
GCA REPORT

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NEW DEVELOPMENTS

President Signs Stopgap Bill, WARN Not to Apply to Sequestration Layoffs

President Obama Sept. 28 signed into law a stopgap bill to fund the federal government which will ensure continued funding until March 27, 2013. The so-called continuing resolution (CR) essentially continues current spending arrangements with a small cross-the-board increase for most federal agencies. The negotiated CR with congressional leaders keeps faith with the \$1.047 trillion discretionary spending target in last year's budget deal. With the election finally behind us the CR will provide some breathing room to the automatic spending cuts - a "sequestration" - of \$109 Billion from the 2013 budget (\$55 Billion or 10% in Defense cuts and 8% from non-defense spending).

With sequestration looming ahead, there has been significant actions to ensure WARN Act provisions need not be effective. The Worker Adjustment and Retirement Notification Act Appeals applies to certain companies planning to close facilities or lay off workers which require those with more than 100 employees to provide 60 days advance warnings before laying off anyone (many state government have even more restrictive requirements). The Dept. of Labor published a "guidance letter" stating the WARN Act will not apply to inevitable layoffs resulting from sequestration, noting one of the WARN Act exceptions of "unforeseen circumstances" will apply here.

Industry Group Criticizes Certain DOD Authorization Proposals

The Acquisition Reform Working Group representing a large cross section of contracting industries have criticized a number of key provisions in the Senate and House versions of the 2013 National Defense Authorization Act. Significant provisions and accompanied criticisms are:

1. *Raise the small business goal to 25% government-wide and 40% of total value of all subcontract costs (Sec. 1613).* Though the goal is laudable it is impractical where the federal government consistently fails to meet the current

23% goal. Raising the goal without providing additional tools will not work and it eliminates the ability of agencies to have lower goals to meet complex contracting requirements.

2. *Bar using cost type contracts for major defense programs without congressional approval (Sec. 801).* Arbitrarily requiring a fixed price contract vehicle would impose a "one-size-fits-all" solution which precludes more flexible approaches.

3. *Require DOD to review existing profit weighted guidelines and build a new model stressing risk factors intended to lower profit (Sec. 824).* This provision would automatically lower profit without public comment and contractor input.

4. *Under the Senate bill, the government would be allowed to use "additional tools" including certified cost or pricing data to ensure price reasonableness even if products and services can arguably be considered commercial items (Sec. 841).* Though earlier attempts to change the definition of commercial items and expand cost or pricing certification were rejected these additional tools will create uncertainty as to what constitutes commercial products and services which will increase administrative costs, delay award and discourage primarily commercial firms from doing business with the government.

5. *The Senate version would impose a \$230,000 cap on all contractor employees not just executives while the Senate Financial Services Appropriation bill would set a \$400,000 cap (Sec 842).* ARWG condemned imposing an arbitrary cap not tied to total market forces which limit contractors' access to talent and resources.

6. *As discussed below, DCAA will be given access to internal audit reports and supporting material to assess contractors' business systems where denial of records would be used to establish contractors' system as inadequate (Sec. 843).* Subjecting all internal reviews to outside parties "removes the ability to self-correct" and may involve a less than complete review.

7. *Prohibit contracting with entities tied to terrorism such as Sudan, Syria, Iran and Cuba (Sec. 803).* This will have unintended consequences such as preventing contracting with companies having affiliates doing commercial work with these countries, restrict access to needed supplies and jeopardize foreign relations.

8. *Prohibit private security contractors in Afghanistan (Sec. 1214)*. This goes “overboard” where it would prohibit flexibility of a mix of military and proven private security forces. Rather, the Commander of US forces should establish security requirements and decide which private firms can provide security.

DHS Proposes Changes to Rules for T&M/LH Contracts

The Department of Homeland Security is proposing changes to its acquisition regulations that would require agency time-and-materials and labor-hour contracts to include separate hourly rates for subcontractors. The proposed rule would also require contractors to identify their methods of accounting for labor hours incurred that would refine existing FAR requirements to have contractors keep consistent records for proposal and billing purposes (they need not be the same but must be reconcilable). The purpose of requiring separate rates is to ensure that for each contract or task order, subcontractors and affiliates of larger companies have separate rates applied rather than one single rate applied to prime and subcontractors. The proposed rule will create a clause that furthers FAR policies to agree to a price adjustment if a T&M/LH DHS contract results in overbilling because they had not billed in accordance with their record keeping practices. The provision will require a description of how hours for employees exempt from the Fair Labor Standards Act will be kept – one that records all hours worked or records only those hours of a standard work week (*found at <http://www.ofr.gov/OFRUpload/OFRData/2012-20442>*).

NAICS Code Changes Incorporated Into SBA’s Small Business Size Standards Table

Effective Oct 1, 2012 the Office of Management and Budget’s 2012 changes to the North American Industry Classification System (NAICS) will be incorporated into the Small Business Standards Table. The Small Business Administration relies on the table to determine which firms qualify for procurement preferences. Small business standard changes have been made to 41 industries. NAICS created 68 new industry codes either by making new content, splitting some off or consolidating others. New codes were also created for 10 industries and 13 have been reused but modified. The SBA began a comprehensive review of its size standards in 2007 to update reviews that had not be undertaken since the 70s and 80s. The review process is supposed to begin every five years now (*Fed. Reg. 49991*).

PSC Asserts DOD is “Misinterpreting” the Labor and Overhead Cap Objectives, DCAA Issues Guidelines to Help COs Meet the Objectives

The influential Professional Service Council is asserting that the Defense Department is “misinterpreting” statutory provisions that seek to cap service contracts’ labor and overhead rates to 2010 levels. Under section 808 of the 2012 DOD Authorization Act. DOD is required to establish negotiation objectives for contracts and task orders exceeding \$10 million that labor and overhead rates will not exceed 2010 levels where contracting officers are to obtain written approval from the military secretaries if they do. In spite of guidance issued by DOD in July of this year, the PSC states it does not lay out permissible exceptions such as firm fixed price contracts, priced options or contracts using multi-year forward pricing rates. In addition, the guidance does not provide meaningful examples of where 2010 rates are properly exceeded such as, for example, when increases due to the Service Contract Act or Davis Bacon Act occur or changes are made to pension costs caused by harmonizing CAS 413 with the Pension Protect Act of 2006. PSC also states many of the services and DOD agencies misinterpret the rules as prohibiting higher rates rather than establishing negotiation objectives.

In a separate action DCAA issued audit guidance alerting their auditors to be responsive to DOD requests to meet the cost saving goals of section 808. They are told to use readily available information such as contractors’ FY 2010 final cost submittals, contractors’ proposed cost rates (along with historical decrements for unallowable and unallocable costs) as well as year-end labor rates. Auditors are also told to be alert for accounting changes, subsequent to 2010, that may impact the use of 2010 rates. If the contracting officer does request a proposal audit that includes a review of rates, they should follow all guidelines similar to any other proposal. The memo states the DOD directive should not be considered to be a rate cap and they should not be a basis to question costs. Though the DOD directive does not impose requirements on the prime to establish negotiation objectives with its subcontractors, the DCAA memo does state it is the CO’s job to ensure all prices, including that of its subcontractors are fair and reasonable and hence the CO may request information related to significant subcontractors (*12-PSP-022(\R)*).

DOD Seeks to Accelerate Payments to Subcontractors

In accordance with an OMB memo to accelerate payments to subcontractors, the Defense Department

has taken steps to accelerate payments to prime contractors in the hope they will, in turn, accelerate payments to subcontractors after receiving adequate invoices and proper documentation “as soon as practical.” DOD issued a class deviation in August that implements the accelerated payment by adding a contract clause 52.232-99. Several comments we have seen are pessimistic about the effectiveness of this change. First, prime contractors can delay payment because what constitutes an adequate invoice and proper documentation is wide open to interpretation. Second, a prime contractor does not have to pay its subcontractors until it is paid so there can be delays of payment to subcontractors through no fault of their own (e.g. inadequate prime contractor invoices and documentation). One interesting suggestion we read was to reinstate the “paid cost rule” requiring actual payment of a subcontractor before their invoice is submitted and approved.

Final Rule on Reporting Executive Compensation

The FAR Council has implemented as final, with some changes, an earlier interim rule requiring contractors and first tier subcontractors report executive compensation on awards exceeding \$25,000. The interim rule, incorporated in a new FAR clause at 52.204-10, was passed to implement the Federal Funding and Transparency Act of 2006 to have available to the public a single, searchable website. The changes to the final rule include: (1) clarify that prime contractors will report their executive compensation as part of their Central Contractor Registration database (2) changing the exemption from “classified contracts” to “classified information” (3) revise the definition of first tier subcontractor to exclude “the Contractor’s supply agreements with vendors” for purchases of items normally considered indirect costs (4) prohibiting the splitting of subcontracts to avoid the \$25K threshold and (5) reporting on subcontractors is required when the subcontract is awarded but continued reporting is not required unless one of the reported data elements change (*Fed. Reg. 44047*).

Final Rule on Resolving FAR Invoice and Final Payment Inconsistencies

A final rule was passed addressing interim billings and final payments under time-and-material and labor hour contracts to resolve differences between two payment clauses. FAR 52.216-7, Allowable cost and payment provides for invoicing on a bi-weekly basis for large contractors and more frequently for others and submission of the final voucher no later than 120 after

contract completion while FAR 52.232-7, Payment under T&M and LH contracts, allows for monthly invoices and final payments no later than one year after contract completion. The final rule resolves this inconsistency by changing FAR 52.232-7 to be consistent with 52.216-7 (*Fed. Reg. 44059*).

DCAA Issues Other New Guidance

◆ Sampling Low Risk Incurred Cost Audits

(Editor’s Note. A copy of this memo was sent to us by a client who was thrilled to be informed by a DCAA letter that all ICE proposals submitted before 2011 are no longer subject to audit and rate agreements on those submittals will be provided shortly and that their 2011 submittal would be put into a low risk group where DCAA will select proposals for audit on a new sampling basis.)

DCAA has issued a very significant memo that revises audit requirements on low risk incurred cost proposals to ensure its audit resources “are applied to the highest risk.” For all ICE audits begun, there will be no changes. However, a new policy for sampling will significantly reduce the chances of having an ICE proposal being audited for most contractors. The new policy calls for identifying all ICE proposals with less than \$250 million in auditable dollar value (ADV) and assess whether it qualifies as high or low risk in accordance with its Risk Assessment Checklist. All high risk ICEs will be audited and low risk proposals will be sampled using new percentages. Under the revised policy, desk reviews will no longer be conducted where those proposals not selected will be dispositioned by a memo to the contracting officer. A mandatory audit of all ICE proposals with an ADV of \$100-250 million will be conducted every three years. *(Editor’s Note. Since this new guidance will affect whether most contractors get their ICE proposals audited, we will summarize it in greater detail in the next issue of the GCA DIGEST.)*

◆ DCAA Issues Guidance to Obtain Internal Audit Material, Generates Opposition

DCAA has issued guidance providing direction for requesting and monitoring requests for contractors’ internal audit reports. The guidance follows a Dec 2011 GAO report recommending DCAA take steps to facilitate access to companies’ internal audits and determine if additional steps are needed. The guidance stresses DCAA may not ask for access to all internal documents but only those “limited” to DCAA “audit responsibilities. Compliance with the guidance will involve DCAA establishing a “coordinator” and point of contact with the contractor to obtain and monitor DCAA requests for audit reports and working papers.

The guidance references sections of the DCAA Contract Audit Manual for outlining the responsibilities of the point of contact (4-202.1h) and processes auditors should take in requesting the material (4-202-1h(2)). Though the guidance explicitly applies to major contractors, it does leave the door open for non-majors if “it is useful as part of their ongoing audits” (4-202-1h(3)). When access is denied, DCAA will follow its Access to Records procedures including subpoena power (12-PPS-019(R)).

This new guidance is generating considerable opposition. Most notably, Tom Lemmer and Tyson Bareis of McKenna, Long & Aldridge point out the guidance is contrary to case law (*US vs. Newport News Shpblgd & Dry Dock Co.*) that establishes DCAA access rights to only “objective factual material” used to verify actual costs where internal audit material is explicitly referred to as “subjective” in nature and hence outside of DCAA’s right of access. They also point out that in addition to the DCAA audit guidance the proposed 2013 DOD Authorization Act now ties access to internal audit and workpaper material to DOD’s responsibility to ensure contractors’ business systems are adequate and refusal to provide this information will be a basis to disapprove of the contractor’s relevant business system. The authors also state the working papers supporting internal audits often include sensitive information (e.g. interviews, unconfirmed observations) unrelated to the immediate audit objectives leading them to recommend limiting workpaper material only to documenting audit conclusions.

(Editor’s Note. This new audit guidance was brought to our attention by a subscriber after publishing our recent GCA DIGEST article on “Conducting a Mock Audit.” Such audits and associated work papers certainly can be considered to be “internal audit” material, subject to DCAA scrutiny. However, such audits and reports also are considered to be strong internal controls establishing contractors have an adequate accounting system and if improvement recommendations are implemented provision of the reports may cause no harm so judgment on conducting such audits needs to be weighed.)

◆ Auditing Forward Pricing Rate Proposals and an Adequacy Checklist for Them

DCAA has issued a 26 page audit guideline on forward pricing rate audits and an adequacy checklist for forward pricing rate proposals. Highlighted changes include more emphasis on using regression analysis, testing the underlying assumption of using budgetary data, using transaction testing when historical data is used if there have been no incurred cost audits, holding a walk-

through meeting to explain basis of rates, supporting documentation and internal controls, a determination of whether an audit of home office costs allocations needs to be conducted, greater use of trend analysis and conducting risk assessments on both initial and revised FPRPs. The guidance also provides a new checklist for what constitutes an adequate FPRP where there is an emphasis on the need to follow table 15.2 of FAR 15.408 (12-PSP-024(P)).

DCAA Issues Staffing Plan Showing its Audit Priorities

DCAA has issued its 2013 staffing resource plan that shows its audit priorities for the new government fiscal year, starting Oct 1, 2012. DCAA estimates it has resources of 5,373 work hours, a slight increase over last year. Its audit priorities are:

1. Responding to agency demand requests to audit proposals above \$10 million for fixed price work and \$100 million for cost type work. DCAA will treat requests to conduct pre-award surveys of contractors’ accounting system with equal priority.
2. Supporting a joint DCMA/DCAA Cost Recovery Initiative, Phase II, to resolve outstanding CAS compliance and incurred cost findings that are more than four years old.
3. “Reachback” audits of incurred cost proposals where at least some of its dedicated incurred cost teams will continue to whittle away the backlog of audits.

Additional priority audits will include A-133 audits; high priority overseas contingency audits; corporate, group, home office or service center offices for FY 2009 and earlier; business system audits at “high risk” locations and; real time material and floor check audits. Post contract audits (“defective pricing”) and follow up audits to determine if corrective actions were taken are not identified as high priority.

GSA Freezes Per Diem Rates to 2012 Levels

In an effort to contain government travel costs, the General Services Administration announced it would not allow per diem increases over government fiscal year 2012 amounts for 2013 for government and contractor employees. The freeze is considered less drastic than earlier proposals to, for example, drop high cost hotels from the pool used to compute lodging per diem costs. Per diem amounts are defined as being lodging, meals and incidentals.

CASES/DECISIONS

Government Improperly Restricted Task Order Competition

MCC was one of 13 firms receiving a multiple task award to provide various services where all eligible awardees would be given an opportunity to compete for task order awards. Realizing it was falling short of its small business acquisition goals the government competed task orders as small business set-asides where MCC was excluded from competition because it was not a small business. MCC requested compensation for lost revenue for being excluded from the competition and appealed when the CO denied its request. The Appeals Board sided with MCC noting that the Small Business Competitiveness Demonstration Program Act did require subsequent contracting opportunities to be limited to small businesses if it did not achieve its small business contracting goals. However, such “subsequent contracting opportunities” applied to awards of contracts as opposed to an award of a task order within a contract (*MCC Construction, ASBCA No 57400*).

Consultant and Legal Costs are Allowable Contract Administration Expenses

Tip Top requested an equitable adjustment in its contract price when it was required to use a different refrigerant in its contract to maintain air conditioners. Though the Board accepted some of its claimed costs it rejected its claim for consulting and legal fees to negotiate a settlement asserting they were unallowable as costs related to processing a legal claim. In its appeal to the appeals court, Tip Top argued the Board decision conflicted with its holdings in *Bill Strong Enterprises* which held that consulting and legal costs are allowable as contract administration costs. The Court agreed the Bill Strong case applied and concluded they were allowable because they were incurred “for the purpose of materially furthering the negotiation process” (*Tip Top Construction v. Danaboe, Fed. Cir., No. 2011-1509*).

No Penalty Waiver is Justified For Its Inclusion of Unallowable Costs

When DCAA audited Inframats incurred cost proposal it questioned several costs and recommended imposition of \$21,000 of penalty costs on those it asserted were expressly unallowable. Though Inframats did not dispute the allowability of the costs it stated penalties should not be imposed because it was entitled to a waiver of penalties under FAR 42.709-5(c)(1) and (2) which

allowed for a waiver when the contractor can demonstrate it has established policies in place to prevent the inclusion of unallowable costs and the inclusion of the costs were a result of an unintentional error. The Board sided with the government stating Inframats failed to provide any material facts justifying the waiver. The Board stated that before it submitted its ICE proposal (1) Inframats system of support broke down (2) it lost cost information (3) its bookkeeper could not make timely cost entries (4) and its inexperienced controller included unallowable costs under the mistaken belief that DCAA would tell him when unallowable costs were included (*Inframats Corp., ASBCA No. 57741*).

Appeals Board Denies Appeal of J.F. Taylor Executive Compensation Case

The ASBCA denied a government appeal to reconsider its decisions on the JF Taylor case that found DCAA’s approach to conducting executive compensation audits as “fatally flawed.” The government put forth four reasons to set aside the Board’s decision: (1) the board ignored a statutory cap on executive comp (2) legal precedent in the *Techplan* and *ISN* cases was ignored which established the 10% range of reasonableness factor that was rejected in the JF Taylor case (3) JF Taylor’s expert witness should be disqualified because he was a statistics specialist not an expert in executive compensation and (4) the government had successfully rebutted JF Taylor evidence but the rebuttal was ignored by the board. The Board rejected the government’s appeal.

QUESTIONS & ANSWERS

(Editor’s Note. We are excluding our normal feature article and expanding our Q&A section to keep up with a large volume of questions received from our subscribers.)

Q. We realized we should not have used the IRS 179 provisions in our provisional billing rate and incurred cost submittals for 2010 and 2011. (179 treatment allows certain companies to write off the entire amount of otherwise capitalized assets in the year purchased for tax purposes.) DCAA has stated some of our ICE submittals have some minor deficiencies so we are in the process of fixing them – should we change our overhead costs to eliminate the 179 treatment?

A. Yes, you are right to change the overhead rate to account for capitalizing the assets and charging depreciation over their useful life – we are seeing DCAA not only question Section 179 treatment of those costs

but also recommending imposition of penalties. It appears as if the overhead rates are overstated in the year you used the entire 179 cost but understated in out years where now you will charge depreciation on those assets where none were charged before. To avoid potential questioned costs and possible penalties, I would withdraw the earlier 2010 and 2011 ICE submittals since an audit has not yet begun and resubmit revised ones using the proper method of accounting for the assets along with a cover letter explaining the basis for the resubmittal.

Q. Are airline club memberships allowable per the FAR/FTR?

A. I am unaware of any FAR or FTR guidelines on club memberships. I see that DCAA auditors often question it when they see it but I am also unaware of any DCAA guidance on this topic. It is one of those things that the dollar amount is not material enough to litigate. The good news is since the FAR doesn't explicitly prohibit it then penalties would likely not be imposed if they were questioned.

Q. I was relocated last year but am having trouble selling my old home. How long do I have to sell it and still claim my real estate reimbursement expenses?

A. For transfers with a reporting date of Aug 2011 or later, you have two years. The government will pay claims up to one year of settlement date where the employee may apply for a one year extension. Previously, employees were given four years, two years within a settlement and a two year extension.

Q. We want to keep personnel during a rough time but it will increase our overhead too much. We are preparing ICEs as well as fixed price proposals and not sure how to handle the costs.

A. For cost type ICEs, submit actuals and then you'll have the choice of going after underbilled amounts or not later. For fixed price work, offer a lump sum "management concession" not lower rates or lower amounts on costs you are entitled to. By a "management concession" I mean identify all of your actual or projected costs and then offer a credit or gross amount to be deducted from your actual costs for a particular contract. That is preferable to not including all entitled costs in an indirect cost pool since the concession can be an offset against any questioned costs while a lower rate is the starting point for an audit where questioned costs are then deducted from there.

Q. We are a corporation and are required to have a board of directors. In a current negotiation, the Air Force has

deemed the directors' fees as unallowable. We disagree. Our directors' fees have been included in the G&A for decades and have been allowed in numerous DCAA audits. How can we argue this with the Air Force?

A. I agree with you. Unless the fees are "unreasonable" amounts they should be allowable. I would put the burden on the auditor to show where the FAR or even the DCAA Contract Audit Manual makes such costs unallowable. It is certainly worth taking up the DCAA chain of command - I have never heard of reasonable B of D costs being disallowed.

Q. We have a 5 year IDIQ CAS covered prime contract that was awarded prior to the CAS exemption threshold being increased to \$700K. My question - for any subcontracts awarded after the new threshold's effective date, should our subs use the \$700K new threshold or the \$650K old threshold to figure out if CAS applies at the sub level?

A. What threshold to apply depends on the date the individual task or delivery orders are issued. So under an IDIQ contract, various thresholds could apply to the awarded task orders.

Q. I've got a question regarding contract closeouts. We have a contract that is closing out in which there has been an ongoing 15% withholding on the cost plus fee. It appears based on what I have read in your newsletters, the DCAA may not be auditing the ICE submissions of sub-contractors of our rather small size. If so how do contracts ever get trueed up? How do we ever claim the 15% withhold on our Cost Plus fees?

A. You should be able to receive all or at least 90% of the fee withhold when the contract is finished - just bill for it. As for true ups, you may be entitled to quick closeout procedures - we have written about it extensively so use our "keyword" search tool at govcontractassoc.com or Google it if the contract being closed does not represent a large percentage of your business.

Q. We attend several airshows each year to increase our sales overseas. Are they allowable?

A. FAR 31.205-1 makes airshows unallowable as public relations or advertising expenses. A few years ago, in order to encourage more exports, the FAR was modified to allow those airshows primarily oriented to exports to be allowable. So generally, whether airshow costs are allowable usually depends on the nature of the airshow - is it oriented primarily to encouraging

American exports (e.g. the Paris Airshow) or for domestic sales. You have raised an interesting issue in as much as though the airshows you attend are not necessarily oriented to exports, the customers you target and your prior business with them are, in fact, related to foreign sales. I would say if you can document that – what companies you were targeting, history of type of sales with them and what type of business you were attempting to generate – then you should provide a basis to claim the airshow activities were related to exports. If the costs are claimed to be export related and an auditor chooses to still disallow it the chances are pretty good they would cite FAR 31.205-1 as the basis for questioning the costs and then assert those costs deserve a penalty. As a result, unless you can show some clear documentation that the effort was related to exports (the airshow itself, type of business you received historically, type of business you were chasing), then I would be conservative here.

Q. We rent three offices in Afghanistan to support our contracts. We did not propose them as either direct or indirect at the time since we didn't think we would need the facilities so how should we charge them and are the costs allowable?

A. I would say that the three offices would be considered a reasonable, allowable type of expense (e.g. rental, facilities). One question is whether they are allocable as a direct cost to one contract or an indirect cost to multiple contracts. The accounting practice is supposed to be based on cost accounting concepts, not whether you can bill it. So if the facilities are related to one contract it should be charged to that one contract. If there are multiple contracts (or task orders) being worked on you could assert they are an allowable overhead cost chargeable to the relevant overhead pool for that work.

Two things I would point to in how they are to be allocated as well as providing support for their allowability – what is your written policies and how did you propose it. As for the latter, you state you did not propose it as a direct cost since you did not realize your needs at the time so that would not provide much support as a direct cost. However, if there are communications with you and the government as to you expressing the need to purchase or rent them and they agreed to it, that would also constitute good grounds for a direct cost. If the proposal and communication evidence is weak, you may have a tough time supporting it as a direct cost, but the clear need for facilities would entitle you to claim it as an indirect overhead cost.

Q. We obtained some tax advice for some work related to tax issues for US government work performed in Germany. Can we charge it directly to that contract?

A. Though it could possibly be considered an allowable direct cost to your US contract if it was originally proposed that way, the tax fees would normally be considered to be a G&A corporate expense related to taxes since such costs are normally a G&A type expense, even if tax issues are local. To treat it otherwise would likely raise a red flag where due to the small amount involved, would probably not be worth it.

Q. We have some small costs owed to the government so how do we true up our billed costs?

A. The true ups you refer to is the differences between amounts billed and amount deemed to be due after incurred amounts are computed. The requirements, which DCAA is scrutinizing a lot these days, are that you should monitor your rates, compute them by the end of the year and submit adjusting invoices for the amounts. If they are immaterial, then you can get away from making minor dollar true ups where they will eventually be settled when the incurred costs proposals are audited and/or settled. DCAA is stressing the importance of having a written policy addressing this monitoring, computing true ups and invoicing the government both on your part as well as having verbiage that requires you to make sure your subcontractors follow the same practices.

Q. Our cost type contract has reached its funded amounts so we were wondering whether those costs can be considered indirect?

A. The government is always on the lookout so be careful not to allocate normal direct costs as indirect costs, especially when ceiling amounts are exceeded on those contracts. This is an area that auditors are told closely scrutinized where discovery of such practices not only result in disallowance of costs but often become the basis for a referral to government investigative services or the Dept. of Justice that often result in very expensive and time consuming investigations and possible litigation. Be very careful not to allow costs that should be incurred on one contract that has reached its ceiling to be charged either to another contract or charged indirect (cost share contracts are an exception under certain contracts). The temptation to charge such costs is common and cuts across the company – finance people want a place to charge it, project managers want to bill it or preclude cost overruns even employees who may be penalized for being overbudget may be tempted to do this – tight controls need to be in place to prevent it.

Q. Are incentive bonuses allowable?

A. Normally yes but you need to be careful. Bonus expenses are a significant area of audit scrutiny these days so make sure you have a clear written bonus policy that closely follows your practices. If it is a new practice, you may need some documentation that not only a written policy exists but I see bonuses being questioned where there is not an “agreement” between employees and the company. Some or all of bonus expenses could also be questioned if the addition of salaries, wages, bonuses, pension and deferred compensation exceed government compensation survey benchmarks where such analyses used to be limited only to executive compensation but now is being expanded to non-executive employees.

Q. We have encountered an issue that I would like to hear your advice on. DCAA’s CAM Chapter 8-103.2 (Aug. 2012 version), CAS Exemption, Section J says that in cases where the prime contract is exempt from CAS, any subcontract is always exempt from CAS. Is this a new exemption? I searched on line but couldn’t find any other references except for the CAM. We have always operated under the assumption that even if our small business prime contract is exempt from CAS the subcontract is still subject to CAS as long as no exemption applies. If CAM is correct, we will need to change our practice.

A. As for the subcontractor being CAS covered, you need to change your policy. Subcontractors are CAS covered due to the flowdown of a CAS clause in the prime contract (or upper tier subcontract). If that contract is exempt, then there is no CAS clause to flow down and hence the subcontractor is not covered. That does not mean an exempt prime cannot insist on the

CAS clause applying to its subs which then becomes a matter of negotiation with your prime.

Q. I understand that direct material we purchase for our cost type and T&M contracts is considered “government property” but what about indirect costs of material, supplies, etc.?

A. There is a long history of controversy on this issue. Professor Ralph Nash in his July issue of the Nash & Cibinic Report states that under the current rule of the FAR Government Property clause indirect material costs are considered government property. The primary purpose is to save federal dollars by exempting such purchases from state taxes, not to impose strict property requirements on contractors. In practice, the normal requirements associated with government property – managing, accounting, obtaining permission to use it on other contracts and disposing of it under government directions – do not really apply where no contractors follow such steps.

Q. Are Hawaii state excise taxes allowable and if so, are they direct or indirect?

A. We did some research on this and discovered that on cost type contracts, recent cases have ruled that such state taxes are reimbursable. In practice, I have seen contractors charge such taxes both direct and indirect. Sometimes the government won’t accept the costs as direct but as long as its allowable, will accept them as indirect while sometimes they will accept them as direct. You will want to have written procedures in place to provide the opportunity for both types of treatment of these costs since it is not always clear that an ACO will accept direct charging but will likely accept indirect costing if a written policy provides for it.