
GCA REPORT

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NEW DEVELOPMENTS

New Contract-Related Interest Rate Set for First Half of 2006

The Treasury Secretary has set a rate of 5 3/4% for the period July through December 2006. The new rate is an increase from the 5 1/8% rate applicable in the first six months of 2006. 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) (Fed. Reg. 37,638).

Industry Group Challenges DCMA's Opposition to "Rolling Forward" Contract Costs

The National Defense Industrial Association (NDIA) is urging the Defense Contract Management Agency to withdraw a memo that could lead COs to discontinue the use of "roll forward" procedures that allow for later recognition of contract costs when their allowability cannot be settled by the current cost accounting period. NDIA has called for withdrawal of DCMA Information Memorandum No. 05-240 which states use of roll forward should be discontinued because the procedure violates the Cost Accounting Standard 406 in as much as CAS 406 calls for a "correct" cost accounting period to which a cost must be assigned. NDIA states the memo would be a "detriment" to the timely establishment of final billing rates and contract close outs. NDIA states it would be inconsistent with FAR provisions that permit quick closeout procedures, pay forwards and roll forwards to enable timely settlement

of contract costs. NDIA also challenges the assertion that the roll forward procedures violate CAS 406 stating the purpose of the standard is to provide criteria for the selection of time periods to be used as cost accounting periods not for determining the proper cost accounting period for assigning a cost. The group states both CAS and Generally Accepted Accounting Principles provide numerous examples of costs that are incurred in one period but assigned to another such as restructuring expenses assigned as amortization expenses in another period, internally developed software costs and deferred independent research and development costs.

Panel Recommends Changes to Acquiring Commercial Services; Industry Criticizes

A congressionally mandated Acquisition Advisory Panel July 25 approved a series of recommendations intended to strengthen competition and boost "transparency" in the government's acquisition of commercial items and services including orders placed against multiple award contracts. The most significant recommendations include:

1. *New definition for stand-alone commercial services.* In order to ensure that commercial services are, in fact commercial, the new definition at FAR 2.101 would ensure that only those services that are actually sold in substantial quantities in the commercial marketplace are considered "commercial." This would replace the current definition that includes services "of a type" sold in the marketplace where the panel calls for the elimination of the "of a type" language. When acquiring services not sold in the commercial marketplace, the government would need to follow traditional contracting methods e.g. FAR Part 15, Negotiated acquisitions.

2. *Increasing competition.* The DOD requirements for competing services over \$100,000 under multiple award contracts should be applied government-wide. Such requirements include requiring COs to contact as many schedule contract holders as practicable to ensure at least three responses are received by holders capable of doing the work and notifying all FSS contractors that for orders over \$ 5 million consideration of cost or price is a "significant evaluation factor."

3. *New IT professional services schedule urged.* The group suggests the General Services Administration should create a new information technology schedule for professional services that relies on competition rather than posted rates to establish prices. The panel notes while rates play a role in pricing, the price depends more on a level of effort and mix of skills to meet government needs so the GSA should spend less time on negotiating and auditing rates and more time “negotiating key terms and conditions related to services.”

4. *Greater transparency in awards.* Amending the FAR to establish the requirement to publish in FedBizOpps, for information purposes, all sole source task or delivery orders placed under MAS contracts above the simplified acquisition threshold of \$100,000 and requiring agencies to provide a post-award debriefing, consistent with FAR 15.506, on all such orders when a statement of work and evaluation criteria were used in making the selection.

5. *Limited use of T&M contracts.* In response to concerns about price competition and contract management the panel suggests (a) current policies limiting use of time-and-material contracts be enforced (b) converting work performed on a T&M basis to performance-based effort, when possible (c) barring use of T&M contracts unless the “scope of effort” is sufficiently defined to allow efficient use of T&M resources and (d) mandating that T&M contracts be awarded competitively, whenever possible.

6. *Ensure price reasonableness when competition is limited or does not exist.* Revise current FAR provisions that permit the government to require “other than cost or pricing data” and conforming the FAR to commercial practices by emphasizing price reasonableness should be determined by competition, market research and analysis of prices for similar items. These goals would be accomplished by (a) amending statutes addressing price as an evaluation factor to provide that non-price factors should never be “significantly more important than price” (b) statutory change to allow protests of task and delivery orders under MAS when the anticipated value exceeds \$5 million (c) revising FAR 12 and 52.212 to include standardized contract terms for acquiring commercial items and services. The recommendations will be available on the acquisition Advisory Panel Web site at “<http://www.acquisition.gov/comp/aap/index.html>”

Though agreeing in certain respects a multi-association coalition of industry groups criticized several of the Panel suggestions saying it would make procurements

less efficient, less effective and less fair to all parties and would “return to an era” when the federal procurements simply took too long. Specific suggestions that were blasted include:

1. *The new definition of stand-alone commercial services.* By eliminating the “of a type” the government would be limiting access to the latest cutting edge products evolving from the commercial sector to only those that are precisely the same as those required by the government.

2. *Allow protest of task and delivery orders above \$5 million.* Such protests would hurt the government’s ability to get the work accomplished on schedule and would impose extra costs due to administering and responding to protests.

3. *Required increased competition when using T&M contracts.* Once a sole source justification has been made then the appropriate contract type should be used, including T&M.

4. *Deemphasize labor rates.* Schedule contracting should focus on the buying agencies’ processes, not providing less structure in which negotiations take place such as eliminating hourly rates in the base contract.

5. *Creating standardized contract clauses.* The use of the litany of government specific standard clauses has been demonstrated to keep commercial firms from competing in the federal marketplace – a result Congress tried to reverse through creating special authorities for commercial items.

6. *Price should rarely be less important than non-price considerations.* Such a significant revision should be put up to public scrutiny and extensive public commentary.

New Security Clearance Developments

Following numerous complaints about delays in processing security clearance applications, the Office of Personnel Management and the Defense Department announced they are working to ramp up their processing. They recently released statistics showing that in spite of a growing workload they are reducing their case workloads and that after a 2 ½ month delay due to “financial shortfalls” they are again fully operational. The number of Top Secret applications has increased from 3,000 in 2004 to 7,000 per month in 2006 and the number of Secret/Confidential clearances has increased from 14,000 to 34,000 a month in 2006 while the processing time has been cut more than half. The marked improvement seems to be a result of OPM

awarding contracts to five companies to perform the background investigations it normally conducts.

Meanwhile a coalition of industry groups have applauded provisions in the fiscal 2007 homeland security authorization bill that would require DHS to recognize security clearances granted by other agencies and not subject to secondary investigations. The failure to do so in the past has been a significant source of criticism of DHS. In addition the coalition has come out in favor of the new requirement to have all DHS components “meet or exceed” government-wide or departmental standards for clearance investigations, adjudications and suitability reviews.

DOD Issues New Rule Limiting Tiered Evaluations

DOD issued a rule to implement legislative restriction on the use of the controversial practice of “tiered” evaluations in making awards. The 2006 defense authorization act directed DOD to issue guidance prohibiting the use of these so-called “cascading set-asides” unless the contracting officer has complied with certain market research and documentation requirements. The new DOD rule prohibits their use unless the CO (1) has conducted market research in accordance with FAR Part 10 (2) is unable, despite such research, to determine whether or not a sufficient number of qualified small businesses are available to justify limiting competition and (3) includes in the contract file a written explanation why the CO was unable to make the determination.

Under a tiered evaluation the solicitation allows offers to be submitted by all types of businesses but evaluation starts with the level that enjoys the highest preference and ends if the award can be made at that level. For example, if an award can be made after considering small business firms from HUBZone areas then offers from large businesses or other small non-HUBZone businesses are not even considered. Though agencies praised the technique for its efficiency, contractor groups came out in force against it arguing that it caused them to waste precious resources on proposals that were never evaluated.

DOD Issues Guidance On Comparing Health Costs in Public-Private Competitions

The Defense Department has issued guidance to help its buying agencies that are conducting public-private competitions to compare costs of employee health benefits paid by the private sector offeror to those paid

by DOD for civilian employees. Such a comparison is mandated by statute to ensure private sector firms participating in public-private competitions do not receive an advantage over in-house bidders by contributing less toward health insurance than DOD does. The new requirements mandate:

1. DOD refrains from giving an advantage to a private sector provider that does not offer employee health benefits or pays less toward health benefits than DOD pays its civilian employees.
2. Ensures that private sector proposals are adjusted to include an amount that is included in the agency’s cost estimates for its employees.
3. Use OMB’s standard cost factors in effect on the performance decision date in the comparison. In May 2006, when the guidance was issued, the civilian full fringe benefit standard cost factor was 32.85 percent, which includes a 5.7 percent standard cost factor for health and insurance – 5.5 percent for health and 0.2 percent for life insurance. The government must then determine if the ratio of the private sector offeror’s health insurance contribution to its direct labor costs is equal to or greater than the cost factor used by the government. If the ratio is less, the policy directs DOD to make an “upward adjustment” so the ratio is equal to the standard health benefit factor.
4. Exempt from the policy when 10 or fewer DOD civilian employees are involved.

DHS Launches More “User Friendly” SAFETY Act Application Kits

Recognizing the initial application process was overly burdensome, the Department of Homeland Security launched a new kit for contractors to apply for protection under the Support Anti-Terrorism By Fostering Effective Technologies (SAFETY) Act of 2002. The Act allows for certain liability limitations in the event of a terrorist attack for sellers and developers of technologies intended to reduce the risk of harm. After successful application, the liability protection is valid for 5-8 years and it can be renewed. Following many complaints, DHS has overhauled the application kit. The new kit is available at www.safetyact.gov.

Senate Bill Seeks to Expand Small Business Share of Contractor Dollars

The 2006 Small Business Act reauthorization bill has some interesting provisions to expand the percentage of contract dollars going to small businesses:

1. Penalize misrepresentation as small business. The bill would make it easier for the government to prosecute, suspend and debar large companies that obtain government contracts by misrepresenting themselves as small businesses.

2. Subcontracting practices will be scrutinized. To prevent “bait and switch” tactics offerors must certify they will acquire goods and services from small businesses in the amount and quantity used in their proposals unless the small businesses cannot meet quantity, quality or delivery standards and they will have to submit a certified report showing attainment of their subcontracting plans. In addition, (1) failure to make timely payments to small business subcontractors will be considered to be a material breach of the prime contract and (2) pilot programs to provide incentives to prime contractors who exceed their subcontracting plan goals will be encouraged.

3. Multiple awards targeted. Federal agencies will have to establish criteria that (a) sets aside part of multiple award contracts to small businesses (b) sets aside multiple award contracts for subcategories of small businesses (e.g. disadvantaged, women-owned, disabled, etc.) and (c) reserves one or more contract awards for small businesses under full and open competition.

4. Greater share of awards for emergency relief and recovery contracts. Expand the current requirements that small businesses be given a priority to perform a “substantial portion” of contracts in emergency relief contracts to include contractual set-asides, incentives and penalties to increase small business participation.

5. Expand HUBZone eligible areas to include qualified suburban areas of villages, towns, cities and other units of a local government that is in an urban county provided these areas meet the income or unemployment requirements.

DCAA Issues New Guidance

The Defense Contract Audit Agency has issued new guidance to its auditors recently.

- **Stock Option Awards**

In the wake of recent stock options scandals, the Defense Contract Audit Agency has issued guidance to its auditors to be “alert to unallowable costs related to employee stock option awards” when conducting their normal audits. The guidance stresses that the measurement and allowability of such costs are

governed by the Cost Accounting Standard 415 rather than relevant sections of Financial Accounting Standard (FAS) 123(R) because the latter addresses only financial accounting and not government contract accounting and advises auditors to question any stock option cost in excess of the amount measured by CAS 415.

CAS 415 requires that compensation costs arising from stock options be measured by the difference between the fair market value of the stock and the option’s exercise price at the measurement date which is the first date both the number of stock options awarded and the option price is known. Since most companies award stock options to their employees at an option price that is equal to or higher than the market price of the stock at the measurement date, there is generally no allowable compensation cost resulting from the stock options. However, in rare cases where the stock options are awarded at an option price lower than the market price, the difference constitutes compensation costs under CAS 415 and would be considered allowable. For non-CAS covered contractors, auditors are told to cite FAR 31.205-6(k) when questioning the cost because that section of the FAR incorporates CAS 415 in its entirety (06-PAC-023(R)).

- **DCAA’s Role in Evaluating CAS Compliance**

DCAA’s memo intends to clarify agency guidance on evaluating a contractor’s compliance with applicable Cost Accounts Standards. The guidance reminds auditors they are to consider a contractor’s compliance with CAS during performance of all routine audit assignments such as proposal and incurred cost reviews. In addition, DCAA is to perform an audit of all applicable standards once every three years with the exception of CAS 401, 402, 405 and 406. The extent of substantive testing during any of these audits are to be based on risk and materiality of affected costs.

- **FAR Change to Allowable Depreciation Costs Following a Sale Leaseback Transaction**

Following a recent change to the FAR 31.205-11, Depreciation that limits allowable depreciation for assets that have been reacquired subsequent to a sale-and-leaseback arrangement, DCAA’s new guidance to its staff reminding them that allowable depreciation costs for the re-acquired assets are to be based on the original acquisition costs of the assets that have since been sold and leased back then re-acquired. Auditors are told to question costs claimed that exceed this limitation. The memo states the guidance should be read in conjunction with recent FAR requirements

addressing recognition of gains or losses with sale-leaseback transactions. The guidance states the allowable depreciation costs are calculated based on the following formula:

1. Net book value of the asset on the sale-and-leaseback date, plus
2. Allowable gain/loss recognized on the sale-and-lease date, less
3. Depreciation expense considered when determining the allowable lease costs.

The guidance further states the new depreciation limitation is applicable to only those assets that generated costs in the most recent accounting period prior to the reacquisition. It says the rule would not apply in those situations where the contractor has reacquired an asset subsequent to the passing of a full accounting period after the lease is terminated and the contractor ceases use of the asset. The guidance includes a detailed, useful example taking into account both the new changes and methods of computing gains and losses on the disposition of assets (06-PAC-028R).

CASES/DECISIONS

SCA is Triggered When There is Increased Costs Irrespective of Increased Benefits

LSI had a firm fixed price contract to provide the Air Force with aircraft maintenance services and the contract incorporated the Service Contract Act (SCA) which required the government to pay LSI for increases in applicable fringe benefits made to comply with its collective bargaining agreement (CBA). The CBA specifically required LSI to provide employees with a defined-benefit health plan which, in contrast to a defined-contribution plan, obligates the employer to spend whatever is necessary to continue to provide employees with an agree-to level of benefits, even if costs rise. When the cost of providing that plan increased during the third option year it sought reimbursement from the Air Force claiming the plain language of the SCA Price Adjustment Clause protected the contractor from increased costs of providing health and welfare benefits. The government and Appeals Board rejected LSI's position saying it distinguished between increases in an employer's cost of providing benefits, which the Board said is insufficient to trigger the Clause, and increases in the benefits themselves.

The Board stated any increased cost experienced by LSI was caused by inflation and not compliance with SCA.

The Federal Circuit reversed the Board's decision saying there was no merit in the argument the Price Adjustment Clause is triggered only by an enlarged benefit rather than enlarged costs of providing those benefits. The Court said the contract price labor rates will be adjusted to reflect the contractor's actual increase or decrease in applicable wages and fringe benefits where the critical consideration is in "monetary cost to the contractor." The Court concluded the Price Adjustment Clause is triggered by changes in an employer's cost of compliance with the terms of the wage determination – the fact there was no nominal change in the benefit provided is "simply irrelevant" (*Lear Siegler Services Inc. V. Sec of Defense, Fed. Cir., No. 06-1080*).

Air Force Conducted Unequal Discussions In Asking Some Awardees to "Clarify" Labor Rates

The solicitation for a best-value procurement for design and engineering/technical support services required offerors to provide "evaluated" labor rate tables to be used to determine total evaluated prices. After receiving initial proposals, the government found that several offerors had violated solicitation instructions and provided rates that were inconsistent with their "official" rates to be incorporated into the contract (e.g. one was "inflated" while another used "weighted" rates for subcontracts where instructions asked for "average rates"). In order to better determine total prices the government sent "evaluation notices" to some of the offerors requesting "clarifications" and asking them to correct the rate tables. The GAO said that "communications that permit an offeror to correct proposal mistakes constitute discussions unless the mistake is minor." Since the mistakes were not minor the GAO asserted the communications were "discussions" which opens the door for discussing other weaknesses of all the proposals. Hence, UDRI's protest that the government failed to discuss certain evaluated weaknesses of its proposal – unrelated to the labor rates – was sustained because the communications constituted discussions rather than clarifications (*University of Dayton Research Institute, GAO, B-296946*).

Lockheed's Allocation of Computer Costs Violates CAS 418

In 1992 Lockheed Martin formed a wholly-owned subsidiary, Lockheed Information Technology Company

(LITC) to provide centralized mainframe and supercomputer services to various business segments. The predominant users of two Cray supercomputers were two business units – LMSC that worked exclusively on government contracts and LASC that worked exclusively on both government contracts and independent research in support of government contracts. For 1994 and 1995, the subsidiaries units using the Cray computers were charged under a method where LITC allocated its costs applying a fixed cost based on each company's annual forecasted hours for CRAY computer resources (called the "resource commitment" method of allocation). The DCAA reviewed LITC's compliance with the Cost Accounting Standards and concluded Lockheed's resource commitment method violated CAS 418 asserting use of a forecasted usage commitment resulted in significant differences of cost allocations rather than using an actual usage method (called "resource consumption") recommended by CAS 418.50(e)(1). The CO issued a final decision saying the allocation of Cray computer costs violated CAS 418, seeking \$2.7 million of increased costs it asserted the government incurred due to the CAS violation.

CAS 418 requires that cost pools not containing a significant amount of costs of management or supervision where a direct labor or direct material would not be an appropriate base to allocate the indirect pooled costs, one of the following, in descending order of preference be used: (i) a resource consumption measure (ii) an output measure or (iii) a surrogate that is representative of resources consumed. According to CAS 418-50(e)(3) when the third method is used, which was the case here, a permissible surrogate is the use of "pre-established rates, based on either forecasted actual or standard costs" which if used "shall be reviewed at least annually and revised as necessary to reflect the anticipated conditions." In addition, if pre-established rates are revised during a cost accounting period and the variances of the two rates are substantial then the costs allocated up to the time of the adjustment should be adjusted to reflect the revised pre-established rates. Disagreeing with the government, the Court ruled that the use of pre-established rates was not impermissible but rather asserts Lockheed failed to review the rates "at least annually" and revise them "as necessary." Lockheed asserted it was compliant with CAS 418 but did not put forth any evidence to contradict the government's assertions. The Court ruled Lockheed's cost allocation method did violate the CAS (*Lockheed Martin Corp. v US, No. 00-129C*).

Sole Source Award Is Upheld

(Editor's Note. The following demonstrates the advantage of a determination that the contractor paid for its own research and development effort.)

KSD protested a sole-source award to McDonnell Douglas Helicopter (MDHC) for strap assemblies. The court stated the agency was correct in awarding a sole-source award because the assembly was developed at MDHC's expense and thus the government did not own and could not distribute MDHC's proprietary data to KSD or any other party to conduct a competitive procurement. The Court ruled that KSD failed to present any evidence supporting its allegation that the government had funded MDHC's research, testing or design of the assembly. It indicated that much of the costs related to developing the assembly were included in its independent research and development funding which is considered to be development at "private expense." The Court added there was no indication the government had directly paid MDHC or its research nor had acquired rights to the assembly in any other way (*KSD Inc. v US, Fed.Cl. No. 05-1229C*).

Need to Review Subcontractor's REA is No Excuse for Late Notice of Cost Overrun

(Editor's Note. The following illustrates the need to strictly adhere to notification requirements on cost type contracts, even if estimated costs are uncertain.)

The Limitation of Cost (LOC) clause in ITC's cost type contract required the contractor to notify the contracting officer when it anticipated that within the next 60 days its costs, including subcontractor costs, should exceed 75 percent of the contract's estimated price. Rather than submitting notice on time, ITC waited until about six weeks after completing its delivery order to notify the Navy it was seeking \$1.1 million over and above the ceiling of its contract. ITC asserted it was unable to provide timely notice of expected cost overruns because it had to first review a subcontractor's request for equitable adjustment to ensure its claimed costs were allowable and payable. In rejecting its claim, the Board stated the LOC clause "does not limit a contractor's notice obligation to those costs proven to be allowable to a certitude" but rather the notice is required when the contractor "has reason to believe" it expects cost increases. The Board ruled the delay in notifying the Navy hurt the Navy because it was unable to assess the current status of the contract from a cost and technical point of view and ITC was unable to show

the claimed additional costs were not reasonably foreseeable (*International Technology Corp., ASBCA No. 54136*).

Agency Did Not Have to Remove Added Features to Normalize Offeror's Price

(Editor's Note. The following provides a good lesson in using caution when proposing additional items in a best value acquisition.)

In a proposal to provide digitization services to the government, SI voluntarily included an amount to provide disaster recovery services in the event of an emergency. The agency determined that SI's disaster recovery proposal was a strength to its proposal but was of limited value because it had not yet determined whether the extra services were needed. The agency found both SI and Datatrac's proposals were excellent and made the award to Datatrac based on its lower price. SI protested the award claiming the agency should have removed the price associated with the disaster recovery before comparing its price with Datatrac in order to make an "apples to apples" comparison. GAO disagreed stating they were unaware of any requirement in a best-value evaluation where an agency must add or delete costs of a value added feature, even one the agency finds of little value. GAO said SI was not invited to broadly revise its disaster recovery plan because it was not considered to be a weakness and that SI made a "reasoned business judgment" to include the services (*SI International, GAO, B-297381*).

Rise in Steel Costs Did Not Make Subcontract Impracticable

The prime contractor submitted a claim for its subcontractor to recover an increase in structural steel prices, asserting "an unpredictable global steel crisis" invalidated a basic assumption of the subcontract and rendered it impractical. The Board disagreed, finding that though the increase in steel prices was not the subcontractor's fault, the 23 percent price increase did not make performance impractical because it represented less than a 5 percent cost overrun in the subcontract price. Moreover, the fixed-price subcontract assigned the risk of price increases to the subcontractor. While the subcontractor assumed the steel market would remain within a generally predictable range, this was not a basic or normal assumption about general risk of possible increases for a fixed price contract and there was no evidence the prime contractor nor the government shared the subcontractor's assumption (*Spindler Construction Corp., ASBCA, No 55007*).

QUESTIONS & ANSWERS

(Editor's Note. Since we received an unusual amount important questions in the last 4-5 weeks, we thought we would address most of them here rather than pick only one or two and sacrifice our usual feature article for this issue only.)

Q. This year I find myself in the difficult situation of having my provisional billing rates significantly less than my actual indirect rates. CAS 405 talks about identification of unallowable costs and I was wondering if I can, under this standard, unilaterally move some normally allowable costs to an "Unallowable cost bucket" which would allow me to stay within my provisional rates for FY 2006. My company went through some major changes in 2006 and some of our business assumptions (e.g. expectations of more business) did not materialize. I have confidence, however, that the situation will drastically improve in 2007 which will be partially due to having competitive rates we were able to use in our bids in 2006.

A. Though I guess you could charge it to unallowable, I would ask why you would want to do so. There is no problem with submitting the costs as they are and have them audited in which case you would likely have audited rates higher than you billed. Whether or not you go after the difference is a business decision you make which in this case, it seems you would not go after anymore than you billed even though you are entitled to more. I fear if you charge certain costs as "unallowable" you raise a major red flag by not doing so in previous and subsequent years. If you still want to segregate the excess costs, I would prefer to call them a special management concession for a specific year.

Q. I am a government employee who was assigned a job that was expected to last three days but finished it ahead of time and flew home on the evening of the second day. Since I would have had over a 90 minute ride home I stayed in a hotel that night. Am I entitled to per diem for lodging and food.

A. A recent case - *Jerry Dubworth, et al GSBCA 16035 TRAV* - ruled that under similar circumstances the employee was not entitled to any per diem stating that Paragraph C4552 of the Joint Travel Regulations is clear that per diem reimbursement is not permitted at employees' permanent duty station. Of course, since the JTR has limited applicability to private contractors, such a restriction would probably not apply to them even though an auditor may assert that FTRs provide guidelines on what is reasonable and not.

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Q. Amongst the lessons learned in 2006, I see that our need for a Subcontractor/material handling rate is not truly representative of our business mix. I intend to switch from a Value Added G&A to a Total-Cost-Input method, moving to the base of G&A all subcontractor and consultant costs. May I, under this new scenario, cap the G&A that I would eventually charge to the few subcontractors doing business with our company at a rate lower than our G&A Rate? The rationale of a lower G&A would be to (a) remain competitive with contracts that cannot afford a full G&A applied to subcontractors' costs and (b) lower indirect costs incurred to support the work done by Subs.

A. There is nothing that prevents you from capping your G&A rate (or any other for that matter) applied to subcontractor costs even though you are entitled to a higher rate. In fact, it is not unusual for specific customers to insist on that. However, that is a matter affecting specific contracts and should not be a company-wide cap. You may want to consider using a subcontract handling fee which would apply only to subcontracts which would result in you not including subcontracts in the G&A base?

Q. I am sure the government will allow us to direct charge relocation costs of a few of our key personnel but that means we will have to charge relocation costs for our other employees indirectly. Since we are modified CAS covered would we not be violating CAS 402 that states similar costs have to be charged direct or indirect, not both?

A. Charging some relocation costs direct and others indirect are quite common practices. CAS 402 requires similar costs incurred under like circumstances to be charged consistently. I would argue that those similar relocation costs are incurred under unlike circumstances – one is that key relocating employees costs that the government says may be charged direct is one circumstance while costs incurred by non-key employees that the government says may not be charged direct is another circumstance. Of course, in your disclosed practices, you will want to specify that certain categories of costs (relocation, travel, consultants, computer operations, supervisory labor, etc.) are charged both direct and indirect, depending on the circumstances.

Q. We receive a Job Development Tax Credit that is calculated based on building costs and jobs developed (capital expenditures/operating expenses). The credit is given back to us as a refund on our state income tax withholdings. We are uncertain whether they should be credited back to the government. Could you provide some citation from the FAR that would help us in resolving this issue?

A. I would take a look at FAR 31.205-41(d), Taxes that says in part “Any taxes, interest or penalties that were allowed as contract costs and are refunded to the contractor shall be credited or paid to the Government in a manner it directs.” That FAR citation would indicate the credit should be used to reduce the amount of state income tax paid that you then charged indirectly. Of course if you did not include the state income taxes or other relevant tax in your indirect cost pool(s), the pool should not be reduced.