GCA Report

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NEW DEVELOPMENTS

"Implied Certification" Case May Cause Havoc Among Contractors

A new case before the Supreme Court not yet settled as of this writing is being widely discussed as having enormous implications for government contractors. The Supreme Court is deciding a case – *Universal Health Services v United States ex. Rel. Escobar* – about whether the "implied certification" theory should stand. Under "implied certification" a contractor may be liable if they ask for payment from the government if they failed to satisfy a contractual provision or regulation. Every time a contractor submits a request for payment – even just an amount – it is saying they complied with every aspect of the contract and regulations. A contractor does not need to say it complied with every aspect of the contract and regulations because such compliance is implied under the implied certification doctrine. Any and all departures can be deemed violations of the False Claims Act where failure to comply with just one aspect of a contract could result in a judgment of millions of dollars.

Since 1986 Congress made it easier for qui tam whistle blowers, called relators, to prove contractors violated the FCA by alleging false claims and provided large financial incentives for them and the Justice Department to pursue cases, resulting in payments of at least $3.5 billion each year for civil FCA cases. If the implied certification theory is upheld by a majority of the Supreme Court judges, which most analysts say is likely especially with the death of Justice Scalia, there is expected to be a "floodgate" of FCA cases which is bad news for companies doing business with the government (though good news for some lawyers). For those contractors choosing to continue doing business with the government, commentators are saying contractors need to be sure what their contracts require where every time they submit an invoice they have to make sure there is contract compliance. Some commentators are saying the Court may mitigate some of the potential damage by ruling that contractors will be held liable only if they violate a "material" provision but this may be difficult because what constitutes a material provision may not be clear until years after litigation.

OFPP Increases Compensation Cap

The Office of Federal Procurement Policy published the benchmark compensation amounts for determining the allowability of compensation costs under covered contracts awarded before June 24, 2014. The benchmark compensation caps for contractors' fiscal years 2013 and 2014 are now $989,796 and $1,144,888, respectively. After the June 24 date the compensation cap, applicable to both DOD and civilian agencies, is $487,000. As we often remind our readers, these OFPP caps normally apply to larger companies where significantly lower caps may apply to smaller companies *(Fed. Reg. 13833)*. We remind the reader to examine our article in the last issue of the GCA DIGEST on the new compensation rules.

New Contracting Opportunities Are Opening Up

The budget for military base operations support is slated to grow in fiscal 2017 where there is a $23 billion request, a 4.3% increase over 2016. Base operations cover a wide range of opportunities such as facilities operations (e.g. grounds maintenance, utilities, pest control), logistics operations (e.g. food services, freight and property shipments), security services, environmental programs (e.g. compliance with federal, state and local laws and regulations. pollution prevention, clean up), information technology services, housing services, command support (e.g. management and financial analysis, legal support) and energy (access to energy, water and land, water and energy reduction, renewable energy).

The Professional Services Schedule (PSS), formed last October merging eight contract vehicles run by the General Services Administration, is expected to generate significant year end purchasing needs (ending Sep. 30th). The fourth quarter spending frenzy is expected to arise soon because agencies have money to spend or otherwise will loose it. To benefit from the spending, current GSA schedule holders, who are to provide "total solutions to complex professional services requirements from a single source" should seek to make themselves eligible for more services by adding Special Item

Numbers (SINs).and be aware of new subcategories that are added to PSS. For example, current MOBIS contract holders may be eligible for financial services under the FABS subcategories. For non-GSA schedule holders it may be too late to have a slot on a schedule but they may want to form teaming arrangement with those who are. For example, the Seaport-e and OASIS will probably generate high volumes of spending on professional services.

Cybersecurity contractors are being told to prepare for a potential $19 billion request for cybersecurity, an increase of $5 billion over 2016, where they should be looking at smaller federal agencies eager to boost their cyber defenses after such hacker incidents at the OPM, Veterans Administration and IRS. Though Pres. Obama's $4.1 trillion budget request is generating a lot of opposition, cybersecurity is one area that has wide support. Companies and their subcontractors such as BAE Systems and Raytheon are expected to benefit.

Industry and ABA Weigh In on Procurement Issues

The American Bar Association has raised thumbs up to a recent GAO proposal to make the bid protest process more efficient. The proposal would allow for electronic filing of bid protests through a new Electronic Protest Docket System ((EPDS) to replace current protests filed by mail, fax or email. However, the ABA did take issue with the proposal to impose a $350 filing fee to help pay for the new system and the proposed requirement to distribute filed documents to all parties covered by the protective order.

Several trade associations are urging the Labor Dept. to scale back and clarify a proposal to provide paid sick leave for federal contractor employees, calling it burdensome, inefficient and ambiguous. The DOL, acting on a President Obama executive order, would require federal contractor employees to receive up to seven days of paid sick leave per year on all new or renewed contracts in 2017. The leave time can be accrued one day for every 30 days worked or instead, frontloaded for at least 56 hours at the start of each year. Some groups called for modification to the rule such as eliminating record keeping if contractors already provide sick leave while other groups are calling for its outright withdrawal. Unions and worker advocacy organizations praised the proposed rule.

The Council of Defense and Space Agency Associations (CODSIA) and the ABA have called for the withdrawal of proposed Defense Department regulations on future independent research and development (IR&D) expenses saying fears of misuse of IR&D costs are "overblown", current cost accounting rules already address the concerns and "there is no evidence that such behavior is common." The proposed rule will require offerors to describe in detail the nature and value of prospective IR&D projects on which they would rely on to perform the resulting contract. COs could then evaluate proposals that would take into account that reliance by adjusting the total evaluated price to the government, for evaluation purposes only, to include the value of related IR&D projects. CODSIA and the ABA say the new rule fails to answer what problem it is attempting to solve. CODSIA also questioned how such value of related future IR&D projects could be determined or estimated since many such projects are "continuing" and there is no "bright line" to determine whether a given project is benefiting a specific contract while DOD personnel does not have the skills to make such judgments of total evaluated prices for negotiated procurements. CODSIA says contractors have a successful long historical record where it currently can offer innovative technologies to DOD as soon as they are developed where now they allocate those costs over all of its business – government and commercial - as required under the FAR and CAS but if DOD artificially adjusts the initial bid to include all IR&D costs the inflated price almost is sure to make it unaffordable and noncompetitive with lesser bids.

Recent Moves to Expand Opportunities for Small Businesses

A Senate bill would permanently reauthorize the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs. The bill would gradually increase the amounts of SBIR and STTR awards, reduce duplicative reporting, streamline the application process and clarify intellectual property protections. Sponsors state it is time to permanently reauthorize the programs rather than periodically renew them because they have wide support where "they unleash the innovative potential of America's high-tech businesses to drive our country's growth."

The SBA has long maintained the mentor-protégé program that allows large "mentor" companies to provide technical, management and financial assistance to small "protégé" companies where it is designed to help small companies win and perform government contracts and subcontracts which leverage the resources and expertise of larger companies. Heretofore, the program limited protégé status to 8(a) companies where now all small businesses would be eligible to become

protégés. The SBA proposal is expected to pass by the end of summer and both small and large businesses should begin planning partnerships in anticipation of an explosion of new opportunities. Despite the clear advantages to large and small businesses there are some pitfalls expected such as formal size determinations to be set by the SBA before participation, SBA review of joint venture agreements, compliance certification requirements and stiff penalties for noncompliance.

The SBA is proposing to extend contractors' data rights from four years to twelve. Though current practices allow for extending data rights, the proposal would extend the period to a "minimum" of 12 years to provide sufficient opportunity to develop and commercialize technologies developed under the SBIR and STTR programs. Once the period expires the government would receive unlimited right to the SBIR/STTR data to use for any purpose it wants including competitive procurements and foreign military sales. An additional amendment to the proposal would clarify that the government should give preference to Phase lll contracts to those SBIR and STTR firms.

Category Management Approach Projected to Lead to Major Consolidation of Contracts

Thousands of single award and definitive contracts ending after Jan 2016 worth $1.2 trillion are at risk of being consolidated into a smaller number of multiple award contracts (MACs) according to a Bloomberg government analysis. Based on the assumption that contract duplication is rife, the Office of Federal Procurement has announced that the GSA and other agencies will be redesigning the way it procures most everything. The new approach, known as category management, would group all procurements into 19 new GSA defined markets. Adopting private sector practices, grouping all procurements into 19 groups is supposed to allow for better decisions by encouraging agencies to aggressively compare vendor prices and terms to provide greater value.

The new approach is intended to replace the current procurement system which is autonomous, siloed by agencies and spread out over 3,300 active buying offices that do not share information and conducts millions of contract transactions annually. Category management is being touted as making purchases quicker, more efficient and cheaper where many contracts will be consolidated into a much smaller number of MACs. The new approach has already begun where, for example, all civilian agencies will now be making laptop and desktop computer purchases from only three MACs. The five biggest markets Bloomberg analysts see this new approach being adopted in is the five biggest categories: Facilities and Construction ($397 billion), Professional Services ($339 billion), Aircraft/Ships/Submarines ($259 billion), Information Technology ($258 billion) and Research and Technology ($220 billion).

GSA is Sending Warning Letters to Contractors Over Origin of Products

The General Services Administration (GSA) is clamping down on thousands of contractors to ensure the products they sell to the government are made in the US or otherwise comply with the Trade Agreements Act (TAA). Emails sent to vendors state they should conduct compliance reviews by submitting a spreadsheet verifying the country of origin of the products on their GSA schedules as well as Certificate of Origin or other certification from the manufacturers on their letterhead for products made in the US or other countries covered by the TAA which include 124 nations but not India or China.

Proposed Rule on Counterfeit Parts

The Defense Department has proposed a new rule to make costs of counterfeit electronic parts and the costs of rework or corrective action unallowable. Exclusion from this rule includes (1) a contractor has an operating system to detect and avoid counterfeit parts and suspected counterfeit parts that has been reviewed and approved by DOD in accordance with DFARS 244.303 (2) the parts are government furnished property defined in FAR 45.401 or (3) the contractor discovers the counterfeit part or suspected parts and notifies the cognizant CO in a timely fashion (e.g. within 60 days after becoming aware).

New Overtime Rules Expand Service Contract Act Increased Costs

As of May 18 the Labor Department's long awaited rule on which workers are covered by the Fair Labor Standards Act was finalized. The final rule increases the minimum salary threshold below which workers will be entitled to overtime pay if they work more than 40 hours per week – from $455 per week ($23,660 per year) to $913 per week ($47,476 per year).. Once the rule takes effect, Dec 1, 4.2 million more workers who earn less than $913 per week will no longer qualify as an exempt employee under the FLSA and will be entitled to overtime pay for all overtime worked. As an article in the June 7 edition of the Federal Contracts Report by Schlomo Katz and Andrew Crawford shows, the new

rule will also impact employees of contractors whose contracts are covered by the Service Contract Act (SCA) which requires workers working on government contracts to receive prevailing wages, health and welfare benefits and paid holidays and vacations. By increasing the minimum salary from $433 to $913 DOL now redefines not only who is an employee under the FSLA but also automatically broadens who is covered by the SCA.

With the expansion of SCA covered contractors need to examine their pay packages to ensure they are in compliance with SCA. For new non-exempt employees, employers need to identify the correct job classifications. If no job classification on the wage determination fits the employee's job description, employers will have to do a conformance process by which employees submit missing job positions to the DOL to set hourly pay for employees of that skill level. Such conformances may be needed, for example, for newly hired skilled professionals who make less than $913 per week where failure to follow SCA can result in penalties and damages including suspension or debarment. Contractors may be entitled to increased costs caused by the expanded SCA coverage if their contract contains the clause at FAR 52.222-43 that allows for reimbursement of increased employee costs caused by "operation of law." The authors also indicate that, as an alternative, a contractor may be entitled to an equitable adjustment in its contract resulting from a significant increase in SCA covered employees.

Look For Ways to Compete on Bridge Contracts

Following recent GAO reports and cases critical of the government's inappropriate use of bridge contracts, we are seeing articles recommending competitors closely monitor agencies' use of these contract vehicles (e.g. Federal Contract Report, May 24, 2016). As most contractors know, contract expirations do not always line up with start dates for new follow-on contracts where then the government may use "bridge contracts" or remaining contract options to fill in the gap. Recent GAO reports stated there is room for improvement in how they go about filling this gap. An example of inappropriate use is repeated use of these contracts for more than the six months allowed under the Options to Extend Services clause.

New SBA Threshold Determines Whether a Firm is a Small Business

A recent ruling by the Small Business Administration has found that a small business designation is denied if more than 70 percent of its current revenues comes from one customer showing it is not economically independent from this customer. This ruling amounts to an expansion of the "common control" criteria used to determine whether a small business is affiliated with another company for small business designation purposes.

CASES/DECISIONS

Discussions on Staffing Levels are Misleading

The government issued an RFQ for various professional services. Paragon's initial staffing matrix assumed certain staff requirements would be reduced by full time equivalents (FTEs) while for other tasks there would be no reductions. The agency sent Paragon an evaluation notice addressing its staffing matrix and told Paragon to remove various assumptions and "revise the staffing accordingly" resulting in an increase in FTEs and a higher offered price. Following receipt of revised proposals, the government made a best value award to Jacobs who proposed $41.3 million compared with Paragon's $42.8 million following the FTE increase. In its protest, Paragon argued the agency engaged in misleading discussions by directing it to remove certain assumptions when, in fact, the government did not object to the assumptions and hence made the increase in Paragon's FTEs unnecessary. The Board sided with Paragon ruling that when an agency advises an offeror to revise its proposal in a way that does not reflect the agency's concerns the discussions are misleading *(Paragon Tech. Grp., Comp.. Gen No B-412636).*

Contractor is Entitled to Unbilled Fixed Fee Amount

(Editor's Note. The following case addresses the often confusing nature of whether profit is a fixed amount or a percentage of costs.)

The request for proposals included boxes for both fixed hourly labor rates and a "fixed fee." Systems represented in its proposal that it was proposing a fixed fee of approximately eight percent of its estimated burdened direct labor costs. The definitized contract, subsequent modifications and options had separate line items for direct labor and fixed fee. During contract performance the invoices included a fee amount calculated by applying 8 percent to billed direct labor hours. The problem occurred when the billed labor hours were less than

estimated resulting in the contractor not billing for the entire fixed fee amount where the case involved Systems attempting to recover for the entire fixed fee amount that was unbilled. The government argued that the words "fixed fee" represented an eight percent markup on only allowable billed direct labor while Systems argued for a fixed fee amount that was to be added to the billed labor amount. The Board sided with Systems ruling the language in the contract showed the fixed fee portions were independent from the burdened labor amount. Further, the RFP and separate letter contract showed that the government contemplated a fixed rate fixed fee labor hour contract, the RFP included a separate line item for the dollar amount of fixed fee without mentioning a percentage markup and the contract included the Fixed Fee clause at FAR 52.216-8 which explicitly directs the government to pay the fixed amount included in the schedule *(Systems Management and Research Technologies Corp., CBCA 4068). (Editor's Note. Comments on this case suggest a good piece of advice to avoid similar situations – avoid invoicing fees as a percentage but rather invoice based on a time period (e.g. bill a $1,200 fee amount $100 per month.)*

Eichleay Recovery of Unabsorbed Overhead is Allowed

Shortly after approving KBJ's schedule to replace old boilers the government suspended the demolition work until new boilers could be set up locally. KBJ asserted the delay in demolition work was not anticipated in the contract and the delay entitled it to recovery of fixed indirect costs that could not be charged as a percent of direct costs – unabsorbed overhead – using the established Eichleay formula for recovery. The government argued that not all work was suspended and that KBJ's failure to perform other available work concurrently delayed the work. KBJ disagreed stating that the other work was not on the critical path and therefore its delay in performing that work did not delay the project. The Board stated that to recover unabsorbed overhead under the Eichleay formula (1) a contractor must show there was a government caused delay to contract performance for an uncertain duration that was not concurrent with a delay caused by the contractor (2) the delay extended the period of performance and (3) the contractor was required to be on standby during the delay where only non-substantial work could be performed. The Board ruled these conditions were met. As for performing other work, the Board ruled the non-boiler work was non-substantial compared to the contract as a whole. The Board concluded that it was the burden of the government to show it was practical for KBJ to take on other replacement work to absorb the overhead where it failed to meet this burden *(KBJ, ASBCA 58512).*

Termination for Default is Justified

(Editor's Note. The following case shows that sometimes it's smarter to just walk away from a contract opportunity.)

The award was a fixed price contract to design and build a support facility in Afghanistan. The government terminated the contract for default where it awarded a new contract to another contractor and sought $903,000 in "reprocurement" costs from Highland. The RFP clearly put all the risk on Highland such as (1) if the power system is not complete Highland will be required to provide temporary power (2) damage from hostile entities are the sole responsibility of Highland and (3) signing the contract means all risks are to be the sole responsibility of Highland. Not surprisingly, negative events occurred such as severe flooding one month, expulsion of skilled Pakistani workers, closure of the border resulting in a "freight embargo," hijacking critical supplies and many security issues. As a result of these occurrences, Highland could not perform and the contract was terminated for default, putting a black mark against it for competing for future work. Though desirable to negotiate terms for the government to assume some of the risks this is often not possible and prospective contractors may best walk away *(Highland Al Hujaz Co., ASBCA 58243).*

NEW/SMALL CONTRACTORS

Some Indirect Rates You May Want to Adopt – Part 2

(Editor's Note. Since many of our clients and readers have been asking us about adopting different indirect costing methods, we thought we would identify some of the common practices found in both manufacturing and service organizations. This is the second article where the first article appeared in the last issue of the REPORT.)

Service Cost Pools

In addition to actual manufacturing activities, services are often provided within both manufacturing and services facilities. For example, an engineering group may provide production and design services. When the costs of these services are included in indirect manufacturing pools, they can lead to problems with government auditors and customers who are seeking the lowest possible price. For example, if an indirect manufacturing pool includes both manufacturing and

engineering services, a direct labor dollar base could assign a disproportionate amount of indirect costs to direct engineers due to their higher salaries. The government might object if a government contract receives a high amount of allocations or a contractor could suffer by allocating excessive indirect costs of engineering services that could result in non-competitive prices for contractors seeking government business. The solution might be to accumulate engineering expenses into a separate pool (or even multiple pools for, say product, design and software engineering) if the resulting rates would be significant.

Or, consider a service firm with multiple offices. If the government furnishes office space, utilities or supplies it would be inequitable for facilities costs to be included in an indirect cost pool and allocated to contracts for which the government furnishes some or all of these things. Not only would the government object to being overcharged but the contractor would likely not be cost-competitive when trying to win new business. In this case, it is quite common for contractors to keep two types of indirect costs: (1) indirect cost pool(s) at the home location and (2) indirect cost pools at the sites of specific customers. Overhead costs (we will get to G&A costs later) common to all contracts would be accumulated at the first category and costs specific to particular sites at the second category. For example, the home site pool might include rent paid for the home-office space plus fringe benefits for all indirect home office employees while the customer specific site might include no rental costs but all fringe benefits of indirect employees working at that site.

The allocation base for the services we have been discussing is usually direct labor hours or dollars. This is consistent with CAS 418 which prefers use of a labor allocation base when the indirect costs consist of management or supervision activities. Either a labor dollar or labor hour base is appropriate and if the benefits outweigh the effort, two separate pools – one with a labor dollar and the other a labor hour – may be used. Few other bases are usually appropriate though one variation might include fringe benefit costs of direct employees in the direct labor dollar base. Though the amount of costs allocated to a particular contract would most likely not be significant, it would have the cosmetic appeal of a lower indirect cost rate.

Fringe Benefit Pools

Fringe benefit costs include payroll taxes, pension contributions, medical plans, life insurance, employee welfare, etc. Often fringe benefits are not segregated in a separate pool but simply accumulated with other indirect costs. For example, the fringe benefits for both direct and overhead labor are accumulated in an overhead pool and the fringe benefits for G&A labor accumulated in a G&A pool.

Whether it is to appear to lower indirect rates, focus management attention or achieve a higher level of precision, contractors may often decide to use a separate fringe benefit pool. Use of a total labor dollar base is customary even though it is rarely precise. Unless multiple fringe rates are adopted (which is quite rare) everyone becomes accustomed to some level of imprecision since some benefits vary according to the number of employees (e.g. fixed medical insurance per employee) while other benefits vary according to salary (e.g. pension costs based on employee earnings).

Multiple fringe benefit rates may be desirable when fringe benefit rates vary significantly between groups of employees. Common examples include varying state related taxes (unemployment, workers compensation) or different union agreements between sites. Probably the greatest incentive for more sophisticated treatment of fringe benefits is the increased use of less than full time employees. Full time employees may receive all fringe benefits while other less than full time employees may receive a limited range of benefits – say vacation and taxes but no health benefits or pension and still others (sometimes called "variable" or temporary employees) may receive no fringe benefits except payroll taxes. One solution might include accumulating fringe benefits in layers or tiers where the first pool would consist of only statutory benefits applicable to all employees, the second pool would consist of benefits applicable to the less than full time employees and the third pool to variable employees.

Support Pools

Both manufacturing and service firms have a wide variety of potential support pools. Rather than include support costs in overhead pools and crediting the cost portion of revenue to the pools, contractors (or auditors' insistence) can eliminate both the associated costs and revenue of certain support functions from overhead and G&A pools and treat them separately in support or service centers. Such treatments have the added advantage of being able to charge these services as direct costs or indirect costs. Some of the more common support pools include:

Occupancy costs. Occupancy costs include building depreciation, amortization of leasehold improvements, maintenance costs, utilities and other related costs.

The occupancy pool is usually an intermediate pool that is allocated to other indirect cost pools rather than directly to final cost objectives. Square footage is the most common allocation base. Though less common, number of employees (when area and type of space used by each employee is similar) or cubic space (when utilities costs are significant and areas with high ceiling use more than those with low ceilings) can be used when the basis is reasonable.

Computer Operations. The costs include computer operations for equipment, supplies and personnel and are commonly associated with (1) business applications such as accounting and payroll or (2) scientific or engineering applications. A large computer operation might justify creating two pools where accounting functions could be charged to G&A and scientific functions charged to direct cost objectives or indirect cost pools that benefit most. Selection of appropriate allocation bases for the second type of costs can be problematic – use of computer time can be difficult because computers process several jobs at once while other usage measures (e.g. central processing time, number of input or output channels, amount of core storage, number of lines printed, number of records handled) need to be carefully selected and monitored. Head count is often selected as an acceptable surrogate base.

Other Support Services. Other frequently used indirect cost pools collect a wide variety of service costs. Common examples include: (1) reproduction cost pools consisting of costs of copying machines, machines operators, supplies allocated on copies made (2) graphics, art and photographic departments allocated on items produced (3) communications costs such as telephone, cell phones, etc. allocated on headcount or on number of telephone lines or (4) vehicle related expenses allocated on mileage. In addition, special facilities (e.g. wind tunnels, heat treatment, environmental chambers and microelectronic centers) are also common and a usage allocation base such as time spent or number of items processed are usually preferred by auditors over labor bases.

Charge Rates. In the past, the government preferred that all costs in each support center be allocated to benefiting users using a provisional rate that was adjusted at year end for actual costs by charging or crediting the center's costs for over or under allocations. Methods used to accumulate pooled costs and allocation bases have always been a major bone of contention between auditors and contractors so establishing charge rates using commercial prices has gained in popularity. This is generally acceptable as long as contractors can show their costs are similar or above commercial costs.

General and Administrative Pools

G&A costs, sometimes referred to as the remaining costs, are those expenses not identifiable with particular cost objectives but necessary for the overall operation of a business that include the costs of management, legal and accounting, business taxes, selling and marketing and similar costs. In a corporate structure, the firms' G&A expenses may consist of costs at the business unit as well as allocations from the group and corporate level. G&A expenses are allocated based on some measure of the activities of the entire organization. CAS 410 states the preferred bases are the total cost input base, the value added base (excluding material and/or subcontracts) or a single element base (commonly direct labor).

Convincing the government to accept other than a total cost input base for manufacturing firms can be a challenge while having them accept such a base for service firms can equally be a challenge. To do otherwise, the contractor needs to establish a distortion exists and use, for example, a multiple regression analysis to help illustrate the historical relationship. The contractor should not attempt to justify the change based on competitive reasons – this may be a motivator for the contractor but the auditor ignores this and looks only to the concept of good accounting.

QUESTIONS AND ANSWERS

Q. We book numerous transactions such as sale of fixed assets, scrap, accounts payable and receivable adjustments, etc. as "Other Income." Do we need to credit our overhead and G&A pools for these items.

A. Only if the associated "cost" is included as an expense item in your indirect cost pools. So, for example, if you include the cost of reproduction or vehicles in your indirect cost pools, you need to credit the appropriate pool for the cost of income for reproduction services or vehicle usage you charge clients for. Remember, the portion you need to credit is only the cost component of the item since some of the "income" represents profit (though due to the difficulty of isolating the cost from the profit, many contractors choose to credit the pool for all of the income). However, if you choose to accumulate certain types of expenses in a separate service center like we discuss above rather than an indirect cost pool then you do not credit the service center for the income.

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Q. My organization would like to acquire an expensive piece of equipment that would be used for several CPFF, FFP, and commercial contracts. Is it possible for us to purchase the piece of equipment and rent it to the individual contracts on an hourly basis until the cost of the equipment is recovered?

A. There are numerous possibilities to charge government contracts for equipment. An hourly basis should be acceptable but you probably want to make sure your customer will accept it. Also, you want to make sure the payments do not exceed the "cost of ownership" (e.g. depreciation, maintenance, repair, taxes even cost of money but not interest payments) - that is, the amortization of costs that forms the basis of your hourly rate does not exceed the cost of ownership. The exception to this is if equipment rentals are part of your normal business in which case you might be entitled to charge a "commercial rate" - what you charge your commercial customers. Even after you recover your costs (e.g. fully depreciated) you still may be entitled to a rental charge.

Q. We are a small business not covered by OFPP compensation caps so when DCAA asks how we determine our executive compensation pay - what exactly are they looking for and what is the best way to address this subject?

A. They are usually trying to determine whether your "internal controls " over compensation are adequate. Most commonly good internal controls translate into benchmarking your pay to established surveys.

Q. We have several T&M contracts and our ACO is disallowing our G&A markup applied to our material and supply costs saying "the government is prohibited from paying profit on materials costs under T&M contracts.". What do you think?

A. The ACO is wrong, mistaking the allowable "applicable indirect costs" (which includes G&A) that time and material contracts allow for and unallowable fee or profit. The confusion may be partially caused by you when you refer to G&A as a "markup" which is commonly associated with profit or fee.

Q. We have several Overhead pools along with a G&A pool. Normally for staff that is performing a task that benefits the whole company our normal practice is to book the related cost to the G&A pool. However, a few of our indirect employees do not necessarily perform tasks related to the whole company. I am wondering if I have an option to split the costs of these employees between the overhead pool and G&A.

A. The rules are sufficiently general to allow for just about any treatment. The key requirement is to disclose your selected practices and follow them consistently. So G&A is considered costs related to running the company while overhead is indirect costs associated with project support but these are so general that all companies choose their own criteria. If you want to split the costs, you will need to track their time using timesheets because arbitrary percentage splits are generally frowned upon. To me the key considerations should be your pricing objectives and administrative ease. Do you want a low G&A rate to apply to subcontract costs, for example, then charge most costs to your overhead pools or vice versa if you want to minimize your overhead rates. We have written several articles on treatment of indirect costs (including our feature article above) so check our website and use the key word search. Also, feel free to call me to discuss.

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