GCA REPORT

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NEW DEVELOPMENTS

DCAA Issues New Audit Guidance

♦ **Dependent Health Benefit Costs**

Current audits have disclosed that contractors paid a significant number of dependent medical costs claims for family members who did not qualify as dependents under their medical/health care plans. The guidance cites examples of dependent/spousal ineligibility: (1) dependents reach the age where they no longer qualify as a dependent (2) spouses were divorced or deceased or (3) dependents were covered under another plan as well as the current one where the employee failed to notify the contractor of the double coverage where the contractor's plan would require an adjusted premium for the double coverage. The guidance states the overpayments may be a result of inadequate procedures in place to ensure the unallowable costs are not made in which case the failure to have adequate internal controls should be reported as an internal control deficiency and a CAS 405 noncompliance if the contractor's contracts are fully or modified CAS covered.

The guidance states the unallowable health insurance premiums are covered by FAR 31.205-6(m)(1) where the relevant section states "the costs of fringe benefits are allowable to the extent they are reasonable and are required by law, employer-employee agreement or an established policy of the contractor." So since the unallowable costs "do not meet the expressed requirements of the referenced FAR provision (i.e. in accordance with established contractor policy)" penalties are recommended on any such expressly unallowable costs. (*Editor's Note. Commentators have pointed out – correctly in our opinion – that penalties are inappropriate here because DCAA has taken an improper expansive view in considering these costs to be "expressly unallowable" which is the condition for imposing penalties. The quoted FAR section does not meet the definition of expressly unallowable found at FAR 31.001 nor court decisions that have defined such costs as "unmistakable" and "beyond cavil."*) (09-PSP-016R)

♦ **Ensure New Ethics FAR Changes are Incorporated into Accounting System Control Audits**

DCAA has revised its audit guidance for reviewing contractors' control environment during Control Environment and Overall Accounting System Control audits to respond to recent FAR changes related to Ethics and Conduct requirements. The expanded steps in the 24 page audit program is to incorporate recent FAR changes that now require contractors to have (1) a written code of business ethics and conduct (2) a business ethics and compliance training program and (3) an internal control system that facilitates timely discovery and disclosure of improper conduct and ensured corrective measures are promptly instituted and carried out. The guidance includes a summary of the FAR changes as well as a presentation of the audit program with extensive additions clearly noted. Though the guidance does not specify what sized contractors it applies to it does mention that additional guidelines applying to non-major contractors will be issued by Sep 15, which has not yet been issued as late October (*09-PAS-14(*R).

♦ **New ESOP Rules**

The new guidance reflects recent changes to CAS 415, Deferred Compensation that provides costs of Employee Stock Ownership Plans shall be accounted for in accordance with revised CAS 415. The guidance reviews the measurement, allocation and allowability of ESOP costs.

Measurement of ESOP costs. ESOP costs will be measured by the contractor's contributions, including cash, stock, interest and dividends to the ESOP. There are two types of ESOPs (1) non-leveraged where the contractor makes cash contributions to an Employee Stock Ownership Trust (ESOT) which, in turn, purchases company stock with the cash and distributes the stock to employees' accounts or (2) leveraged where the ESOT borrows money from a bank and uses these funds to purchase stock where the contractor's contribution is measured by the total amount of principal and interest on the ESOT loan. The contractors' contributions made in company stock is to be measured at the time it is made where, for example, if a contractor contributes

a block of stock in 2009 to be awarded to participating employees over 10 years the annual contribution will be measured by the market value of the stock in 2009 times the number of shares awarded each year.

Assignment of ESOP costs. The basis requirement of CAS 415 for assigning deferred compensation which includes ESOPs has not changed so the cost of ESOPs are assigned to the cost accounting period the contractor incurs the obligation to compensate the employee. This assignment of ESOP costs to an accounting period will occur only if the contribution, whether it be cash or stock or any combination, is awarded to employees and allocated to their accounts by the Federal tax deadline, including permissible extensions. So, for example, if the award to employees are made in 2008 but the contributions are not made until April 10, 2009, the costs are recognized in 2008.

Allowability of ESOP costs. Whereas CAS 415 will exclusively govern measurement and assignment of ESOP costs whether or not contracts are CAS covered, reasonableness and allowabililty are to be determined in accordance with FAR 31.205-6(a). So, for example, section 6(i)(2) provides that compensation represented by dividend payment or calculated based on dividend payments are unallowable and hence any dividend payments included in ESOP contributions are to be questioned. The guidance states that section 6(q) has not yet been updated to reflect the CAS 415 revisions so discussions about ESOPs meeting pension plan definitions should be ignored (*09-0PAC-013(*R).

- **Audit Alert to DoDIG Fraud Handbook**

(*Editor's Note. We are seeing a definite increase in referrals of contractors to various investigative agencies for possible fraud activities – our consulting business working with contractors and their attorneys in such investigations has substantially increased – so it's a good idea to see what one major source of such referrals consider to be indicators of potential fraudulent actions.*)

Auditors are reminded that part of their risk assessments for their audits is to assess the risk of fraud. This includes reviewing the fraud risk indicators specific to the audits and documenting any risks identified. Auditors are told the principle source for the applicable risk indicators are to be found at the DOD Office of Inspector General's (DoDIG) Handbook on Fraud Indicators for Contract Auditors where the new address is at http://www/dodig.mil/PUBS/igdh7600.pdf (*Note we wrote an article about fraud indicators in 2008 in the REPORT.*)(*09-PAS-012(*R).

New FAC Issued

The Federal Acquisitions councils issued a final rule Federal Acquisition Circular 2005-36 where two are of particular interest to our government contractor readers:

1. Time-and-material and labor-hour contracts that are subject to the Service Contract Act will incorporate FAR clauses 52.222-43, Fair Labor Standards Act and Service Contract Act- Price Adjustments and 52.222-44, Fair Labor Standards Act and Service Contract Act – Price Adjustment. The rule writers have stated the changes will avoid more cost by means of adjusting contract unit price labor rates. Contracts covered by the SCA allow contractors to adjust contract prices for labor and fringe benefit cost increases determined by the Labor Department to ensure "prevailing wages" are paid to contractor employees. Certain contractual methods of adjusting for contract labor rates such as allowing for wage and benefit escalations, equitable adjustments or economic price adjustments will also allow for corresponding increases in profit, overhead and general administrative costs because those rates are applied to the increased labor and fringe benefit amounts. The FAR clauses above provide for the relevant increases in labor and fringe benefits but explicitly prohibit any increase in profit, overhead or G&A that is associated with the wages and fringe benefits. Of course in the unlikely event of a decrease in wages or fringe benefits, the profit, overhead and G&A will also not be lowered.

2. The FAR will be revised to reflect Cost Accounting Standards clauses to make the CAS applicability threshold the same as the threshold for compliance with the Truth in Negotiations Act (currently $650,000).

Bill Will Allow Incumbent Contractors to Recompete as Small Businesses

Rep. Parker Griffith (D-Ala) has introduced the Small Business Fair Competition Act H.R. 3558 that provides incumbent contractors who have outgrown their small business status will be allowed to compete as small businesses for follow-on proposed contracts if the goods and services to be procured are "substantially the same" as the previous contract. The contractor can represent that it is a small business if (1) it was a small business when it was awarded the previous contract (2) is no longer a small business and (3) it would revert to being a small business if it was not awarded the proposed contract.

New DOD Rule on Undefinitized Contract Actions

The Defense Department recently issued final rules affecting undefinitized contract actions (UCAs). The new UCA rules implement the FY 2008 defense authorization act where DFAR Part 217.7404-4 states that when determining the appropriate amount of funds to be obligated on UCAs the CO will limit it to meet the contractor's requirements for the undefinitied period. Also for profit determinations under UCAs, if substantial amount of work is completed the profit negotiated should reflect the reduced cost risk to the contractor for costs incurred during contract performance *(Fed. Reg. 37649)*.

E-Verify Rule Now in Effect

Following several delays by the Obama administration and two federal court cases denying motions for an injunction, the requirement for federal contractors to use the E-Verify system is now in effect. In June 2008 President Bush issued an executive order requiring federal government contractors to verify the work authorization of all new hires and existing personnel assigned to perform work on future federal contracts after which the FAR Councils issued a proposed rule spelling out the federal agencies' responsibilities under the order. Under the final rule, starting September 8 of this year, E-Verify is required for all federal contractors, regardless of size, holding a contract with a period of performance longer than 120 days with a value above $100,000. Subcontractors will also be required to participate in E-Verify if they provide services or construction with a value above $3,000. There were several challenges in the courts against the rule (e.g. the rule violates rights of contractors, violates several immigration regulations) and several industry groups attempted to prevent implementation of the rule on the grounds the challenges were likely to succeed but the courts rejected the injunction attempts.

New Mentor Protégé Programs in HHS and GSA

The Department of Health and Human Services recently proposed and the General Service Administration recently issued final rules establishing mentor-protégé programs to encourage prime contractors to help small businesses qualify for its contracts and subcontracts. Both departments state the purposes are to increase the base of small businesses eligible for prime contracts and subcontracts, increase actual amount of such contracts and to foster long term business relationships between prime and small business entities. The form of mentor assistance to protégés include financial management and overall organizational management and planning as well as technical assistance, rent-free use of facilities or equipment, loans, property, temporary assignment of personnel for training purposes and any other "mutually beneficial assistance." Incentives for mentors may include additional evaluation points toward award of contracts, credit toward attaining subcontracting goals and annual nonmonetary awards for supporting protégés. Mentors may have more than one protégé where protégés must be small business concerns, independently owned and operated and not dominate in their fields (*Fed. Reg. Nos. 36487 for HHS and 41060 for GSA*).

OMB Issues Guidance on Improving Federal Contracting

The Office of Management and Budget issued government-wide contracting guidance to improve visibility of contractor performance, achieve more "balance" between public and private labor and cut down on "risky" contracting. The guidance requires agencies for the first time to track contractor performance through a new unified database – Past Performance Information Retrieval System (PPIRS) - intended to improve agencies' use of contractor performance information. The guidance also seeks to help agencies achieve the "best" mix of public and private labor where agencies will be told to examine at least one program, project or activity that is at risk of relying too heavily on contractors. It also requires agencies to review their existing contracting and acquisition practices to cut 7 percent of spending over two years by strengthening the acquisition workforce, improving planning and market analysis and leveraging government buying power. Some of the cost savings are expected to be achieved by decreasing by 10 percent noncompetitive awards and use of "unnecessary" and "high risk" cost-plus and time-and-material contracts. The executive associate director, Jeff Liebman, added though the guidance discourages such non-competitive vehicles that provide for "open-ended" spending such contracts could still be the best choice when the scope and/or cost of the work is unknown. Liebman suggested, for example, that when an agency has awarded a higher-risk contract and becomes more certain about its requirements the contact can then be converted to a lower risk type one (*"http://www.whitehouse.gov/omb/assets/procurement"*).

DCAA Director "Reassigned" and New Director Selected

We just received notification as this newsletter goes to print that the current DCAA Director, April Stephenson

will be replaced, effective Nov 9, by Patrick Fitzgerald, Auditor General of the Army. This stunning announcement is particularly interesting because we have never seen the recruitment of a director of DCAA outside of the agency. Whereas all the DCAA auditors we informally approached expressed support for Ms. Stephenson all the contractor and industry representatives we talked to expressed some form of relief. One comment is typical – it states though overall changes may take time to filter down to the branch offices, they express optimism that a "new business-like direction in the conduct of DCAA" will occur so that now there will be "professional accountability" and audit opinions will now be based on "materiality concerns rather than the attribute based systems audits." We look forward to a greater attitude of resolving DCAA-raised issues in a more cooperative manner than the rather adversarial stance we have been seeing lately.

CASES/DECISIONS

Variation in Quantity Clause Provides for Adjustment in Contract Amount

(*Editor's Note. The following case illustrates the importance of taking advantage of the Variation in Quantity clause which frequently is not voluntarily offered.*)

Brinks' contract to provide guard services included a Variation in Quantity clause that provided Brinks would be entitled to an adjustment if services varied by more than 25 percent of estimated hours. During the base year, the services were only three percent of the estimated hours where there was a 9 percent markup for overhead and other indirect cost and it submitted a request for additional compensation to recover its increase in costs resulting from the 97 percent shortfall. In its rejection, the government said that (1) there was no guarantee of any hours in the contract and (2) Brinks would receive a windfall for work it did not have to perform. The Board agreed that the contract did not guarantee any hours but sided with Brinks for additional compensation explaining that when the government failed to offer the minimum amount of hours expected, the fixed indirect costs originally allocated to the hours the government failed to order were incurred nonetheless but not compensated for. It stated the Variation in Quantity clause provided for an adjustment in the hourly rate in situations where the stated range of estimated hours was exceeded or not met so as to cause the contractor to reap a windfall or incur a loss (*Brinks/Hermes Joint Venture V State Dept., CBCA, No 1188*).

Court Says Pricing Disclosure Would Violate FOIA

The Air Force received a request under the Freedom of Information Act to disclose GE's unit prices in an award of two contracts for spare parts but GE opposed the disclosure asserting it would cause substantial harm and fell under the FOIA Exemption 4. Exemption 4 protects privileged and confidential information obtained from a person if they can demonstrate either the disclosure would likely impair the government's ability to obtain necessary future information or cause substantial competitive harm. The Air Force claimed (1) GE failed to show it faced actual competition and hence faced no competitive harm (2) failed to articulate the nature of the competitive harm (3) customer leverage is not itself recognized as competitive harm for FOIA Exemption 4 and (4) GE's unit pricing would not give GE customers leverage over the company in their own contracts.

The Court originally sided with the government but then reversed their decision stating the government's reasons were contrary to prevailing law or unsupported by the evidence. GE adequately demonstrated it faces actual competition over jet spare parts to both future contracts with the Air Force and contracts with other countries. The Court explained GE had the burden of producing evidence that release of pricing information would cause competitive harm but did not need to demonstrate precisely how the disclosure would cause the harm. As for customer leverage, the DC Circuit court had expressly ruled that customer leverage was potentially harmful and therefore was the basis for nondisclosure. Finally whether or not its customers would have leverage against GE was found to be irrelevant where the Court stated its customers would likely use the disclosed information to demand lower unit pricing if the disclosure was made (*General Electric Co v Dept of Air Force, DDC No 1:01-cv-01549*).

Opportunities to Appeal Past Performance Evaluations are Limited

(*Editor's Note. The following illuminates how much ability you have in reversing an agency's past performance evaluation.*)

Todd sued to force the Army Corps of Engineers to remove "unfair" and "inaccurate" unsatisfactory performance evaluations from the government's appraisal system. After the Corps rejected its appeal of the evaluation Todd appealed stating the evaluations were made without proper procedures and was erroneous. The Court ruled the allegations constituted a proper claim but concluded it was not authorized to

award equitable or injunctive relief because it cannot force the agency to change or remove the performance evaluation but could only remand the case back to the Corps with "proper and just" instructions. The Court explained that "proper and just" instructions do not trump the general prohibition to provide an injunction against the evaluation noting a CO's decision to assign a particular evaluation is discretionary where the contractor is entitled only to a determination of whether the agency's rating constituted an abuse of discretion. However, it added that should it find procedural deficiencies or an unfair evaluation, it could issue a declarative judgment to help the agency address identified concerns on remand (*Todd Construction V US, Fed. Cl. No 07-324*).

Third Party Beneficiary Cannot Appeal Under the Contract Disputes Act

(*Editor's Note. In the following case, the commentaries were more interesting than the case in as much as it clarifies entities who can go after funds who are not contractors.*)

In anticipation of the possibility of GM&W not being able to pay its subcontractor, FloorPro, amounts due because of other claims against it, the Navy and GM&W agreed to modify the contract to specify the Navy would issue a check payable to FloorPro and GM&W. Despite the mod, the Navy paid GM&W without naming FloorPro as payee after which FloorPro sent a claim to the CO for payment who refused, saying FloorPro did not have a contract with it. Though FloorPro could bring action against the government in the prime contractor's name GM&W did not sponsor the claim so FloorPro brought an action in its own name to the appeal board alleging the contract mod made FloorPro an intended third-party beneficiary. The Appeal Board agreed with FloorPro but the Federal Court overruled emphasizing that a CDA appeal only authorizes a "contractor" to bring action, disagreeing with the appeals conclusion that a third-party beneficiary is an exception. Since FloorPro was not a "contractor" the appeals board had no jurisdiction over the issue (*Winter v. FloorPro, Inc, 2009 WL 1812782*)..

In commentary concerning the case, there are circumstances when a party other than the contractor can seek recovery:

1. Subcontractors can bring "pass-through claims" which are sponsored by the prime contractor and brought in the prime contractor's name.

2. A subcontractor may have privity of contract with the government if the prime contract acts as the government's agent when the prime enters into a subcontract.

3. Sometimes both participants in a teaming arrangement may have privity with the government if one of the teaming partners is not designated as a prime contractor.

4. Under the Tucker Act, third party beneficiaries are entitled to recovery.

5. In some circumstances, a surety can proceed against the government under the doctrine of equitable subrogation.

Employees Ordering Work Lacked Authority

Sinil's Army repair and maintenance contracts were managed by the Directorate of Public Works (DPW). DPW personnel ordered work that subsequent audits indicated were inappropriately ordered due to a misinterpretation of contract requirements.

The government rejected the request for additional compensation asserting the DPW employees who authorized changes and substituted work outside the scope of the contract had no express or implied authority to do so. The appeals board agreed explaining that Sinil's contracts included a "Contracting Officer Representative" clause which provided the COR was not authorized to make any commitments or changes affecting price, quality, quantity, delivery or any other term of the contract where only the CO had such authority (*Sinil Co, ASBCA Nos. 55819 and 55820*).

Army Lacked Basis for a Sole-Source Contract Extension

A Disabled Veteran-Owned Small Business Concern (SDVOSBC) set aside contract for chemical toilet services was awarded to DAV where it was subsequently revealed DAV did not quality as a SDBOSBC. The SBA noted its regulations may but do not require a termination or suspension of the contract so it decided to allow DAV to continue performance for the base year but stated it would not exercise the first option year. However, the Army changed its mind when it prepared a justification of a four month sole-source extension stating it did not have another contract in place for the services. MCS filed a protest stating the Army should have issued a solicitation in which it would be able to compete. The GAO clarified though it would not consider challenges to exercise an extension due to matters of contract administration it would consider protests alleging that a decision to exercise an option instead of conducting a new procurement.

The GAO noted though it acknowledged the absence of another contract made for an "unusual and compelling urgency" to make the extension but concluded the urgency was caused by the Army's failure to plan for this procurement in advance and hence ruled the Army improperly extended the contract on a sole source basis (*Major Contracting Services Inc., GAO B-40172*).

NEW/SMALL CONTRACTORS

Accounting for Subcontract Labor

(Editor's Note. Though we have addressed alternative accounting treatments of purchases labor in a prior issue of the GCA DIGEST (First Quarter, 2004), a specific issue has surfaced with one of our clients that we thought would be of interest here. It illustrates how subcontract labor can be treated on contracts other than as an ODC where there may be significant limitation on how much add-ons can be made.)

Our client's practices of treating subcontract labor, who we will refer to as "Contractor," utilized mostly subcontract labor on its commercial work but used primarily employee labor on its large cost type contract with the federal government. Contractor's indirect rate structure was overhead applied on a direct employee labor cost base and G&A applied on a total cost input base where it applied its full overhead, G&A and profit rate on employees for the government contract while in the unusual case of using subcontract labor, it applied only G&A with no profit. The auditors made a determination that the skill categories of labor for the subcontract and employee labor were essentially the same and reasoned that the allocation of overhead, G&A and profit on the employee labor used on its government contract represented an inequitable allocation of such costs to only government work where no such allocations except G&A were applied to the subcontract labor for commercial work. Contractor agreed to change its accounting practice and contacted us for advice.

Though we considered preparing a response challenging the auditor's recommendation to change the accounting our client decided to simply change the practice. One option our client put forward was to compute average rates for different labor categories where for pricing and billing purposes, the average rate for each category would be billed and the overhead base would consist of all employee and subcontract labor costs. The auditor interestingly resisted this approach, asserting that adding the total burden to an already higher subcontract hourly rate would result in too high of a cost for subcontract labor in spite of lower overall indirect rates (because of the higher base created by including subcontract labor). I say "interestingly" because the proposal would have tended to lower the costs on government work and raise it on commercial effort.

The next option we put forward was to calculate an average employee rate for each labor category, take the hourly rate for each subcontractor and break that hourly rate into two components – one for direct labor consisting of the average employee labor rate for the relevant skill category and the remaining amount would be apportioned to the overhead pool. This was justified by saying the invoice is comparable to a direct charge plus an overhead charge, like Contractors' employees. We considered two other ways of making the breakdown: (1) identifying the breakdown on the subcontracts' invoices or (2) prorating the hourly rate on the same ratio as the contractor's direct versus indirect cost ratio. However, for various reasons Contractor rejected the two alternatives.

Once the desired method was decided upon, we pointed out in an opinion paper that both case law and DCAA guidelines allowed for the selected method (the auditor was not from DCAA but respected their guidance). We pointed out that one seminal case, Software Research Associates (ASBCA 88-3 BCA) approved the selected approach (it even approved the two other alternatives that were rejected.) We also pointed out that DCAA's Contract Audit Manual, Chapter 7-2102 approved of the treatment of purchased labor as either a direct cost such as an ODC or as a direct labor cost where the excess over employee labor could be charged to overhead as long as a "causal and beneficial relationship" could be shown. In examining the DCAA guidelines we were also struck by another acceptable approach our client had not considered earlier. That is, the creation of a separate overhead rate calculation for subcontract labor where the pool would consist of similar costs in the employee labor pool but exclude fringe benefits and taxes not applicable to subcontractors

QUESTIONS AND ANSWERS

Q. We have ten employees who we would like to be able to access your current and prior newsletters as well as use your Ask the Experts service. Do we have to have ten subscriptions or can we work out a deal?

A. We are receiving these types of requests from about 20% of our subscribers so we are working out deals on a case-by-case basis. Call or email us if you are interested.

Q. I read your last issue with great interest where you discussed moving certain expenses previously considered to be G&A to overhead. I would not consider them to be "changes to an accounting practice" for purposes of divulging changes because they do not meet the definition of an accounting practice – "any disclosed or established accounting method or technique which is used for allocation of cost to cost objectives, assignment of cost accounting periods or measurement of cost." I would argue an accounting practice centers on defining a cost as direct or indirect, establishing cost pools, eliminating or adding pools, determining the period it is considered to be incurred and changing the allocation base for a particular indirect cost pool. Charging a cost at one time to G&A and another as overhead does not represent a change to me. What do you think?

A. I think you make a good case for the change not to be considered a change to an accounting practice. Unfortunately, DCAA will normally not agree – they have always insisted that the type of transfer of costs we describe in the article should be considered an accounting change and we have not had occasion to fight the issue. We took a look at one of our favorite texts – Accounting for Government Contracts, Cost Accounting Standards edited by Lane Anderson – and could not find any examples of accounting changes cited in the Cost Accounting Standards, DCAA guidance or the text that included the switch of costs from G&A to overhead being considered an accounting change which would tend to lend support to your position.

However in another section of the text, it points to six possible areas related to the allocation piece of an accounting practice: (1) size and number of cost objectives (2) size of cost pools (3) content or composition of the cost pools (4) size of allocation base (5) type of allocation base and (6) content or composition of allocation base. An important Court case – *Martin Marietta Corp (ASBCA Nos. 38920, 41565*) rejected items (1) (2) and (4) as being cost accounting practices leaving the remaining three items, including (3), as defining cost accounting practices. So this certainly hurts your argument.

Q, In the past, auditors conducting a Contract Purchasing System Review (CPSR) applied a 30% factor to assess competitiveness between two proposals to determine whether two bids were indeed in the "competitive range". We are looking at two bids - $550K and $740K (40% more) where both bidders meet the minimum technical requirements and are qualified to manufacture the product and the lower bid was within the anticipated "should cost" range. So, is any additional price analysis required (cost analysis is not since it is under $650K)?

A. Though I'm quite familiar with CPSRs (conducted them as a DCAA auditor and helped numerous clients get through them) I'm not aware of this specific 30% requirement you mention. The regulations applicable to both COs seeking prime contractors and requirements for contractors seeking subcontractors are quite general where they leave it up to contractors to formulate their own thresholds (most don't). The team conducting the CPSR will often use their own judgment, which varies widely, as to adequacy of the policy and thresholds if they are established.

As for your specific competition, let me put my CSPR audit hat on, assuming this situation surfaces during a transaction sample. First, they would be familiar with your procedures and would ensure your purchase decision was conducted in accordance with them, including any internal thresholds. As long as both bidders are technically capable and the $550K was in the "should cost" range, I don't see the need for additional analysis to justify selecting the lowest bidder. However, if you selected the higher one, your policies should address best value determinations for it and your documentation for this purchase should show why you selected the higher priced bidder with a quantification of the non-cost benefits e.g. quality, reliability, meeting schedule requirements, quantifying the price premium against best value criteria, etc. If price reasonableness cannot be determined, you may still ask for cost data which is a new emphasis these days, even if it is below the $650K amount (that applies to only certified cost or pricing data).

Q. I have a question about CAS 403, home office allocations. In reading this standard, my understanding is that for the exception of line management cost allocation, using a value-added base (representing total activity) would not be acceptable for any grouping of costs other than residual expenses. Is my understanding correct and if not, would it be an acceptable practice to classify non-line management home office expenses as homogeneous pools and allocate them using value-added base.

A. Unlike residual expenses over the threshold that requires use of the three factor formula I'm not aware of any particular allocation bases that are required for homogenous pools. Though there are lots of examples

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with suggested bases provided there is no absolute requirements so value-added could be used if you can demonstrate that base is appropriate alluded to a good "causal beneficial relationship" with the final cost objectives.

Q. We are most likely going to engage an outside firm to do a business valuation of our company. The purposes are internal where they are to assist us in business planning, including business succession planning. Is this sort of cost likely to be treatable as an allowable indirect cost? I have not found where it is expressly unallowable, but I have not researched this at all carefully at this point

A. Seems to be OK. If the transaction is spotted by DCAA they will likely inquire about it so you'll want to make sure you can document the purpose of the evaluation for reasons you cite as opposed to a merger or divestment or long term financing (in which case the evaluation expenses would be unallowable).

Q. I currently have an issue with a DCAA audit. In 2006 we were going to lease a vehicle for a cost type contract. The lease cost was $19K for the remaining 24 months of the contract. We decided to purchase the vehicle for an additional $15K for a total cost of $34K. The $19K was charged, in agreement with the CO, as an up-front direct expense in 2006, because funds were available. The $15K was then depreciated over three years where the depreciated amounts were included in G&A. The auditor says we cannot charge direct and indirect for the same vehicle. My position is that only the appropriate amounts were charged. What do you think?

A. DCAA is apparently making the point that like costs incurred under like circumstances must be treated consistently as either direct (no matter whether the contract pays for it) or indirect in accordance with CAS 402 or FAR equivalent. You need to demonstrate why these are either unlike costs (not true) or unlike circumstances (likely true). You can demonstrate this by first indicating in your disclosed practices that auto or auto lease costs are sometimes direct and sometimes indirect where conditions are specified. Short of that, you need to demonstrate that though such costs are usually indirect (probably your best argument) the lease costs were charged direct in this case because they were needed only for that one contract and there was an agreement to treat them direct. Your best bet is to show there was some documentation about there being an agreement. Check out the example of security guards in CAS 402 where though normally charged indirect guards hired to protect one building dedicated to one contract can be charged direct.

Q. Historically, we have used our firm's tax depreciation entry as the basis for our incurred cost submittal and it never was challenged in an audit. My CPAs conducted an analysis of tax versus GAAP method and found an immaterial difference. This makes sense since under GAAP we would have capitalized additional asset purchases related to the original assets while for tax reporting we simply expensed them in the years purchased. Now they are questioning our method.

A. For non-CAS covered contractors, the GAAP method is the preferred, default method of charging depreciation. However, if you can demonstrate a different method, including tax, provides a better way to reflect the amortized cost of the asset you may use that method (e.g. a shorter period of useful life than that used for GAAP purposes, accelerated depreciation more appropriate than straight line used for GAAP). The burden is on you to show a different method is better. The fact that the tax versus GAAP method results in an insignificant difference should help your position.

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