
GCA REPORT

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NEW DEVELOPMENTS

FAR Council Finalizes Compensation Cap to All Employees

The FAR Council has adopted as final, with no changes, an interim rule issued June 2013 to expand the senior executive benchmark to all contractor employees on DOD, NASA and Coast Guard contracts. The rule enacts section 803 of the 2012 National Defense Authorization Act and amends FAR 31.205-6(p) and applies to all contracts awarded after Dec 31, 2011 for compensation costs incurred after Jan 1, 2012. The change allows companies to exempt highly skilled positions such as engineers and scientists.

Two influential industry groups assert the rule is a “significant step backward” stating it applies retroactively back to Jan 1, 2012 which constitutes a breach of contract because it is a “retroactive application to a change to a cost principle for which the government must pay damages.” The delay of 18 months in issuing the change to the FAR will require contractors to “unscramble” their accounting to make this change in allowable costs incurred during the 18 month delay and will require them to maintain more than one billing structure during 2012 and 2013. The FAR Council downplayed the criticism saying it affects a tiny minority of contractors.

New Compensation Cap Takes Effect June 24 Causing Confusion

The allowable cost limit for reimbursable compensation for contractor and subcontractor employees drops to \$487,999 for contracts awarded and costs incurred after June 24, 2014. The new limit was set by the Bipartisan Budget Act (BBA). The new cap adheres to section 702 of the BBA that revised the compensation cap to apply 180 days after enactment of the Act. The cap will apply to compensation of all employees not just senior executives where an exception can be allowed for highly skilled employees such as engineers and scientists to “ensure the agency has continued access to needed skills.” The BBA \$487,000 cap is a significant reduction over the \$952,308 set by the Office of

Procurement Policy established in 2012. The BBA was approved by the Senate on Dec 18, a day after the National Defense Authorization Act which called for a \$650,000 cap where the President signed both on Dec 26th but signed the BBA last making the lower cap apply. The BBA cap will be adjusted annually to conform to the Bureau of Labor Statistics inflation index.

Though the cap takes effect June 24, 2014 some commentators have stated they have no idea what the cap is for 2013 while others state the 2012 cap of \$952,308 will apply in 2013 unless it is changed. The OFPP has been “erratic” in establishing its mandated compensation caps where it waited until December 2013 to establish the \$952,308 cap for calendar year 2012. The confusion has been increased by other changes such as application of the cap to all employees of contractors and subcontractors with DOD, NASA and Coast Guard awards. This meant that companies doing business with these agencies as well as civilian agencies had to adjust their accounting methods to deal with different caps – one for the top five executives and one for all employees. At the end of 2014 contractors may find themselves computing one general and administrative rate for civilian agency contracts awarded by June 24, 2014, another for DOD contracts awarded before that date and yet another for all contracts awarded after June 24, 2014. It has been “a little bit of a mess” since it was not clear at the time the President signed the two bills on Dec 26th which cap would take precedence.

Executive Order Expands Pay Rules Under the Fair Labor Standards Act

A move that will expand contractors’ treatment of uncompensated overtime, an executive order has been issued that increases the pool of workers eligible for overtime pay under the Fair Labor Standards Act (FLSA). Though salaried employees are generally exempt from overtime pay requirements there is a threshold below which salaried employees must be paid overtime. Previously, the FLSA guaranteed salaried workers overtime pay if they made less than about \$23,000 per year. However, pending final rules, the new executive order is estimated to increase the threshold to approximately \$50,440 per year.

DCAA Issues New Guidance

• Labor Qualifications on T&M Contracts

The audit guidance alludes to earlier guidance that discussed the fact that auditors should question costs on time and material contracts related to labor hours for employees who do not meet the labor qualifications set forth in the contract. The guidance alludes to FAR 52.232.-7(a)(3) that states labor hours incurred to perform tasks for which labor qualifications were specified in the contract will not be paid to the extent the employees performing the work did not meet the qualifications specified in the contract unless specifically authorized by the Contracting Officer. The new guidance clarifies that contracting officers have the authority to approve use of non-qualifying labor both before and after the labor is provided and directs auditors to coordinate with COs before issuing audit findings in this area. Even in circumstances where the CO's approval has not and will not be granted the guidance states the CO is not going to withhold payment of all labor costs when an employee does not meet the labor qualifications if the work delivered adequately completed the contract scope of work. In these cases, the guidance states the CO needs to modify the contract for a new rate or a contract line item to reimburse the costs. Auditors will assist the CO in arriving at a rate that "is more appropriate than the rate charged by the contractor (e.g. a rate based on the fully burdened rate of pay for the unqualified employee or the labor category where that employee truly fits)." Some comments we have seen state DCAA is not technically qualified to make an employee qualification determination.

The guidance goes further and directs the auditor to consider whether contractors' failure to meet contract requirements constitutes weak internal controls and hence represents an inadequate accounting system where adequacy would include assurances that the contractor received CO authorization. Comments on this vulnerability to an assertion of significant deficiencies in its accounting systems have been very critical calling such prescriptions "simplistic" without considering whether the failure is material or systemic where contractors are urged to resist such auditor assertions as inconsistent with the definition of "significant deficiency" in the Business System rules (*MRD 14 PPD-008(R)*).

• Impact of Compensation Caps on Forward Pricing Audits

This guidance alerts auditors to changes to compensation limitations we discuss above and states they will affect all audits but focuses on how they will affect forward

pricing audits. The guidance alludes to (1) NDAA 2012 extension of compensation caps to all employees and (2) the Bipartisan Budget Act (BBA) cap of \$487,000 for all employees on awards made after June 24, 2014. The guidance states exemptions to the caps may apply to narrowly targeted employees such as engineers and scientists. It also states that auditors are to coordinate with ACOs to decrement proposed forward pricing rate proposals or forward pricing rate agreements if the compensation caps are not incorporated. Interestingly, the guidance does not address how contractors should implement the new ceiling leading commentators to express worry that auditors may attempt to apply the \$487,000 cap to awards made before June 24 (*MRD No. 14-PPD-004(R)*).

• Cancelling the Handbook on Fraud Indicators

The new guidance withdraws the DCAA handbook on fraud indicators because of the handbook's age and the fact that scenarios set forth in the handbook are "outdated." In place of the handbook the guidance directs auditors to "use examples of Indicators of Fraud Risk in the GAGAS Appendix Section A.10," relevant risk factors identified in earlier DCAA guidance (dated July 31, 2013) and the DODIG Contract Audit Fraud Scenarios and Resources website (*MRD, No 14-PAS-003(R)*).

• Allowability of IR&D Costs

New guidance to auditors on the Jan 2012 change to the DFARS requirement that contractors whose segments are allocated more than \$11 million of IR&D costs must report anticipated Independent Research and Development projects to the Defense Technical Information Center (DTIC) to demonstrate that projects are of interest to the DOD and hence allowable under DFARS 231.205-18. The guidance (1) confirms the reporting is for *anticipated* IR&D projects and are not required to reconcile with actual IR&D effort (2) IR&D costs are to be treated as expressly unallowable (subject to penalties) if they have not been reported in the DTIC and (3) auditors should consider whether the failure to report to DTIC constitutes weak internal controls that may result in an accounting system deficiency. Comments on this guidance worry that DCAA involvement in DTIC reporting may lead to opinions that reporting of IR&D projects may be considered to be insufficient and hence unallowable (*MRD No. 14-PAC-005(R)*).

SBA Increases Revenue-Based Size Standards for Five Years of Inflation

As of July 14, 2014 the Small Business Administration is adjusting all of its size standards that are based on revenue to account for five years of inflation since the last adjustment. There are 476 industries affected by the change. The SBA is using the Gross Domestic Product price index to obtain the best measure of inflation where it determined the amount of inflation from the first quarter of 2008 to the last quarter of 2013 was 8.73%. The SBA calculated the new size standards by multiplying the current size standards by 1.0873 and then rounded the total to the nearest \$500,000 resulting in new standards between \$5.5 million and \$38.5 million. The SBA is now required to review its size standards every five years following passage of the Small Business Jobs Act of 2010 (*Fed. Reg. 33647*).

DOL Releases Proposed Rule Setting \$10.10 As Minimum Wage for Federal Contractors

The White House and Labor Department June 12 released a proposed rule that would raise the minimum wage for workers on federal service and construction contracts to \$10.10 per hour. The proposed rule, which will be adjusted annually for inflation, is expected to affect 200,000 workers and will become final on Oct 1. The proposed rule implements Executive Order No. 13658 which the President signed on Feb. 12 and is to apply to all contracts starting Jan. 1, 2015. The proposed rule would apply to all construction contracts covered by the Davis Bacon Act, service contracts covered by the Service Contract Act, concession contracts such as providing food and service contracts such as child care. The \$10.10 will also apply to workers with disabilities where current law allows for lower wages than other workers. Tipped workers will also receive an increase, doubling their current hourly rate of \$2.13 to \$4.90 where starting in 2016 their minimum wage will climb 95 cents per year until they receive 70 percent of the prevailing minimum wage. There has been minimal comments by industry groups to the increase.

Proposed Rule Will Require Reporting Cost Data on Service Contracts

The Defense Department has proposed a rule to require service contractors to report labor hours and cost data, intended to implement a provision of the 2008 National Defense Authorization Act. The proposed rule would require contractors and subcontractors to report the data to DOD using the Enterprise-wide Contractor

Manpower Reporting Application (ECMRA) database. Contractors will submit the data either at the end of contract performance or Oct 1 of that year, whichever comes first. The proposed rule will apply to all solicitations, contracts and task and delivery orders and include commercial items exceeding the simplified acquisition threshold. Exceptions to the reporting will be for construction, lease or rental of equipment or facilities, utilities, freight and shipping and classified services. DOD says the rule is intended to “help it manage its labor force and make strategic workforce decisions.”

Industry representatives are expected to come out against the rule. The Professional Services Council states in an interview the information will not be useful to DOD where, for example, reporting labor hours is “meaningless” in fixed price contracts since extra hours do not cost the government anything where such information does not help in workforce planning.

GSA Completes Its OASIS Awards

The Government Services Administration May 15 announced the award of 74 contracts for complete professional services under its One Acquisition Solution for Integrated Services (OASIS) program which follows the GSA's award in February of 124 contracts under the small business set aside component of OASIS. Under OASIS SB all professional services contracts will be set aside for small business (the Air Force announced it will use only OASIS SB contracts) while the regular OASIS will include contracting 50 percent to small business. OASIS is intended to provide its government clients a “more flexible full service offering” that complements the GSA's multiple award schedules (MAS) where it will offer agencies new ways to meet requirements for both non-commercial and commercial professional services which will be provided through different types of contracts and pricing at the task order level. It covers a broad range of service disciplines under seven core areas: program management, management consulting, engineering, science, logistics, financial management and ancillary support. Vendors may compete in one or more of these core areas where initial terms will be for five years with a five year option. The value of the OASIS program is estimated at \$60 Billion, \$6 Billion per year. There are currently 10 protests of ASSIS SB and 5 protests lodged against the unrestricted programs so there will be no task orders finalized until these protests are resolved, estimated to be in August.

Executive Action Issued to Protect Employees' Rights To Discuss Pay Information

In action intended to detect and remove discriminatory compensation practices, President Obama signed Executive Order No. 13665 requiring government contractors to allow discussions of compensation levels without retaliation and directed the Labor Department to require reporting of summary compensation data by sex and race. The EO is intended to protect employees "from retaliation if they broach the topic of unequal compensation" by barring contractors to retaliate against employees or applicants who may discuss, inquire or disclose compensation levels. The EO does not compel employees to discuss pay levels, publish or otherwise disseminate pay data but rather provides a "tool" to increase "transparency." The EO's concurrent memo to DOL requires the agency to propose within 120 days a rule that would require federal contractors and subcontractors to submit DOL summary data on compensation paid to their employees including data by sex and race. In considering the proposed rule DOL is told to consider (1) directing enforcement toward entities where reported data suggest potential discrimination in compensation not where there is no evidence of pay violations (2) minimizing the burden on contractors and subcontractors, especially small businesses and non-profits (3) encouraging voluntary compliance with all federal pay laws and (4) avoiding record-keeping requirements and relying on existing reporting frameworks to the maximum extent possible. The Professional Services Council expressed "deep reservations" about requiring only government contractors to disclose salary practices to the DOL where they are now already heavily regulated where the president's action represents "another potentially disruptive, costly and unique requirement imposed on our industry."

What is Behind Increased Suspensions and Debarments

The General Accounting Office issued a report stating numerous federal agencies have "reinvigorated" their suspensions and debarment programs. In a Bloomberg interview with Todd Canni of McKenna and Long, he states suspensions have more than doubled from 2009 to 2013 while debarments have increased at an even faster rate. Reasons cited for the increase include (1) heightened attention by Congress has resulted in increased suspension and debarment programs at many agencies (2) programs are more aggressive where now "fact based" cases are brought forward rather than in the past relying on civil and criminal judgments and

(3) the government is casting a wider net where now agencies are pursuing action against more parties such as affiliated firms and individuals, increasing cases from one wrong doer to up to 20. Mr. Canni states the suspension and debarment officials (SDOs) "hold all the cards" where there is a relatively low burden of proof to impose suspension and debarment actions. In addition, FAR Part 9.4 vests the SDO with discretion to determine whether there is a cause for action, whether or not there is adequate evidence and where there are no independent checks on the SDO short of expensive litigation. These expanded programs do not necessarily mean there is an increase in wrongdoing but rather an increase in investigations. Nonetheless, with less government business and more competition Mr. Canni predicts there will be an increase in wrongdoing such as improperly obtaining and using information from source selection officials, bid and proposals or proprietary data. Similarly, bribes to government officials and primes receiving kickbacks from

DOD Issues Final Rule on Counterfeit Electronic Parts

The Defense Department issued a final rule on detection and avoidance of counterfeit electronic parts. Both the proposed and final rule provide that contractors who supply electronic parts or items that include electronic parts under contracts covered by the Cost Accounting Standards are responsible for "detecting and avoiding use or inclusion of counterfeit electronic parts or suspect counterfeit electronic parts." The final rule clarifies the applicability of these requirements by adding the term "electronic" to the term "counterfeit electronic part" to remove any ambiguity that the rule might be applied more broadly. The final rule also adds an intent element in defining a counterfeit electronic part as a part that "has been knowingly mismarked" to avoid fears that ordinary noncompliant parts might be considered counterfeit. The definition of "suspect counterfeit electronic part" was also revised to provide that a part is not suspect counterfeit unless "credible evidence...provides reasonable doubt that the electronic part is authentic." By adding the term "credible evidence" contractors may now conduct an investigation to determine whether a suspect part is counterfeit and once it is determined to be so, the rule disallows all subsequent costs associated with rework and corrective action. Several other notable changes to the proposed rule were also added (*Fed. Reg. May 7, 2014*).

Class Deviation Issued to Evaluate Orders Place Under GSA Schedule

The Director, Defense Procurement and Acquisition issued a class deviation allowing contracting officers to use their own determination of whether individual orders, blanket purchase agreements and other agreements have fair and reasonable pricing using proposal analysis techniques found in FAR Part 15. The class deviation was made to go around the FAR 8.404(d) provision that states since the General Services Administration has already determined that prices and rates for supplies and services offered under multiple schedule awards are fair and reasonable ordering activities are not required to make separate determinations about whether pricing is fair and reasonable. Most commentaries state the change will make it more difficult for DOD to use GSA supply schedule contracts to acquire its supplies and services.

Proposed Rule is Being Prepared to Have DOD Contractors Self-Certify Their Business Systems

Though the new proposed rule is not yet finalized an abstract has been put out that provides that the DFARS will be amended to require contractors to provide reports on their accounting systems, estimating systems and material management accounting systems regarding their compliance with DFARS system requirements. The rule is apparently being driven by DCAA who does not have the resources to adequately audit all large contractors who are covered by the business system requirements of DFARS. The change would require the contractor to hire an outside CPA firm to complete full audits of all business systems similar to those conducted by DCAA where the result will be more timely audits but increased costs for contractors. Commentators are saying contractors will have a hard time recovering the costs for these audits in the current environment of pressure to reduce indirect costs and will also have a hard time finding qualified CPA firms with the government contracting experience to conduct these audits. Though the rule is not yet published there is already increasing pressure for contractors to ensure they are in compliance with business system requirements where recently, the Department of Energy is making a move toward self-assessment of contractors' business systems.

CASES/DECISIONS

Contractors Continue to Triumph in Statute of Limitation Case

(Editor's Note. The appeals board has continued the recent trend of protecting contractors because government tardiness has exceeded the six year Contract Disputes Act's Statute of Limitations.)

The government sought to disallow \$3.8 million in Laguna's subcontracts in Iraq asserting these subcontracts were awarded without proper competition and Laguna had failed to document the reasonableness of the subcontract prices. On Dec 6, 2005 the Iraq office of DCAA issued an audit report to the Salt Lake City Branch Office concluding Laguna's subcontract management system and related internal control policies were inadequate and could not be relied upon. On Feb 9, 2006 the Salt Lake City Branch Office forwarded these findings to the ACO in a separate audit report where the government inexplicitly failed to issue a final report on the \$3.8 million claim until Dec 2012. The Board sided with Laguna's assertion the claim was barred by the CDA because more than six years had passed from the date the claim accrued. Because the government was "fully aware of" Laguna's alleged failure to document the reasonableness of the subcontract prices in both the Dec 2005 and Feb 2006 audit reports it held the government claim accrued no later than Feb 9, 2006 making the Dec. 2012 final decision more than six years (*Laguna Constr. Co., ASBCA No. 58569*).

Impasse in Negotiations Establish Right to Appeal

(Editor's Note. A formal final decision by an ACO is not the only trigger to file an appeal.)

Ensign's contract was terminated and its termination settlement proposal was not settled after numerous exchanges so it filed a notice of appeal. The government claimed the appeal board had no jurisdiction since it was not a Contract Disputes Act claim following an ACO's final decision but the board ruled it had jurisdiction because the parties had reached an impasse in negotiations. It stated an impasse occurs when an objective observer would find that continued negotiating is unwarranted or has been abandoned by the parties and the contractor has sought a final decision which was met here where the termination contractor office sent Ensign an email saying "it was apparent that negotiations will not close the gap" (*Ensign-Bickford Aerospace & Def. Co., ASBCA No. 58671*).

Federal Election Commission Rules on Election Bans in Light of Supreme Court Ruling

The Federal Election Commission rejected a legal challenge (*James vs FEC, D.D.C. No. 12-1451*) that attempted to impose a limit on total contributions to federal candidates citing the recent McCutcheon case settled by the Supreme Court 5-4 ruling that said a long standing limit on the amount a contributor can give candidates, political parties or traditional political action committees (PACs) violates the First Amendment. But in a separate case (*Wagner v. FEC, D.C. Cir. No. 13-5126*) involving the decades old ban on federal campaign money from government contractors the FEC said it would continue to defend the ban despite the McCutcheon ruling. Its lawyers said the McCutcheon case “did not address the reasons that the contractor contribution ban is justified” such as “pay-to-play” arrangements. The FEC stated the McCutcheon ruling was limited to the question of whether aggregate contribution limits are justified under the First Amendment and indicated that other restrictions on campaign contributions remain in place. The FEC attorneys said the federal ban on contractor campaign money is constitutional under the analysis used in the McCutcheon case because its objective is to prevent “corruption and its appearance” in the process of obtaining contracts which was a goal approved by McCutcheon.

Negligent Estimate Claim Survives

In its contract to provide laundry services in Iraq, Am. Gen. submitted a claim that the government negligently estimated its requirements. The government argued it was not subject to a negligent estimate claim which applies only to requirements type contracts. The board sided with Am. Gen stating negligent estimate claims may be pursued if volume estimates are material on a contract where if the estimates underlying the contract’s price were negligently estimated and Am. Gen. relied on them then a claim based on that negligence is valid (*Am. Gen. Trading & Contracting WLL, ASBCA No. 56758*).

Joint Venture Does Not Need Approval Before Contract Award

NASA issued an 8(a) set aside solicitation for facilities services and a joint venture BGI-Fiore submitted a proposal. NASA concluded BGI-Fiore was ineligible to compete because it had not been certified by the Small Business Administration for participation in the

8(a) program and BGI-Fiore protested. The GAO sustained the protest saying they should not have been excluded because 13 C.F.R. 124.513(e) allows a joint venture to compete for an award as long as the SBA approves the agreement before award is made (*BGI-Fiore JV LLC., GAO B-409520*).

NEW/SMALL CONTRACTORS

When is a Claim for a Price Adjustment Justified

We were surprised to see in our recent Grant Thornton survey summary that 83% of the respondents state the government asks them to perform work that is out of scope with the original contract and that 77% of these contractors to not request an equitable adjustment or pursue a claim for the additional costs that are expended. This is particularly startling in this budget cutting environment where every precious dollar contractors are entitled to should be pursued. Yes, there may be reasons not to pursue contract price adjustment such as fear of losing new work if you are perceived as nitpicking but we find such fears often misplaced. Contracting personnel are used to dealing with contractors who go after funds they are entitled to (they often suggest it in the first place) where fears of them being angry are highly exaggerated. We believe contractors need to be more aware of when there is out of scope work ordered by their customer and more aggressive in requesting more funds for that work, especially in this environment of less contracts and subcontracts and pressure to lessen profit on work that is awarded. We have asked an attorney colleague of ours who specializes in claims for out of scope work, Tim Power of the Law Offices of Timothy Power, to revisit this issue to provide some simple guidelines on when equitable adjustments are valid and here is his response.

Though there are usually a long list of regulations and rules affecting a government contract it is not necessary to know them to spot a potential claim. A few questions can help clarify when you are eligible for a claim against the government.

1. *Is the performance of the contract different than I planned when I bid the job?* If yes, and the difference in performance is increasing the time or cost of performance, then you have valid grounds for a claim against the government for the additional time or cost to perform the contract.

2. *What factors are causing the difference in performance?* The key to identifying entitlement and presenting your claim is to identify the specific causes for any changes in the performance. You should thoroughly investigate the causes for a delay, additional costs or why performance is different than you intended when you bid.

3. *Was I missing crucial information that would have changed the way I bid the contract?* During the bid phase, the government has an obligation to tell you about information it has that impacts the costs or methods of performance. This is especially true if the government knows you do not have the information or that it is unlikely you will learn about the information while you are preparing your bid. The information could be about the site (e.g. history of flooding) or about the process of performance (e.g. problems encountered by previous contractors providing the service or product).

4. *Did anything change from the time I bid, when I started performance or since?* This might include changes on a site for service or construction type contracts or changes to government budgets or policies.

5. *Do I interpret a contract requirement differently than the government?* Differences in interpreting contracts are endless – time of performance, product or service to be provided, method of production or construction, etc. There are numerous rules about interpreting contract terms all starting with a common sense approach to interpretation. If the government's interpretation seems unreasonable or far-fetched, you should investigate further.

6. *Are the government's inspections of my work reasonable and according to the standards required by the contract?* The contract contains specifications and drawings for how the work will be performed. Other sections of the contract contain inspection standards that define how the government will inspect the work to determine acceptability. This latter section does not define the work required. Sometimes, however, inspectors will measure or consider work that is not required by the contract merely because there is an inspection standard listed.

7. *Has the government caused the difference in performance?* The strength of your claim and how much you recover may depend upon the cause for the different performance. Generally, the government must be the cause of the difference. Therefore, a critical step in determining the existence of a claim is to establish the government has, in some way, caused the difference in performance.

QUESTIONS & ANSWERS

Q. We are reluctant to provide a breakdown of costs on our subcontract invoices since it will divulge our rate structure and amounts to our prime who we may compete against in the future. What can we do?

A. If you are likely to compete with your prime, that's a good argument not to divulge a breakdown of costs on your invoices. However, if the government is requiring it of all cost type subcontracts its hard to fight that. Perhaps you can submit an invoice to the prime identifying the total of burdened costs and a separate one to the government identifying a cost breakdown. It is dependent on what you can negotiate.

Q. We agreed to the "take it or leave it" offer from the government for our FY 2007 rate settlement. The changes we agreed to will have a ripple effect - we will need to apply the same criteria to all our subsequent ICE's that are on file. This means that we will have to re-submit and "re-certify" each ICE as of the date of re-submission (DCAA will not audit an ICE that is not certified as of the date of submission). I believe DCAA will take this to mean that their 6-year audit performance window under the Statute of Limitations provisions now begins from the re-certification date, not the original date.

A. You raise a question that I do not think has been clearly resolved in the courts - whether the new submission is simply a minor revision of the original submission (and the original date applies) or represents an entirely new submission where the new date applies. If DCAA is insisting on the later date, there is probably not much of a basis to challenge them other than to assert in your cover letter (and hence put yourself on the record) that you believe it is a minor revision to the original submission so if subsequent cases rule in your favor you have a basis to claim the earlier date.

Q. We have a government SBIR CPFF contract for which we subcontracted a vendor for foundry services under a CPFF arrangement. I know that we are required to monitor our subcontracts, but I do not know to what extend and how to go about it.

A. The regulations are general and do not provide a great deal of practical guidance. They say, for example, it is the prime's responsibility to audit their subcontractors, make sure they have an adequate accounting system, their invoices are accurate, etc. Sometimes, DCAA provides the audit function, but less and less these days, at least on a timely basis. You can request they audit your subcontractor. Alternatively, you will contract with CPAs

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like us (make sure they have DCAA audit-like experience) to do the audit where the parties, if the subcontractor is reluctant, agree not to divulge subcontractor information to the prime but rather will put forth a position on the amount claimed (e.g. question \$X dollars of overhead, \$Y of direct labor).

Q. We have a multi-year lease with increasing rent each year. GAAP requires that the rent expense be straight-lined over the life of the lease, therefore, there is more expense recorded than cash paid in the first half vs. the second half of the lease (e.g. 3 yr lease at \$12 – \$14 - \$16 over three years would be straight-lined at \$14 each year). The auditor argued that we were overcharging the government in the first years. We were able to demonstrate to another auditor the straight line charges was a GAAP requirement and DCAA accepted our costs. What do you think?

A. Its not always clear cut. You're lucky it was resolved around GAAP. Some auditors cling to the position of the original auditor that allows costs only up to the cash payments. They will claim there are several examples of GAAP costing that is not accepted by government contract accounting requirements.

Q. You helped us on some compliance issues a few years ago. We are submitting a proposal where we would be supplying some standard parts for an aerospace customer that is under contract with the government. Our profit after cost for the parts is 4.5%. This is a simple pass-through of material but it does require receiving it, source inspection, securing documentation and processing the documentation through our customer system which is a standard procedure. I guess I'm curious that if the profit is 4.5% and this is a pass-through transaction, would applying G&A be overkill? How can this be handled without undue time and cost? This is not a sole source bid. There are 4-5 companies quoting on this.

A. As I remember, you have a total cost input base for your G&A rate that includes all material, including the material you want to pass through. Hence you would be entitled to apply a G&A rate to the material plus any negotiated profit. However, it appears as if you don't want to do this for competitive reasons. If so, you can voluntarily lower the G&A rate to a rate you believe would be acceptable to your client by, for example, lowering the G&A pool of costs by offering a "management concession." Though it might impede your desire for a speedy result, you could try to obtain a forward agreement where you agree not to charge G&A to certain "pass through" items and in exchange, ensure such material costs can be excluded from your G&A base.

Q. We subscribe to your newsletter and I have a question I am hoping you can help me with. We have primarily CFFF type contracts. I understand that the fee dollars are supposed to be fixed, regardless of what your cost ends up being, and that billing throughout the period of the contract is based on percentage of cost. What I am confused about is what prevents a contractor from deciding to run all of their contracts at below their original estimated cost in an attempt to essentially gain a higher percentage fee?

A. Unless a contract stipulates that the fixed fee is based on a range of costs to be adjusted if you fall below or above that range, then you are right. You could estimate costs on the high end to negotiate a higher fixed fee and then get a higher percentage fee when actual costs are below those estimated. Of course, such a practice may be visible in your ICE submittals so the pattern of overestimating costs could result in a decrement of estimated costs on future contracts when it comes to calculating your fee percentage not to mention making you vulnerable to estimating deficiency assertions.