
GCA REPORT

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NEW DEVELOPMENTS

Legislation Passes Repeal of 3 Percent Withholding

President Obama signed the long hoped for repeal of the three percent withhold of some payments to contractors. The underlying bill repeals a 2005 law that had been postponed from implementation by Congress and the IRS to 2013. It would have required the federal, state and large local governments to withhold 3 percent from payments over \$10,000 to vendors which was intended to combat tax avoidance. However, industry, business owners and lawmakers all said the legislation would adversely restrict cash flow and would cost more to implement than it would produce in revenue.

Industry Comments on Proposed FY 2012 DOD Act

Acquisition related provisions in the recent conference report on the fiscal year 2012 defense authorization bill that is awaiting presidential signature has drawn mixed responses from contractor and government groups. Most notably, the conferees found middle ground on the contentious issue of executive compensation. The bill expands the allowability of contractor executive compensation to cover all contractor employees instead of just the five most highly-paid executives in each company as current law now provides. Its also provides exemptions for scientists and engineers when necessary to ensure continued DOD access to necessary skills and capabilities. Industry's Professional Services Council, while not happy with the expanded limitation to all employees, applauded the decision to leave the current, formula-based approach alone rather than impose recommended cap amounts such as \$200K or the amount paid to the President (currently around \$400K). The government-oriented Project on Government Oversight decried the fact that contract employees will make more than the President and will apply only to Defense contracts. The PSC also singled out other provisions of the bill for praise including (1) a requirement to give contractors a 14-day time period to provide comments before past performance information is posted on government websites (2) a ban

on any requirement that contractors provide political contribution information in conjunction with the federal acquisition process and (3) language clarifying that contractor performance of functions "closely associated" with its mission may be outsourced.

Contractors Must Now Attest to Compliance with Post-Employment Limits

A final rule amending the DFARS will now require contractors who employ former senior Pentagon officials or acquisition executives to attest they are in compliance with post employment restrictions applicable to those employees. The new rule is in response to a recent GAO study finding DOD officials are working for defense contractors on assignments related to their former positions. "Covered DOD officials" defined in DFARS 252.203-7000(a) are those that left DOD service on or after Jan 28, 2008 and either (1) participated personally and substantially in any acquisition with a value of \$10 million or more and served in specifically highlighted positions or (2) served within DOD as "program manager or deputy, procuring contracting officer, ACO, member of the source selection evaluation board or chief of a financial or technical evaluation team for a contract in an amount in excess of \$10 million." The new rule will apply to all solicitations including those for task and delivery orders (*Fed. Reg. 71826*).

Recent Proposal to Require Submission of Cost and Pricing Data Generates Opposition

The influential American Bar Association has come out against a DOD proposed rule that would require contracting officers to use price or cost analysis to confirm an offer is "fair and reasonable" when only one offer is received. The proposed rule would apply a stiffer policy for determining adequate competition exists than the current FAR 15.404 provision which states a CO can accept a single bid after judging it was submitted under the expectation of competition. The ABA stated the rule would increase price, drive away competition and increase lone bids where it erroneously presumes cost/pricing data is needed to prove competition exists. Commercial firms and low dollar contractors would be

disproportionately affected where they lack the resources to provide cost/pricing data. The comments also noted two GAO studies on one-bid solicitations that concluded COs should have the discretion to make judgments about whether competition existed and that competition does exist if the firm expects others to bid. The FAR clearly prohibits submitting of cost or pricing data for commercial items or when the price is based on adequate competition. Using a different approach the proposed rule calls for only creates confusion. The ABA recommends further study of the issue and if it does pass, it should not apply to commercial items and services as well as contracts less than \$10 million.

DOD Chief Says Contractors Face a Bumpy Road But Brighter Skies Ahead

Acting Undersecretary of Defense for Acquisition, Technology and Logistics Frank Kendal told industry representatives that federal contractors are in for a “bumpy ride” over the next few years in the current atmosphere of budget cutting but the good news is the procurement budget will stabilize. Contractors can look forward to an improved acquisition workforce and a reduction of audits by DCAA when business systems are deemed adequate. In the medium term DOD will continue to squeeze service contractors as budgets shrink where the government will have no choice but to look for efficiencies in its buying of products and services. As a result, contractors can expect a few years of instability as things get resolved and they should look for ways to provide good value to the government. On a positive note, the era of contract cutting will end in a few years and lead to a time then the government will begin “procurement programs they can finish.” Also, the insourcing trend has mostly run its course where the government is capping the number of employees it will be hiring.

Recent DCAA News

The Defense Contract Audit Agency has released some significant audit guidance, is the subject of a new GAO report, generated significant comments on recent actions and unintentionally offered an interesting way to challenge unreasonable auditor actions.

◆ DCAA Issues Guidance on Defective Pricing and Incurred Cost Audits

The Defense Contract Audit Agency revised its audit program for post award audits (i.e. defective pricing) to expand steps to ascertain “risk assessments.” The “enhanced risk assessment procedures” call for a step to hold a walk-through of the pricing action with the

contractor to identify the cost or pricing data submitted for the pricing action that is under review and the steps that were taken to ensure the most accurate, complete and current data were disclosed to the government. The guidance states the walk through will serve to achieve an understanding of the basis of the estimate of the pricing action and an understanding of the internal controls that are in place to avoid defective pricing (*11-PPD-030(R)*).

DCAA has also revised its audit guidance for major incurred cost audits to cover such areas as direct labor, contractor compensation and excessive pass-through costs. The new procedures include steps to “enhance risk assessment” to obtain a walk-through of the incurred cost proposal with the contractor to obtain an understanding of the basis of the claimed costs and related documentation, significant controls and relevant policies and procedures related to significant cost elements. (*Editor’s Note. We are increasingly seeing DCAA requests for written policies addressing preparation of ICEs.*) The guidance alludes to earlier guidelines addressing the process of documenting an understanding of relevant internal controls and a “better link” of results of a risk assessment and audit procedures performed. The policy has also revised the Guide for Determining Adequacy of Contractor Incurred Cost Proposal to provide an even more comprehensive guide in determining adequacy of final indirect cost proposals at both major and non-major contractors where auditors are reminded they must evaluate contractors’ incurred cost proposals for adequacy upon receipt and notify contracting officer and contractors, in writing, of significant inadequacies (*11-PPD-014(R)*).

◆ Tough Road Ahead Dealing With DCAA

We are finding increasing complaints by clients and subscribers about dealing with DCAA these days where we have addressed these issues many times. A recent interview with a procurement attorney, Sandy Hoe of McKenna, Long and Aldridge published in the October 18 edition of the Federal Contracts Report illustrates what we are seeing. She mentions that many of her clients are finding it difficult to negotiate with the agency even on issues that used to be relatively noncontroversial. Examples cited include: (1) insisting on cost data and detailed price data on items that were selling at commercial prices for many years such as leasing assets which are now largely fully depreciated and (2) uncertainty and inflexibility in evaluating contractors’ business systems. She attributes many of these difficulties to severe GAO, IG and Senate criticisms where DCAA management has scrambled to

tighten audit rules where, for example, it will no longer conditionally approve contractors' business systems, imposes tougher positions on access to records and allow relatively short periods to produce requested documents before matters are escalated to senior management and subpoenas are issued. Interim rules are now making it too easy for the government to withhold payments. Trying to reason with DCAA has become an "unavailing" experience and now contracting officers are very reluctant to take any position that DCAA would not approve of. The lesson is that the rules have definitely changed where it is difficult for not only contractors but also DCAA and the government. The pendulum has swung to the side of much stricter government enforcement but the silver lining is that nothing lasts forever.

◆ GAO Issues Report to Expand Access to Contractors' Internal Audits

The GAO has issued a report to expand DCAA access to internal audit information generated by contractors. The report stated that contractor audit departments have complied with relevant audit standards but has concluded that DCAA's limited access to the internal audit information limits its oversight functions. The GAO concluded that DCAA requests too few internal audit reports that are relevant to its defense contract oversight where auditors said they could not identify relevant internal audits and were uncertain whether those reports would be useful in any event. The GAO concluded that by failing to access internal audits, DCAA was limiting its effectiveness as well as its efficiency to evaluate contractors' internal controls. GAO recommended the DOD Secretary direct DCAA to (1) ensure that the central point of contact (POC) for each contractor coordinates issues pertaining to internal audits (2) periodically assess information compiled by the POC regarding the number of requests for internal audits and their disposition and (3) train staff regarding how and when company internal audit reports can be accessed and used to improve audit efficiency. The Defense Department concurred with the recommendations. (*See Defense Contract Audits: Actions Needed to Improve DCAA's Access to and Use of Defense Company Internal Audit Reports (GAO-12-88)*).

◆ DCAA Auditor's Independence Was Impaired

(Editor's Note. Though most auditors are highly professional even when we disagree with positions they may take, the following indicates an interesting position to take when that unusual bad apple auditor appears.)

When a contractor complained to a DCAA supervisor about an auditor's inappropriate behavior toward its employees the supervisor counseled the auditor to remain professional. The next day the auditor emailed the contractor's chairman to express frustration over the allegations and noted "slandorous accusations will only increase my diligence." When the contractor provided DCAA with the email it agreed the auditor's independence was impaired, a critical element of Generally Accepted Government Auditing Standards, when it relocated the auditor from the contractor's facility to the field office but it did not reassign three other audits of the contractor that were assigned to the auditor. The Inspector General highly disagreed with this action and asserted management had failed to investigate the contractor's complaints where if accurate, would constitute misconduct. It called for DCAA to revise its training and consider administrative action for managers' failure to follow GAGAS and investigate contractors' complaints (*dodig.mil/Audit/Reports/FY12aps/DODIG-2012-002*).

CAS Board Issues Final Rule Harmonizing CAS Pension Accounting With Pension Protection Act

The Cost Accounting Standards Board Dec 27th issued a long awaited final rule bringing its standards in line with requirements of the 2006 Pension Protection Act on minimum pension plan contributions. The rule revised CAS 412 and 413 to include the recognition of a "minimum actuarial liability" and "minimum cost" which are measured to determine the PPA minimum required contribution. It also accelerates recognition of actuarial gains and losses and makes other changes to harmonize CAS with the minimum required contributions established by the PPA amendments to the Employee Retirement Income Security Act such as accelerated gain and loss amortization, mandatory cessation of benefit accruals, projection of flat dollar benefits, present value of contributions receivable, interest on prepayment credits and a transition period. ERISA establishes minimum funding requirements to protect retirees' benefits and do not address accounting practices while CAS is designed to achieve uniformity in cost accounting practices in government contracts so the changes are intended to "better align" the two. The final rule discarded some "overly complex" provisions in the earlier proposed rule that would recognize actuarial liability and minimum normal costs to three threshold criteria (*go to Fed. Reg. 32745 for the full text of the final rule*).

Final Rule on Personal Conflict of Interest

The FAR Council issued a final rule that places greater responsibility on contractors to prevent personal conflicts of interest (PCIs) on the part of their employees who perform agency acquisition functions “closely associated with” inherently government functions. In addition, such contractors will be required to prohibit covered employees with access to nonpublic government information from using it for personal gain. The earlier interim rule was modified after receiving public comments including revising the definition of “covered employee” to include applicability to subcontracts (*Fed. Reg. 68,017*).

Industry Opposes Increased Use of Lowest Cost, Technically Acceptable Evaluations

Industry representatives are saying the budget cutting atmosphere in Congress is pushing federal agencies to award too many contracts on a lowest price, technically acceptable (LPTA) basis, especially service contracts. The influential Professional Services Council (PSC) says the LPTA contracts do not reward innovation where companies that invest in research and development get no credit for being better than average. Though LPTA may be OK for commodities or off-the-shelf items they are a poor match for differentiated products or services where quality and performance matters. Several congressional representatives and other government officials expressed agreement with the assertion where agencies need to be educated.

New Rules and Commentary on Small Business Related Actions

It has been a busy time for recent proposals affecting small business. A few significant ones include:

1. The Small Business Administration recently proposed rules to adjust the size definition of small businesses in 52 industries in two broad categories of businesses. The proposed changes would increase revenue-based size definitions of small businesses in 15 industries in the NAICS Sector 51, “Information” and in 37 industries in Sector 56, “Administrative and support, waste management and remediation services.” The current proposal can be found in the Federal Register 63216. It follows other size standard changes for various professional services in March.

2. A new interim rule is imminent that would allow COs to set aside multiple award schedule (MAS) contracts for small business in accordance with the

Small Business Jobs Act of 2010. The set asides will not be mandatory but industry representatives are saying the program will have a “huge impact” on small business.

3. Leaders of the House and Senate small business committees cheered the agreement in the DOD fiscal year 2012 policy bill reauthorizing the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs for six years.

4. A recent article by three attorneys of Jenner & Block in the Nov 8th issue of Federal Contract Report identify several proposed actions coming from the proposed Small Business Jobs Act of 2010. These include:

- a. In pressure to actually use subcontractors that are proposed, prime contractors will have to use a “good faith effort” to obtain products and services from the same small business subcontractor included in its proposal where failure to do so or if payments to subcontractors are more than 90 days past due, the prime contractor will have to provide a written explanation why.

- b. To clarify the more than half dozen definitions in the FAR, the SBA has defined “subcontract” to mean “any agreement...entered into by a government prime contractor or subcontractor calling for supplies and/or services required for performance of the contract (including modifications).” Purchases from affiliates of the prime or subcontractor are not included and the rule clarifies that subcontract award data reported is limited to awards made to “their immediate next-tier subcontractor” or subcontracts awarded outside the US.

DOD Wants Increased Use of Fixed-Price Incentive Contracts

The Defense Department issued a final rule amending the DFARS to increase use of fixed price incentive (firm target) contracts. The rule requires COs to give particular consideration to the use of FPIF contracts, especially for acquisitions moving from the development to production stages (*Fed. Reg 57677*).

CASES/DECISIONS

Appeals Board Disallows Deferred IR&D, Bonus and Recruiting Meals Costs

(Editor's Note. Since this is a significant case addressing important cost principles and issues, we intend to write up the case more thoroughly in the next issue of the DIGEST where we will also address types of documentation needed to allow these costs.)

The Air Force awarded SplashNote a cost reimbursable contract to develop technologies to facilitate team collaboration. It charged three categories of costs to overhead and G&A that the government found was unallowable: (1) deferred IR&D costs (2) a bonus paid to the CEO and (3) meal costs to discuss recruiting professional colleagues. The government issued a demand payment for these three categories of unallowable costs for \$84,950 and SplashNote appealed after the CO issued a final letter.

With respect to the deferred IR&D costs, the board found that FAR 31.205-18 generally disallowed deferred IR&D costs and found nothing in the contract that authorized it. The Board also rejected SplashNotes contention the government was stopped from denying the costs since prior audits had not questioned the costs.

The Board next ruled the CEO's bonus was unallowable under FAR 31.205-6(f) because it constituted a distribution of profits. Letters to employees announcing the bonuses pursuant to the company's profit sharing plan supported this conclusion.

Finally, the board ruled the costs related to discussing recruitment were unallowable recruitment costs. The contractor's contention they were allowable travel or trade business, technical or professional costs were covered by other FAR cost principles the board ruled were not relevant (*SplashNote Systems, ASBCA No. 57403*).

Inadequate Accounting System is Grounds for Rejecting a Proposal

(Editor's Note. The following case provides justification for rejecting an entire proposal rather than just giving it negative grades if an accounting system is deemed inadequate.)

Relying on a DCAA issued audit report saying KMS's accounting and estimating systems were inadequate the Army concluded its accounting system was inadequate for awarding a cost reimbursable contract and found the proposal to be unacceptable under the management factor. KMS argued the Army improperly treated the issue of inadequate accounting system as a matter of proposal acceptability saying it should be limited to a matter of an offeror's responsibility only. The Army agreed that adequacy of an offeror's cost accounting system is generally a matter of responsibility but where a solicitation provided that the accounting system is a stated evaluation factor the issue become a matter of the proposal's acceptability. The GAO ruled for the Army saying it reasonably determined KMS's proposal was unacceptable under the management factor and that

its cost accounting system was inadequate where either rationale provided a sufficient basis for rejecting the KMS proposal (*KMS Solutions, LLC, B-405323*).

Can Change Any Aspect of a Proposal Following An Amendment

Following an award and a protest, the agency amended the solicitation to revise criteria related to past performance. After the amendment, Power Connector revised several parts of its proposal including its price where the government argued because the amendment only impacted past performance, it could not revise its price. GAO sided with the contractor saying when an agency amends a solicitation offerors should be allowed to revise any aspect of their proposals, including those that were not the subject of the amendment, absent a good reason for limiting revisions. The GAO noted that the change to past performance criteria would have made Power Connector's proposal less desirable so as a result it would have lowered its price to enhance its competitiveness if given the chance (*Power Connector Inc., GAO, B-409916*).

Interest Clock Starts When ACO Receives a Claim

The Armed Services Board of Contract Appeals ruled the contractor was entitled to collect interest on a certified claim under the Contract Disputes Act from the date an administrative contracting officer receives a certified claim (*SRI International, ASBCA No. 56353*).

Legal Services is a Contract Covered by FAR, Not a Personal Services Contract

(Editor's Note. We find the following case interesting since we often find the term "personal services contract" bandied about inappropriately.)

A law firm providing legal advice and assistance to the Energy Department resisted a Labor Department compliance audit asserting it held a personal services contract and hence was not subject to the FAR including that section addressing the audit. The Labor Department ruled the contract was not a personal services contract which is formed when contractor personnel "are subject to the relatively continuous supervision and control of government" where such a contract is characterized by such things as being personal in nature when the contract performance is principally at the agency's facilities, is comparable to services performed by the agency's personnel and the firm's services are expected to last more than one year. Here, the legal services were performed at the firm's offices,

its tools were provided by the firm and supervised by the firm's personnel where the government only reviewed the firm's work product. Most importantly, its personnel were not supervised and controlled in a manner "the government normally exercised over its employees." Further, the FAR prohibits award of personal services contracts unless there is specific authorization to do so which here there was no such authority. Lastly, the contract expired within a year of award where actual work stopped even earlier (*OFCCP v O'Melveny & Myers, DOL OALF, No. 2011-OFC-00007*).

QUESTIONS & ANSWERS

(Editor's Note. We are postponing our usual feature article this issue to catch up on some of the increasing number of questions we have received from subscribers and clients. Our "Ask the Experts" feature has become very popular.)

Q. We have an ID/IQ contract where our ACO is telling us we must withhold fee on our delivery orders. My understanding is the fee withhold applies at the contract level, which we have not yet reached. What say you?

A. A recent case we reported on, WestWind Technologies, asserted the language in the contract addressing "fee withholds" and "as stated in the Schedule" was applicable at the task and delivery level since the IDIQ contract did not contain any specified fee language. You will need to look at your contract carefully to see whether this ruling applies to you or whether there is language indicating the fee withhold applies at the contract level.

Q. We are a professional services firm and we want our G&A rate to be as low as possible so we charge all our payroll taxes and fringe benefits and most other indirect costs (supplies, rent, phones, etc.) to overhead. DCAA is now asking us why we are not charging these costs to G&A. What do you suggest?

A. In general, you would want to emphasize that costs are charged to one rather than two indirect pools (1) to avoid significant administrative effort to distinguish them and (2) the impact is not material. For non-fringe benefits you would want to show (1) those costs are more related to either support of projects or direct labor rather than the company as a whole (2) the administrative burden of separating out those costs is not worth the effort and (3) it is not at all uncommon to charge such costs to only one pool. As for charging fringe benefit costs to G&A, it is more of an uphill battle

since those costs should generally follow the labor (i.e. fringe benefits for direct labor and overhead labor go to overhead and those associated with G&A go to the G&A pool). In general you would want to make the administrative burden and immaterial impact arguments discussed above. In addition, you may want to consider shifting more G&A labor to overhead. You will also want to draft a written policy describing these practices and provide it to the auditor.

Q. We are screening unallowable accounts at the end of the year. We fear DCAA will not approve of our approach. Any suggestions?

A. Conduct a valid statistical sample of transactions in "risky" accounts. There are various software programs out there to identify a valid statistical sample including the one used by DCAA – E-Z quant. Though such an approach is not considered as strong an internal control as screening them at the time the costs are entered into the accounting system, the stat sample approach should be accepted where even DCAA audit guidance provides such an approach is valid.

Q. DCAA is asking whether we would accept them performing a multi-year incurred cost audit for FYs 2006 and FY 2007 together. They state that what this means is that when they select accounts for testing, they will pull the universe for both years together and select a sample from the combined universe. Where statistical sampling is used they would project the questioned costs to each year based on percentage of costs in each universe. They are asking a series of questions to ensure they are comparing "apples and apples" for the two years such as did we maintain the same accounting practices and internal controls or are the cost elements in accounts similar. Would you accept their proposition?

A. I'm not inclined to make DCAA's life easier, only yours. That's an interesting new approach DCAA is taking where for the price of one they can get two - do transaction testing for both years at one time and project the results to both ICEs. I understand it's a new approach and they are probably just getting the kinks out where possibly in the future they will provide an incentive for contractors who agree.

In your case, you are considered to be a "low risk" contractor - e.g. non-major contractor, ICEs submitted on time, no history of significant questioned costs, etc. Low risk contractors' ICEs are supposed to be audited at least every third year (a third is selected by lottery each year) where if you are not selected for two years, you can expect an audit the third year. So that tells me

there is a good chance that one of the years - 2006 or 2007 - will not be audited so why give them an opportunity to find questioned costs in that year where otherwise they wouldn't have any because they didn't audit it? Even if you are not low risk, given the possibility of big cuts in DOD, DCAA's ranks may decrease making it years before they get around to 2007. So I would be inclined to reject their not so generous offer. You may cite as reasons for rejecting their offer one of the reasons they ask you to address (e.g. increased internal controls over certain accounts, differences in cost elements in the accounts, etc.) However, if you are waiting for DCAA to issue reports to close out contracts where moneys are due, you may want to accept their offer in order to expedite payment.

Q. The government has just issued a demand letter (December, 2011) for penalties resulting from questioned costs stemming from our 2004 ICE. You said the six year statute of limitations may apply since we submitted the ICE in May 2005. Should we get an attorney?

A. We put the question to an attorney colleague of ours. He said there are no cases addressing the Statute of Limitations (SOL) for ICE submittals. In one case, McDonnell, the ruling was as of the date of the audit report, not ICE submittal. He said our client's position is reasonable – they were required to submit the ICE by June 30, 2005 which they did, the clock for SOL should start then, and the government “should have known.” The government is fighting SOL assertions a lot these days and will assert the process is very involved (auditor didn't get to it, etc.). You have a reasonable argument but no slam dunk. If you decide to seek a decision on the SOL issue, he also recommends filing for a deferred payment agreement because you are challenging the government's position. 60% of the time it is agreed to so you would be able to temporarily waive payment of their demand letter.

Q. We are expecting a CPFF contract award of around \$50M - \$90M. This will be a negotiated contract (perhaps with a 3 year period of performance). We expect this award in the first quarter of 2012. So assuming that this is awarded at \$48 or \$49M, but we will have other negotiated awards will this contract be fully CAS covered?

A. No. The cumulative rule (more than one where added up they exceed \$50 M) applies to the prior year. So awards greater than \$7.5 M in 2013 will likely be fully CAS covered but not in 2012.

Q. DCAA is asserting our accounting system is inadequate citing (1) facilities costs is inequitably allocated to contracts where labor works at a Naval base, needing an offsite rate (2) Xmas party expenses are unallowable and (3) we are not monitoring indirect rates.

A. On the surface, all their assertions appear reasonable so you should say you concur, make fixes and negotiate a quick return date for them to confirm the fixes were made. You may be able to negotiate a fast follow-up date by agreeing to their conclusions, allowing them to quickly issue their report.

Q. We want to avoid disclosing compensation of seven owners – can we create a holding company.

A. I don't know why not because they would no longer be part of the segment doing business with the government and those costs are not being allocated to government contracts. However, if there is a home office allocation including their salaries, then those costs may be reviewed.

Q. We would like to change our corporate structure from four service divisions to two – one that would be considered a “fixed price” division and one a “cost reimbursable” division – where we would then have separate overhead rates for each division. Do you see a problem?

A. I don't see any problem as long as the two divisions can be justified as two separate business units. However, type of contract is usually not a criteria for establishing separate business units. Each needs to report to a home office and normally have separate management and administration. If that is the case, you can likely defend the two divisions and then establish separate rates for each division.

Q. We want to assign an Accounts Payable person who will charge their time to two separate divisions based on the time expended for A/P processing, etc. I am concerned about accurately tracking this time. I am also thinking about setting up a Service Center to allocate that person's time and efforts based on the contract values of the two divisions.

A. Both your ideas are valid. If you can trace the AP person's time to work related to separate divisions then that should work. However, that is usually a tough thing to do in which case your service center idea might be better.

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Q. We are thinking about buying the building we have leased for the last 5 years. However, my concern is that the lease would then be between related parties (the LLC set up to buy the building and our current company). We would like to keep our current lease rate. However, if interest on the SBA loan is unallowable for current company, then the LLC would not be able to make its payments. Also, we do not currently have any government contracts where we requested Facilities Cost of Money. What do you think?

A. Yes you're right, the LLC would probably be considered a related party transaction so you would be limited to the cost of ownership of the property as opposed to the current lease payments. You'll need to run the numbers to see what the cost of ownership would be - depreciation, cost of money (on land also), repairs, maintenance, etc. - and compare the result to the lease payments. You're also right to be concerned about not proposing COM prior to award of cost reimbursable contracts as well as fixed price. For the cost reimbursable contracts, if you didn't propose it you are likely not entitled to recovery on your incurred cost submittals unless you arrange contract mods where the new arrangement is reflected.

Q. My client is a person that owns 5 individual companies. He wants to go after a Government contract that is set aside for a small business. There is not a parent company where each of the five companies operates on their own. My question is does the revenue cap of \$7M apply to the one company for their respective NAICS code or is the Cost of Ownership applicable to all the companies combined which would be more than \$7M.

A. The rules are a bit murky these days. If there is common control of the companies they would usually

be considered affiliated and hence the cap would apply to all combined. However, recent rules have made exceptions for, for example, private equity firms or venture capitalists where each company owned stands on their own. You need to check into these new rules and see if your client's circumstances qualify.

Q. We submitted a proposal for a 7 week demobilization task ending at the end of the year after we lost the bid and protest as incumbent. Our contracting officer, who is very upset about our protest, requested that we use indirect rates based on 2011 year-to date actuals through September. The CO is telling us that she is issuing a contract with a clause that our rates are subject to audit and downward adjustment only based on the audit report. Since we lost our major contract and expect very little work during the last three months of the year (lower cost base), I stated that we will either accept the contract value based on the submitted indirect rates or accept adjustment both ways (up or down) based on the full 2011 year pool and base. She is refusing and is telling me either agree or no contract. Is this right?

A. She is wrong about accepting only actual rates through September. Indirect rates should be based on annualized actuals or estimates. However, it is not unusual for her to offer only a downward adjustment determined after audit so I don't think you can fight that (though you can try). You should provide a proposal based on an annualized indirect cost rate (9 months of actuals and 3 months of projected costs) where the base will be adjusted for lower costs for the last three months. You can provide some verbiage in your cover letter indicating annualized indirect rates are the only appropriate rates to use.