GCA REPORT

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NEW DEVELOPMENTS

OMB Issues Guidance on "2 for 1" Executive Order

The Office of Management and Budget recently offered federal agencies implementation guidance on Executive Order (EO) 13771. Pres. Trump issued the EO in January to require agencies "to identify at least two existing regulations to be repealed" for every new proposed regulation. The new OMB memo, in a Q&A format, reiterated the requirement for agencies, unless prohibited by law, to (1) identify two regulations to be repealed for every new proposal (2) ensure that total incremental cost of all new regulations finalized in FY 2017 is "no greater than zero" and (3) offset any new incremental costs associated with new regulations by eliminating costs associated with at least two prior regulations. According to the memo, the offset provisions apply to both interim and final rules but not to notices of planned rulemaking. In response to early comments to this new "hot" area, the memo explains how to measure the costs and savings and provides definitions to such terms as "offset", "regulatory action" and "total incremental cost."

DCAA Issues Two Memos on Low Risk Determinations of ICPs

The Defense Contract Audit Agency has substantially reduced the number of incurred cost proposal (ICP) audits it conducts in response to criticisms over its backlog of audits. For all ICPs with an ADV of less than $250 million (auditable dollar value – dollar value of cost reimbursable or T&M contracts) DCAA reviews each ICP for adequacy and then classifies each as either high or low risk. All high risk ICPs are audited while low risk ICPs are placed in a "low risk universe" and sampled to determine audit selection (we address criteria for selection and how to minimize chances of being high risk below). Auditors are to issue a low risk audit determinations and rate agreement letters for those contractors whose ICPs are not audited.

- **Establishing Consistent Dates For Monitoring ICP Low Risk Determinations**

To end a wide variation of dates it uses to monitor its ICP data, DCAA has issued guidance to determine what is the correct date for receiving an ICP, date the sample is run and the date the contractor will be notified that an audit will not occur. To maintain consistency, auditors are told to enter the entrance conference date as the date the auditor actually begins preparing the low risk memorandum. The auditor should reach out to the contractor and contracting officer at this point to let them know they are preparing the memo and rate agreement letter (reflecting the proposed rates included in the ICPs). Once this notification is made, they are told to complete the rate letter and close out the assignment ASAP *(17-PIC-005(R).*

- **NASA is Not Accepting DCAA Low Risk Determinations**

DCAA is issuing a memo stating NASA is no longer accepting low risk determinations issued by DCAA on contractors where the preponderance of their work relates to NASA contracts. DCAA offices are told to cease issuing these low risk determinations. For authorized audits where NASA contracts are not the preponderance of the work auditors are told to coordinate with NASA to determine if there are any concerns before issuing low risk determinations. The memo reminds auditors that they should not be auditing NASA contracts unless approved by NASA *(17-PIC-005(R).*

As a reminder to our readers, the following determines what percent of contractors' low risk ICPs are selected for audit: ADV less than $1M – 0%; $1M to $50M – 5%; $50M to $100M – 10%; $100M to $250M – 20%, with mandatory audits every three years. The key is to avoid being in the high-risk pool. Risk factors include high questioned costs in the last audit (e.g. 10% of ADV for less than $1M, 5% of ADV or $100K for $1M-$5M or over $250K for $5M-$250M ADV contractors). Additional risk factors include fraud referrals, unacceptable or inadequate accounting system opinions or specific risk factors having a material impact on the ICP. Unless they enjoy having their ICPs audited, contractors should keep their risk factors low by making sure they have an

adequate accounting system, ICP are properly prepared and submitted on time and potential for significant questioned costs are minimized.

IR&D Rule Proceeds Despite Vigorous Industry Opposition

Traditionally, defense contractors that invested in independent research and development would be reimbursed for their outlay as long as it was of interest to the DOD. In November 2016, DOD issued a proposed rule to offset the competitive advantage of contractors with significant IR&D investments when they substantially reduce their bid prices because they rely on future IR&D costs. The rule would require contracting officers to adjust a contractor's bid price on acquisition programs, for evaluation purposes only, by the amount the contractor proposes that future IR&D costs will reduce their price. The DOD's Director of Defense Pricing, Shay Asad, states the proposed rule is progressing where there are no indications the Trump Administration is planning on rescinding the proposal. The American Bar Association is advocating DOD should withdraw or postpone the proposed rule. The ABA warns the proposed rule "runs counter" to existing IR&D law and cost principles, cost accounting standards and effectively penalizes contractors for lowering costs on contracts through their near term IR&D projects. The ABA says the rule will stifle innovation by benefitting contractors who do not invest in IR&D, would raise long term costs of acquisition programs, estimating future IR&D costs would be onerous and addresses a problem that does not exist. Industry groups are similarly challenging the proposed act.

Proposed Legislation to Expand HUBZone Eligibility

(Editor's Note. We are particularly glad to see this legislation since some of our clients take advantage of their HUBZone eligibility to win set aside contracts and subcontracts, resulting in great employment opportunities in impoverished areas.)

Rep. John Delaney (D-MA) introduced bipartisan legislation to extend the Small Business Administration's Historically Underutilized Business Zone Empowerment Contracting (HUBZone) program that would include changes to allow communities more time to use the program and adjust to potential changes in eligibility where absent new legislation, the HUBZone program will end in 2018. Sponsors of the bill state that HUBZone has made a huge difference in the communities that struggle in the economy where loss of HUBZone status currently face close to 100 counties in 25 states. The legislation would extend the redesignation period to seven years allowing greater investment in these communities and allow business and communities more time to diversity to make their transition more seamless.

Example of How a Merger and Acquisition Can Expand Opportunities in the New Federal Marketplace

An interesting case study came to our attention showing the benefits of merger activity contributing to expanded government business opportunities. Pacific Architects and Engineers (PAE) is poised for expansion at Dept. of Homeland Security and such new contract vehicles as the OASIS after its purchase of FCI Federal Inc. PAE provides aviation, infrastructure and logistics services to the federal government while FCI provides immigration and national security services. PAE with $1 billion in annual revenue is acquiring fast growing FCI which sells primarily to DHS and Departments of State and Justice. FCI has increased its federal obligations to $173 million in 2016 compared to $5.4 in 2012 where projections indicate the acquisition will add $200 million annually to PAE's federal market revenue. The acquisition will add to PAE's past performance record where FCI is a prime contract holder on the GSA's Professional Services Schedule and has subcontract experience in DHS Technical, Acquisition and Business Support Services (TAVSS) which will provide past performance credibility on the subsequent OASIS contract (that will supersede TAVSS) and the Navy's SeaPort-e contract.

DCAA Issues Annual Report to Congress

In what some commentators opine as a clever marketing tool to tout its accomplishments, DCAA has issued its annual report providing statistics on its performance. The report highlights its all important return on investment statistic of $5.7 to $1 – for every $1 of expenses, DCAA generates $5.7 of costs questioned. This statistic is used to assert not only its entire budget of $630 million is paid for but an additional amount of $2.7 billion of benefit is generated. Other highlights of the report include:

1. It has achieved its congressional mandate to become current on its incurred cost backlog to the equivalent of 18 months. The elimination of the backlog has occurred because of recent developments to reduce the number of "low risk" contractors selected to audit (see article above) and implementing multiyear audit techniques and may have been incentivized by recent calls to use independent audit firms to take over many of the audit functions reserved for DCAA.

2. DCAA reported improvements in timeliness of its audits. Forward pricing (bid proposals and forward pricing rate proposals) improved to 66 days from 110 days in 2012 (measured from the date the proposal or a request to audit was received and the date of the audit report). It should be noted that DCAA has changed the start time for measurement of elapsed time for incurred cost proposals from the day the proposal was received to the entrance conference date.

3. DCAA highlights its success with preaward audits both in timeliness and number of accounting systems deemed acceptable which is a prerequisite for awards of cost type contracts. In comparison with 120 days in 2012, DCAA has closed that period to 60 days. DCAA attributes its increase in the number of contractors' systems deemed adequate to its outreach program to small contractors while some commentators attribute the increase to changes in its audit scope and pass/fail criteria for preaward audits.

4. DCAA notes it is increasing the number of system audits it is responsible for – accounting, estimating and material management accounting system (MMAS) audits. It should be noted that the number of audit reports issued in 2016 (21 with 15 planned in 2017) indicates the audits are not accomplished very quickly.

Commentators indicate that the freeing up of some resources will result in increases in defective pricing and systems audits.

Blacklisting Provisions Proceed

The Senate is moving closer to block certain parts of President Obama's Fair Pay and Safe Workplaces executive order No. 13673 dubbed by business groups as the "Blacklisting" provision. One part of the provision that seems headed for rescission would require contractors bidding on new contracts worth $500,000 or more to disclose labor and employment law violations and require CO to consider this information when evaluating bids. However, another part of the provision is still very much alive which requires contractors performing on these contracts to provide wage statements to certain employees detailing their total and overtime hours, pay rates, gross wage and itemized deductions. Some commentators are saying though the self-reporting rule has been rescinded, requirements to comply with a whole assortment fair pay, safety and federal and state employment laws and regulations are "still in play." Actions with unfavorable outcomes like Dept. of Labor administrative findings and settlements or OSHA findings can still be considered by contracting officers in award selections.

Bills are Introduced to Repeal David Bacon Act

Anticipating major infrastructure spending, Congress is initiating several bills to repeal the Davis-Bacon Act's prevailing wage requirements. The Davis Bacon Act requires certain federal contractors to pay labor at least a wage the Department of Labor determines corresponds to similar work in the state where the contract is performed. Sen. Mike Lee and Rep. Steve King in their repeal acts state the prevailing wages are not set by market forces but rather "federal bureaucrats" where repeal will allow contractors to hire more workers of all skill levels while lowering costs of covered contracts. Another proposed bill – the TIRE Act - argues prevailing wages are based on complex surveys disproportionately represented by labor unions where repeal would mean government tax dollars would go to "projects and jobs, not to overpriced union labor contracts."

Midsize Companies Being Squeezed Out of US IT and Logistics Contracts

Two of the federal government's most important contracts – the GSA Alliant Large Business and OASIS unrestricted - are squeezing out mid-tier companies. Too big to quality for small business preferences and lacking resources to compete with large contractors, companies with $25 million to $500 million in annual contract revenue are finding themselves in no man's land. Though mid-tier firms are big players on many multiple award contracts, only 22 active mid-tier companies won 10.7% of Alliant LB contracts (to be supplanted by the $50 billion Alliant 2 LB contract to be awarded this year) and 7.6% on OASIS Unrestricted. One interpretation of the poor showing is the GSA self-scoring methods of measuring past performance to award slots on these contracts have extensive security and certification requirements that many such firms lack.

DOD Seeks Feedback on its Draft Commercial Item Guidance

The Undersecretary of Defense Acquisition, Technology and Logistics is seeking comments on its draft two volume Guidebook for Acquiring Commercial Items. Though the guidance is intended for procurement specialists who might be involved with contractors who offer commercial items or are planning to do so (we are very interested since we work with clients who offer commercial item pricing) others may also benefit. The first volume focuses on commercial item determinations, including use of prior determinations, acquisition of commercially available off-the-shelf items and treatment of supplies and services of

nontraditional defense contractors as commercial items. The second volume covers pricing of commercial items including market research, the prohibition on obtaining certified cost and pricing data, price analysis, services price analysis and preparing for price negotiations.

Federal Spending on Professional Services Buck Cost Cutting Trends

Despite forecasts for declines in government spending in an environment of budget cuts, spending for logistics, supply chain management, accounting and other professional services rose for the second straight year in 2016. Professional services have been the government's second largest market accounting for 16 percent of annual spending. The largest category include management advisory services and non-IT technical and engineering services. The contract vehicles to be used by the Office of Management Budget and General Services Administration are expected to include the GSA's Professional Services Schedule, One Acquisition Solution for Integrated Services (OASIS), Alliant 2, the Navy's SeaPort-e, GSA's new Human Capital and Training Solutions (NCATS) and the Army's Responsive Strategic Sourcing for Services (RS3).

CASES AND DECISIONS

Board Cannot Order a Past Performance Evaluation Revision

CompuCraft sought an injunction with the board to a negative evaluation in the Contractor Performance Reporting System (CPARS). The Appeals Board joined other courts and boards ruling it did not have jurisdiction to order an agency to alter its evaluation even when, as in this case, the contractor has standing to sue the government based on a substantive allegation it acted "arbitrarily and capriciously" in assigning an inaccurate and unfair performance evaluation.

Commentators on the case state that it is the contractor, not the courts, who can change a CPARS evaluation. When a CPARS rating is issued contractors have 14 calendar days to rebut statements and add information (FAR 42.1503(d). The best practice is to (1) closely examine the contracting records to support a detailed written explanation of what the CPARS author may have overlooked or failed to consider and (2) reach out to the CO to see if they will meet to discuss the performance evaluation and consider a revision to a more favorable review. Such a meeting often works but even if it does not the evaluation must include the contractor's written response as part of the evaluation in the CPARS *(CompuCraft v GSA, CBCA No. 5516).*

Transfers Between Subsidiaries On Cost Type Contracts May be Made at Catalog Price

ATS worked on a cost plus training contract where under two prior contracts its Logistics subsidiary provided training materials and equipment at catalog prices and on this contract Logistics transferred the materials at its catalog price and ATS billed the government at that price. DCAA questioned the difference between the price amount it charged the government and the cost basis of the transfer asserting that under a cost type contract it must charge the government at cost. The contracting officer sided with DCAA asserting even though ATS proposed the material and equipment at catalog prices it could not overcome the CPFF terms. In addition, the CO said ATS did not qualify for the exemption in FAR 31.205-26(e) that allows material transferred between divisions to be billed at price if it is the practice of the transferring division to price such transfers at other than cost because the transfers lacked "economic substance." The Board rejected the government's position ruling the cost principle does not require or even mention transfers to have economic substance and the government failed to show that the transfers at price were not the sort of transfers contemplated by FAR 31.205-26. ATS employees credibly testified that it was Logistics practice to consistently transfer its training materials and equipment at its catalog price to its subsidiaries and hence the Board ruled they satisfied the FAR cost principle *(A-T Solutions, ASBCA No. 59338.)*

Historical Data Is Not Per Se Sufficient For a Reasonable Estimate of Requirements

In its firm fixed price requirements contract to provide anticipated materials and equipment as troops withdrew from Iraq and Afghanistan, Agility sought an equitable price adjustment when it incurred increased costs over those estimated by the government. A lower court ruled against Agility asserting the government had provided objective, historical data from which the offerors could extrapolate future needs. A higher court disagreed saying the government did provide a negligent estimate of its needs and that the lower court failed to consider a solicitation amendment chart that erroneously projected stable and even decreasing needs. It stated that the provision of objective, historical data did not end the inquiry as to whether its estimate was negligent ruling that providing an offeror with historical data was not

reasonable per se. Here the contractor provided the court a government memo anticipating a surge in its material and equipment leading the higher court to rule it should have used this information to estimate its needs. It concluded that because the government anticipated a higher workload simply providing historical data did not constitute the most current available information to provide a realistic estimate as required under FAR 16.503 *(Agility Defense & Government Services Inc. v U.S., CAFC 61 CCF).*

Relator Failed to Prove Materiality in Implied Certification Case

The contract required KBR to provide a range of services in Iraq including morale, health and recreation (MHR) services. In a qui tam action, a former employee of the contractor (called a relator) alleged KBR inflated headcount data on number of soldiers using the MHR and failed to keep accurate records to support its costs. The district court ruled in favor of KBR asserting there was nothing "unreasonable or inherently false" in its method of accounting for usage of the MHR services and the relator provided no evidence that the alleged headcount practices were material to the government's payment decisions. It ruled absent a connection between headcount and cost determinations, "it is difficult to imagine how the maintenance of false headcounts would be relevant much less material to the government's intention to pay KBR." The case is receiving much attention in the light of the recent Supreme Court *Universal Health Svcs.* case addressing the implied certification theory that make a defendant liable if it makes representations in submitting a claim but omits its violations of statutory, regulatory or contract requirements. To establish liability the case said a relator must prove the compliance with those requirements is material to the government's decision to pay where the standard of materiality is evolving *(McBride v Halliburton Co. WL 655439).*

NEW/SMALL CONTRACTORS

Basics of Uncompensated Overtime

Many of our readers are telling us that DCAA is scrutinizing their uncompensated overtime practices more than ever. Maybe less ICP audits and more invoicing and accounting system audits are generating this or recent executive orders now on hold are reducing the number of exempt employees. Since this increased attention plus the fact there have been some changes since we last wrote about it, we thought it would be a good idea to address this area now.

Definition. Under the Fair Labor Standards Act overtime must be paid to hourly employees whenever they work more than 40 hours in a week but not to salaried executive, administrative or professional employees even though they often work more than forty hours per week. The Act refers to hourly employees as "non-exempt" and salaried employees (those not paid overtime) as "exempt. Uncompensated overtime (UOT) then refers to the work exempt employees perform above and beyond forty hours per week.

Worry About "Gaming." Both the government and contractors competing for awards have reason to be concerned. The government has long been worried that improper treatment of uncompensated overtime provides the potential for "gaming" the system. Let's consider an exempt employee who earns $1,000 per week and worked 50% of their time on cost type federal contracts and 50% on commercial work. During a normal 40-hour workweek the exempt employee would likely charge $25 per hour to both projects ($1,000 divided by 40 hours equals $25 per hour).

Now consider the same exempt employee who works 50 hours during the week, 25 hours on the cost type job and 25 hours on the commercial job. The contractor may intentionally or unintentionally charge the same $25 per hour to both jobs resulting in $1,250 being allocated to direct projects while the exempt employee receives only $1,000. Alternatively, if the contractor charges only eight hours per day to projects no matter how many hours its employees work, the firm may allocate all five hours worked to the cost type contract and only three hours to the commercial contract.

Contractors also need to be concerned if some of its competitors are likely to have their employees work ten hours per day and hence bid and pay them at $20 per hour. Your firm may need to match this ten hours or continue the eight-hour day and either lower benefits or risk offering a higher non-competitive price.

"Forty-Hour" Versus "Total Time Approach." Numerous companies require their employees to record a maximum of eight hours per day or forty hours per week. Such "forty hour" companies have employees charge only the first 8 hours to jobs or indirect functions while others permit exempt employees to select where to assign their 8 hours. Alternatively, "total time" companies have their employee identify all hours worked and assign these hours to all cost objectives (e.g. contracts, tasks, etc.) or indirect functions.

Responding to the first "gaming" potential of allocating more costs to projects than employees are paid, many government bodies have called for mandatory total time reporting. Responding to the second "gaming" potential of evaluating offerors' hourly rates using different UOT computations that may result in overworking employees and hence incurring performance risk, other government bodies have called for explicitly divulging UOT practices.

DCAA Guidance. In practice, it is generally the determinations of the Defense Contract Audit Agency that determine whether "the government" accepts or rejects the contractor's handling of uncompensated overtime in both bidding and costing circumstances. It is important to understand DCAA's guidance because (1) it is, by far, the most comprehensive and (2) is, by default, the primary basis of determining proper treatment of UOT.

DCAA's Contract Audit Manual (DCAM) Part 6-410 addresses UOT. Its stated goal is to determine (1) whether a contractor accounts for all hours worked and if not, whether the government materially suffers (2) whether the contractor is allocating an "equitable share" of labor costs to government contracts (e.g. is not "gaming" the system) and (3) whether all work such as UOT is included in the base for purposes of calculating indirect cost rates.

Though some agencies have advocated it, DCAA, surprisingly, does not require total time reporting unless there is a "material" inequity from the contractor's failure to record total time. DCAM instructs its auditors to request a copy of the contractor's policy addressing UOT and make sure that that the contractor's method of bidding UOT is consistent with the way it accounts for UOT. If the contractor records only forty hours per week, the auditor is to conduct a floorcheck and/or interview exempt employees to determine whether they work more than 40 hours. If there is UOT, the auditor is to suggest that full time recording is preferable. If the contractor refuses, the auditor is then encouraged to expand the floorcheck/interviews to determine whether the failure to record all hours results in a "material" difference in cost allocations to contracts. In practice, we have observed that DCAA will not go through an analysis of whether the absence of total time recording is needed – they will often state a contractor should adopt the total time method if UOT hours is more than a trivial amount. If they determine that the absence of total time reporting results in material overcharging the government, auditors are told to cite contractors for noncompliance with FAR 31.201-4 and when covered by cost accounting standards, also CAS 418.

DCAA recommends three acceptable accounting methods for the treatment of UOT:

Method 1. *Calculate an average rate (sometimes called effective rate) for each pay period, based on salary paid divided by total hours worked and allocate costs to cost objectives based on that calculated rate.* In the example cited above, if the pay period was bi-weekly and the exempt employee worked 100 hours rather than the standard 80 hours, the rate to be applied to each hour worked would be $20 ($2,000 salary/100 hours).

Method 2. *Assign the total hours on a pro rata basis to all cost objectives worked during the pay period.* In the example, the 25 hours worked on the government contract (50%) and the 25 hours worked on the commercial contract (50%) would result in applying the same percentages of salary to the respective contracts (50% of $1,000 salary or $500 to each contract).

Method 3. *Allocate costs using an estimated annual rate and credit any variance to an indirect account.* In our example, if the contractor expects the exempt employee to work 2,600 hours then his hourly rate will be $20 ($52,000 divided by 2,600 hours). If actual hours vary, then the difference is added to the indirect pool if less than 2,600 hours and deducted if more than 2,600 hours.

Two variations are sometimes accepted by DCAA under certain circumstances:

Alternative Method 1. *Allocate employee's hourly rate on a standard week and credit the indirect cost pool for excess hours at the same rate.* In our example, charge all cost objectives at $25 per hour and if the standard workweek is exceeded, credit the indirect account for each hour exceeded times the same $25 per hour.

Alternative Method 2. *As a variation of Method 2 above, determine a pro rata allocation of hours worked each day and distribute the daily salary using the pro rata allocation.* In our example, if the exempt employee worked 5 hours on a government contract and 5 hours on a commercial contract today, their $200 daily salary would be apportioned 50% to each contract for that day.

In practice, DCAA's reaction to these two alternative methods vary widely. We sometimes see complete acceptance of Alternative Method 1 while other auditors adamantly reject its use at similar type contractors, insisting on adoption of one of the three "acceptable" methods to avoid being cited for noncompliance. Sometimes one of the alternative methods are eventually accepted after DCAA determines a lack of materiality, allocations of the "credit" to all contracts is not distortive

or negotiations have demonstrated the difficulty and high cost of implementing one of the "acceptable" methods.

If UOT is material or you plan to bid on competitions where you or others are likely to compute rates based on UOT, then it is a good idea to adopt total time reporting and one of DCAA's suggested approaches. If not, you should decide on a how you will record the eight hours (e.g. first 8 hours, last 8 hours, 9-5 hours) and commit them to writing so a method is established and implemented.

Recent Changes

On January 29, 2015 FAR 52.237-10 was revised to provide additional explicit requirements over UOT. Prior to the change for contracts issued before March 2015, the provision *implicitly* required that disclosure of accounting for UOT be required only if the proposal included estimated UOT hours. This was considered only a solicitation requirement and was not pulled into the contract awarded where there was no regulation stating that UOT must be accounted for. The change *explicitly* requires the disclosure of accounting for UOT on all contracts awarded after March 2, 2015. The formerly defined average UOT rate now became known as "an adjusted hourly rate" which was defined as multiplying the hourly rate for a 40-hour workweek by 40 and then dividing the result by the proposed hours per week. For example, 45 hours proposed on a 40-hour workweek rate of $20 per hour would be $17.78 per hour ($20 X 40 divided by 45). A new provision required application of the new adjusted hourly rate to all proposed hours, whether they be regular or overtime. This requirement applies to all exempt employees at both the prime and subcontract level and includes UOT hours that are in indirect cost pools for normally direct labor employees. Though agencies have long looked suspiciously at proposals that bid excessively low rates resulting from use of UOT, the new provision made this concern explicit making proposals with unrealistically low labor rates or that do not otherwise demonstrate cost realism to be considered in a risk assessment and will be evaluated for award considering that assessment. As for DCAA guidance following the changes, there has been no changes to the DCAA Contract Audit Manual.

QUESTIONS & ANSWERS

Q. Our proposal is being evaluated and our project manager has suffered a career ending sickness. We have a replacement who is at least as qualified if not more so but we are wondering whether to notify the government and risk losing the contract.

A. The risks of loosing the contract are too high not to notify the CO. If you either fail to notify the agency of the replacement or they simply award you the contract without any discussions it is quite likely another bidder would protest the award where most attorneys agree that under current case law the protester would win. Under that case law, if a key personnel (e.g. someone whose resume must be submitted and evaluated by he agency) departs after proposal submission but before award the awardee is required to disclose the departure where then it either must deem the proposal unacceptable for failing to meet a material requirement or permit the offeror (and others) to rectify the departure by opening discussions. Tara Wood and Richard O'Keeffe of Wiley Rein in a Feb. 14th article in the Federal Contract Report prescribe the following. Identify a replacement of at least equal qualifications and notify the CO of their departure as quickly as possible. If discussions are ongoing and no final proposal revisions (FPR) have been submitted this is the best scenario and the departure should be discussed and identified in the FPR. If discussions are closed when notifying the agency of the departure you should request the opportunity to modify the FPR further to remedy the departure. Though the agency need not reopen discussions you should do your best to seek a narrow revision. Also, you need to be prepared to respond to assertions of "bait and switch" – relying on people it knows it will not use. The key is to always be prepared to replace and respond quickly.

Q. Though we have had our accounting system audited and have received an "adequate" opinion we often see other words, mostly in solicitations, like do we have an "acceptable" or "approved" system. Is there a difference?

A. This confusion is quite common and we were glad to see a blog by the Redstone group addressing this issue which we agree with and will form the basis of our response here. To the uninitiated there would appear to be little difference in the adjectives – "adequate", "acceptable" or "approved." The question does one of the opinions allow you do "self-certify" one of the other opinions? The answer is usually no.

There really is a hierarchy of status of your accounting system. On the first level is "adequate" accounting system. This is usually associated with a preaward or post award review of your system which is required for performing a cost reimbursable contract (FAR 16.301-3(a)(3). If you pass it, you then have an adequate accounting system which is usually referenced in audit

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reports and occasionally is elevated to a letter from the CO "approving" your system. The second level is an "acceptable" accounting system which follows one of the business system audits DCAA conducts, mostly with large contractors (DFARS 252.242-7005 and 7005). These audits are significantly more involved with far greater transaction testing, effort and time than of the preaward audits. The higher number of areas looked at runs the higher risks of finding deficiencies. The third level is "approved" accounting system. Unlike the other two, there is little guidance on how one gets an "approved" ratings. Rather, according to DFARS 252-242-7005/6 there is explicit reference to a "disapproved" system following a systems audit. However, DCMA's Instruction 13 does describe the process of approving or disapproving an accounting system which states a CO may issue a letter notifying the contractor the system is approved if no significant deficiencies in a business system audit is found. The bottom line is there are hundreds if not thousands of contractors with adequate accounting systems but very few with approved systems.

Q. We have been preparing several proposals this year and I want to make sure I am accurately accounting for these bid and proposal costs. I'm confused on what indirect rates should be applied. What do the regulations say?

A. B&P costs, like IR&D costs, usually have overhead applied to the labor part. This is because in computing your overhead rate, you are required to include direct labor as well as B&P labor in the base. However, B&P costs are normally included as one of the components of your G&A pool so there is no G&A applicable. FAR 31.205-18 addresses allowability of B&P costs where it states the method of computing it must be consistent with almost all elements of CAS 420 whether or not your contracts are covered by CAS. In CAS 420-40(b) it states that B&P costs should consist of all costs except G&A and CAS 420-50(a) states overhead costs should be applied.

Q. We currently maintain a very simple rate structure and use TCI to allocate G&A. If we were to acquire another small contractor, would we simply apply our rate structure to them as well? What would happen on their contracts which they had bid using their own structure such as a value added method? Also, if the acquired company remains a separate entity, would we be required to allocate our G&A costs to them somehow.

A. There are two common options when acquiring a company (especially a smaller one you are describing): (1) merge them into your company and use your indirect rate structure, adding the new company's costs into the pools and bases or (2) keep the small company separate and they will use their own structure. If you take the first approach, it would be considered an accounting change for the acquired company and they would need to go through the accounting change process. As for G&A allocation, you would probably need to allocate it as a home office allocation if the new company benefits. However, if you claim it does not receive benefit from the parent company and they have their own staff that provides the benefits then you can argue no allocation of the parent's costs need to be allocated.

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