GCA REPORT
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NEW DEVELOPMENTS

DCAA Issues Guidance on New Relocation Rules

The Defense Contract Audit Agency issued guidance on new allowability rule changes to FAR 31.205-35, Relocation costs issued in the June 27th Federal Register and then issued supplemental guidance on how to compute so-called tax grossup expenses. The initial guidance states the new rules affect contracts awarded on or after July 29, 2002 and provides a chart on the status of the rules before and after the rule change date. Specifically:

1. House hunting and temporary lodging (FAR 31.205-35(a)(2)). Before the change, allowable costs are limited to a maximum of 60 days for the employee and 45 days for spouses and dependents where the change allows all such costs with no time limits if they are reasonable per FAR 31.201-3.

2. Payments for increased income on FICA and income taxes (commonly called "tax grossups"). These costs were unallowable before the change (FAR 31.205-35(c)(4)) and allowable after the change (FAR 31.205-35(a)(10).

3. Payments for spouse employment assistance. These costs were unallowable per FAR 31.205-35(c)(5) and are now allowable per FAR 31.205-35(a)(11).

4. Lump sum reimbursement of miscellaneous expenses per FAR 31.205-35(a)(5) and (b)(4). Before the change they were limited to $1,000 and after the change are limited to $5,000.

The guidance states when auditors are evaluating claimed relocation costs, they must ensure the correct version of the Federal Acquisition Regulation is used. The date the contractor incurs the costs do not determine which version of FAR 31.205-35 is applicable but rather which version of the FAR is in place on the contract date. In other words, the changed costs are "expressly unallowable" on contracts awarded prior to July 29, 2002. The guidance also reminds auditors that penalties apply to "expressly unallowable" costs (MRD-02-PAC-059(R)).

DCAA issued supplemental guidance sixteen days later on the proper calculation of tax grossup payments to employees. It states a common method for computing the tax grossup is:

$$\text{Tax Gross Up Factor} = \frac{x}{1.0 - x}$$ (Where x = employee's marginal tax rate)

For example, assume the employee's marginal tax rate is 28% and the non-deductible moving expenses are $50,000. A company would commonly compute the tax-grossup as:

Tax grossup factor = 0.28/(1.0 – 0.28) = 0.3888888
Tax grossup amount = $50,000 X 0.3888888 = $19,144.44

The guidance reminds auditors (and contractors, for that matter) that simply increasing the employee's $50,000 payment by 28% (i.e. $14,000) will not make the employee whole since it must be sufficient to not only pay for the additional tax on the taxable relocation expenses but also on all amounts paid to the employee to reimburse them for the additional employee taxes (MRD-02-PAC-064(R).

Final Rule Issued on Other Transactions

The Department of Defense August 27 issued a final rule regarding use of "Other Transaction" authority for prototype projects which exclude controversial audit provisions proposed earlier. Use of OTs are authorized for prototype projects directly relevant to weapons or weapons systems acquisitions or development and are considered transactions other than contracts, grants or cooperative agreements which are not subject to the laws and regulations that apply to typical procurement contracts. They usually include cost sharing arrangements by the government and private firms.

DOD believes the flexibility offered by OTs are essential in offering access to cutting edge technology generated by commercial firms who traditionally resist doing business with the government. The new rules are intended to address DOD concerns that a number of

OTs have been awarded to traditional defense contractors and accordingly, provides that OTs are not to be used for prototype work unless (1) at least one third of the total project cost is paid by parties other than the government (2) at least one "non-traditional defense contractor" is participating to a "significant extent" in the project or (3) the senior procurement executive of an agency determines "exceptional circumstances" justify use of an OT where other methods are not feasible. A "non-traditional defense contractor" is defined as a business unit that has not for at least one year prior to the OT agreement date entered into or performed on a contract (1) fully CAS covered or (2) any other contract exceeding $500,000 to carry out prototype projects or basic, applied or advanced research projects for a federal agency subject to the FAR.

Responding to concerns that contractors have excessively used prior work as significant portions of their cost sharing contributions, the new rule provides that non-federal amounts provided by businesses may not include costs incurred before the date the OT agreement becomes effective. Costs incurred by a business unit or their subawardee incurred after the beginning of negotiation but prior to the OT agreement date may be counted only if (1) they were incurred in anticipation of entering into the OT agreement and (2) it was "appropriate" to incur the cost at the time to insure successful completion of the OT agreement.

The original proposed rule provided for audits of claims for both awardees and significant subawardees by DCAA for traditional defense contractors and auditors by either DCAA or independent auditors for non-traditional defense contractors. Public comments stressed the proposed rule would deter participation in OT agreement by the very non-traditional companies OTs are intended to attract. DOD decided to withdraw the controversial audit provisions stating it would consider revisions to the proposal.

DOD Says Guidelines Are Not Equivalent to Law

(Editor's Note. It is quite common for auditors and government contracting personnel to refer to various guidelines issued by their agencies to support their positions. The following seeks to lessen this tendency and encourage government employees to rely on regulations rather than guidance to support their position. However, as consultants to contractors, we often find it advantageous to point out to auditors and CO representatives that their guidance supports specific contractor positions.)

Following recent criticism that the DOD's new guidelines on accounting changes are being cited as law, Director of Defense Procurement Deidre Lee issued a memo September 10 stating guidance issued by its office (DPP) is to be applied by government contracting personnel in negotiating and administering government contracts but is not to be considered legally binding on contractors. When issues arise, contracting personnel are told to cite applicable regulatory references (e.g. FAR, Cost Accounting Standards) or specific contract clauses to support their position. This memo was included in recent DCAA guidance (MRD-02-PAC-070(R)) that stressed auditors should reference appropriate regulations when they formulate positions based on DPP guidance such as what constitutes an accounting practice change.

DOD Extends Asset Step-Up Waiver

Director of Defense Procurement Deidre Lee extended until September 30, 2005 a class deviation which prevents the disallowance of indirect expenses allocable to asset step-ups resulting from a business combination. The waiver was originally authorized in 1999 and states all DOD contracting activities must deviate from the requirements of FAR 31.203(c) when costs disallowed under FAR 31.205-52 are required to be included in the indirect cost base.

Prior to 1996, contractors measured the costs of all assets acquired in a business combination under the purchase method of accounting on the basis of fair market value (FMV). This usually resulted in an increase in the value of assets over their pre-business combination book value. The FMV value is referred to as the step-up amount. FAR 31.205-52 was initiated to disallow the step-up amount because it often led to increased costs (e.g. higher depreciation, higher cost of money) assigned to government contracts due to the business combination. When assets valued at FMV are included as part of the base for allocating indirect costs, CAS requires that all costs be part of the base including any step-up amount. FAR 31.203(c) makes unallowable the share of indirect costs allocated to this disallowed step-up amount, which results in the contractor being penalized because their otherwise allowable indirect costs are reduced. The deviation from FAR 31.203(c) is intended to not penalize the contractor simply because they engaged in a business combination which the government recognizes often results in savings.

The deviation applies to all future contracts as well as to indirect rates applicable to open cost reimbursement contracts and other contacts requiring indirect costs be settled before the contract price is established. The

authorizing memo for the extension is at "www.Acq.osd.mil/dp/".

DCAA Clarifies Requirements for Unilateral Cost Adjustments

DCAA issued supplemental guidance intended to "clarify" its recent guidance issued June 17 addressing government requirements to unilaterally adjust contract billings. The earlier guidance instructed auditors who are developing unilateral rate recommendations for high risk contractors to decrement total contract costs by 20 percent in the absence of recent relevant historical cost data and to where relevant data existed, to use the data to develop recommended rates. A high risk contractor is one who fails to submit its final indirect cost proposal within six months after it is due and has not received a written extension from the CO.

The new guidance stresses the development of recommended rates should be applied not only to physically completed contracts but also to active contracts. The guidance states that if the contractor does not submit an adjustment voucher on active and physically competed contracts "within a reasonable time", usually considered 30 days after the CO's unilateral determination, then the auditor should issue a DCAA Form 1 to suspend excess costs (MRD-02-OWD-052(R).

Government Issues FAC-09

The FAR Council issued changes to the FAR effective August 30 that primarily seek a middle ground between generating more competition in awarding task and delivery orders under multiple agency contracts without eliminating the efficiencies from such contract vehicles. The major changes include:

FSS. The final rule makes clear that FAR Part 13 (Simplified Acquisition Procedures) and Part 19 (Socioeconomic Programs) do not apply to orders placed against the General Service Administration's Federal Supply Schedule. Because orders under Multiple Award Schedules are considered issued under full and open competition, ordering offices need not seek further competition, synopsize the requirements, make a separate determination of fair and reasonable pricing or consider small business programs.

Orders. Individual orders must clearly describe all services to be performed or supplies to be delivered so that full cost or price for the performance can be established when the order is placed. Orders placed must be within the scope, issued within the period of performance and within the maximum value of the contract. When acquiring IT or related services, COs must consider using modular contracting methods.

Fair opportunity. The CO must give each awardee a fair opportunity to be considered for a delivery order or task order exceeding $2,500. The exemption to this is a sole source award issued in the interest of economy and efficiency because it is a follow-on to an order already issued, provided all awardees were given the fair opportunity to be considered for the original order.

In addition, the FAC-09 (1) increases the amount of the micro-purchase threshold from $2,500 to $15,000 for procurements of supplies or services where the procurements are to facilitate defense against terrorism or biological or chemical attack and (2) adds to subcontracting plans that large business must prepare goals for veteran-owned small businesses and a three percent government-wide goal for service-disabled, veteran-owned small businesses (Fed. Reg. August 30, 2002).

House Seeks to Protect Anti-Terrorist Manufacturers from Liability

The House passed bill creating the new Cabinet-level Department of Homeland Security contains provisions that limit the liability of manufacturers of anti-terrorism technologies and establishes a presumption the contractor defense applies to covered products. The legislation reflects the view that without it the nation's product liability laws "threaten to keep important technologies from the market where they could protect our citizens."

The DHS Secretary will designate the anti-terrorist technologies that qualify for protection. The seller will still be required to conduct safety and hazardous analysis on the technology and supply the government with all such information but once approved, will be placed on the "Approved Product List for Homeland Security." Once on the list and a product liability lawsuit arises there would be a "rebuttable presumption" the government contractor defense applies which can be overcome only by evidence the contractor acted "fraudulently or with willful misconduct" in submitting information to support its designation. The presumption will apply whether the product is sold to government or to nonfederal customers. (The government contractor defense, established by the Supreme Court in *Boyle v. United Technologies Corp.*, provides the contractor is protected from liability if it can pass a three part test – (1) the government approved reasonably precise specifications for the item (2) the

item conformed to these specifications and (3) the contractor warned the government about dangers from the use of the item that were known to the contractor but not the government.)

The bill will still recognize grounds for claims but will prohibit punitive damages not intended to compensate a plaintiff for actual losses nor allow noneconomic damages unless physical harm occurred.

Air Force Issues Guidance on Bankruptcies

The current environment of corporate failings and economic uncertainty has the government scrambling to create updated accounting practices and operating procedures. One recent addition is a new Air Force "Contracting Officers' Guide to Bankruptcy" at www.safaq.hq.af.mil/contracting/. The new guidance gives COs new procedures for handling contractor bankruptcies.

The Guide provides basic bankruptcy law information including types of bankruptcies. It direct COs to independently verify the bankruptcy status of the contractor by confirming court filings and asks the CO to compile information on the financial status of the contract along with possible claims the contractor may bring or the government may have against the contractor. The CO is told to determine whether (1) the contractor's performance has been acceptable and if continued performance by the contractor is desired (2) there is any default needing to be cured (3) the contract should be terminated either for convenience or default and (4) it is acceptable to transfer the contract – with Air Force approval – to another contractor. The Guide advises COs to "keep a ready ear" for subcontractors and suppliers' complaints about discontinued payments but advises against direct payments to subcontractors on the grounds it would be unfair to other subcontractors and would be a breach of contract to prime contractors.

A recent article in the August 20th issue of Federal Contract Report by Peter McDonald of KPMG and Paul Pompeo of Holland & Knight suggest that recent proposals to increase identification of fraud when conducting normal financial audits will bring audit scrutiny up to the level of fraud detection by government contracting auditors. Though the recent proposals will not likely increase fraud detection by government auditors, the increased effort by financial auditors will result in increased visibility for the government from, for example, voluntary disclosures by firms and access to financial workpapers by government auditors.

BRIEFLY…

SBA Expands and Simplifies Loan Program

The Small Business Administration announced a new SBAExpress pilot loan program intended to expand the number of lenders participating in the loan program and increase access to capital for small businesses. Under the new program, lenders may use their own forms and processes to approve SBA-guaranteed loans, resulting in minimal paperwork rather than the often extensive paperwork that discourages wide participation. The agency will promote "immediate response" on most SBAExpress applications. The maximum limit on SBAExpress loans has been increased from $150,000 to $250,000 and the SBA will be offering additional incentives for banks to meet the needs of new and startup small businesses requiring smaller loan products of $50,000 or less. For additional information on all SBA programs contact 1-800-U-ASK-SBA, 704-344-6640 or www.sba.gov.

Government-Wide Past Performance Retrieval Database Launched

Implementing an earlier announcement, Angela Styles, Administrator for the Office of Federal Procurement Policy announced the launch of a new government-wide past performance retrieval database called the Past Performance Information Retrieval System (PPIRS). The website is at www.ppirs.gov and will support the multitude of different report card collection points in the government. It is intended to eliminate collection redundancies and will keep contractors deemed irresponsible by one agency from taking their business to another agency that is unaware of the negative past performance history.

GSA Unveils Web Tool for GSA Schedule Buyes

The General Services Administration launched its "e-buy" tool in August designed to assist federal buyers in procuring services and products under multiple award programs. Federal agencies can post RFQs on a website, vendors can issue a quote and orders can be issued electronically to accepted vendors either through the current GSA Advantage! or via agencies' own internal system. All vendors listed in GSA Advantage! are eligible to view and submit quotes through e-Buy. E-buy is considered a significant improvement over the previous practices of issuing RFQs directly to vendors via email or paper where only vendors selected by the buyer could access the RFQs and compete.

A76 Website Overhauled

In order to expand the number of private companies bidding on supplies and services under so-called A-76 (public versus private) competitions, the government has established "SHARE A-76" to provide "one stop shopping for A-76 competitions." The website is intended to link internal and external websites having anything to do with A-76 and will include such features as (1) ease at bookmarking frequently visited pages (2) providing new A-76 Cost Comparison Process Model pages (3) new research capability to find the newest documents (4) library allowing browsing by document type (5) best practices and (6) new ListServ groups to help find and email peers. The SHARE A-76 website is at http://emissary.acq.osd.mil/inst/share.nsf.

CASES/DECISIONS

Engineering Advances Constitute Cost or Pricing Data and Must Be Disclosed

Contractor was issued a task order to manufacture and deliver interface adapters (1A-3) used to test circuit cards. The 1A-3 adapters required use of peripheral devices to work. Six months before the task order was issued, Contractor successfully developed and produced an engineering advance consisting of a different adapter (1A-9) that did not need peripheral devices. After the award Contractor successfully used the 1A-9s. During a post award audit, the government discovered that the contract price included the peripheral devices and the CO put forth a claim for defective pricing, arguing the engineering advances should have been disclosed during price negotiations so the government could delete the peripheral device costs from the contract price.

Before the Board the government argued that the success of the 1A-9 engineering advance together with the fact both adapters performed identical functions made it likely the advance could be incorporated into the 1A-3 adapter making the peripheral devices unnecessary. Contractor asserted there was no guarantee the 1A-9 could be used and added though they performed the same test function, the adapters were dissimilar. The Board sided with the government noting the Truth in Negotiation Act requires contractors to disclose all "cost and pricing data" during negotiation. TINA defines "cost and pricing data" as all facts a prudent buyer or seller would reasonably expect to significantly affect price negotiations, adding only "verifiable" factual information, not projections or estimates of future cost needs to be disclosed. The fact the adapters tested the same circuit cards, the design manager testified he was "reasonably confident" about the new technology and the contractor anticipated using the new technology for testing convinced the Board the engineering advances constituted "cost and pricing data" and should have been disclosed during negotiations (*Lockheed Martin Corp. d/b/a/ Sanders, ASBCA 50566*).

(Editor's Note. Commentators on this case have stressed the engineering advance was "cost or pricing data" because it was "relatively certain", indicating other situations where relative certainty was not present might conclude the information was not "cost or pricing data." For example, in FMC Corp. (ASBCA 10095, 661) the Board held the contractor's continued, albeit unsuccessful, experimentation with new, more efficient drilling technology was not "cost or pricing data" even though the process eventually worked because when the price was negotiated, it appeared the new process would only have long range benefits.)

Can Adjust Price Even if Deleted Items Not Priced

(Editor's Note. It is often a good idea to anticipate actual work requirements when pricing a proposal but the following demonstrates a pitfall of this normally sound tactic.)

Contractor based its bid price on the assumption, after contract award, the government would implement a series of design changes that would delete some of the contracted work. Accordingly, it omitted the cost of this work in pricing its proposal and won the contract partly because of its lowest price. When the government actually deleted the work and sought a downward price adjustment, Contractor claimed it should not have to lower its contract price because the price it offered omitted the cost of the deleted work. The Board disagreed stating the decision of Contractor to omit the costs of required work in the expectation of its later deletion should not deprive the government of entitlement to a price adjustment. In reaching its decision the Board quoted a 1994 decision in *Knight's Piping Inc.* which explained "the integrity of the competitive procurement process obliges bidders to base their bid prices on the specified contract requirements as solicited and not substitute their subjective expectations about what work will need to be performed. Therefore, the amount Contractor actually bid for later deleted work is irrelevant to the computation of the downward adjustment due the government" (*Fire Security Systems Inc. ASBCA 53498*).

Costs for Items "Intended for Sale" Can't be Considered MP&E Costs

Shortly after winning a cost type contract to build spacecraft components, TRW decided to design and manufacture a solar array panel (which absorbs sunlight and converts it to energy to power a spacecraft) where it capitalized the costs as manufacturing and production engineering expenses in accordance with FAR 31.205-25 (Manufacturing and production engineering) and charged the related depreciation expenses indirectly in accordance with FAR 31.205-11 (Depreciation). TRW's intentions were twofold: it intended the solar array would be adapted as a component of a variety of spacecraft that TRW intended to build for the government and also thought the array could become the basis for a product line that could be sold outside spacecraft programs. The contractor asserted the costs were allowable MP&E expenses while the government denied the costs, saying the solar array costs were not depreciable because they were for a development item "intended for sale" and hence unallowable as MP&E costs.

The Board sided with the government noting TRW did not meet the "burden" to prove the solar array costs should be MP&E. Though the solar array panels proved to be "unflightworthy" for government spacecraft and TRW terminated the project as a separate product line, the Board found that TRW, from the start, contemplated it could develop a solar array subsystem product line for sale and it was "committed" to do so. Accordingly, TRW did not meet "the FAR criteria for allowability of MP&E costs", namely that such costs must be for developing equipment, tools or systems expected to be used in producing products that are "not intended for sale." Though it was true the solar array was intended as a component of TRW's products it was also true it was intended as a separate product line and hence the company was not entitled to allocate the depreciated solar array costs as an indirect cost to its cost type contract (*TRW Inc. ASBCA 51172*).

Lowest Price is Valid Consideration Under "Best Value Competition

(Editor's Note. The following provides a good reminder of the need sometimes to put forth the lowest price, even under so-called "best value" competitions.)

The protester for a security guard services contract claimed the award on a "best value" solicitation placed excessive reliance on lowest price. The GAO disagreed stating though the RFP included standard "best value" language it was "sufficiently clear" the award would be made to the lowest priced offer that complied with the buying agency's requirements. Though the RFP stated the award would be based on the "most advantageous proposal", it did not establish any evaluation factors. The RFP stated offerors had to meet the conditions of the solicitation, offeror had to be responsible and price considered fair and reasonable. With such language, there was no basis to conduct a comparative evaluation and hence award to the lowest price bidder was justified (*Duncan Security Consultants Inc. GAO-290574*).

FAA Properly Considered Experience of Predecessor

The protester asserted the government's evaluation of awardee's proposed personnel and past performance/ corporate experience was improper because the company had undergone new ownership. The FAA's Office of Dispute Resolution in Acquisition disagreed reasoning that despite changes in corporate ownership, the awardee's management structure and employment of both technical and management personnel as well as its functional operations were largely unchanged from those of its predecessor corporation (*Enroute Computer Solutions, FAA ODRA, No. 02-ODRA-002206*).

NEW/SMALL CONTRACTORS

Screening Unallowable Costs

Increased frequency of accounting system reviews by the government and the hiring of new employees from the commercial sector have led to numerous requests to provide written information on screening unallowable costs. The following can provide a useful reminder to veteran employees, highlight the basics for new employees and provide some essential checkpoints for preparing written policies for screening unallowable costs, an essential element for "adequate" internal controls.

A government contractor must, at some point, demonstrate its accounting system can identify and exclude – screen - unallowable costs from proposals, billings and incurred cost submittals. FAR 31.201-6 and CAS 405 are the guiding regulations for screening and accounting for unallowable costs. A determination of inadequacy in this area can range from a recommendation to make improvements to the

conclusion the contractor's accounting system is inadequate for government contracting purposes. This determination, in turn, can result in failure to award a contract until adequacy is demonstrated, suspension of progress payments and vouchers and/or inability to obtain government work in the future.

Unallowable costs include:

1) *Costs Identified by Pertinent Laws and Regulations.* These are the costs identified by FAR 31.205 cost principles and separate agencies' cost principles which are continuously being interpreted by court and board decisions, expert opinion and the Defense Contract Audit Agency.

2) *Contract Specific Costs.* Contracts often specify criteria that must be met for a cost to be allowable or that may express a ceiling limitation. Common examples include travel and subcontracting costs must be approved, overtime over a specific level is not reimbursed and indirect cost rates are capped.

3) *Advanced Agreement.* These agreements are commonly negotiated with Administrative Contracting Officers to affect one or more costs.

4) *Directly Associated Costs.* These normally allowable costs are unallowable because they would not have occurred had not the unallowable cost been incurred. For example, reasonable travel costs associated with attending a golf event is unallowable.

The following areas are commonly scrutinized by government auditors:

1) **General policies and procedures**. These should be in writing and should provide that direct and indirect costs are properly classified as allowable or unallowable (including associated costs). The policies and procedures should demonstrate that unallowable costs are identified and segregated from contract costing, billing and pricing when the contract amount is not completely based on commercial item pricing. These written procedures should address, at a minimum:

a. General ledger accounts for unallowable costs. One account is acceptable for a very small business but other separate accounts should be created where cost categories may contain significant unallowables (e.g. travel, legal, advertising etc.).

b. List of unallowable costs. All unallowable costs should be identified with relevant FAR references. A brief discussion of conditions that make an unallowable cost allowable (e.g. product or service advertising is unallowable while advertising for employees is allowable) should be included. (*We intend to prepare an article for the GCA DIGEST that will summarize FAR 31.205 unallowable costs.*)

c. Internal controls. Normal internal controls for financial accounting should be included in efforts to screen unallowable cost. A list of duties by position, management review evidenced by signature requirements, separation of duties to ensure unallowables "don't slip through", and flowchart or narrative of the screening process.

d. Communication and training. Describe how appropriate personnel are informed and what, if any, training is provided. For example, do traveling employees and their supervisors know about travel and entertainment rules and are key accounting and contracts personnel knowledgeable about all relevant cost principles?

e. Adequate documentation and record keeping. Do procedures exist on how to brief a contract, document reasons why a specific cost is allowable, and identify relevant forms (e.g. travel expenses with space for purpose of travel and excess travel costs)?

2) **Attention to "Hot" Areas**. Though they change depending on areas highlighted by GAO reports and media attention, we find auditors currently seem to be focusing on the following areas:

a. Entertainment (FAR 31.205-14). Distinctions contractors make between unallowable entertainment costs and allowable costs such as certain travel, public relations, employee morale and health, etc.

b. Independent Research and Development and Bid and Proposal (FAR 31.205-18 and CAS 420).

c. Legislative Lobbying (FAR 31.205-22).

d. Professional and Consultant Services (FAR 31.205-33).

e. Relocation Costs (FAR 31.205-35).

f. Selling Costs (FAR 31.205-38). Are selling costs distinguishable from bid and proposal costs and are they properly segregated by class of customer (e.g. government, foreign, commercial)?

g. Travel (FAR 31.205-46). Excess travel and associated costs of unallowable activity.

h. Trade, Business, Technical and Professional Activity. Procedures should be in place that adequately describe the business purpose of the meetings or conferences.

i. Excess Compensation (FAR 31.205-6).

Though government auditors can be expected to focus on the areas described above, contractors should be

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alert to other potential areas. These are most likely to include high cost categories as well as "favorite" areas each auditor tends to have.

3) **Point of Entry Screening**. The organization should screen for unallowable costs up front rather than after the fact when cumbersome and expensive screening is required for certification or incurred cost submittals. Individuals incurring the expense and reporting it on a document should identify the unallowable cost. Personnel reviewing expense reports and vendor invoices should clearly identify the unallowable cost on the document and enter the cost into the appropriate account in the general ledger. These point of entry practices not only save time and money but can reduce the perception of your organization being considered a high audit risk requiring extensive transaction testing.

QUESTIONS & ANSWERS

Q. One of the suppliers we are considering using informed us there would be a $5 drop in unit prices they had previously quoted for a key component after we submitted our proposal but before we have negotiated a price with the government. Must we divulge this to the government?

A. I assume you are concerned about defective pricing. First, it depends whether the contract is covered by the Truth in Negotiations Act (e.g. does the contract require submission of *certified* cost and pricing data, does it exceed $550,000). Many contracts are not covered by TINA and hence there is no requirement to divulge this information. If TINA covered, you most likely have to divulge the information if it is factual, relevant to negotiations and would have a significant impact on price. Failure to do so means you did not submit the most current, accurate and complete cost or pricing data as of the date of price agreement which makes the contract subject to a defective pricing reduction. However, even if covered by TINA, you may not have to divulge the information if it does not meet the definition of cost or pricing data (see the *Lockheed Martin* case discussed above) or you do not intend to use the supplier because, for example, there are quality or delivery schedule problems.

Q. We are being audited by a state agency and they are telling us we should be deleting a portion of our industry association fees related to lobbying costs. I never heard of this and DCAA has never questioned it. What do you think?

A. On some association fee invoices, lobbying costs are identified for tax purposes since lobbying costs are not deductible. Though we initially thought the state auditors were in error (after all, it is not a contractor's responsibility to identify "unallowable" costs incurred by organizations they purchase goods and services from) we took a look at the DCAA Contract Audit Manual and found in the section for auditing Dues and Membership Fees in Chapter 7-1102(b) it states lobbying portions of association dues should be identified and deleted from charges on government contracts. The fact DCAA did not review these costs (as former DCAA auditors we never did) was, most likely, because such costs are usually immaterial.

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