA is stating we need to provide 12-15 years which we disagree with. What do you think?

A. DCAA's period seem to be extraordinarily long so I would put the burden on them to demonstrate the basis for their 12-15 years. You appear to be using IRS guidelines which are normally fine with non-CAS covered contractors whereas you need to conduct your own analysis of useful lives for each major asset class and then use that as the basis for useful lives. Make sure to exclude time that assets are out of service but not yet disposed of which DCAA may not be doing if they are conducting their own analysis.