GCA Report

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NEW DEVELOPMENTS

FY 2017 NDAA Passed

The FY 2017 National Defense Acquisition Act has more significant procurement features than other recent NDAAs where they will be implemented by amendments made to the Defense Federal Acquisition Regulation (DFARS). The following is a summary of some of the most significant changes.

Section 813. Reduce use of lowest price, technically acceptable source selection methods where they would "deny the benefits of cost and technical tradeoffs in the source selection process." Now LPTA will be used only in situations where six factors are fulfilled such as being able to describe minimum requirements expressed in terms of performance objectives, measures and standards; little to no additional value is derived from meeting minimal technical or performance standards; little or no subjective judgment is needed to identify desirability of one offeror over another and: the CO has justified use of LPTA. LPTA is to be avoided for acquisitions for (1) IT, cybersecurity, systems engineering and technical assistance, advanced electronic testing, audit or other knowledge based services (2) personal protective equipment or (3) training or logistics services overseas.

Section 820. The Cost Accounting Standards (CAS) should, to the extent possible, be reconciled with Generally Accepted Accounting Principles (GAAP). Commentators have stressed this is unlikely to be fruitful since GAAP, CAS and IRS rules are often different because they have different purposes. The CAS Board will hire an Executive Director and will meet at least quarterly compared to the current lack of staff let alone a director as well as hardly any meetings. The CASB will be responsible for addressing CAS problems identified in Board or Court cases and there will be an increase in the number of contracts eligible for a waiver where agency heads will be allowed to exempt from CAS requirements contracts valued at less than $100 million (currently at $15 million). The NDAA also established a separate Defense Cost Accounting Standards Board for the Defense Department where the language is uncertain whether there will be different CAS applicable to Defense contracts.

Section 821. The micropurchase threshold has been raised from $3,500 to $5,000. For these purchases, most FAR clauses are not included and competition is not required if the purchaser considers price to be reasonable.

Section 822. The Truth in Negotiations Act (TINA) will be amended to reduce the circumstances in which an offeror is required to submit certified cost and pricing data before contract award. Before such data was required for prime contracts exceeding $750,000 where now such data will not be required for contracts, subcontracts or contract modifications for which price is based on "adequate competition that results in at least two or more responsive and viable competing bids." The prime contractor will now be responsible for determining whether its subcontractors are subject to TINA.

Section 824. Contractors must now report their bid and proposal costs separately from their independent research and development costs. The NDAA also establishes a goal of limiting B&P costs to no more than one percent of the amount of contractor sales to DOD and requires that DOD contract with an outside firm to study what is driving B&P costs and how to reduce them. Comments indicate DCAA will likely be asked to review contractors' B&P costs to determine if the one percent rule is met.

Section 825. Under Multiple Award contracts, agencies, at their discretion, may eliminate cost or price as an evaluation factor when issuing task or delivery orders if multiple contracts are awarded for the same or similar services.

Section 829. Fixed price contracts will be the preferred contract type that includes fixed price incentive contracts. Section 831 establishes a preference for using performance-based contract payments wherever practicable. Under this, payments will be "structured around the results achieved as opposed to the manner by which the work is performed."

Section 871 and 872. Two provisions directed at use of commercial item contracting include (1) requiring procurement officials to include in their market research for commercial items information to support the CO's price reasonableness determination and (2) when contractors respond to commercial item solicitations, they will be allowed to submit information on the value of the commercial items offered and COs may consider this information when determining price reasonableness. Section 876 reiterates the preference for commercial items and use of appropriate market research.

Section 891. DCAA will not be able to provide audit services to non-Defense agencies unless the DOD Secretary certifies that the backlog of incurred cost audits is less than 18 months of incurred cost inventory.

Final Rules on Congressional Inquiry Costs, Paid Sick Leave and Subcontractor Payments and Class Deviation on IR&D Technical Exchanges

A final rule was passed to disallow costs federal contractors may face when they undergo questioning on Capitol Hill. The rule amends FAR 31.205-47(b) to disallow costs incurred "in connection with" a congressional investigation or inquiry that results in a criminal conviction, finding of civil liability for fraud or similar misconduct, a decision to suspend or debar the contractor, rescind or void the contract, terminate the contract for default or any disposition of the matter that would have led to any of the above outcomes. The rule applies to only cost reimbursable contracts so there is no reimbursement for such costs under fixed price contracts where commentators stress contractors are on their own when faced with high profile projects (e.g. F-35 Joint Strike Fighter, IT problems in roll out of Obamacare) *(Fed. Reg. 4732).*

The FAR has been amended to implement Pres. Obama's Executive Order 13706 and the Labor Dept.'s final rule requiring contractors to permit an employee to accrue not less than one hour of paid sick leave for every 30 hours worked where Contractors may limit the amount of paid sick leave an employee is permitted to accrue or have available for use at any point to no less than 56 hours. The rule applies to solicitations issued on or after Jan 1, 2017 and applies to all contracts and subcontracts at all tiers for amounts exceeding the micropurchase level *(Fed. Reg. 13706). (Editor's Note. This rule has some twists and turns which we intend to address in more detail in the next issue of the GCA DIGEST.)*

A final FAR rule requires prime contractors to self-report late or reduced payment to their small business subcontractors where COs will need to record these into the Federal Awardee Performance and Integrity Information System. The rule adds examples of payment or nonpayment situations that are considered justifiable and not subject to reporting such as there is a contract dispute about performance, partial payment is made for amounts not in dispute or administrative mistakes and late performance by a subcontractor leads to later payment by the prime. The rule will apply only to first tier small business subcontractors but will apply to contracts for commercial items *(Fed. Reg. 4239).*

A class deviation has changed a recent rule on IR&D costs. The class deviation alleviates the requirement that a technical interchange occur *before* costs are incurred on IR&D projects where a transition period for this requirement will provide that an interchange with a technical or operational DOD government employee should occur *sometime* during the contractor's 2017 fiscal year *(Fed. Reg. 4239).*

New Contract-Related Interest Rate Set for First Half of 2017

The Treasury Secretary has set a rate of 2.50% for the period January through June 2017. The new rate is an increase from the 1.875% rate applicable to the last six months of 2016. The Secretary of the Treasury semiannually establishes an interest rate that is then applied for several government contract-related purposes. Among other things, the rates apply to (1) what a contractor must pay the government under the "Interest" clause at FAR 52.232-17 and (2) what the government must pay a contractor on either a claim decided in its favor under the Contract Disputes Act or payment delays under the Prompt Payment Act. The rate also applies to cost of money calculations under Cost Accounting Standards 414 and 417 as well as FAR 31.205-10 and when a discount factor is used to calculate the present value of future payments (e.g. deferred compensation).

New Opportunities

Bloomberg News has complied numerous contracting opportunities that are on the horizon. Here are some significant ones.

Tech startups are struggling to tap the $82 billion IT federal contracts market, especially in the exploding cybersecurity market. For tech services, the main challenge is learning the procurement process while

for product sellers it is gaining government safety certifications.

Honeywell International was recently awarded the 10 year $26 billion maintenance and operations contract for Sandia labs, over Lockheed who held the contract since 1993.

Contractors should get ready to vie for spots on the Army's $37 billion RS3 contract, scheduled to be awarded March 31. RS3 combines contracts where it will house most of the professional services spending of the Army over the next decade. The 10-year contract will have about 50 awards, 20 reserved for small businesses. Though large businesses will probably win most of the spending commentators are expecting the overall market to shift as small businesses begin to absorb some of the work.

Nine opportunities totaling $63 billion are expected soon where RFPs will be released by March 31. They include FNLCR ($18B), GTACS ll ($5B), PIF ($4.7B), CHS 5 (43.9B), ETSC ($2.4B), AMS ll ($2B), ITSS-5 ($1.4B) and SDI-NG2 (41B). Most programs are for professional services while two others – FNLCR and PIF are for research and development.

The National Oceanic and Atmospheric Administration is expected to release requests for proposals for $3 billion in professional and technical services in April and June. The vehicles include five different subsections: satellites, ocean, fisheries, weather and enterprise missions where each has requirements for professional services such as studies, analysis, and reports; applied research and consulting; satellite systems services; engineering and data collection.

DCAA Issues Guidance on Assisting Reviews of Final Vouchers for Contract Closeouts

The Defense Contract Audit Agency has issued guidance to its auditors in type of services it may provide to contracting officers to assist in processing final vouchers for contract closeouts. Most of the guidance represents slides to be used in training auditors as well as step-by-step instructions COs should take to approve final vouchers.

The guidance alludes to a requirement, effective June 30, 2011, for contractors to update their incurred cost proposals, Schedule I – Cumulative Direct and Indirect Costs claimed and billed – to reflect settled rates and cumulative costs within 60 days of rate settlement. Since the vast majority of ICPs considered to be low risk have already been settled without audits, this requirement is widespread. COs can use this updated information to help them close out contracts. Though Schedule I should provide sufficient data for contracts awarded on or after the effective date, the guidance provides additional steps that auditors may need to take on older contracts. These steps might include requests by the CO to provide specific information that might not be included in COs' files such as copies of low risk memos, final certified ICPs, ICP reports, signed rate agreements or additional audit work might be conducted in audit areas that are considered to be risky such as direct costs or level of effort hours *(MRD 17-PIC-001(R).*

Protest Sustain Rate Increases

Almost half of contractors' protests are receiving at least some relief according to a recent Government Accountability Office report. The GAO's effectiveness rate increased to 46 percent where effectiveness rate is defined either as the GAO sustaining the protest or an agency fixing a procurement error with corrective action. The filing of protests increased 6% over 2015 where the GAO agreed with contractors 139 times, nearly double the 2015 sustain rate. Though the sustain rate has significantly increased, the fix through corrective action has not indicating, according to specialists, that agencies seem to be taking their chances at a negative decision. The most common reasons for sustaining protests are (1) unreasonable technical evaluations (2) unreasonable past performance evaluations (3) unreasonable cost or price evaluations and (4) flawed selection decisions.

Federal Spending Increases, Number of Vendors Decrease

Federal contractors watching competition intensifying and markets tightening over the past several years got some relief in 2016 where according to Bloomberg contract data, Pentagon spending increased 8.5 percent to $305 billion in 2016, reversing four straight years of decline. Civilian agency spending also grew 5.9% to $170 billion which is the third year of growth for non-DOD agencies.

Despite the increase in federal spending the same Bloomberg data marked a 10-year low in the number of first time federal vendors. The number of first time sellers with signed contracts was 15,925, 13 percent of the government 124,000 vendor pool, the second lowest percentage in a decade. More spending on fewer contracts has created more prosperous vendors but is cause for concern that the decline in vendors and their percentage share is reflecting a decrease in the health

of the government's industrial base. Reasons cited for the decline include agencies have become much more choosier about companies they do business with, new businesses are subject to intense scrutiny during the solicitation processes over issues of security, capability, commerciality and competitiveness while vendors selling cutting edge technologies are subject to a number of certification programs resulting in significant barriers to entry and increased use of multiple award contracts that limit the number of task order bidders to a preselected number of contractors.

NASA to Reward Excellence with Contract Extensions

NASA is proposing to amend the NASA FAR to implement policy on the use of additional contract periods of performance – or award terms –as an incentive if a contractor has superior performance and if the government has an ongoing need and funds are available. The proposed rule provides considerations when using such incentives, distinguishing between contract options and the award term, procurement procedures and minimum contract values and requirements for the award term incentive plan to be incorporated into the contract. The stated purpose is to provide a non-monetary incentive for excellent performance and to provide a more stable business relationship for the contractor and its employees. NASA contracting innovations are often a harbinger for other agencies *(Fed. Reg. 89038).*

FAR Proposed Rule Implements SBA Rule on MAC Set-Asides

The FAR Council is proposing a rule to expand set aside and partial set asides for small businesses under multiple award contracts (MACs). The proposed rule implements a final rule issued by the Small Business Administration in 2013. The SBA Oct 2013 rule amended its regulations to establish policies and procedures for setting aside task and delivery orders for small business under MACs, reserve at least on MAC for small businesses and how to determine size under certain agreements *(Fed. Reg. 61114).* The proposed rule provides guidance on small business contractors' responsibilities with respect to performance of work requirements such as limitations of subcontracting and the nonmanufacturing rule. See our July/August 2016 issue of the Report on recent change to "limit on subscontracting" rules. *(Fed. Reg. 88072).*

CASES/DECISIONS

Board Addresses Several Cost Disallowances and Retroactive Disallowance

DCAA and the DCMA questioned several categories of TSI's costs where the Board addressed them.

Marketing Costs. The Board disagreed with the government's assertion that certain marketing costs were unallowable because the consultant did not create a work product. The ASBCA rejected this argument holding that FAR 31.205-33 may require provision of a consultant's work product but if it does not require the creation of work product for the consultant to perform its duties the invoice supporting the incurred costs was sufficient.

Expensed computers. The board agreed with the ACO's questioning of expensing computers saying they should have been depreciated over several years. Here such expensing would have diverged from it prior practices where TSI did not demonstrate the computers were modified for non-office work which would have justified the expensing.

Executive Bonuses. The Board sided with the ACO's disallowance of bonus payments because TSI's bonus plan was defective where the one-page memorandum purporting to establish the bonus was utterly lacking in clearly defined criteria for making bonus decisions, leaving the decision making to the "unfettered discretion of the three bonus recipients." It ruled the bonus policy lacked specificity and constraints where memos in support of the bonuses reflected their arbitrary nature by referencing generalized achievements without tying them to the amounts of the bonus.

Legal Costs. The Board held TSI was entitled to defend itself in a Naval Criminal Investigative Service investigation and it also rejected the government's contention that TSI sought costs in the wrong year. FAR 31.205-33 generally precludes payment of those costs while the investigation is pending but TSI provided sufficient documentation that the investigation was completed in the year it claimed the costs.

Subcontractor Costs. Contrary to FAR provisions in the contract the Board agreed with the disallowance of direct subcontract costs because they were not preapproved by the ACO. It rejected TSI assertion that the CO's technical representative later determined the subcontracts were performed in support of TSI's

statement of work, ruling the COTR did not address the reasonableness of the costs which is fatal to TSI's attempt to provide after-the-fact justification for these costs.

In the past we were often successful in challenging DCAA's questioning costs that it had previously allowed in other audits asserting that the principle of equitable estoppel prevented such disallowances when they harmed contractors. That argument was severely limited after a later court ruled an additional condition must be present to justify use of estoppel – there had to be "affirmative misconduct" by the government. In this case TSI argued that "affirmative disallowance" did not require such misconduct. The majority of judges ruled the retroactive disallowance argument was the same as equitable estoppel and hence the failure of DCAA to question costs in the past was not sufficient to challenge the disallowances here since no misconduct occurred. However, a dissenting opinion in the case said that unlike estoppel, the Board has not unambiguously applied the requirement of affirmative misconduct to retroactive disallowance, making use of this argument in the future potentially fruitful *(Tech Sys Inc., ASBCA 59577)*.

Board Invalidates Broad Interpretation of Prime's Responsibility for Managing its Subcontractors

(Editor's Note. The following case addresses the very hot issue of what are the prime's responsibilities over its subcontractors. We will address this important case in more detail in the next issue of the GCA DIGEST.)

DCAA questioned $103 million of subcontract costs claimed by Lockheed Martin asserting they did not properly oversee their subcontractors or review their costs in accordance with the FAR 42.202 where a literal interpretation requires the prime contractors to act on behalf of the ACO for each subcontract under cost reimbursable contracts. The audit report alleged Lockheed failed to prove it (1) confirmed subcontractor personnel qualifications through a resume review (2) confirmed the accuracy of subcontractor's invoiced hours through a timesheet review and (3) obtained subcontractor incurred cost submissions or contacted the government if it was unable to obtain them. Lockheed acknowledged there are FAR requirements regarding management of subcontractors but stated its practice was not to collect ICPs from the subcontractors but rather advise them to submit them to DCAA nor was there any FAR or DCAA requirement for subcontractors to submit ICPs to the prime. After identifying the administrative responsibilities of the prime and discussing FAR 42.202 the ASBCA sided with Lockheed *(Lockheed Martin Integrated Sys., Inc. ASBCA No. 59503)*.

KBR Is On the Hook for Gifts to Supervisor but Not to Employee

A subcontractor provided several gifts like meals, drinks, entertainment and golfing to two KBR employees, one a supervisor and the other an employee with less authority in violation of the Anti-Kickbacks Act. In its decision, the Court drew a clear line between an employee with significant and relevant responsibility over KBR and another without. The Court found the gifts given to the supervisor were improper because the subcontractor wanted KBR to overlook performance deficiencies where the supervisor had sufficient authority to make KBR responsible for the violation. However, the Court found no violation of the anti-Kickback Act with the gifts given to the other employee since he lacked the same authority to make KBR responsible finding no kickback occurs if the gift giver is only seeking to build a reservoir of goodwill to obtain future business. Comments on the case indicate larger contractors should be pleased with this decision since a low level, rogue employee gift acceptance cannot get the whole company in trouble *(US v Vavra v Kellogg Brown & Root, 5th Cir., No. 15-41623)*.

Partial Termination Justifies an Equitable Adjustment for Unrecovered Fixed Costs

(Editor's Note. This case reminds us that there is more than one way to characterize a change to a contract. Characterizing it as a partial or full termination, request for equitable price adjustment or both can significantly affect both entitlement and amount of recovery. This is an area where it makes sense to get some expert advice where such advice is usually reimbursable by the government.)

The Army partially terminated a five year with three option years contract for food services at 18 dining facilities. In developing its price Mo. estimated its variable costs for labor hours that vary by proportion of business volume and its fixed prices such as salaries of its project manager, building manager and maintenance workers, cost of the job site office and home office expenses. The contract included a requirements clause at FAR 52.216-21 that provided the government shall order all the supplies and services contained in the contract schedule and referenced a termination clause at 52.249-2 that provided that if a termination is partial, the contractor may file a proposal for an equitable adjustment for the pries of the continued portion of the contract. The government closed six facilities and

significantly reduced production hours. Mo. submitted a claim for the increased costs to perform the remaining contract work and the CO denied the claim asserting the failure of requirements to meet estimates does not entitle the contractor to an equitable adjustment. The Court sided with Mo. stating the CO "misses the point" where the parties entered into a different contract than the one that existed after the partial termination where the original contract included 50 percent more dining facilities and close to 300,000 more production hours making it impossible to recover its fixed costs on reduced unchanged work *(Mo. Dept. of Soc. Svcs., ASBCA 59191)*.

Low Ball Bid is Unrealistic

The agency's estimated costs for an indefinite delivery/ indefinite quantity services contract was between $133 million and $140 million. The agency disqualified BlueWater's low bid of $114 million and when it protested, the GAO upheld the decision because the protester could not explain any unique technical aspects to justify deviating from the range as the solicitation required *(BlueWater Fed. Sltns, GAO, B-413758)*

NEW/SMALL CONTRACTORS

Some Basics of Defective Pricing

About ten years ago, defective pricing audits were a major focus of government contracting officers and auditors. Whereas most of the attention was on large contracts (after all, that was where there was the greatest dollar return for the effort) with little attention on subcontracts, we are seeing a significant increase in auditing not only smaller contracts but also subcontracts worth as little as $500,000. The increased attention on smaller contracts and subcontracts is likely a result of less audit demands for auditors' time and periodic DODIG reports that DCAA is not doing enough defective pricing reviews. Whatever the reason, contractors with little or no experience in defective pricing audits (or the more euphemistic title "post award reviews") need to get up to speed. We thought it would be a good time to briefly discuss the basics of defective pricing and what to expect from a defective pricing audit.

The Truth in Negotiations Act (TINA) covers defective pricing. TINA requires prime contractors and subcontractors to submit cost or pricing data for contracts or pricing actions (e.g. a contract change or modification) in excess of $750,000 (less in prior years) and to certify the data is accurate, complete and current. A waiver to this requirement exists under one of five conditions: (1) adequate price competition exists (2) commercial items are acquired (3) prices are set by law or regulation (4) a waiver is granted when the government deems prices are fair and reasonable (e.g. submission of "other than cost or pricing data") or (5) a modification is made for acquisition of a commercial item. We recommend contractors seek one of these waivers whenever possible. What is and is not "cost or pricing data" and when and how this data should be brought to the attention of the "government" is a source of almost unending litigation. For example, cost data refers to facts (e.g. actual labor rates, hours expended, price quotes from vendors, records of incurred costs) while estimates and judgment (e.g. budgets, profit plans, methods of performance) are not considered facts and hence not data that must be divulged (though the facts upon which estimates and judgments are based are considered data).

Even though the contractor signed a Certificate of Current Cost or Pricing Data the contractor may have inadvertently included "defective" data in the proposal that the government relied upon in negotiating a contract award. If the government can prove the contract or subcontract price is overstated because of its reliance on the defective data both the prime contractor, and through its flowdown clauses, the subcontractor is subject to a reduction in its contract price. Even though a contract price may be the result of many factors other than defective data (e.g. negotiating skills, perceived market conditions, etc.) the presumption is, short of evidence to the contrary, the government overpaid by the amount of the defective data and the adjustment is equal to the amount by which the cost or pricing data was overstated. In calculating the adjustment, the government usually recognizes offsets which means that if a contractor *understates* some cost or pricing data submitted in support of its proposal then that amount can be used to offset any overstatement the government claims exists.

Defective pricing is sometimes confused with allegations of fraud. Remember, defective pricing is not a crime! Defective pricing need only require (1) cost or pricing data is defective (2) the contractor certified to the accuracy, completeness and currency of the data and (3) the government made an overpayment in reliance on the data. For fraud to exist, the contractor intends to defraud the government and/or it knew the data was inaccurate, incomplete or noncurrent. If fraud exists, the contractor may be criminally prosecuted either under the False Statement Claims Act or administratively under

the Program Fraud Civil Remedies Act of 1986. Of course, a defective pricing review can evolve into a fraud case if the auditor suspects fraud and refers the case to an investigation unit of the buying agency.

Audit Steps

During an audit, the auditor will establish a baseline for all contracted cost elements (e.g. labor, materials, overhead). This baseline is usually the last proposed amount adjusted by any subsequent cost or pricing data used in negotiating a price. Next, the auditor will request the contractor supply actual incurred cost for the contract or if the contract is not complete, then incurred costs plus estimates to complete for each cost element. The auditor will compare the proposed and actual data and will then focus mainly on those cost elements where actual costs are significantly less than the proposed amounts. The auditor will attempt to determine whether these lower cost items reflect defective data by determining (1) if operations proposed were not performed or (2) costs proposed were not incurred or (3) whether items of direct cost proposed were higher than was appropriate based on information available but not disclosed. Examples of the latter are a firm quote was in hand after the original proposal was submitted but before price was agreed to or a previously used supplier who was known to submit low bids and was subsequently used was not included in the proposal. Common audit steps include conducting interviews, reviewing board of director minutes, examining proposal files, comparing estimated work with actual work tasks, looking for evidence of new or improved processes that may have been known at the time of price agreement, updating historical labor hours to determine the learning curve benefits, etc.

Remember, a contract price is not defective simply because subsequent changes (e.g. market conditions, changes in make vs buy decisions, labor availability shifts) allow a contractor to obtain lower prices.

Once the review is complete, the auditor then calculates a recommended price adjustment, computing direct costs, indirect costs and profit and also taking into account relevant offsets. For the prime contractor or upper-tier subcontractor, the adjustment will include the defective pricing findings associated with audits of subcontractors. It is critical to ask for and receive an exit conference to discuss the results of the review. In our experience, more than most audits, the audit findings are based on incomplete facts and misinterpretations affecting the findings. The exit conference and subsequent follow-up communications at the audit level provide a great opportunity to negotiate more acceptable results before positions harden later.

QUESTIONS & ANSWERS

Q. *(Editor's Note. Many of our clients wisely run by us questions and intended responses they are thinking about providing the government before they actually do so. Here is a recent example where problems were averted.)* DCAA is asking us to provide a summary of hours charged on our government contracts and subcontracts but we don't really track hours charged, but rather direct labor costs so I plan on telling him that we do not track hours in our accounting system.. Can you see a problem?

A. Your statement "We do not track hours in our accounting system" can be deadly. You do not want to indicate you cannot produce a report that summarizes hours worked by project for direct labor people. Auditors call this a "labor distribution report" (contractors may have different names for it) and it is considered to be a critical internal control. I am worried that if you can't do so, the auditor may conclude you do not have an adequate labor system in place. You do not, I repeat, do not want this to occur. You do say you produce reports identifying labor costs by employee and you do know their base pay so I do not think it is would be terribly difficult to produce a report showing labor hours.

Q. We were a subcontractor to a prime on a government contract. The prime never paid us – no dispute about our performance, the prime was simply having liquidity issues. We hired a collections company on a contingency basis to attempt to collect the overdue receivable. They were successful, and now we owe the collections firm 15% of the payment. Since the collections firm used a lawyer to pursue our claim – could this be considered an allowable legal fee?

A. We were curious whether the FAR cost principle for legal expenses addressed your question so I took a quick look at FAR 31.205-47(b) and (f) and didn't see anything related to collection from a prime or even collection from the government so I would say it is not an unallowable legal expense. However, wouldn't you know it, FAR 31.205-3, Bad debts, does address it and makes it unallowable. The cost principle makes bad debts related to uncollectible accounts receivable due to customer or other claims along with any "direct associated costs such as collection costs and legal costs are unallowable."

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Q. We have a large staff of indirect labor. On our largest subcontract, the prime contractor has given us permission to use many of our indirect staff to help set up the work and charge it directly. Does that cause a problem for our other work?

A. It is not unusual for certain contracts to create, for example, a task order or CLIN representing administration or project management functions where normally indirect personnel accumulate their costs and charge it directly to that task order. There should be no problem as long as "double counting" is avoided – if the indirect personnel salaries are included in an indirect pool, the portion of salaries charged direct should be credited to the same pool. We would also advice showing in your written policies that normally indirect personnel may charge direct and provide examples of where that occurs.

Q. Though we have several contracts with other government agencies, we have recently submitted our first proposal to the Department of Defense and the agency personnel told us that our G&A is too high, indicating an amount over 12% is excessive. Is this true? If we proposed a 12% rate, we would be losing money on the contract.

A. We constantly hear about contracting officials, either through misunderstanding or negotiating ploys, putting forth myths about appropriate indirect cost rates. Such assertions either represents "common wisdom" or they may correspond to actual negotiated prices on earlier contracts - perhaps with the contractor, its competitors or firms in the same business. Since indirect cost rates, especially G&A, has a wide variety of ways of computing them (i.e. different costs elements in the pools and bases) it does not make sense to have one across the board rate considered to be the best. If such an assertion is made, request the official cite the regulation. One way of preventing such assertions is to not disclose the cost elements of your proposal unless it is specifically required by the solicitation.

Q. Is self-insurance costs that exceed the amount we would pay for premiums unallowable. Does the FAR address this. If so, should these unallowable costs be included in our overhead base which includes direct labor plus fringe benefits.

A. FAR 31.205-17((c)(3) does state that if insurance is available, self-insurance costs plus insurance administration costs that exceed the cost of comparable purchased insurance plus associated admin costs are unallowable. As for inclusion of the unallowable costs in your overhead base, the answer would be no since you compute a fringe benefit rate and apply the resulting percentage to direct labor. The unallowable costs should be excluded from the fringe benefit pool (numerator) when computing your fringe benefit rate, not excluded from the overhead base since that is a product of your direct labor costs times your fringe benefit rate.

Q. We have a staff of full time employees and are considering using a group of individuals for two contracts that will not be employees. How should we account for them for costing and billing purposes?

A. The most common methods include: (1) charging them as subcontractors applying only normal indirect rates appropriate to subcontractors or temporary labor (2) charging a portion of the billed costs as "direct labor" and then charging the remaining costs to overhead and/or fringe benefit pools and applying normal overhead and or fringe benefit rates to the direct labor for billing purposes or (3) creating a special rate to apply to the direct labor portion.

GCA REPORT P.O. Box 1235 Alamo, CA 94507 (tel) 925-362-0712 (fax) 925-362-0806 Email: gcaconsult@earthlink.net
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