GCA Report

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NEW DEVELOPMENTS

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

The Treasury Secretary has set a rate of 1 3/8% for the period January through June 2013. The new rate is a decrease from the 1.75% rate applicable to the last six months of 2012 and is the lowest rate ever set. The Secretary of the Treasury semiannually establishes an interest rate that is then applied for several government contract-related purposes. Among other things, the rates apply to (1) what a contractor must pay the government under the "Interest" clause at FAR 52.232-17 and (2) what the government must pay a contractor on either a claim decided in its favor under the Contract Disputes Act or payment delays under the Prompt Payment Act. The rate also applies to cost of money calculations under Cost Accounting Standards 414 and 417 as well as FAR 31.205-10 and when a discount factor is used to calculate the present value of future payments (e.g. deferred compensation).

DCAA Responds to Recent Case Criticizing their Approach to Executive Compensation

(*Editor's Note. Most commentators, including us, are very disappointed in DCAA's response (or lack of it) to the two recent cases rejecting their approach to evaluating executive compensation. In the past, DCAA used to attempt to translate board and court decisions into audit guidance but such a traditional approach is being rejected here.*)

DCAA has responded to the JA Taylor decision on executive compensation stating they see this decision as presenting a unique set of facts. The report and commentary on this development was revealed by Darrell Oyer in his Dec newsletter where it states, on the negative side, that DCAA does not consider the case relevant to other situations unless the facts are identical – including down to the penny in the amount of compensation. Mr. Oyer states, on the positive side, the JA Taylor case addressed several objections to DCAA's approach where if the facts are similar to those of the JA Taylor case, DCAA should honor the Board's decision. The case held there were eight areas where DCAA (1) ignored the actual dispersion of data in surveys and simply applied a 10 percent range of reasonableness factor (2) ignored survey size where, for example, a survey consisting of 10 companies should not be weighted as much as a survey of 10,000 companies (3) did not first consider financial performance in determining what percentile to use (4) did not consider non-financial discriminators (5) did not use the same industry classification each year over the four year period (6) did not use the same titles for the same positions/people over the four year period (7) did not use the same surveys over the period and (8) mixed and matched "median" and "mean" each year. We will need to see whether DCAA follows Mr. Oyer's advice.

3-Tier Approval Steps Established for Conference Expenses

In response to recent scandals surrounding exorbitant expenses for government sponsored off-site conferences, DOD has recently established a three-tier approval plan for conferences. Approving authorities are to determine whether physical attendance is necessary and cost effective or whether the goals can be achieved through teleconferencing or other means. The memo states one level of approval will be required for conferences below $100,000, another approval for conferences between $100,000-$500,000 and the secretary level for conferences costing over $500,000. The memo explicitly bars "entertainment-related expenses" such as motivational speakers, promotional items, decorations and recreational activities outside the conference. Though no guidance has yet been established for contractors many commentators are expecting auditors to closely scrutinize all conference-related expenses and apply similar criteria as the government is imposing on its employees. For example, we have recently come across a management alert issued by the Department of Energy's OIG pointing out there were 109,000 foreign trips costing $360 million mostly taken by contractor employees, stating though it is not DOE policy to regulate contractor travel, identification of all such trips are easily accessible where auditors can ask whether they are "necessary" or "affordable."

Debate over Contractor Employee Compensation Continues

Both union and industry representatives are aggressively putting forth their positions on level of executive and non-executive compensation. Numerous labor organizations signed an Oct. 18 letter asking leaders of Senate and House committees to reduce compensation caps. The letter asserts allowable compensation has outpaced inflation by 53% over the last 12 years, the OMB executive compensation cap increased 10% in 2012 compared to 2% for members of the armed forces, capping compensation to $200,000 would save $5 billion per year, higher levels are not required to attract qualified employees and contractors can still pay more out of profits. Such reasoning has resulted in the Senate proposing a $230,700 cap in 2013 compared to the $763,029 cap currently in force in the 2013 DOD Authorization bill while the house is proposing a $400,000 cap. The Professional Services Council came out against the proposals stating it would make it more difficult to attract highly trained professions to work on government contracts.

ABA Balks at Removing Contractors' Rights to Appeal a Past Performance Evaluation

The American Bar Association has come out against the proposed elimination of a requirement that disagreements over a contractor's past performance evaluation be reviewed at a level higher than the CO. The FAR Council solicited comments on its plan to revise a proposed rule providing standardized government-wide past performance (PP) evaluation factors and performance ratings to "improve economy and efficiency." The ABA endorsed the original proposal but believes that eliminating a contractor's right to an administrative review of adverse PP ratings would have the opposite effect, increasing the likelihood of expensive litigation, undermining confidence of the PP evaluations, reduce oversight of the process and make PP evaluation vulnerable to abuse. It pointed out that a recent case (*Bannum v. US, 404 F.3d 1346*) supports its position by ruling an internal review above the CO by someone familiar with the contract should eliminate mistakes and potential bias of a CO.

Better Buying Power 2.0 Initiated

The Defense Department unveiled its update to its Better Buying Power (BBP) initiative, known as BBP 2.0 to "create industry productivity incentives and improving the acquisition workforce." DOD states the original BBP initiative, launched in Sep. 2010, made significant strides in achieving its goals of $100 billion over five years that made affordability analyses, should cost estimates, fixed price incentive contracts and stress on competitive contracting and service contracting routine.

BBP 2.0 will look for other contract vehicles when appropriate and reward suppliers who consistently show superior cost, schedule, performance, quality and responsiveness. In addition, BBP 2.0 will respond to recent criticism of expanded use of lowest price, technically acceptable (LPTA) criteria by improving the definition of "technically acceptable" and will require a better definition of "best value" in those procurements. Goals for increased productivity will include use of fixed price incentive contracts in early stages of new weapons systems, reassess incentives, reduce the backlog of DCAA's incurred cost audits and increase use of performance-based logistics. For services procurements, BBP 2.0 will continue using senior managers to determine use of services, improve training for personnel who write the requirements, improve market research and promote small business opportunities.

Industry representatives such as the Professional Services Council is recommending less use of fixed price incentive contracts and more variety of contracts to avoid "one size fits all" approaches and expressing concern that use of LPTA will not work when, for example, more complex technologies are involved.,

CAS Board Seeks to Redefine Commercial Items

Under a new proposal the current exemption to cost accounting standards coverage for fixed price contracts and subcontracts for the acquisition of commercial items would be changed. The proposal would replace the current long list of exemptions with a more generalized phrase "contracts and subcontracts for the acquisitions of commercial items." The evolution and expansion of contract vehicles used to purchase commercial items has led to an inconsistency between the regulatory text covering commercial items found in 48 CFR 9903.201-1(b)(6) and other regulations. The inconsistency would be resolved by using the wording in the 1996 Federal Acquisition Streamlining Act and eliminating the need to update and add ever new contracting vehicles for commercial item acquisitions (*Fed. Reg. 69422*).

DCAA and DRAP Dispute the DOD IG Report Criticizing Retreat from Low Dollar Audits

The 2010 decision to transfer low dollar contract audits from DCAA to DCMA has generated criticism from the DOD Inspector General office saying the transfer will cost taxpayers $249.1 million per year. The IG recommended turning the audits back to DCAA but DOD's Office of Defense Procurement and Acquisition Policy (DRAP) disputes the IG's assertions saying they were flawed. The DODIG report stated that the transfer of proposal audits to DCMA ($10 million or less of fixed price, $100 million or less of cost type) would result in DCAA not finding $1,885 of questioned costs for each audit hour adding up to the $249.1 million figure where it added DCMA would most likely not conduct their own low cost analyses and could not replace the potential return of the more experienced DCAA.

Both DRAP and DCAA disagreed with the IG report saying it does not account for the additional savings of DCAA switching to higher dollar proposals claiming that redirecting just 10 percent of the audit effort to those audits would generate $663.8 million in questioned costs. The IG did not dispute the assertion that more questioned costs could result but said DCAA could have redirected its audit effort to other areas that generate far less per hour savings such as special audits, defective pricing, cost accounting standards and incurred cost audits. DCAA stated questioned costs were not the proper metric where it should have used sustained, net savings which was half the $249 million savings cited.

Most industry comments we have seen agree with DRAP and DCAA's position, saying "it seems a little silly to focus on only one side of the equation" and using questioned costs as the metric overstates the savings. However, one organization, Project on Government Oversight (POGO) states that raising the DCAA audit threshold is "bad business" where it continues the "acquiescence to contractor interests." (*The DOD IG report can be found at dodig.mil/PUBS/documents/DODIG-2013-015*).

EVMS Deficiencies Result in a $47 million Withhold

(*Editor's Note. Earned Value Management Systems of large contractors have recently become a significant audit focus of DCMA where now dedicated EVMS teams expand those audits. The following shows the downside of significant deficiencies being found.*)

The Department of Defense has announced it is withholding $47 million in payments to Lockheed due to problems found in its Earned Value Management System in the J-35 fighter program. The Defense Contract Management Agency found Lockheed violated 19 of the 32 EVMS regulatory standards and attributed much of its 80% cost overruns over initial estimates to its flawed EVMS.

DCAA Audit Guidance on Audit Planning With Contractors

The Defense Contract Audit Agency has issued guidance to auditors to have them continue communicating with contractors and contracting officers to plan audit effort for the upcoming year. The field audit offices (FAOs) will meet, preferably in the first quarter of the fiscal year, with their contractors and related COs at locations where significant audit effort is planned. Meetings as soon as possible will allow time to request records and time for the contractor to obtain them as well as arranging for personnel to support audit effort. The intent of the meeting is not to change the planned audit effort but to ensure the effort is time phased in an efficient and effective manner. For locations without significant audit effort, a teleconference may be appropriate (*12-PPS-028R*).

Proposed Rule to Provide More Prompt Payments to Small Business Subcontractors

A proposed rule would amend the FAR to require accelerated payments to small business subcontractors. The proposed rule would require prime contractors, upon receipt of accelerated payment from the government, to make accelerated payments to small business subcontractors "to the maximum extent possible." The new rule would not provide new rights under the Prompt Payment Act or affect the application of its late payment interest provisions. The new rule would implement a temporary policy issued by the Office of Management and Budget in July which required accelerated payments, typically 15 days.

DOD is Failing to Follow Its Own Policy on One-Bid Awards

The Inspector General Office of the Defense Department issued a report stating DOD is not following its own guidance when awarding competitive contracts with a single bid resulting in failure to maximize cost savings in such awards. DOD issued

several memoranda in 2010 and 2011 providing guidance for single bid competitive contracts that included (1) limiting performance period of singe bid knowledge-based contracts to three years (2) directing contracting officers to re-advertise a contract for at least another 30 days when a single bid is received in solicitations open for less than 30 days (3) direct COs to negotiate with the offeror if no more bids are received and (4) make negotiations based on certified cost or pricing data or other data. The IG reviewed a sample of 107 contracts and found multiple errors by COs including failure to correctly code 29 as single bid contracts, failing to follow single bid guidance for 31 of the remaining 78 single bid contracts, failing to develop adequate competition plans and failing to prevent 39 of 47 contract mods from exceeding the three year limit on contract mods. The report recommended steps to improve oversight and monitoring of these contracts (*a copy of this report can be found at "dodig.mil/Audit/reports/fy13/DODIG-2013-002"*).

GAO Says Government is Not Leveraging Its Buying Power

The General Accounting Office issued a report saying the major buying departments are leveraging only a fraction of their $857 billion of purchases through "strategic sourcing" to achieve savings. Strategic sourcing discourages individual procurements in favor of broad aggregate purchases that may be managed by a central office. The report notes there are four broad principles successfully found in the commercial sector – top leadership commitment, improved knowledge of procurement spending, supporting structure and processes and leadership and metrics – that should be adopted in government to go from a largely decentralized approach to a consolidated approach. Recommendations include (1) set strategic sourcing goals with clear metrics to be monitored (2) evaluate how best to establish highest spending categories of products and services and establish a list of these items best subject to strategic sourcing and (3) ensure organizations responsible for purchasing have the resources to implement strategic sourcing.

GSA Mileage Rate Change

Effective Dec. 28, 2012, the government mileage rate for using private vehicles is now $0.565.

CASES/DECISIONS

Board Rules Several Costs are Unallowable and Subject to Penalties

The following case addresses allowable employee morale and welfare costs (FAR 31.205-13) versus unallowable entertainment costs (FAR 31.205-14), rental expenses and whether penalties should apply. DCAA and DCMA questioned costs related to a club that provided clay shooting and fishing trips to five of Thomas' executives where Thomas asserted these costs were allowable under the employee morale cost principle for contributing to morale, fitness and team building. DCAA and DCMA also questioned other costs such as a jazz ensemble playing at an otherwise allowable corporate event, flowers for employees' special occasions (births, illness, death, weddings), rent paid by the company for property owned by the owner at less than market rates and a Christmas party that also served as a banquet to recognize employees were also unallowable (they ruled only two of the 26 hours of activities related to corporate activities). The appeals board ruled all the costs were unallowable and subject to FAR 42.709 penalties for being expressly unallowable where it rejected Thomas' assertion that the penalties should be waived since it was a novice contractor (*Thomas Associates Inc., ASBCA No. 57797*).

Legal Costs Related to Fraud Allegations are Allowable Costs if the Company is Not Found Liable

(*Editor's Note. The following case underscores the provision that the outcome of a fraud case determines the allowability or unallowability of the legal related costs.*)

Under its operations contracts at the Rocky Flats nuclear weapons plant, James Stone brought a qui tam suit under the False Claims Act (FCA) alleging Rockwell misrepresented or failed to disclose certain environmental problems. A jury award of $4.1 million was made to Mr. Stone but the Supreme Court found the court lacked jurisdiction since Mr. Stone was not an "original source" for the information. Rockwell sought reimbursement for legal costs of defending the Stone lawsuit and the appeals board sided with Boeing, who was the successor to Rockwell, asserting that from the time Stone brought the lawsuit in 1989 to the time the government took it over in 1995, Boeing was entitled to recover the defense costs since legal costs for litigation expenses for which it is not found liable

are allowable. Both parties appealed where the court stated the appeals board correctly determined that costs relating to fraud claims where the government was successful are unallowable whereas costs related to Rockwell were allowable since it was successful (*Chu v Boeing Co., Fed. Cir. No. 2011-1304-1317*).

Bad Faith Not Necessary to Show Breach of Duty for Good Faith and Fair Dealing

Sigma was awarded a contract to market and manage properties for HUD where it alleged the properties included those referred to as "new acquisition" and "transition" properties where in its bid it assumed both properties would be equally divided among contractors where the transition properties were significantly more profitable because they required fewer services. Sigma and another contractor received a one year base with four option years where part of the contract stated each vendor would receive an equal share of each type of property. Sigma submitted a certified claim for $656,000 representing lost profit and higher costs due to the unequal distribution of properties to the two contractors. In its appeal Sigma alleged HUD breached its implied duty of good faith and fair dealing by refusing to respond to its frequent requests for its contracted amount of transition properties while HUD asserted that allegations of lack of good faith and fair dealing must be accompanied by bad faith which was absent here. The appeals board disagreed with HUD saying the covenant of good faith and fair dealing that is inherent in every contract does not require a showing of bad faith – a claim the government breached its duty of good faith and fair dealing is not the same as claiming the government acted in bad faith. An allegation of breach of good faith and fair dealing is an allegation that the contracting party was "deprived of its fruits of the contract" while an allegation of bad faith is "malice" which does not necessarily deprive a party of the fruits of its contract. Quoting other cases, the board stated a party can prove a breach of good faith and fair dealing by "lack of due diligence or failure to cooperate" or "subterfuges and evasions" (*Sigma Svcs. Inc. v Dept of Housing and Urban Development, CBCA 2704).*

Ruling Issued on Rejection of Contractor Contribution Ban

A federal judge rejected an injunction to prevent a government contractor from contributing campaign funds stating Congress may bar government contractors from contributing to candidates, parties and their committees. Despite the recent *Citizens United* case where the Supreme Court struck down long standing restrictions on campaign spending by corporations, the judge ruled that case left intact the ban on government contractor contributions. The judge pointed out a long history of restrictions on "pay to play" contributions from government contractors and pointed to several local and state restrictions that have been held up. The judge's ruling did not determine whether contractors may give funds to other than candidates and their parties (e.g. political action committees). It ruled that people who run PACs or run corporations have legal identifies distinct from government contractor corporations (*Wagner vs. The Federal Election Commission, D.D.C., No. 11-1841*).

Unequal Treatment of Offerors' Bids Justifies Recovery of Bid Costs

(*Editors Note. The following case reminds us of the need to track bid and proposal costs for each separate bid.*)

The agency sought to replace its heating and air conditioning system. One day after the solicitation closed Rogan faxed a bid adjustment that lowered its bid by $60,000 which made its bid $688 lower than JCN's bid. The agency decided Rogan's bid offered the best value. In its first protest JCN prevailed and in the reevaluation Rogan again was awarded the contract and JCN protested again because the agency modified the existing contract to account for the work Rogan had completed after which the contract was terminated for convenience. JCN then filed suit arguing (1) the agency treated Rogan and JCN unequally because Rogan had access to certain details as the incumbent (2) Rogan lacked requisite experience and (3) allowing Rogan to enter a price modification after solicitations closed breached the agency's implied obligation to treat offers fairly. Though it rejected the last two points, the court agreed the agency had treated the offerors unequally but since the performance was near complete it awarded JCN its preparation and proposal costs (*JCN Construction Inc. v. US, Fed. Cl., No. 12-335C*).

Limited Recovery of Government Costs Due to Poor Documentation

(*Editor's Note. We thought it would be interesting to show how the government suffered for inadequate documentation for its claimed costs.*)

In its logistics contract Veridyn Corp filed a complaint to recover $1 million in costs, legal expenses and lost profit for an alleged breach of contract while the government, in turn, sought $1.9 in counterclaims that included $357,000 in (1) Dept of Justice attorney costs

(2) labor costs the agency incurred and (3) costs for a forensic auditor from DCAA to provide supporting and consulting services. Though the government prevailed in many of its claims, it was denied the $357,000 because it did not provide sufficient documentation to support its attorney and agency labor costs because it did not submit timely timesheets or billing records even though DCAA did provide timesheets for its efforts (*Veridyn Corp., v. US, Fed. Cl. No. 06-150(C*).

SMALL/NEW CONTRACTORS

Checklist for Adequate Forward Pricing Proposals

(*Editor's Note. The startling shift of most proposal audits and certain systems audits from DCAA to DCMA has made the remaining audit areas subject to even greater audit scrutiny. One of these areas is forward pricing audits so we decided to summarize new guidance DCAA has issued to its auditors last September in the form of an Adequacy Checklist.*)

Before an actual audit occurs, DCAA is tasked with making an initial assessment of adequacy as soon as possible after receipt of the submittal. Since time is often very tight between submittal of a proposal and an award, it is important that the submittal be right in the first place. We recommend contractors use this checklist as a QA device to ensure the proposal meets these criteria so as to avoid return of the proposal and delay.

Auditors are told to request a walkthrough with the contractor to obtain a better understanding of the submission, estimating methodology, location of cost or pricing data and relevant policies and procedures. During this walkthrough auditors are encouraged to discuss any concerns they have. DCAA states that most of the criteria for adequacy found on the checklist are included in the FAR and DFARS where such areas are referenced but states some criteria not referenced were added by DCAA to "help the negotiation and review process." Additional items may also be added if required by the CO. Finally, the adequacy of supporting data may not be realized until way into the audit so the initial assessment of adequacy can change once the audit has started.

The 29 checklist items are broken down into general requirements, direct labor costs, indirect costs (e.g. overhead, G&A, fringe benefits) and facilities cost of money. For each item, auditors are to say "Yes", "No" or "N/A" and provide comments and references to their workpapers.

General Requirements

1. Properly completed first page or summary page prescribed by FAR Table 15.2.1.

2. An index identifying and referencing all supporting data accompanying or identified in the proposal. The checklist states supporting data should be included in the proposal or be readily available. If not included in the proposal, the basis of estimate should include the location of the data and a contact person with phone number and email address.

3. If the submission is a revision or update of a previously submitted proposal, the revision should include an explanation for the update and identify changes made.

4. Is the proposal mathematically correct and does it reconcile to the referenced supporting data.

5. Is the proposal internally consistent. For example, is the directly labor base used to calculate overhead the same as the labor base included in the G&A allocation base.

6. Do the proposed costs based on judgmental factors include an explanation of the estimating processes and methods used including, when relevant, projections from known data.

7. Was trend and budgetary data provided? If so, was an adequate explanation of how it was used provided, including adjustments to the data.

8. Does the submission include a comparison of prior forecasted to actual costs and if so, are they in the same format as the proposal with an explanation or analysis for differences. (*Editor's Note. Though occasionally asked for during an audit, the addition of this comparison is new and we shall have to see how insistent DCAA is in having it either included in a proposal or readily available.*)

9. Was any known changes to business activities or processes disclosed that were not previously known. The checklist provides several examples such as cost reduction initiatives, changes in company objectives in the light of new business conditions, changes in accounting practices (e.g. reclassifying direct versus indirect costs, new methods of allocating indirect costs

and their impact), advance agreements, acquisitions or divestments, shutdown of facilities, changes in business volume and/or contract mix).

Direct Labor Rates

1. Basis of estimate identified that includes an explanation of the methodology used to calculate direct rates.

2. Is the location of data (e.g. payroll) identified.

3. Are escalation factors identified for out years, which costs are the factors applied to and the basis for the factors used.

4. Are planned or anticipated factors that can change rates identified such as composition of labor rates, labor categories, union agreement and headcount.

Indirect Cost Rates

1. Basis of estimate includes an identification of the methodology used to develop the rates.

2. Is the location of supporting documents specified.

3. Are indirect expenses identified by burden center, by cost element, by year and is this presentation consistent with the accounting system used to accumulate actual costs.

4. Are significant contingencies shown.

5. Are significant planned or anticipated changes in the nature, type or level of indirect expenses identified, including fringe benefits.

6. Are allocated costs from home offices, shared services, etc. shown with a contact person identified.

7. Are intermediate cost pools identified and a reconciliation of these costs to show how they were allocated.

8. Are escalation factors for out years identified, what costs were they applied to and the source for the factors.

9. Is there adequate detail for the allocation base.

10. Was supporting detail for the proposed allocation base identified such as budgets, other proposals, contract values, etc.

11. Did the proposal show how it was reconciled with long range plans, strategic plans, sales forecasts, operating budgets, etc.

Cost of Money

1. Was a cost of money computation based on CASB-CMF provided. If so:

2. Was a summary of net book value of assets provided, both distributed and non-distributed.

3. Were the underlying records to support the net book value provided.

4. Was the treasury rate identified.

Once the checklist is completed, a determination of "Adequate" or "Inadequate" along with comments is made. Identified inadequacies should be discussed with the contractor and CO during the walkthrough and if the proposal is "so deficient that an examination cannot be performed" DCAA is to recommend to the requestor that an audit cannot be made. A written summary of the inadequacies should be prepared to give the CO an understanding of them and corrective action needed. Finally, auditors are told, for significant deficiencies, a flash report should be considered. *(Editor's Note. There is no guidance on what constitutes "adequate" or "inadequate" so there is a great deal of auditor discretion here resulting in inconsistent findings throughout the agency. Also, though the guidance indicates inadequacies should be pretty bad to recommend stopping the audit and issuing a flash report, we often find that any determination of "inadequate" no matter how minor the deficiencies is used to return the proposal and that estimating system flash reports are becoming very common.)*

QUESTIONS & ANSWERS

Q. What can we do when DCAA issues a final report and Form 1 for questioned costs.

A. You used to be able to appeal, with considerable success, DCAA's position to the ACO anxious to resolve issues but that is much less possible today where ACOs almost always accept the auditor's opinion. We have been finding more success with contractors filing an appeal within 90 days of the CO's final decision with one of the contract appeals boards (no filing charges) and then having attorneys negotiate settlements with agency attorneys short of the expensive litigation process. It seems like some DCMA attorneys are taking the role the ACO used to take in attempting to resolve cost allowability and allocability issues.

GCA REPORT
P.O. Box 1235
Alamo, CA 94507

Q. Are early check-in fees allowable – upgrade fees are typically unallowable but I'm not sure about early check in?

A. The criteria is reasonableness. I assume you are talking about hotels. If the fee exceeds your per diem rate then it might be unallowable if there is not a good business reason to arrive early. If there is, you could consider it a miscellaneous costs that might be allowable.

Q. We are writing a policy regarding Business Meals and wanted to verify DCAA's position on what is considered "reasonable" to them for a business dinner meal expense. We typically thought it was around $70 per person (including alcohol) but we can't seem to locate any documentation on this. Is there any written guidance for auditors or elsewhere that documents this?

A. Again, reasonableness is the criteria. We don't usually see DCAA questioning the amount of per person costs unless it is unusually high. Alcohol is always unallowable but the $70 per person is not an amount we are aware of unless an individual auditor decides to use per diem amounts to define what is "reasonable" which would be unusual. Rather than challenging the amount per person, DCAA is more apt to question the dinner as business related, saying it is unnecessary or is an entertainment expense. You are right to prepare a written policy where all anticipated types of business dinner events are addressed and definitions of which events are business related or more for entertainment.

Q. We scan all of our vendor records but a DCAA auditor has told us they may not be acceptable as source documents unless certain conditions are met. What do the regulations say about this?

A. The regulation is short and sweet. FAR 4.703(d) states three conditions must be met: (1) scanned records must preserve accurate images including signatures and graphics (2) an effective index system is in place to permit timely and convenient access to scanned documents and (3) original records are retained for one year after imaging to permit periodic validation of the imaging system. However, be aware that DCAA auditors may and often do seek to impose additional "internal control" requirements (e.g. written procedures, periodic internal and external audits, easy access to records during an audit) to accept a scanning system. We usually recommend meeting with DCAA to determine objections ASAP.

Q. I have a question regarding the allowability of severance pay. We recently eliminated an indirect position and laid off the employee. We are going to give him two weeks' pay as severance pay. I am trying to determine if this severance pay is an allowable indirect cost that I can allocate to G&A (the employee charged 100% to G&A), or if it is an unallowable cost.

A. Yes, it should be an allowable indirect cost. An auditor could object if you don't have a written policy or an "agreement" with employees so make sure you have a written policy describing the company's severance policy.

Q. We are pulling a submission and resubmitting from a prior year (2010) because we haven't been audited since 2006 and have found some errors in the submission. Does the ACO penalize contractors for that?

A. No, as long as the audit hasn't started.