// GCA Report
(A publication of Government Contract Associates)
November - December 2005 Vol 11, No. 6

NEW DEVELOPMENTS

Proposed Changes for Payments and Appropriate Use of T&M and LH Contracts

The FAR Council has proposed numerous significant changes to the Federal Acquisition Regulation for payments for non-commercial time and material and labor hour (T&M/LH) contracts and when use of T&M/LH contracts are appropriate for commercial items. Payments changes under FAR Case 2004-015 include:

Billing Subcontractor's labor. At the root of a proposed change to FAR 52.232-7, "Payments Under T&M and LH Contracts" is whether the government will pay for subcontractors' efforts based upon the contract's fixed hourly rates or on the prime contractor's actual costs. The new rule would require listing subcontractors, in the payments clause for the prime contractor, to be paid using contract rates for that effort. If the subcontractor is not listed, it would be treated as an "other direct cost" (ODC) and the government would pay only the amount invoiced by the subcontractor and any relevant indirect costs but no profit. For indefinite-delivery contracts, the contracting officer would include language in the FAR payment clause stating the subcontractors performing direct labor hours would be listed in each task order. The change requires the prime contractor be vigilant about listing the subcontractors in the FAR payment clause and failure to do so risks the government's refusal to pay for subcontract effort on the basis of contract rates.

The FAR payments clause provides for payment at the contract's hourly rate for "direct labor hours performed." This language is commonly interpreted to encompass prime and subcontractor efforts where, for example, blended rates may be based on the assumption that both prime and subcontractors, efforts will be covered by the contract labor rates. In contrast, the clause also addresses "materials and subcontracts" and states that a prime contractor will be compensated for this effort, which is often called ODC, on a cost reimbursable basis. The difference between these two treatments was addressed in a 2000 ASBCA decision involving *Software Research Associates* where the board held that subcontractors should be paid the rates in the contract if they do the work described in the contract's labor categories and are qualified to do so while if they do not meet this test, then they are paid on a cost-reimbursable basis.

Expanding definition of "materials." Both FAR 16.601, Time and material contracts and the payments clause discussed above address treatment of "materials" (e.g. cost reimbursements, prohibition of profit, allowability of applicable indirect costs) but the current description does not address subcontract costs even though they are often more significant. The proposed change would revise "materials at cost" to include "direct materials, subcontracts for supplies and services, other direct costs and applicable indirect costs."

Contractor furnished material. The Council has proposed amending Alternate I to FAR 52.232-7(b)(8) to state if a contractor furnishes its own materials that meet the definition of a commercial item at FAR 2.101 the price for such materials shall be the contractor's established catalog or the market price. The ability to charge at such prices should depend on the CO deciding whether an alternate clause should be included in the contract. Since commercial prices presumably include an element of profit, the Council has proposed revising the FAR provision to provide for an exception of no profit or fee on these materials.

Billing subcontracts and interdivisional transfers for incidental supplies and services. The Council is proposing to clarify that subcontracts for incidental services be reimbursed at the actual subcontract price plus allowable indirect costs while for interdivisional transfers, the proposed change would limit reimbursements to actual costs or commercial prices of the division performing the work.

Application of Prompt Payment Act. The proposed change would add language to FAR 52.232-7(i) that would include application of the Prompt Payment Act for interim payments under T&M and LH contracts for services (*Fed. Reg. 56314*).

Implementing the 2004 National Defense Authorization Act, the FAR Council has proposed changes to allow for expanded use of T&M and LH contracts for commercial services under certain circumstances. The government has studied how T&M/LH contracts are used in the commercial world and concluded they are used (1) when requirements are not sufficiently understood to complete a well-defined scope of work and risk of increased costs can be managed by surveillance of costs and performance (2) these same services are generally offered on a fixed-price basis and (3) some services - e.g. emergency repairs – are sold predominantly on a T&M and LH basis. In light of these findings, the government has recommended the proposed rule, to make sure such contracts are used in the "best interests of the government," allow an agency to purchase any commercial service on a T&M or LH basis if the agency has completed a determination and findings (D&F) containing sufficient facts and rationale to justify that a firm-fixed price is not suitable. The D&F should establish it is not possible at the time of placement of the contract or order to accurately estimate the extent or duration of the work or anticipate costs with any reasonable degree of certainty (*Fed. Reg. 56318*).

FAC 2005-06 Issued

The FAR Council released Federal Acquisition Circular 2005-06 Sept. 30. Significant changes to the FAR include:

1. *Statistical Sampling to Identify Unallowable Costs*. Two proposed rules allowing use of statistical sampling to identify and account for unallowable costs under federal contracts were finalized into a government-wide rule that provides criteria for use of statistical sampling and addresses application of penalty provisions. Under the rule, which amends FAR 31.201-6, statistical sampling will now be an acceptable practice for contractors in accounting for and presenting unallowable costs provided (1) the sampling results in an unbiased sample that is a reasonable representation of the sampling universe (2) any large dollar value or high risk transaction is reviewed separately and excluded from the sample and (3) the statistical sampling result permits audit verification. In addition, the rule provides that for any indirect cost in the sample that is subject to a penalty under FAR 42.709 the amount projected to the sampling universe from that sampled cost is also subject to the same penalty provisions.

Further, the use of statistical sampling should be subject to an advance agreement between the contractor and ACO where the agreement will specify the basic characteristics of the sampling process. If an advance agreement is not used, the burden of proof falls on the contractors to establish the sample methods are adequate.

2. *Relocation Costs*. The final rule revises FAR 31.205-35 giving contractors the option of being reimbursed on a lump-sum basis for three types of relocation expenses: (1) costs of finding a new home (2) costs of travel to the new location and (3) costs of temporary lodging. The types of costs are in addition to the miscellaneous relocation costs for which lump-sum reimbursements are already permitted.

3. *Training and Education Costs*. FAR 31.205-44 is revised to eliminate confusing language and restructuring the rule to list "only specifically unallowable costs." The change eliminates several specific limitations on the allowablilty of costs associated with various categories of education e.g. different treatment of full-time and part-time undergraduate education costs and limiting allowable costs to training and education related to the field the employee is working in or is expected to work. Except for six unallowable public policy exceptions (e.g. overtime compensation for education and training for other than bona fide employees) the reasonableness of specific training and education costs will be assessed by reference to FAR 31.201-3, Determining reasonableness.

4. *End of Price Evaluation Adjustment*. The rule cancels the authority of civilian agencies to apply a price evaluation adjustment to certain small disadvantaged business concerns in competitive acquisitions.

5. *Anti-Lobbying*. Implementing an interim 1990 rule, the new rule now requires the insertion of two FAR clauses, 52.203-11 and 52.203-12 in all solicitations and contracts exceeding $100,000 that will generally prohibit recipients of federal contracts, grants and loans from using appropriated funds for lobbying the federal government in connection with a specific contract, grant or loan (*Fed. Reg. 57448*).

Groups Concerned About Considering Subcontract Management in Evaluation

A proposed government-wide rule requiring contracting officers evaluate how well federal prime contractors manage their subcontracts and achieve small business subcontracting goals in forming past performance evaluations has drawn critical comments from the American Bar Association and CODSIA, an influential industry group. The BAR representatives said studies

show that past performance analysis at the prime level adequately captures subcontract management and additional emphasis is unnecessary. They added (1) FAR 9.104-3 already requires government to consider contractors' compliance with subcontracting plans (2) past performance evaluations should focus on the end product not subcontract management (3) if there is a concern about compliance then there should be increased management emphasis rather than more regulatory requirements and (4) additional compliance requirements should consider the tight manpower resources of government contract resources.

CODSIA focused on other deficiencies of the proposed rule. For example, COs should determine why a particular contractor failed to achieve certain subcontracting goals where reduction in contract scope, early termination or other changes beyond the control of the contractor may have affected compliance. The industry group expressed concern the proposed rule substitutes mechanical achievement of a numerical goal when the real obligation is to make a good faith effort. CODSIA also said the current $100,000 threshold for application of the proposed rule is too low if a CO really intends to evaluate past performance and they recommended a $1 million for services and $5 million for systems threshold.

DOD Contractors Can Continue Claiming Indirect Costs Related to Asset Step-Ups

A rule that prevents disallowance under DOD contracts of indirect expenses allocable to an asset step-up resulting from a business combination will continue in effect until Sept. 30, 2008 according to a memo issued by the acting director of the DOD Office of Procurement and Acquisition Policy Dominick Cipicchio. The rules takes the form of a class deviation from requirements of FAR 31.203(c) when costs disallowed under FAR 31.205-52 are required to be included in the contractors indirect cost base.

The original class deviation in 1999 explained that prior to April 1996, the cost accounting standards measured, assigned and allocated the costs of tangible capital assets acquired in a business combination under the purchase method of accounting on the basis of fair market value. This usually resulted in an increase in the value of the assets over the pre-business combination book value (i.e. fair market value usually exceeds net cost basis) which is referred to as step-up amount. FAR 31.205-52 disallows costs stemming from this step-up amount. When assets that are valued at fair market value (including step-up amounts) and the resulting costs like depreciation of assets or amortization of intangible assets are included as part of the base for allocating indirect costs FAR 31.203(c) renders unallowable that share of the indirect expenses that are allocable to the disallowed step-up amount. The class deviation stated the purpose of FAR 31.205-52 was to assure that depreciation or amortization of any step-up amount of assets were not increased as a result of the business combination but here "contractors should not be penalized by having their indirect cost recovery reduced." "Thus when costs disallowed under 31.205-52 are required to be included in the indirect cost base the indirect expenses proportionate to those disallowed costs will not be disallowed on the basis of FAR 31.203(c)." The updated class deviation applies to all future contracts as well as indirect rates applicable to all open cost reimbursement contracts or any other situations requiring that indirect costs be settled before contract prices are established.

Industry Criticizes Proposed Rule on Safety Notification Requirements

A proposed Defense Department rule that would require contractors to notify the department promptly of any potential safety issues in certain kinds of items delivered under their contract is "burdensome" and "overly expansive" says two major contractor groups. The proposed rule requires contractors to notify DOD within 72 hours regarding nonconformances in critical safety items and all nonconformances that may result in a "safety impact" for systems, subsystems, assemblies or subassemblies integral to a system. It would apply to replenishment parts identified as "critical safety items", systems and subsystems, assemblies and subassemblies integral to a system and support services for such items. In separate letters by the Professional Services Council and National Defense Industrial Assoc. the industry groups urged either numerous changes or a revision of the proposed rule.

Examples of concerns expressed include:

1. Flow down requirements to lower tier subcontracts, particularly those providing commercial items and services are a problem.

2. Notification requirements are too "expansive" and should be limited to "truly significant to those of safety." Under the proposed rules, contractors could be required to report any "bug" in software that is a part of a critical system. Only risk of injury or loss of life rather than "all technical noncomformances" for replacement parts should be reported.

3. The 72 hour notification time frame is too short to discover or acquire "credible information" and should be extended to five business days and must be based on "articulable facts not just a belief or suspicion."

4. The rule provides COs "confusing direction" what are "critical safety items" or which subsystems, assemblies or subassemblies are "integral to a system." Because of uncertainties, they will likely automatically include the proposed notification clause out of "an abundance of caution."

5. The proposed $200,000 damage threshold triggering notification is too low and should be raised to at least $1 million.

DCAA Audit Guidance Issued

The Defense Contract Audit Agency has issued recent guidance to its auditors that will be incorporated in the next edition of its Contract Audit Manual (DCAM). Significant guidance includes:

- **Financial Capability Audits at Parent and Subsidiary Locations**

In the light of recent corporate scandals, DCAA has put considerable emphasis on conducting reviews of financial risk assessments and financial capability. A recent guideline addresses these audits when there are parent companies of the segments/subsidiaries performing the contract. The guidance states the audits should generally be performed at the parent company (home office) rather than the segment. There are generally two exceptions to this: (1) DCAA does not have access to the parent company or (2) the parent company does not guarantee the subsidiary's performance and the parent company does not obtain the subsidiary's cash (commonly referred to as "cash sweeps") (*MRD 05-PPD-057(*R).

- **Allowability of Administrative Leave and Other Assistance Costs Related to Katrina**

DCAA Oct 28 issued clarifying guidance of an Oct 11 memo from the Acting Director of the Defense Procurement and Acquisition Policy (DPAP). The guidance alludes to the DPAP memo that states administrative leave granted to contractor employees due to Hurricane Katrina are to be considered a fringe benefit and allowability should be determined under FAR 31.205-6, Compensation for personal services. DCAA guidance states the DPAP is similar to DCAA Contract Audit Manual at 7-1224, Administrative Leave Due to Weather-Related Closures where allowability of such payments should be considered on a case-by-case basis.

The Guidance states the DPAP memo also alludes to "other unusual contractor expenditures" which is not specified but adds it includes such costs as temporary housing for employees who lost their personal residences, subsistence payments, temporary lodging and subsistence while under evacuation orders and travel costs to and from safe havens where the costs can far exceed administrative leave. The guidance also states auditors should assist ACOs to obtain advance agreements for allowability of employee assistance costs and auditors should ensure that all avenues of potential insurance recoveries have been exhausted before the government pays for Katrina-related costs (*MRD 05-PAC-065(*R).

- **Allowability of Leave Donations for Katrina Victims**

DCAA Oct 18 issued separate guidance alerting auditors to the Defense Procurement and Acquisition Policy Oct 11 memo regarding allowability of costs of contractor employees donating vacation or unused leave time for the victims of Hurricane Katrina. The memo states such donated leave time are allowable compensation costs under FAR 31.205-6, Compensation for personal services and not unallowable costs under FAR 31.205-8, Contributions or donations. The memo also references Internal Revenue Service Notice 2005-68 dated Sept 8 advising that the leave donations do not constitute taxable income to the employee and that employers may treat these donations as either ordinary and necessary business expenses or charitable contributions (*MRD 05-PAC-064(*R).

- **Revised FAR Cost Principles Regarding Recognizing Gains and Losses on Disposing of Assets Under Sale-and-Leaseback Transactions**

DCAA has issued guidance intended to clarify a recent FAR 31.205-16 change we reported on regarding recognition of gains and losses on disposing of assets associated with sale-and-leaseback transactions and how the change affects lease/rental cost limitations in FAR 31.205-11, Depreciation costs and 31.205-36, Rental costs. The guidance provides two helpful examples, one for a gain and one for a loss, and shows actual deletions and additions to the relevant cost principles.

Recognition Date. Whereas prior to the rule change there was no specific identification of a date for recognizing

gains and losses under a sale-leaseback arrangement, the new coverage requires the gains or loss be recognized on the date the contractor becomes a lessee.

Allowable Loss Limitation. Since sale-and-leaseback transactions are usually made to raise capital, the government is concerned that recognizing losses based on the net amount realized rather than on the fair market value of the asset may put the government at risk of reimbursing costs of raising capital and artificially inflating the loss. The revised rule requires that the allowable amount of a loss be limited to the amount by which the net book value (i.e. undepreciated balance of the asset) exceeds the fair market value of the asset.

Government Participation in Gains. FAR 31.205-16 has always limited recognition of any gain associated with disposing of capital assets to the amount of depreciation costs it previously recognized where for costing purposes, gains and losses are "considered as adjustments of depreciation costs previously recognized." Hence the government's participation in the gain (i.e. credit) does not extend to any appreciation in asset value in excess of its acquisition cost.

Limitation on Lease/Rental Costs. The rental and depreciation cost principles continue to limit the rental and lease costs associated with a sale-and-leaseback transaction to the amount that would have been allowed had the contractor retained title to the asset. To ensure the government reimburses only its equitable share of an asset's original acquisition cost, the allowable rental/ lease costs will be computed based on the adjusted net book value after recognition of the gain or loss.

Existing Leases Under Sale-and-Leaseback Arrangements. The guidance recognizes that assets under currently existing leases resulting from prior sale-and-leaseback transactions would not have been subjected to the recognition of gains or losses nor the the current rental/lease cost limitations reflect such gains or losses. Hence the guidance says auditors should advice ACOs that an advanced agreement may be beneficial (*MRD 05-PAC-053(*R).

Air Force Issues Revised Past Performance Guidelines

The Air Force recently released a new Contractor Performance Assessment Reporting System (CPARS) guide. The guide, which replaces a 2004 guide, sets policy, assigns responsibilities and establishes procedures for collecting and using contract past performance information in its source selection decisions. The new CPARS guide is available at "cpars.navy.mil/cparsfiles/pdfs/AFManual0905.pdf".

Travel…

Per Diem Reimbursement Is OK When Staying at Your House if it is Not Your "Work" House

Michael was assigned temporary duty (TDY) for four days in Orlando. Though his main residence is in Avon Park, Michael stayed at his other residence in Orlando. Though not claiming lodging, his request for reimbursement for per diem and incidental expenses was rejected by the Air Force, claiming the Joint Travel Regulations (JTR) prohibit it. The Board disagreed claiming it had previously ruled that employees who stay at family residences while on TDY should be reimbursed for meals and incidental expenses and this rule applied to Michael because his residence in Orlando was not his "work" residence i.e. the residence from which he commuted to his permanent duty station (PDS). The Board noted agencies are prohibited from providing employee per diem within limits of their PDS but such residences do not include every home owned by the employee – only the one from which they commute from on a daily basis (*Michael G. Stevens, GSBCA 16652-TRAV*).

Costs of TDY Home are Allowable But Not Costs of Shipping Furniture

After a trial period of two months, Harriette was authorized a long term temporary duty (TDY) assignment from October 2003 through April 2005. She sold her house at her permanent duty station and found a new one at her TDY location where for the first month she rented before buying where she decided to furnish it with furniture shipped from the home she sold rather than renting items from stores in her TDY location. Her agency asked for the Board's opinion on two matters: (1) was she entitled to reimbursement of expenses incurred at her TDY location and (2) could she be reimbursed for the costs of shipping her furniture to the new house. The Board ruled, on the first matter, she was entitled to reimbursement, noting employees may be reimbursed for costs incurred at a TDY location (e.g. mortgage interest, property taxes, utilities, etc.) as long as the residence "was not purchased before the start of the assignment for other reasons." The Board added Harriette would be entitled to the costs of ownership whether or not she had sold the house at her permanent location. As for the furniture moving expenses, the Board said she could not be reimbursed the cost because the FTR does not authorize an allowance for shipping furniture to a TDY location, even if the cost of renting furniture is greater than the

expense of moving it (*Harriette Treloar, GSBCA 16699-TRAV*).

CASES/DECISIONS

Agency Can't Get Difference Between Actual and Estimated Bond Prices

Panegea held a fixed price contract that included the defective pricing clause that entitled the government to an adjustment in contract price if the submitted cost or pricing data was defective. As is normal, the parties did not reach agreement as to the individual cost elements of the proposal but agreed only as to the total contract price. Included in its proposal was an estimate on bond premiums where the government sought a contract price reduction upon learning that the actual costs of the premiums were lower than those estimated for pricing purposes, asserting that Panegea's certificates of cost and pricing data submitted in its proposal entitled it to the price reduction. The Board sided with Panegea, ruling the estimated costs included in the proposals were not cost or pricing data and hence no price reduction was justified. The Board stated unless a bidding schedule for a fixed price contract specifically requires bidders to include actual bond costs in the bids, the Payments clause in a fixed price contract does not limit the contractor's right to receive the entire contract price, even if the actual bond premiums incurred after contract award are less than those estimated during the bidding process. The Board concluded that here Pangea was not required to include actual premiums in its proposals and the parties entered into negotiations based on proposals that included estimates of bond premiums (*Pangea Inc., GSBCA No. 16688*).

Fee Denied on Cost Type Terminated Subcontract Work

Lockheed Martin held a cost plus fixed fee prime contract to provide demonstration of antenna and transmitters for the Navy's AEGIS missile program. Its subcontract for antenna work was cost type while its subcontract on transmitter work was fixed price. The Navy terminated the contract for convenience where each subcontractor submitted a termination proposal to its next upper tier contractor where Lockheed included these proposals in its settlement proposal to the government and Lockheed sought recovery of fee for work performed by its subcontractors. Citing FAR 49.305-1 covering terminations for cost type work, the Government refused fee on the cost type subcontract work. Before the Board, Lockheed argued that FAR Parts 15 and 16 showed an intent to treat cost-type and fixed-price contracts the same for recovery of fee or profit, arguing it would be "incongruous" for different treatment. The Board sided with the government claiming that FAR 49.305-1(a) is clear that fee for subcontractor effort would not be included in subcontractors' settlement proposals for cost type work and called Lockheed's claim about equal treatment a "nebulous" assertion (*Lockheed Martin Corp. v. England, 2005 WL 2293084*).

No Interest Due on Funds Not Advanced for Wages

SCCC's contract called for increases in contract price to incorporate changes to increased wage determinations. Earlier, the Board decided that SCCC was entitled to a price adjustment due to the wage determinations where it was awarded increased wages, taxes, profit and Contract Disputes Act interest. Subsequently, the Board decided on another case – *Richlin* – where the contractor could not receive CDA interest on wages owed to its employees because the contractor had not advanced its own funds to pay the increased wages and based on that decision ruled SCCC would not be entitled to the interest. Though SCCC put forth cases indicating the Board was prevented from altering its earlier decision the Board alluded to *Raytheon* that ruled the CDA does not permit a contractor to recover money it has not spent. To pay them interest on funds not expended would result in an inappropriate windfall to SCCC (*Schleicher Community Corrections Center Inc. v US, DOTBCA No. 3067*).

"No Less Than" is Not "Sum Certain" for a Claim

(*Editor's Note. It is not uncommon for a contractor submitting a claim to have some uncertainty in the amount it is due. The following indicates that in spite of these uncertainties, a definite dollar amount should be clearly presented.*)

Sandoval presented a claim to the government for delay damages that included the statement "no less than $1,072,957.05." The "no less" language was based on the uncertainty that additional claimed amounts would be needed to cover additional days of delay. The Board dismissed the appeal because the claim was improper since the Contract Disputes Act requires that all claims by a contractor against the government related to a contract must contain a demand for a "sum certain." The Board concluded that "no less than" amount is not a "sum certain." It stated the same is true for an "in excess of" amount (*Sandoval Plumbing Service Repair, Inc., ASBCA No. 54640*).

SMALL/NEW CONTRACTORS

Is it Ever Appropriate to Low Ball a Bid?

In both our consulting practices and inquiries from subscribers we have often been asked questions related to whether it makes sense to "low ball" proposals – that is propose prices that do not recover full costs of a project. We have encountered considerable resistance from the financial side of contractors' houses for bidding on work that the CEO has earmarked as critical to winning, insisting they would loose their shirts. Though we will focus on the economic value of bidding on the project, there are, of course, numerous pros and cons that may outweigh the economic benefits or costs. Examples of benefits of bidding on less profitable work may include (1) getting your foot in the door for future work – either expectations of follow-on work or getting exposure to government agencies not previously worked with (2) obtaining important experience – technological, learning to do business with the government, seeding abilities in other parts of the business that are transferable to other government or commercial work (3) keeping employees working. Cons can be equally compelling such as (1) low economic value can promote lower quality or service levels that might result in adverse past performance ratings or (2) provide less than optimal use of valuable resources that are difficult to replace such as personnel and equipment.

In a recent case study we encountered the Contractor's company-wide overhead rate was 150% and its G&A rate was 24%, a bit on the high side of the normal range experienced by professional services firms. In competition for a $50 million contract, Contractor's prior bid was 60% higher than the company that was awarded the contract. The winning bidder was characterized as a "body shop" – little permanent staff of professionals with minimal overhead costs who hire personnel only when a contract is won – and they have learned that during contract performance, the government was not pleased with their performance and would be happy to find someone else. Through various legal channels, Contractor determined that the incumbent would likely bid an all in-rate of a certain amount and to equal that proposed price, Contractor would need to bid overhead rates of 50% and G&A of 15%. The CEO and project managers did not want to take any chances of proposing too high a price so they decided they would bid these rates by providing significant "management cost reductions" from their actual projected costs and would be willing to cap their rates to assure the government reasonable costs.

We discussed this issue with some of Contractor's financial personnel who were understandably concerned the company would "loose its shirt" if they bid these rates and were stuck with capped rates if they won. In discussing the matter with Contractor, an analogy from one of our old accounting instructors came to mind that provided an interesting framework to consider the problem.

Picture a funnel with a spout off the side and the bottom of the funnel going into a big bucket. Revenue dollars flow into the top of the funnel and some dollars go out of the side funnel. These dollars represent payment for direct costs - labor, ODCs, etc. The remaining dollars flow into the big bucket which represent all the other costs like overhead and G&A. When the bucket is filled with dollars (overhead and G&A expenses paid for) the excess overflow is the firm's profit. So, if the bucket is full, any additional dollars that exceed the direct dollars out can be considered profit. Though a relatively high percentage of dollars would flow out the side spout under the new contract to cover the direct labor and ODCs, still some dollars would flow into the bucket.

If the bucket is full when the contract is in place and the contract would not generate significant additional overhead or G&A costs, then even the low proposed rates would generate considerable profits since most if not all dollars flowing into the bucket would be excess and hence profit. Even if the bucket was not full, then the residual dollars would help fill it up. Of course, this would be a fool-hearty pricing strategy for all contracts (the bucket never gets enough dollars to cover expenses let alone generate profit). It would even be fool-hearty for the new contract if it is expected to generate significant indirect costs which would enlarge the bucket resulting in less or no overflow at all. But for some marginal contracts this low-bid pricing can be a good strategy.

QUESTIONS & ANSWERS

Q. We are bidding on a negotiated firm fixed price contract where we are required to submit cost and pricing data and would like to include a warranty in our price. How should we price the warranty to recover direct material and labor as well as overhead and G&A?

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A. I'm not sure how your firm accounts for warranty costs so I can't give you a definitive answer but let me give you some general ideas. Warranty costs are generally allowable unless they are inconsistent with the terms of the contract. The DCAA Contract Audit Manual, which is consistent with our experience, identifies three ways that can be used for pricing and costing purposes: (1) an ODC where direct labor and direct material as well as an allocable share of indirect costs may be included (2) an indirect cost where all estimated warranty costs would be included in an appropriate pool or (3) a cost that is allocated on a reserve basis. In the last way, the estimated costs may be charged either direct or indirect with a corresponding credit to a reserve for warranties - DCAA likens it to accounting for bad debt losses.

If material, you might expect DCAA to look at the proposed costs in some detail. For example, they would likely review the RFP to verify warranty costs are requested, compare how you treat warranties on this contract compared to others, request historical warranty cost data to compare with your proposal and look at your accounting practices to ensure such costs are segregated. If an audit is anticipated, you want to make sure these audit areas are satisfactory so your accounting and pricing practices are not called into question.

Q. Several of our employees have had to travel to some locations damaged by recent hurricanes and often had to stay in lodgings and eat in locations at a considerable distance from their destinations, often paying higher amounts than local TDY per diem limits. I know the travel regulations say they are entitled to per diem reimbursement in areas they are assigned to so how do I determine allowability of travel expenses?

A. Interestingly, the General Services Administration issued September 29 a travel bulletin, effective until March 1, 2006, authorizing actual expense reimbursement for per diem expenses for employees traveling to areas affected by Hurricane Rita or Hurricane Katrina. The bulletin states government agencies may waive the FTR 301-117 requirement to limit per diem travel to a TDY location. The bulletin also states the waiver allows agencies to approve actual subsistence reimbursement that is less than 300 percent of the application per diem rate without further justification.

Q. We were, until recently, a small business and all of our employees were required to complete detailed time sheets, including those who charge indirect, admin, sales, etc. At the end of the fiscal year we used the actual labor. We were recently acquired by a large defense contractor where their indirect employees are charged 100% to sales, admin, or other indirect function. That leads me to believe that our employees should be categorized either 100% direct or 100% indirect and consequently our indirect employees need not complete time sheets. Is this correct? Have we been charging indirect labor incorrectly?

A. No, you haven't been doing it incorrectly, only different than your new parent. As for categorizing labor as direct or indirect, that is quite common. You, of course, want to be able to charge indirect people direct when they work directly on jobs so you need that flexibility but its OK to categorize them as direct or indirect. As for requiring indirect people to use time sheets, DCAA does not have clear guidance on this so, in our experience, most auditors would have no problem while a few would. Except for that occasional auditor who thinks all employees should record time, there should be no need to require 100% indirect employees to complete timecards. If, however, some of those employees do charge direct, then they should complete them.

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