GCA REPORT
(A publication of Government Contract Associates)

November - December 2008 Vol 14, No. 6

NEW DEVELOPMENTS

DCAA Issues New Guidance

The Defense Contract Audit Agency has issued several significant memos to its auditors.

♦ **Annual Testing of Contractor Eligibility for Direct Billing**

The DCAA memo addresses auditors' annual testing of contractors' on-going eligibility for direct billing. The name and focus of the revised audit program is to ascertain whether there can be continued reliance on contractors' internal controls for direct billing purposes as spelled out in the DCAA Contract Audit Manual (DCAM) 6-1007.6. The guidance includes a proforma memo for the record that provides auditors will select a sample of paid vouchers submitted directly to the government paying offices and will (1) test the contractor's procedures for preparing vouchers on flexibly priced contracts (including T&M and labor hour contracts) and (2) verify the contractor is current in submitting its incurred cost proposals and final vouchers. The proforma memo will state that the tests were made, continual reliance can be placed on the contractor's procedures and the incurred cost proposals and final vouchers are submitted on time. If the tests indicate the vouchers cannot be relied upon the memo should state so, a flash billing system report should be issued and the memo should state the direct billing program will be rescinded. Similarly with untimely submittals, the memo should state the incurred cost proposals or final voucher are not timely submitted, a flash estimating system report should be issued and direct billing will be rescinded (*08-PPD-034(R*).

♦ **Alert Concerning Compensation Consultant Results**

DCAA issued an alert addressing concerns about executive compensation reasonableness when a contractor uses a compensation consultant. The guidance notes contractors frequently use compensation consultants to establish executive pay and states these consultants may not be independent, especially when they perform other services for the contractor. Auditors are told not to rely on the consultant's determination on reasonableness of compensation without performing a review of the survey data used in establishing the compensation. They are told that the consultant's data should be "based on reliable and unbiased surveys that are representative of the contractor's relevant market or industry." They are also told that no one survey is sufficient to determine the market value of pay for all contractor positions and the memo suggests that a primary survey may be selected with secondary surveys used to collaborate the results of the primary survey. If risk is disclosed, auditors are told to perform their own assessment using available survey data within DCAA by going to regional DCAA compensation specialists (08-PPD-035(R). (*Editor's Note. Though the above guidance can be interpreted in various ways we believe it represents a further step away from the traditional practice of allowing contractors to make their own determinations of what is reasonable executive compensation where DCAA primarily validates the controls used to make the determination. Now, DCAA is getting close to saying contractors should use both the same and number of surveys it uses to determine reasonableness of compensation. Based on our experience of actually participating on DCAA compensation teams, we have discussed in prior articles the shortcomings of DCAA's approaches and data they use but nonetheless, we fear that DCAA is moving closer to requiring contractors to use their survey data and number of surveys. DCAA survey data is quite expensive to obtain and often yields less accurate results than other means contractors use.)*

♦ **Risk Alerts on Current Economic and Financial Conditions**

DCAA has issued guidance reminding its auditors to be on the lookout for unfavorable or adverse financial conditions that could affect cash flow, produce inefficiencies and impede contractors' ability to perform their contracts. (*Editor's Note. The guidance points to CAM 14-300 and we also refer our readers to prior articles we have written on contractors' financial risk – use our search function at govcontractassoc.com.*) Auditors are told to be continuously alert to any indication of unfavorable financial conditions that would especially arise in progress payment audits, annual testing of eligibility for direct billing, billing system reviews and interim voucher reviews. Examples of possible unfavorable

financial conditions include (1) increases in aging and amounts of accounts payables (2) defaults on loan and line of credit agreements (3) denial of usual trade credit from suppliers (4) restructuring of debt with higher interest rates (5) noncompliance with loan/line of credit covenants (6) loss of principle customers or suppliers (7) unpaid or late payments of state, local or federal tax liabilities (8) deteriorating bond ratings (9) failure to fund pension plans (10) loans from employees or issuing stock in lieu of salary (11) significant unpaid debts or other liabilities (12) unusual progress payments or other billing concerns or (13) poor physical condition of facilities. When these or other indicators of financial risk are present, auditors are told to initiate a financial condition risk assessment (*08-PPD-036(R*).

President Signs FY 2009 DOD Appropriations Act

The President signed the FY 2009 defense appropriations act providing for $487.7 Billion in discretionary spending authority that contains several contracting related provisions, many of which apply government wide:

1. Create a database that will contain information about contractors awarded contracts in excess of $500,000. Information will include civil, criminal or administrative proceedings in connection with an award or contract performance for the last five years, contracts that were terminated due to default, contractors that have been suspended or debarred and administrative agreements intended to resolve suspension or debarment proceedings. Access to the database will be for "appropriate acquisition officials" in federal agencies, or "other government officials" the General Services Administration deems appropriate. The Bush administration opposed the database as "unwieldy" saying much of the information is already collected and available by other means.

2. Require greater competition for task and delivery orders placed under multiple award contracts. There are now new restrictions on use of the "unusual and compelling urgency" exception to following the Competition in Contracting Act (e.g. use of the exception for less than one year). Also competitive procedures will be put in place that describes the work of each order, gives MAC contractors a "fair opportunity" to be considered and includes "as many contractors as practicable" considered to be at least three or where the CO states in writing no other qualified contractors could be identified in spite of reasonable efforts. The American Bar Association recently issued a memo recommending the new rule should be amended to clarify that a timely protest of a solicitation for a TO/DO should trigger an automatic stay of performance.

3. Limit use of cost reimbursement contracting. Requires amendments to the FAR within 270 days that will address when cost type contracts are appropriate and establish an acquisition plan process to support use of such contracts and identify the workforce resources necessary to award and manage them.

4. Price reasonableness for services that are "of a type." Will require COs to make a written determination that an offeror proposing a service that is not offered and sold competitively in the commercial marketplace but is "of a type" that is offered and sold in substantial quantities has provided sufficient price and/or cost information to allow a price reasonableness determination to be made. The FAR changes will also authorize a CO to request actual labor costs, material costs and overhead rates if the information on prices paid for similar items is deemed insufficient to determine the proposed prices are reasonable.

5. Access to contractor employees. Expands the GAO's authority to inspect contractors' records to include interviewing any current prime or subcontract employee about a contract unless it was awarded by sealed bidding. Industry objections to earlier proposals have been significant.

6. Excessive pass through costs and award fees. Will require a FAR amendment to address use of subcontractors that add no or negligible value on cost reimbursement contracts and profit on work performed by lower-tier subcontractors if the higher tier contractor adds no or negligible value. Also FAR will be amended to provide guidelines on the amount of award or incentive fees a contractor may receive on cost type contracts where incentive fees will be linked to periodic performance evaluation scores.

7. Where non-FAR agreements are entered into (e.g. other transaction agreements, cooperative R&D agreements to develop and build prototypes) FAR guidance will put forth guidelines to protect the government's interest in intellectual property.

8. In response to wasteful and fraudulent accounting practices in Iraq and Kuwait, the changes ask for a reevaluation of the current exemption from cost accounting standards on contracts performed outside of the US.

9. Provides for a definition of "inherently governmental functions" when deciding to promote a public-private competition when such inherently government functions are not performed by an agency.

10. Provides guidelines and FAR clauses to ensure that when contractor employees perform work traditionally performed by government employees they are not tainted by potential conflict of interest. The guidelines will identify PCOI, prohibit contractor employees from improperly using non-public government information and discipline employees who do not comply with new rules.

Past Performance Information to Include Local and State Government Contracts and Private Contracts

The FAR Secretariat submitted to OMB a request to approve an extension of currently approved information collection requirements concerning past performance information. If past performance is to be an evaluation factor for selection of an award the proposed rule affords offerors the opportunity to identify federal, state and local government as well as private contracts performed by offerors that were similar to the contract being evaluated. Past performance information is information about a contractor's work under previous contracts that is relevant for source selection (*Fed. Reg. 67489*).

GSA Proposes Incremental Funding for Fixed Price, T&M and LH Contracts

The General Services Administration is proposing to amend its acquisition rules to authorize incremental funding for fixed price, time and materials and labor hour contracts. The FAR provides clauses for incremental funding for cost type contracts while it does not do so for the others despite the fact there is no prohibition to do so. The proposed rule will amend GSAM Subpart 532.7 and add a new clause to specify which contract lines items are incrementally funded and the amount of the total contract price that is available for payment. The clause stipulates the contractor will agree to perform up to the point at which the total amount payable by the government approximates but does not exceed the total amount currently allotted to the contract where the contractor is not authorized to continue work on those items beyond that point. The clause further requires contractors to notify COs in writing at least 90 days prior to the date when "in the contractor's best judgment" the work will reach the point where total amount payable by the government will approximate 85 percent of the total amount allotted to the contract for the applicable items. In addition to estimating the date this will be reached the contractor must include in the notification an estimate of additional funding needed until the next scheduled date for allotting additional funds. Also the clause provides for an equitable adjustment of item prices, delivery deadlines or both when the contractor incurs additional costs or delays due to the government's failure to allot more funds (*Fed Reg. 58515*).

SBA Issues Rules on Small, Disadvantaged and Women-Owned Firms

The Small Business Administration published an interim final rule that allows firms to self-certify their status as small disadvantaged businesses (SDBs) for subcontracting purposes without first receiving a SDB certification from the agency. The rule permits a subcontractor to claim it qualifies as an SDB if it believes in good faith that it is owned and controlled by one or more socially and economically disadvantaged individuals. The SBA said in the past only those firms that had been certified by the SBA could certify themselves as SDB for federal prime contracts and subcontracts but now the new rule is necessary because it had to cease performing certification as of the end of the FY 2008 because current funding for the SBA program was "unreliable and unpredictable" where there was no assurance other agencies would continue funding the SBA program. Rather than providing the "costly, time consuming" process of certification the SBA says self certification in good faith will be "cheaper, quicker and less burdensome" for all concerned.

In a separate action, the SBA issued a final rule authorizing federal agencies to set aside contracts for women-owned small businesses (WOSBs) in industries where such firms are shown to be underrepresented and the procuring agency determines that a set-aside would cure past discrimination. Section 8(m) of the Small Business Reauthorization Act of 2000 allows for set-asides on procurements up to $3 Million ($5 Million for manufacturing) for WOSBs who are at least 51 percent unconditionally and directly owned and controlled by women who are US citizens. To qualify as an economically disadvantaged women-owned business (EDWOSB) at least 51 percent of the owners must also show an impaired ability to compete due to diminished capital and credit opportunities as well as a personal net worth of less than $750,000, excluding ownership in the businesses and equity in their homes (*Fed. Reg. 56940*).

ABA Group Recommends Elimination of GSA Price Reductions Clause

The American Bar Association Section of Public Contract Law is recommending the elimination of the price reduction clause (PRC) in multiple award schedule contracts as well as current sales practices (CSP) stating they are confusing to comply with and are unnecessary since increased competition is now required.

The PRC provides for ongoing monitoring of discounts offered to Multiple Award Schedule (MAS) contractors' "basis of award" customers while CSP allows for evaluation of discounts offered by MAS contractors in the commercial marketplace. The ABA states the PRC is a "complicated" clause requiring contractors to monitor their pricing practices in effect at time of award where even the most conscientious MAS contractors can run afoul of the requirements while with the CSP there is considerable confusion regarding time period, transactions and discounts subject to disclosure rules and there is frequent deviation from written policies that may result in even lower discounts.

The ABA group asserts significant changes in the MAS program over the last several years have made the PRC unnecessary since now prices may be determined to be fair and reasonable solely on order competition practices. Significant changes making a more competitive process includes (1) new MAS ordering procedures increasing competition at the task and delivery order level (e.g. see the current 2009 defense authorization act changes reported above) (2) current process of publication of products and pricing by schedule contractors where buyers can select contractors who they want to order from (3) proliferation of MAS program over the years that have substantially increased the number of contractors competing and (4) increased competing vehicles such as governmentwide acquisitions through the MAS program.

GSA Head Advocates More Use of GSA Commercial Item Schedules

Anticipating a heightened focus on federal procurement in the next administration, the acting head of the General Services Administration has stated it is a "complete waste of resources" for separate agencies to continually procure their own commercial supplies and services that are offered under GSA schedules. It sighted numerous examples of "unnecessary" procurements of items by separate agencies rather than using the GSA where such practices were cited as putting excessive pressure on a "thinly-stretched acquisition workforce."

New FAR Rules For Contractor Ethics Finalized

The FAR Council published a final rule November 12 laying out requirements for a contractor code of business ethics and conduct, an internal control system and mandatory disclosure to the government of violations of criminal law or civil False Claims Act (FCA). The final rule culminates numerous proposed rules put forth over the last year that incorporates several comments.

For internal controls, contractors must establish and maintain specific controls to detect and prevent improper conduct related to any government contract and subcontract. The Council provided a general framework where contractors can discover wrongdoing on their own and notify the government of possible wrong doing such as an anonymous hotline. Contractors can use their judgment in coming up with program details and the systems must be in place 90 days after receiving a contract.

Mandatory disclosure. Government contractors must notify the contracting agency's inspector general and CO if it discovers credible evidence of a crime related to a contract or an FCA violation. The rule allows government officials to suspend or debar a company from government work if it knowingly fails to disclose crimes or significant overpayments by the government for more than three years after final payment. The contractor has the opportunity to examine the credibility of the evidence of the alleged crime before telling the government and before being charged with knowing failure to notify (*Fed. Reg. 67064*).

Final Rule Mandating E-Verify Use is Passed

Despite significant opposition to the proposed rule, the FAR Council issued Nov. 14 a final rule requiring federal contractors and subcontractors to confirm the employment eligibility of all existing employees who are directly performing work under a contract covered by the new rules. The new E-Verify rules applies to contracts awarded after Jan 15, 2008 where period of performance exceeds 120 days and has a value of $100,000 and for subcontracts above $3,000 where the prime contract includes the E-Verify clause. Existing indefinite delivery indefinite quantity contracts for future orders will be amended if the period of performance extends at least six months after Jan 15. Contracts that are for commercially available off-the-shelf (COTS) items or those that would be COTS items but for minor modifications are not subject to the E-

Verify requirements. The Department of Homeland Security's E-Verify system will be used (*Fed Reg. 67649*).

CASES/DECISIONS

Minority Set-Aside Statute Violated Equal Protection

The US Court of Appeals for the Federal Circuit has ruled that the 2006 federal statute establishing a defense contract "goal" for small businesses owned by "socially disadvantaged individuals" violates the Constitution's Fifth Amendment's equal protection component. The statute in question, 10 U.S.C. No 2323, sets aside a "goal" of 5 percent of DOD procurement expenditures for contracts and subcontracts with "small businesses owned and controlled by socially and economically disadvantaged individuals" and allows for up to a 10 percent "price evaluation adjustment" (PEA) when comparing bids of minority and non-minority firms. The statute was first enacted in 1986 and renewed at various times where it has been suspended through March 2009 because DOD has met its set aside goals.

The lawsuit was brought in 1998 by a business owned by a white woman who complained she lost a contract to a socially disadvantaged firm as a result of a PEA. A series of complicated rulings and appeals resulted in a ruling by the district court that the statute met the "strict scrutiny" and "narrow tailoring" that earlier cases established had to be met (e.g. *Adarand Constructors*). The appeals court looked at the studies intended to show discrimination that justified the statute and found that five of them had failed to account for differences in size or relative capacity when citing discriminatory patterns so by focusing on percentages of firms in the market owned by minorities rather than percentage of total marketplace capacity that approach substantially increased the disparity ratios. This failing was magnified by the limited geographic reach of the firms that were located in one state, two counties and three cities that were deemed to be inadequate to identify discrimination nationwide. The Court concluded the studies in question and other "anecdotal" evidence used to justify the statute along with the failure to produce a single incident of discrimination by DOD failed strict scrutiny requirement and hence violated the fifth amendment. The court stressed its holding applied to the particular evidence offered by DOD and the district court and should not be construed as stating any blanket rules about other studies that may exist (*Rothe Development Corp v DOD. Fed. Cir/ No. 2008-1017*).

GAO Rules Set-Aside Provisions Apply to Task and Delivery Orders

The Navy awarded a multiple award, indefinite delivery-indefinite quantity training system contract (TSC) to eight firms of which four were small businesses. The agency issued a delivery order proposal request as a small business set aside to its TSC awardees where only Delex and another firm provided certifications as small business concerns. Believing Delex would not submit an offer the Navy withdrew the set aside because it did not expected to receive competitive offers from at least two responsible small businesses. In response to Delex's protest, the agency first argued that when an agency places task and delivery orders under multiple award contracts it need not comply with FAR 19.5 including the "Rule of Two" (i.e. requiring agencies to set aside for small businesses any acquisitions exceeding $100,000 if there is a reasonable expectation of receiving fair market prices from at least two responsible small businesses) because the Rule of Two is not part of FAR 19.5. The GAO disagreed stating though the Rule of Two is not specifically set out in the Small Business Act it has been adopted as the FAR's implementation of the Act's requirement through various "notices and comment rulemaking." Addressing the agency's next assertion that FAR 16.5, which governs multiple award ID/IQ contracts, exempts task and delivery orders from FAR 19.5, the GAO disagreed stating the Navy misread the provisions where without an express waiver of the Small Business Act (implemented here by the Rule of Two) there is no basis to conclude that the Rule of Two limited exemption from full and open competition can exempt agencies from complying with FAR Part 19.5 (*Delex Systems Inc. GAO, B400403*).

Claim Not Certified Cannot be Appealed

(*Editor's Note. The following shows the downside of failing to properly certify a claim.*)

MedTek submitted a letter to the agency CO requesting $350,000 for contract delays, legal fees and losses related to performing its contract and received a denial from the CO which MedTek considered to be a final decision. It next appealed the final decision to the Board of Contract Appeals who refused to hear the case asserting the $350,000 claim was not properly certified and hence the Board had no jurisdiction to hear the appeal. The Board explained that the Contract Disputes Act states a claim of more than $100,000 must be certified and failure to do so precludes the board from having jurisdiction to consider an appeal from a CO's decision

on that claim. The Board explained a contractor must certify that a claim is made in good faith, that the supporting data are accurate and complete to the best of its knowledge and that the amount requested accurately reflects the contract adjustment for which it believes the government is liable. In addition, the certifier must be authorized to certify a claim on behalf of a contractor for claims of more than $100,000. Here there is no evidence the claim was ever certified (*MedTek Inc., CBCA No. 1153*).

Agency Failed to Show Its Override of Automatic Stay was Proper

(*Editor's Note. The following case addresses when it is legitimate for the government to override the requirement to impose an automatic stay on the award of a contract when there is a timely protest issued.*)

The National Highway Traffic Safety Administration awarded an information technology services contract to Centech where upon e-Management filed a timely protest with the GAO. Nonetheless the government waived the automatic stay required under the Competition in Contracting Act (CICA). The court addressed whether the decision to override the stay was legitimate in the light of four factors discussed in an earlier *Motor Vehicle Mfrs* case – (1) adverse consequences resulting from the stay (2) reasonable alternatives to the override existed (3) did the agency consider the potential cost of proceeding with the override and (4) the override's impact on competition and integrity of the procurement system. The court ruled the override of the automatic stay was improperly decided upon. The court rejected the agency's assertion it would not be able to maintain its IT system stating there was no such evidence presented. For the second factor, the court concluded there was no evidence of a serious exploration of options and there was in fact other reasonable alternatives the agency chose not to pursue. As for the third factor, the court said the agency's cost benefit analysis was flawed where it improperly identified the costs of sustaining the protest as "reprocurement costs" and its assertion that the override would avoid "termination" and "interruption costs" were not proper elements to be considered "benefits." Finally for the fourth factor, the court claimed the agency's assertion it had a reasonable chance to prevail in the protest did not relate to the automatic stay or integrity of the procurement system (*E-Management Consultants v US, Fed. Cl. No 08-680*).

Contractor Did Not Accept Purchase Orders or Possess a Contract

The Defense Supply Center Columbus (DSSC) issued a purchase order for 14 vehicle gears and a second one for 16 additional gears to Comptech. Though DSSC extended the delivery dates by 60 days and when it discovered certain bore holes were out of tolerance Comptech asked for a waiver but DSSC denied it stating that parts out of tolerance were unacceptable so it cancelled the POs and the contractor officer sent a letter representing its final decision. In its appeal, Comptech asserted DSSC improperly cancelled its POs stating the cancellations should have been converted into terminations for convenience where it was entitled to certain costs. The Board disagreed finding the two POs were not signed by any Comptech representative and did not contain any other indication of acceptance. The POs comprised only an "offer" to buy certain supplies on specified terms and conditions and the offer was accepted by the act of timely delivering the requested goods. The Board explained that Comptech's initiation of performance was substantial enough to create "option contracts" binding the agency to keep its offers open until the dates set forth in those offers but Comptech's actions "did not convert the POs into binding contracts for the sale and purchase of gears." The Board added the offers lapsed by their own terms because of Comptech's failure to tender complete performance and hence there was no contract that could have been terminated (*Comptech Corp. ASBCA No 55526*).

SMALL/NEW CONTRACTORS

Advanced Agreements

We have been working with several clients who are faced with the need to either propose different indirect rates than those applicable to its other government contracts (both higher and lower rates) as well as treating normally indirect costs as direct. One of the options most have been considering and we have been helping them with is negotiating advance agreements with the government that will cover one or a group of unique contracts. From time to time we have alluded to the need to establish advance agreements with the government when it is necessary to change an accounting practice to either increase or decrease allocation of costs to an individual or group of government contracts and have even addressed advanced agreements in general. Where it used to be

relatively infrequent we are now seeing a lot more advance agreements being used both in fixed price contracts to minimize recovery problems when added work is contemplated or terminations or claims may occur as well as in flexibly priced contracts. The following provides a basic primer on advance agreements addressing regulations under both fixed and flexibly priced contracts.

♦ Regulation

FAR 31.109 addresses advance agreements. It states such agreements should be established before costs are incurred to avoid confusion and clarify treatment of costs by a contractor. Advance agreements cannot make an otherwise unallowable cost allowable but is intended to resolve in advance differences of opinions on the allowability or allocability of specific costs. Though not exhaustive the regulation identifies sixteen specific cost topics that are good candidates for advance agreements. In our experience the following are most common: compensation, charges for depreciated assets, pre-contract costs, royalties and patents, selling and distribution costs, travel and relocation, idle facilities and capacity, severance pay, plant conversion, professional services, indirect costing methodologies, public relations and advertising, training and most common these days, independent research and development costs.

♦ Process

So not to "muddy the water" it is usually not advisable to put forth advance agreement proposals before contract award but rather, after contract award but well in advance of either incurring the expense or reporting the cost (e.g. claims, terminations, incurred cost proposals, forward pricing rates for other contracts). A straight forward narrative describing how the cost(s) will be treated addressed to the appropriate ACO is the best approach. Justification for the treatment and allusion to the benefits for the government is advisable. The appropriate ACO is either the contractor's cognizant ACO or if the agreement affects only one contract then the ACO over that contract. Since it is the ACO's decision, I would not advise sending copies to other agencies such as government auditors unless their approval is likely. Though it is not uncommon to have DCAA review the proposal, it is also common for the ACO to by-pass DCAA and in consultation with their price analyst, to make a decision. In its guidance, DCAA instructs its auditors to incorporate all advance agreements in its reviews but if they believe such agreements are "not in the government's interest" to express such an opinion in their audit report.

♦ Examples

For fixed price contracts usually awarded on a competitive basis, no cost and pricing data is normally submitted. Though many veteran contractors may have approved government accounting practices often committed to writing (e.g. disclosure statements, written procedures) more and more contractors do not so when it comes to proposing additional work based on cost estimates or preparing a claim or termination an advance agreement detailing contract costing treatment of certain costs is advisable to avoid substantial questioned costs later. Several cost categories that contractors will want to consider under such circumstances are:

1. *Direct vs. Indirect Charging.* Though veteran government contractors have established criteria for direct and indirect charging, newer contractors and commercial subsidiaries of veteran contractors need to establish how, for example, computer services will be treated.

2. *Home Office G&A Rates and Pools.* Just about every contractor has their own unique ways of accumulating and allocating general and administrative costs (either at the business unit, intermediate home office or corporate level). Mark up, percentage or daily rates may need to be established for claims based on extra work, delays, etc. These rates can be established either before or after contract award and will largely avoid protracted battles about cost allowability and allocability issues later.

3. *Field Office Costs.* Overhead rates, often referred to as general condition costs for construction work and project support costs for non-construction work, are commonly recovered on both a percentage or daily rate basis. Advanced rates using either method can be established so one method used on a prior contract need not be the presumed method for all government contracts.

4. *Equipment Pricing.* Whereas the contract commonly specifies equipment or supply prices when in operation, costing idle assets can be a highly disputed matter for purposes of quantifying claims. Such disputes can be avoided by proposing rates for extra work or delayed work.

5. *Other Items.* Other items to consider for advanced agreements include (a) fringe benefit rates (b) self insurance costs (c) overhead rates for one business unit or segment rather than for the company as a whole and (d) individual company rates when two or more companies are involved in a joint venture.

In addition to pricing items for contracts not subject to cost analysis there are the more traditional contracts

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requiring cost based data either for forward pricing or incurred cost purposes where advanced agreements need to be considered. In our experience, each of the cost items identified above in the Regulation section should be considered for advance agreement. For example, DCAA will generally not recognize costs of idle facilities for longer than one year where such costs may need to be incurred longer or expensive literature used for disseminating information may be questioned as unallowable advertising expenses. Some good candidates for advance agreements are:

1. *Rate Structures*. Whereas proposed rates may be based on a business segment, the contractor may plan on performing most of the contract by a specific division or group within the segment having different rates. These differences may need to be specified in the contract or in a subsequent advance agreement. In addition, it may be advisable to establish a separate rate such as a subcontract administrative or material management rate for a contract where no such rates for other contracts exist.

2. *Rental Transactions*. Assets that were charged to government contracts on the basis of depreciation, maintenance, cost of money, etc. would be changed under circumstances where, for example, a sale/leaseback arrangement occurred where the assets would be charged on the basis of a rental agreement. In addition, arrangements where rental costs might be questioned because of perceived related party arrangements or unequal lease provisions (e.g. higher rents at end of lease) are excellent candidates for advance agreements.

3. *Compensation levels*. Though the FAR has established ceilings on executive compensation, DCAA commonly questions compensation levels for other individuals and classes of employees usually based on survey data. An advance agreement providing justification for levels of compensation likely to be disputed later can save a lot of work in this rather nebulous area.

QUESTIONS & ANSWERS

Q. We have two business units that have separate tax ID numbers. Our disclosed practices states we calculate G&A for both units but can we consolidate the units into one?

A. It largely depends on whether the two units meet the definition of a business segment and whether the combined unit does. Take a look at the definitions of business segments in various cost accounting standards (we have also written about it – use our key word search) – e.g. separate management, reporting relationships, control by corporate headquarters or intermediate group. Three options come to mind: (1) one consolidated business segment (2) two separate segments where G&A costs for both are pooled and allocated to the two units consistent with CAS 403 requirements or (3) continue doing what you are doing.

Q. Our budgeted rates for vehicle and equipment unit prices are significantly lower than actual rates – should I bill our customer and if so, how?

A. If the unit rates are cost reimbursable and are merely provisional unit costs (as opposed to negotiated fixed unit rates) then like your indirect rates, you may adjust billings as soon as you are aware of the difference. You can either bill for the period's underbilling and then adjust the unit billing rates upward or simply make the adjustment to reflect both projected costs going forward and the amount underbilled in the prior period.

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