NEW DEVELOPMENTS

Cascading Set-Aside Procurements Under Fire

Several industry representatives and legal experts have recently harshly criticized the government’s increasing use of “cascading” set-aside procurements and are asking they be used only “as a last resort.” In a cascading set-aside procurement, all offerors submit their proposals at the same time but evaluations occur in stages by tiered socioeconomic category e.g. HUBZone firms first, 8(a) next, then small business and finally all businesses. The competition ends at the first stage that identifies a winning offer resulting in all offerors in later stages not being considered. Because this technique provides government agencies the ability to easily meet its procurement responsibilities without having to undertake extensive market analysis to determine the likelihood of receiving responsible bids by socioeconomic category, cascading procurements have become increasingly popular.

In its July 12 letter to the Office of Federal Procurement Policy, the Professional Services Council stated that under cascading procurements it is entirely possible that the vast majority of companies that have expended “precious amounts of proposal money to develop their submittals” will never be evaluated. The PSC states this is a “fundamental departure” from the longstanding practice where all bidders are evaluated fairly at the same time under the same evaluation criteria. Both the PSC and Vern Edwards writing in the August 2005 issue of The Nash & Cibinic Report assert the practice violates numerous FAR provisions. For example, the requirement that market research be used to determine whether certain categories of firms are capable of performing is being substituted by the “poor proxy” of cascading set asides.

FAR Council Issues FAC-05

The FAR Council issued changes to the FAR in the form of Federal Acquisition Circular 2005-05 (Fed. Reg. 43576). Significant changes include:

1. Amending an earlier FAC issued June 18, 2004 that inadvertently established incorrect content requirements for certain sole-source orders, the change adds a new section governing justification and approval when ordering items off the Federal Supply Schedule when there are limited sources offering bids. The new rule requires written justification when an ordering activity limits consideration to fewer than three schedule contractors: (1) for orders between the simplified acquisition threshold of $100K and $500K, the contracting officer must certify the justification (2) between $500K and $10 million, the competition advocate within the activity placing the order must justify (3) between $10 million and $50 million ($75 million for DOD, NASA and the Coast Guard), the justification must be approved by the head of the procuring activity placing the order, a designee or the agency’s senior procurement executive and (4) exceeding $50 million ($75 million for DOD, NASA and the Coast Guard) the justification must come from the agency’s senior procurement executive. Circumstances that may justify placing an order when less than three offerors bid include (a) only one source is capable of responding due to specialized nature of the work (b) the new work is a logical follow-on to an original FSS order that was not placed on a sole-source basis (c) the item is peculiar to one manufacturer or (d) an urgent and compelling need exists.

2. Remove the requirement that a CO withhold 5 percent of the payments due under a time-and-material contract unless such a withholding is necessary to protect the government’s interest or is prescribed in the contract schedule. A contract modification must be issued if the CO decides to require withholding, contractors rather than the government may take the withhold prior to submission of their voucher and the $50K withhold ceiling applies to the entire contract rather than an individual task order.

3. Clarifies that a prime contractor must confirm that a subcontractor representing itself as an Historically Underutilized Business Zone (HUBZone) small business concern is properly certified. The new rule stems from several studies indicating that some prime contractors are overstating their HUBZone accomplishments because some subcontractors are
incorrectly claiming to be certified as HUBZone firms. Prime contractors must confirm that a subcontractor representing itself as a HUBZone small business is certified by the Small Business Administration – either by accessing the Central Contractor Registration or contacting the SBA.

4. Clarifies the basis for determining the rental charges for the use of government property and is intended to encourage so-called dual use of such property. The rule establishes that the time in which the property is actually used for commercial purposes rather than the time it is available for use will determine the basis for the rental charges. The rule also permits contractors to obtain property appraisals from independent appraisers, permits appraisal-based rentals for all property and allows COs to consider alternate bases for determining rentals.

Industry Weighs in on Limitations on Time-and-Material Contract Use

Industry representatives are seeking to block a planned amendment by Senator Levin to the 2006 defense authorization bill to limit “excess charges” under Defense Department time-and-material (T&M) and labor-hour (LH) contracts. Under the draft amendment, subcontractors would be reimbursed for direct labor hours on the basis of fixed hourly prime contractor rates “only if such hourly rates are set forth in the contract for that specific subcontractor.”

The issue stems from April 2004 guidance issued by the Defense Contract Audit Agency pointing out an inconsistency between General Services Administration and FAR provisions. The guidance points out that the GSA’s website says only if there is a contractor teaming agreement does the prime contractor and subcontractor bill on its own GSA schedule rates while under a prime contractor/subcontractor relationship, the prime should bill for the services/labor hours performed by the sub at the prime contractor’s labor hours performed by the sub rather than at the subcontractor’s rates. However, DCAA observed that FAR 42.232-7(b) specifically limits the reimbursement of costs in connection with subcontracts to the amounts paid by the prime contractor. In its guidance, DCAA advises its auditors when reviewing orders placed under the GSA schedule contracts to ensure the prime/sub versus teaming arrangements are clearly established.

Numerous industry groups have opposed the Levin amendment stating it would pose “potential disaster” for small and mid-sized businesses because no prime will accept the work of subcontractors if they cannot properly price risk and still be accountable for total performance. The groups object to the reference of “excess charges” in the Levin amendment asserting nothing in DCAA’s work supports the accusation. Also, since the amendment would apply to new task orders under already awarded contracts, all approved pricing agreements would have to be renegotiated. The Industry groups concluded no legislation is required at this time since DCAA and GSA have been meeting to resolve audit issues related to T&M contracting and the FAR Council is reviewing possible FAR clarifications in this area.

OMB Updates its Pay Raise and Inflation Factors Used in Public vs Private Competitions

(Editor’s Note. Its always nice to know what assumptions your competitors are using to cost out their proposals. The following provides information on what inflation factors the government will be using. They also represent a kind of “floor” you can point to when your inflation factor assumptions are challenged by the government.)

The Office of Management and Budget has updated its annual federal pay raise assumptions and inflation cost factors it uses for computing government personnel and non-pay costs in public-private competitions conducted in accordance with OMB Circular A-76. Federal pay raise assumptions for 2005 are 3.5 percent for civilian and military personnel and for 2006 and thereafter, 2.3 percent for civilian and 3.1 percent for military. Non-pay inflation factors for such items as supplies, equipment, etc. are 2 percent for 2005-2006 and 2.1 percent thereafter (Fed. Reg. 44130).

CAS Board Issues Proposed Rule on ESOPs

In the last step required to change a cost accounting standard (CAS) the CAS Board July 21 issued a proposed rule on the measurement and recognition of costs of employee stock ownership plans (ESOPs) under government contract costs. Key elements include:

- Defining ESOPs more broadly than the Generally Accepted Accounting Principles definition by including not only plans that meet the GAAP definition but also any plans that are designed to invest primarily in the stock of the contractor;
- Provide that the cost of the ESOP is the amount contributed to the plan by the contractor, based on the market value of the contributed stock or property at the time the contribution was made;
• Provide the contractor’s contribution to the ESOP is assignable to the cost accounting period only to the extent the stock or cash resulting from the contribution is awarded to employees and allocated to individual employee accounts by the tax filing date for that period, including “permissible extensions.”

The rule will revise CAS 415, deferred compensation and make it clear that accounting for ESOPs will be covered by that standard and no other. Up to this point, there has been varying interpretations whether CAS 415 or CAS 412, pension costs, would rule. The proposed rule does not distinguish between leveraged and unleveraged ESOPs and does not address the issue of whether interest costs on leveraged ESOPs will be allowable. This decision of whether interest costs will be allowable will be made by the FAR.

White House Establishes 2007 R&D Priorities

According to a July 6 White House memo from the Office of Management and Budget Director Joshua Bolten, agencies are told they should couple their requests for federal research and development funding to reduce or eliminate low priority science and technology programs and instead, should focus on R&D activities that favor “interagency coordination” through the National Science and Technology Council. High priority R&D projects include advance homeland security technologies, genetics, nanotechnology, high-end computing and environmental sciences. For details on the high priority R&D areas obtain a copy of the memo at www.whitehouse.gov/omb/memoranda/fy2005/m05-18/pdf.

Katrina Relief Generates Changes in Some Procurement Rules

The $51.8 billion emergency supplemental funding measure signed by President Bush Sept. 8 included some emergency procurement procedures related to Katrina relief efforts that included: (1) the micropurchase threshold is increased from $2,500 to $15,000 (e.g. use of the government credit card) (2) the simplified acquisition threshold is increased from $100,000 to $250,000 and (3) the threshold for using the commercial items test program is increased from $5 million to $10 million. In addition President Bush Sept. 8 issued a proclamation suspending the Davis-Bacon Act which requires federal construction contractors to pay locally prevailing wages, as determined by the Labor Department, on all projects in excess of $2,000. The suspension has incurred the ire of many democrats and labor unions while President Bush asserted the suspension will “result in greater assistance to these devastated communities and will permit the employment of thousands of additional individuals” because of lower costs.

SBA Issues Rule to Boost Small Business Participation in HUBZone Program

The Small Business Administration Aug. 30 made some moves to make it easier for small businesses to participate in the Historically Underutilized Business Zone (HUBZone) contracting program in order to increase the base of small businesses eligible to take advantage of the program. Effective immediately, a HUBZone small business concern (SBC) no longer need be entirely owned by US citizens but instead is eligible to participate in the program if it is 51 percent owned and controlled by US citizens. In addition the new SBA rule expanded the areas that qualify as HUBZones by (1) authorizing areas in which military bases have been closed to be treated as qualified HUBZones for five years (2) revising the definition of “non-metropolitan county” to allow a county’s unemployment rate, rather than the statewide unemployment average, to be taken into account in eligibility determinations and (3) extending the period during which areas can be designated as HUBZones from three years after they no longer qualify until either the release of the 2010 census data or the three years after the date their qualification ended, whichever comes later.

Established in 1997, the HUBZone program is intended to encourage businesses to move to or expand their business operations within economically distressed urban and rural areas by providing HUBzone contract set-asides and a 10 percent price evaluation preference to eligible SBCs when competing against non-HUBZone SBCs. To qualify, an SBC must have a principle office in a HUBZone area and at least 35 percent of its employees must reside in a HUBZone.

New DCMA District Established to Handle Secret Contracts

The Defense Contract Management Agency Aug 11 revealed it has established a new organization to manage classified systems and contracts. The DCMA Special Programs District (DCMAS), which will be located in Alexandria, VA, will provide contract management services in which DOD “uses enhanced security measures exceeding those normally required.” Though it has handled special access programs since 1986, the establishment of a separate organization will enable DOD to pay more attention to meeting security
concerns of the agency and its contractors. The Defense Contract Audit Agency currently has a separate unit handling special access contractors.

Travel...

(Editor's Note. Though only three parts of the Federal Travel Regulation formally apply to contractors – combined per diem rates, definitions of meals and incidentals and conditions justifying payment of up to 300% of per diem rates – many contractors choose to follow the FTR either because some contracts call for incorporation of it or they choose to follow it. Therefore, we continue to present significant new changes or decisions likely to affect contractors’ travel and relocation expenses.)

New Relocation Incentive Pay

The Office of Personnel Management has issued interim rules authorizing the payment of recruitment, relocation and retention incentives to federal employees that allow federal agencies to offer relocation incentives to current employees to accept a position that would be difficult to fill without the incentive. Agencies may offer up to 25 percent of an employee’s annual rate of basic pay in effect at the beginning of the service period multiplied by the number of years in a service period. So, for example, an employee may receive 100 percent of their annual rate of pay if the employee signs up for a four-year service agreement. In addition, an agency may request OPM increase the 25 percent limit up to 50 percent of the employee’s annual basic rate of pay with a 100 percent of salary limit on total incentive pay. The payment may be made on a lump-sum basis either at the beginning or end of the full service agreement or as a series of payment throughout the term of the service agreement. Though they may keep what they received earlier, the relocation incentives must be terminated if the employee is demoted or separated for cause or receives a less than “Fully Successful” rating (Fed. Reg. 25732).

Circumstance Beyond Employee’s Control Do Not Justify Increased TQSE

When Kenneth was transferred the VA authorized relocation benefits that included 30 days of temporary quarters subsistence expenses (TQSE) where he paid $91 per night. Because he needed to travel extensively during his first month at the new location, he had no time to find lodging and requested a 30 day extension to his TQSE period within two weeks before his benefits were to end. Though FTR 302-6.100 requires extension periods to be reimbursed at approximately 25 percent less than the TQSE rate for the first 30 days, Kenneth requested extension period reimbursement at the $91 daily rate, asserting the extra costs were beyond his control because (1) the VA delayed approval of his TQSE extension and (2) his hectic schedule precluded him from arranging cheaper lodging. The Appeals Board rejected his appeal, ruling the VA properly applied the correct formula in reducing the amount due to Kenneth and that it was irrelevant whether Kenneth had sufficient time to arrange cheaper lodging (GSBCA 16630-RELO).

Government Can’t Deny Business Travel Expenses With Proper Medical Documentation

(Editor’s Note. If physical needs require business class seating, make sure to have adequate medical opinion backing you up.)

Gary’s need to fly business class was based on the fact he suffers from back problems and is very tall (6’8”) and had three statements from doctors explaining that because of his condition and height he should be provided special accomodations. The Defense Department denied the business class premiums after a fourth doctor under contract with DOD examined the three medical reports and stated the information he reviewed did not demonstrate Gary was so handicapped and physically impaired that he needed other then lower cost economy accomodations such as bulk head or 2 economy seats. The Board sided with Gary stating the FTR 301-10.14 authorized premium class other than first class airfare to accommodate employees’ disability and special needs if competent medical need exists which was met by the three doctors’ reports. The Board reasoned DOD was unable to refute the need for business class seating, particularly since the fourth doctor’s opinion was based on Gary’s file and not a physical examination and it had no special qualification to refute the other three doctors (GSBCA 16667-TRAV).

Reimbursement of Relocation Costs are a “Right” No Matter What Was Originally Agreed To

A federal employee accepted a job transfer to another location and signed an offer that included the statement “no real estate costs are included with the move.” Being advised the government must reimburse certain travel expenses no matter what the travel authorization says, Olivier requested reimbursement for her relocation expenses. The government refused payment saying (1) she was informed such expenses would not be reimbursed and (2) the agency lacked funds to pay her. The Appeals board sided with the employee, citing a prior case holding reimbursement of an employee’s
relocation expense when transferred in the interest of the government is a “right pursuant to law and regulations” and here department’s offer of employment attempted to impose an invalid condition on her transfer. As for insufficiency of funds, citing another case, “budget constraints cannot form the basis for denying an employee relocation expenses” when the travel is in the interests of the government (LaVerle Olivier, GSBCA 16598-RELO).

**CASES/DECISIONS**

**Tiered Pricing, Overstated Quantity Does Not Make Bid Nonresponsive**

(Editor’s Note. The following case demonstrates where tiered pricing can be used to gain extra valuation points and the proposal need not be considered nonresponsive.)

McNeil provided a tiered pricing scheme in response to a solicitation for an indefinite delivery, indefinite quantity contract for at least 1,000 hours of linguistic services. The offer provided hourly rates for the 1,000 hours and proposed lower rates for increasing hours up to 50,000. The GAO rejected a protest asserting McNeil’s proposal was non-responsive. The GAO stated though the invitation for bids did not contemplate tiered pricing, McNeil’s bid – under which the price for the contract line items varied with the number ordered – was low under all possible calculations included where the firm’s higher hourly rates were applied to the 1,000 hours. The GAO said its tiered pricing neither expressly or implicitly limits its obligations to perform in exact accordance with the solicitation but the effect would only be to reduce the cost of performance as larger quantities are ordered. Hence, McNeil’s deviation from the pricing scheme called for in the IFB was immaterial and did not render its bid nonresponsive (SOS International, Ltd. GAO, No. B-295533).

**Offeror Properly Represented Its Capabilities in Proposing Incumbent’s Employee**

(Editor’s Note. Though we have often noted the requirement to obtain written commitments from proposed key personnel when the solicitation requires it, the following demonstrates how to capitalize on the experience of incumbent’s key personnel when you are bidding against the incumbent.)

While employed by Orion, the incumbent contactor for an Army facility management contract, Zucconi responded to a blind advertisement where Fiore, a non-incumbent bidder offered him employment if Fiore won the contract. Zucconi verbally accepted and provided a resume which Fiore included in its proposal. After this, Zucconi signed a no-compete agreement with Orion that prohibited him from assisting any other bidder and hence Zucconi did not assist in Fiore’s proposal preparation and Fiore’s did not use his resume during any subsequent orals presentations. Though it used an interim Project Director during its orals, Fiore did verbally propose Zucconi as Project Director without Zucconi’s permission where Zucconi subsequently reaffirmed his agreement to work for Fiore if it won the contract. When Fiore won the contract, Orion protested asserting Fiore engaged in improper bait and switch tactics.

The Court sided with Fiore stating that the level of commitment Fiore obtained from Zucconi – essentially “if you win, I will work” – was sufficient to justify both the inclusion of Mr. Zucconi in the proposal and the expectation he would be the Project Manager if Fiore was awarded the contract since the solicitation did not require letters of intent. The Court ruled the bait and switch cases Orion relied on were not applicable because they dealt with bidders who proposed names of employees, who unlike Zucconi, were unwilling or unable to work for the bidder at all or failed to show the required levels of commitment. It concluded no case supports the proposition that a bidder may not include the name of potential employees with its bid if the person is willing to work for the bidder upon award of the contract. Finally the Court ruled that a non-incumbent bidder does not have to abide by an employment agreement as long as the bidder wished to hire the employee and the employee’s inclusion in a proposal accurately reflects the availability of the employee if the bidder wins the award (Orion International Technologies v US, Fed. Cl. No. 04-250C).

**Government Must Request Binding Prices for ID/IQ Contracts**

(Editor’s Note. The following case somewhat undermines the common practice of asking offerors to price out sample transactions in their proposals that are not binding if they receive a contract.)

The RFP for multiple awards of an indefinite delivery, indefinite quantity contract for travel office services included a price schedule for transaction and management fees but rather than asking offerors to complete the schedule asked for non-binding fees for sample tasks that would likely differ from actual future agency requirements. CW argued that this price
Evaluation was flawed because it did not require offerors to honor proposed prices should one win the contract, thus permitting them to propose unrealistically low fees. The GAO agreed finding the lack of binding fees precluded the agency from meaningfully evaluating costs to the government and that proposals based on actual intended fees might be unfairly rejected as too costly (CW Government Travel, No. B-295530).

**GAO Upholds Consideration of Other Vendors’ Contracts During Price Realism Analysis**

(Editor’s Note. The following illustrates that when low rates are used to bid on price sensitive work you need to demonstrate the labor categories that are bid on need to be “roughly similar” to other work or at least, other vendors’ work.)

Evolent’s proposal for telemedicine engineering and technical support services included labor rates that were based on discounts over its labor rates contained in its federal supply schedule contract. In response to questions, Evolent provided to the Navy a price schedule for its federal schedule supply contract that included such positions as “systems analyst” and “systems engineers,” the hours billed, billing rates and detailed cost breakdowns. The Navy concluded that Evolent’s proposed hourly rates represented a reasonable discount from its FSS rates and that they were comparable to the FSS rates of other vendors as well as other bidders on the contract for “roughly similar” labor categories. A protest asserted Evolent’s labor rates were so low as to make it unable to provide staff for contract performance. The GAO rejected the protest noting that under the FAR, an agency may use the same or similar items or services to determine if prices are realistic. The GAO disagreed with the protester’s assertion that the FSS labor categories reviewed by the Navy were broad categories of information technical services rather than specific positions set forth in the RFP, such as “telemedicine systems engineers.” The GAO said there was no reason to question the Navy’s determination that systems engineers in its FSS schedule were “roughly similar” to the medicine systems engineers, especially since they had similar titles (Grove Resource Solutions Inc., GAO No. B-296228).

**Mods that Reduce Contract Scope Must be Competed**

(Editor’s Note. Though increasing contract work through a modification is typically considered to be an uncompetitive “beyond scope” change, the following addresses a rarer form of this anti-competitive action when a contract reduces contract work.)

A contract to Poly-Pacific that originally called for providing and recycling but not disposing of cleaning abrasives for planes was changed to providing and recycling or disposing of cleaning abrasives where the disposing option could be accomplished much cheaper and could be provided by more competitors. A potential competitor heard about the modification and filed a protest against the change arguing the changed scope of work should be competed and not given sole-source to the Poly-Pacific. Siding with the protester, the GAO said the proper test is whether there is a material difference between the modified and original contract and if there is such a difference then the modification is an improper change and hence should be competed separately (Poly-Pacific Technologies, Inc., Comp. Gen. Dec. B296029).

**NEW/SMALL CONTRACTORS**

**What’s a Fair Profit or Fee?**

(Editor’s Note. Subscribers and clients frequently inquire about guidelines the government uses in evaluating proposed profit. Yes, there are guidelines and a general familiarity with them can often protect profit earned and provide opportunities for additional profit. We have addressed this topic from time to time (the latest in the November-December 2001 issue of the GCA REPORT) but could not find a better source than an article by David Bodenheimer of the law firm Crowell & Moring LLP in the November 2001 issue of the now-defunct Lyman Report.)

In FAR 15-404-4(a)(3) there is a policy statement that we have often quoted when government buyers seek to impose the lowest possible profit on our clients: “the government and contractors should be concerned with profit as a motivator of efficient and effective contract performance. Negotiations aimed merely at reducing prices by reducing profit … are not in the government’s interest…and do not provide proper motivation for optimum contract performance.”

- **Acceptable Contract Fees**

**Statutory Limits.** FAR 15-404 imposes statutory restrictions on certain contracts: (1) 15 percent for cost-plus-fixed-fee contracts for research and development (2) 6 percent for architect-engineer services related to public works or utility projects and (3) 10 percent for other cost-plus-fixed fee contracts. In addition, regulations generally disallow profit from claims for
delays under the Suspension of Work and Government Delay of Work clauses (FAR 52.242-14 and 17, respectively). Also, regulations provide for no-fee contracts when the contractor agrees to cost-sharing arrangements under FAR 16-303.

What’s a Fair Profit Rate? The question “what is a fair profit” can be as elusive as reasons for or against a given profit rate. Nonetheless, a surprising number of cases have centered on a 10 percent profit rate as the going rate for doing business with the government (Ideker, Inc. found 10% to be reasonable; Kong Yong Enter Co. found 10% to be fair and Techno Engineering & Constr. rejected 4% when 10% was normal). For contractors looking for higher profit rates, 15 percent has been widely accepted in cases involving contract changes and breaches (Big Chief Drilling Co., Yamas Constr) though many cases for changes have provided far less profit.

What happens to fee when a cost type contract overruns the original budget? Does the ceiling amount cover only costs where fee can be collected in excess of the ceiling? It depends. Where the Limitation of Funds clause limits the government’s obligation for “costs” incurred (without reference to fee) the courts have generally held that a contractor first recovers its full costs up to the ceiling (without any reduction to fee) and then collects fee over and above the ceiling (Allied Signal, John McMullen). Conversely, when the contract specifies that the Limitation of Funds clause includes both fee and cost, the contractor may not recover either cost or fee above the ceiling.

• Profit on Changes

The right to profit when changes increase a contractor’s cost is well established. The purpose of an equitable price adjustment under the Changes clause is to “keep the contractor whole when the government modifies a contract.” An essential element for this “wholeness” is allowance of a fair and reasonable profit.

The government often attempts to thwart the established principle of profit on additional cost in three ways:

1. Profit on changed work should be limited to the profit rate in the original bid. While the courts do consider the original profit rate, cases have generally provided for higher profit rates on contract changes than those originally proposed (Ryan-Walsh gave 10% when the original was 5%; Keco Indus. provided 5% when the original bid was no profit).

Factors found to justify higher rates than those found in the original agreement include: (a) changed work imposes greater risk and difficulty on the contractor than the original bargain (Ryan Walsh vs. US) (b) when changed work has increased the complexity and difficulty of performance (Franklin W. Peters & Assoc. justified a higher fee when design changes occurred) and (c) when a constructive change to an option resulted from an improper exercise of the option (Safeguard Maintenance Corp.). Conversely, when a contractor has already incurred the costs for the additional work, a lower profit rate than originally bargained has been found to be justified because the associated risk is less than with future work.

2. When the contract is in a loss position, zero profit is appropriate. The courts have ruled that while it is appropriate to hold a contractor to the risks it assumed for the originally contracted work, it is not proper to hold the contractor to the same risk when performing additional work and undertaking additional risk it had no reason to anticipate (Stewart & Stevenson Service, Inc., Accord, Litton Systems).

On the other hand, when the government seeks a price adjustment for a deductive change (e.g. lower scope of work), the government will seek recovery from both overhead and profit. If the deducted work would have been performed at a loss, the courts have refused the government’s demand for profit for to do so would unfairly pyramid the contractor’s losses by deducting profit that would have never been earned.

3. Profit should not be applied to overhead and G&A costs. Unless profit is expressly excluded by contract provisions, the courts have generally ruled that profit is to be applied to not only direct costs but indirect costs as well.

Also, though profit on contract breaches was disallowed in a few older cases, modern cases have ruled that profit should be allowed.

• Requirements of Profit Analysis

FAR 15-404 states most agencies making noncompetitive contract awards totaling at least $50 million per year shall use a structured approach for determining the profit or fee objective when those acquisitions require a cost analysis. The Defense Department in DFARS 215-404 also provides for a structured approach for developing a pre-negotiation profit or fee objective when cost analysis is required. Exceptions are made for competitive contracts, cost-plus-award-fee contracts and federally funded R&D Centers.
QUESTIONS & ANSWERS

Q. I read in the March-April 2005 issue your article about establishing a separate fringe benefit rate. I found this article very interesting especially with regard to the ability of actually lowering the overhead rate by adding fringes to the Direct Labor in the base of the overhead pool. I just would like to receive confirmation that this is an acceptable, by DCAA standards, methodology.

A. Establishing an overhead rate with direct labor plus fringe benefits is a common, acceptable practice so, in itself, should not violate DCAA's standards. However, when making any kind of significant accounting change, it will very possibly raise a red flag with DCAA so they may ask you to justify, in writing, the change and demonstrate there is no adverse cost impact to the government on prior contracts.

Q. I know tradeshows, not related to generating export sales, are unallowable. However, there are some in my organization (i.e. mostly technical personnel and technical management) that consider these costs as allowable exceptions to unallowable public relations (e.g. “disseminating technical information”, communicating with the public, press, stockholders, creditors and customers, etc) - see FAR 31.205-1. Also, some meetings can be considered allowable selling expenses.

There really isn't any FAR definitions of a tradeshow or definitions of other allowable gatherings. Certainly there are certain gathering in industries that are traditionally considered tradeshows (e.g. Paris Air Show) and those would qualify as tradeshows. Other than those, it comes down to what each company decides for itself are unallowable public relations events or allowable exceptions, business conferences, selling expenses, strategic marketing planning events, etc. You would be most safe to draft a policy and procedure that distinguishes between unallowable and allowable events and then follow that procedure.

As for labor costs associated with tradeshows, the guidelines are if the labor associated with the unallowable activity is “material” then yes the labor should be unallowable along with the other costs associated with the tradeshow. If not “material,” then you do not have to disallow the labor. The regulations do not define what is material and even individual auditors differ widely. In our experience, amounts over 5% are usually considered material (say, over 5% of salary) while less than 2% is usually immaterial. In between, government opinions will vary. You may want to identify what is considered material for you in the written policy discussed above but, personally, we don’t like to commit to a particular number. If auditors do assert that the amount of labor is material for labor you did not disallow, there is generally a reasonable dispute in which case penalties should not be imposed.