GCA Report

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NEW DEVELOPMENTS

House Panels Addresses DCAA Backlog

Testimony by DCAA Director Anita Bales to the House Armed Services Subcommittee states the backlog of incurred cost submittal audits has been shrinking by 4,000 a year where the remaining backlog is 4,677. Though she expected the backlog to end by 2018 recent hiring freezes puts that goal in jeopardy. Bales said that multiyear audits have reduced audit time by 40 percent and using low risk sampling has closed over 14,000 incurred cost years without an audit. Bales also cited the 2016 return on investment of 5.7 to 1 in "actual benefits and dollars that don't go out on contract or money we get back." Industry representatives urged the committee to use third party auditors for incurred cost and business system audits to eliminate the audit backlog stating audit activities are not inherently government functions. Bales responded that use of independent CPAs to provide more efficiency is mistaken since they audit financial statements in accordance with generally accepted accounting principles while incurred cost audits review for compliance with FAR and CAS and that contractors are very concerned about who sees their proprietary data.

Trump Revokes Fair Pay Executive Order

Pres. Trump finally revoked the Obama Executive order 13782 which rescinded recent FAR amendments requiring contractors to disclose recent violations of labor laws and regulations. Many industry organizations are praising the action for removing "an unfair and onerous burden" which critics have said would have "blacklisted" contractors *(Fed. Reg. 15607).*

Bait and Switch Protests May Increase After Paradigm Decision

A GAO report states contractors may file "bait and switch" protests if a competing company promises to use a key employee and the that person leaves for greener pastures and the agency awards the contract to that company anyway. The report says it may be easier to protest bait and switch following a recent decision in *Paradigm Tech. Inc.* In the Paradigm case the GAO sided with the protester saying the employee's departure meant the awardee no longer satisfied a material contract requirement where the GAO recommended the agency either reject the awardee's proposal or reopen discussions, receive revised proposals and make a new selection. The GAO report stated the ruling did not demand that a protester show the awardee materially misrepresented itself where the development could lead to more successful protests if more offerors are found unable to follow through on their proposal promises.

The traditional bait-and-switch protest test has three elements to satisfy *(CACI Tech):* (1) an awardee either knowingly and negligently represented that it would rely on specific personnel that it did not expect to furnish during contract performance (2) the misrepresentation was relied upon by the agency and (3) the agency's reliance on the misrepresentation had a material effect on the evaluation results. The Paradigm decision arguably made it easier for protesters to challenge awards tainted by these personnel changes by taking away the material misrepresentation requirement. A subsequent case, *URS Fed. Svcs Inc.* supported the Navy's rejection of an offeror that lost a senior engineer citing Paradigm stating upon withdrawal of key personnel prior to contract award the agency must pick one of the two GAO recommendations. The URS decision said agencies can slap a "technically unacceptable" rating on the offeror who lost a key employee and move on to the next offeror.

Meanwhile Cherie Owen of Jones Day said Paradigm did not involve a traditional bait and switch because the employee in question left after the proposal was submitted where here it was not a misrepresentation at the time of proposal submission asserting a change in circumstances that make a proposal less accurate is not really a bait and switch. She says the three-part test – with the material misrepresentation requirement – still applies to bait and switch. She says that neither Paradigm or URS is about bait and switch stating for it to apply the proposal needs to be inaccurate at the time of proposal submission. The fact the proposal was accurate when submitted takes this situation out of the realm of bait and switch where it is simply another case where circumstances changed after proposal submission resulting in a proposal that though accurate when submitted no longer reflects the reality of how the contract will be performed.

The circumstances for a proposed key personnel to change jobs prior to award is very common and can have devastating consequences on a contractor who invested a lot of funds for the proposal. Attorneys cite the fact that employers have little control over the timing of key person departures. Suggested actions include incentivizing key employees to remain on the job through and beyond award. Agencies can also take steps to, for example, limit the number of key personnel they request or ask offerors to demonstrate the ability to recruit and hire trained personnel as opposed to requiring identification of specific individuals.

Contracting Opportunities Galore

With the end of the fiscal year approaching, reconfiguration of prior contracts and the high number of large procurements coming on board we thought it would be a good idea to review some of the big ones. They offer not only opportunities for prime contract work but contractors should be aware of prime awardees to be able to seek subcontract work.

According to an Army amendment released June 7 companies that did not receive Phase 1 awards for the $37.4 billion professional services contract known as Responsive Strategic Sourcing (RS3) will still be considered for Phase 2 awards which will be used to acquire services such as engineering, research, logistics, acquisition, strategic planning, education and training. Bloomberg reported that 55 of the 387 bidders who submitted bids won slots on RS3 where majors include ManTech, Booze Allen, BAE Systems and CSRA while CACI, Northrup Grumman and Raytheon, incumbent contractors, were shut out and have filed protests. The protests were filed May 26 for the IDIQ contract vehicle where it is expected to delay start of Phase 1.

The DOD has released a draft RFP for $28 billion Information Analysis Center (IAC) multiple award contract (MAC) to buy studies, complex analysis, engineering and services that generate scientific and technical information. The new IAC MAC will have at least 14 contracts across three pools – chemical and biological, large business and small business. The final RFP is schedule to be released at the end of June.

The General Services Administration is on schedule to announce awards for the $65 billion Alliant 2 and Alliant 2 Small Business government wide acquisition contracts before the end of Sept. 30, 2017. Since 2009, the predecessor contracts, Alliant and Alliant Small Business has generated $20 billion.

The pace of transition to the GSA's $50 billion Enterprise Infrastructure Solutions (EIS) contract is picking up where the GSA recently issued a request for information calling for solutions to provide network connectivity to 100 small federal agencies and 60 Native American tribes. EIS, expected to be awarded "soon" consolidates three major telecommunication contract vehicles – Network Enterprise and Universal, WITS 3 and 70 regional local service agreements.

A projected trillion-dollar price tag to upgrade, support and maintain the US's three-legged nuclear arsenal over the next 30 years is likely to be confirmed in a new assessment now underway by the Congressional Budget Office. The project was initiated by Pres. Obama and has been endorsed by Pres. Trump. Most of the money won't be spent until after 2022 and is generating significant criticism from arms control advocates and skeptics in Congress.

Many people are saying there is plenty of 2017 funds left for vendors to modernize IT, especially at the end of 2017 fiscal year. With the Omnibus-spending package in effect (see story above) agencies continue to spend at fiscal 2016 levels and find themselves with full year's funding increase to spend in only five months. Because DOD, the biggest market for IT, reports its contract spending with a 90-day lag, its spending reports will not include obligations in the last three months where it has 74% of contract spending remaining.

The Army will be releasing a final request for proposals any time for the $7 billion Softward and Systems Engineering Services Next Generation (SSES NexGen) multiple award contract to provide systems and software services, cybersecurity, infrastructure support, configuration management and program support. The Army is adding 10 small business slots as part of an on-ramp effort.

The Defense Advanced Research Project Agency (DARPA) is planning a busy summer for its 15-year $850 million technical and analytical support contract. The DARPA wide multiple award, ID/IQ contract has a base period of five years and two five year award terms to provide technical support including subject matter experts, overseeing R&D, analyzing R&D procurement and analytical support for planning, graphics and website services, supporting front office and financial, travel and executive assistance. A final RFP is coming in mid-July with proposals due in August.

The recent US-Saudi weapons deal to allow sale of $110 billion of defense equipment and related services signed May 20 is expected to be a boon for US contractors. Sales are expected in five broad categories – border security and

counterterrorism, maritime and coastal security, air force modernization, air and missile defense and cybersecurity and communications upgrades. Majors have announced memos of understanding with the Saudi government such as GE, Lockheed, Raytheon, Boeing and Jacobs Engrg.

When Do Executive Orders Affect Contract Provisions

A commentary by Ken Weckstein and Shlomo Kata of Brown Rucnick in the April 4 edition of Federal Contracts Report address the issue of when executive orders affecting labor should be considered parts of a contract. The authors point to a long history of one president issuing executive orders affecting contractors' labor that were rescinded by subsequent presidents and even reinstated by other presidents. Few presidents made greater use of the executive order power over government contractors than Pres. Obama whose orders include making unallowable costs related to exercising collective bargaining rights (EO 13495), giving employees of prior contracts right of first refusal (EO 13495), minimum wage of $10.20 (EO 13658), "Fair Pay and Safe Workplace" requirements to disclose violations of labor laws and paycheck transparency that must provide employees and subcontractors information about status (EO13673) and pay and sick leave provisions (EO 13706). Though conventional wisdom states most of these EOs are intended to be rescinded by the new administration the question remains how do they affect current contracts. For example, should contractors budget for sick leave, are unionizing activities planned, should they plan the expenses to comply with paycheck transparency or minimum wages? Answering these questions are complicated by the steps required for an executive order to become a contract requirement. When an EO is issued, an agency like the Labor Department or FAR Council must create regulations implementing the order, proposed rule must be published in the Federal Register and commented upon, final rules published and then effective dates for contracts must be considered, all of which can take months, even years. Even if an EO is rescinded, the provisions may still apply if they were included in the contract before rescission. In order to determine if an EO is part of the contract the authors recommend contractors should read their contracts and offerors should read their solicitations. Or if a burdensome provision is removed, you may need to defend against a demand for a deductive change from the original contract price.

Procurement Trends

- **Buy American Proposals Proliferate**

(Editor's Note. Many of our clients are dusting off their "Buy America" policies and flow down clauses to get back up to speed during the recent Trump Administrations emphasis on this.)

Laws requiring use of US sourced goods and services for government contracts is expected to be bolstered by an executive order issued April 18 by Pres Trump. The EO seeks to maximize US content and minimize waivers and exceptions to laws collectively known as "Buy America." US trade agreement partners, almost 60 countries, are typically given waivers to the Buy American Act of 1993 which requires federal agencies to purchase domestically produced materials on contracts exceeding a certain amount. Congress, where many Democrats voiced approval of the EO, has been introducing bills that would expand Buy America policies and laws where, for example, Buy America provisions are included in a $1 trillion infrastructure blueprint. Some former DOD officials have told congressional committees that Buy American provisions may be too restrictive where they will limit the ability to field the most capable business systems and technology *(Fed. Reg. April 18).*

- **Multiple Award Contract Increase**

A recent Bloomberg analysis found that multiple-award contracts (MACs) account for about one quarter of the $476 billion spent annually by the federal government. Several findings include: (1) MAC spending is being consolidated into fewer vehicles (2) competition at the task order level is intensifying (3) the share of spending on government wide acquisition contracts is surging, accounting for 11 percent of all MAC spending (4) the GSA Schedule 70 remains the largest MAC vehicle where IT and professional services remain the largest (5) small business spending on MACs has reached its highest level since 2012 (6) the number of task orders and average bids per task order are down and (7) more than half of all MACs had just one bid.

- **Government Seeks More Commercial Off-the-Shelf Software**

The government is on pace to have the most commercial off-the-shelf (COTS) software requirements included in procurement solicitations. The trend is a result of more government buying of software and reaction to bid protests such as Palantir Technologies which are demanding enforcement of COTS procurement rules. Building new or buying existing software is a consideration all officials must resolve. Guidelines for acquisition of commercial items in FAR Part 12 are helping the COTS market which require agencies to do market research to determine if a pre-existing commercial product meets agency needs. Also fixed price procurements are in vogue these days where such contract vehicles are used for COTS

software. Cost type contracts for most custom software is decreasing were there is a noticeable shift away from cost type software contracts affecting such contractors as Harris Corp. and SGT.

- **Federal Small Business Spending Exceeds SBA Goals**

Federal agencies have surpassed their small business procurement goal for the fourth straight year, spending $100 billon on unclassified prime contracts with small companies in 2016. The government's small business goal is set at 23 percent where agencies exceeded their statutory goals for small disadvantaged businesses and service disabled veteran-owned small businesses but fell short on goals for women-owned businesses and vendors located in Historically Underutilized Business zones. Recent reports have stressed that subcontracting with small businesses has not been as successful.

House Panel Proposing Acquisition Reforms

House Armed Services Committee Chairman Mac Thornberry's acquisition reform bill is generating attention and wide-spread accolades. The bill is intended to give members about one month to provide feedback and changes before the bill is folded into the annual National Defense Authorization Act. The Thornberry bill includes provisions to (1) allow DOD to use online, business-to-business marketplaces to buy commercial items (2) authorize DCMA to select DCAA or qualified private CPAs to perform incurred cost audits to free up more DCAA time for forward pricing audits (3) collect data on service contracts representing 53 percent of the $274 billion spent (4) enable DOD to negotiate technical data from defense contractors during the competition process – an earlier state – to obtain better prices for technical data and (5) curb the use of "bridge" contracts requiring project managers to explain while they are using bridge contracts that keep incumbents providing services to the military beyond the original period of contract performance rather than holding a new competition.

Omnibus Bill Passed

President Trump May 9 signed the omnibus appropriations bill to fund discretionary government operations for the balance of fiscal year 2017. The Consolidated Appropriations Act of 2017 complies with FY 2017 spending caps imposed by the Bipartisan Budget Act of 2015. The $1.163 trillion dollar bill provides $1.07 trillion in base discretionary spending where Trump praised the increased funding for the departments of Defense and Homeland Security and expressed concern that Congress did not "exercise fiscal restraint" to include reductions in non-defense spending to offset the higher spending elsewhere. The bill has been praised for the amount of bipartisan support that was generated to get passage and now there is less than five months left for Congress to pass bills to cover spending for 2018.

Don't Mistake Payments for Fraud Approval

There seems to be several cases being decided addressing whether government payments on a contract lets contractors off the hook when alleged misconduct is asserted. Some attorneys stress that ceaseless payments to a government contractor do not necessarily show an agency approved of or was indifferent to misconduct when asserting the False Claims Act was violated. Continued payment in the face of fraud can mean an agency (1) wants to avoid excess costs associated with terminating payments (2) lacks resources to take action against fraud (3) prioritizes the need for uninterrupted public services like health care and public safety and (4) interrupting a long running contract is not advantageous. However, some situations reach different conclusions. For example continuing to pay a contractor despite knowledge of noncompliance is "very strong evidence" that noncompliance was not material, a criteria for false claims established in the recent Supreme Court ruling in Universal Health. Some defense attorneys assert if a government agency to which an allegedly false claim was submitted makes a payment in response, it provides evidence that the company did not know and could not know the claim it submitted was false.

OMB Delays Implementing "Super Circular"

The Office of Management and Budget has delayed until Dec 25, 2017 the deadline for grantees and other federal awardees to implement procurement standards of the "Super Circular." The standards cover cost principles, small business subcontracting, bonding requirements and other administrative requirements for federal grants and financial agreements awarded to "non-federal entities." The Super circular is intended to replace most OMB Circulars affecting most entities receiving grants and other federal vehicles such as educational institutions, not-for-profits and certain commercial firms.

CASES/DECISIONS

Appeal Addresses Certain Unallowable Costs

In an appeal of a case we reported on in the past on penalties imposed on expressly unallowable costs, new rulings on the allowability of certain costs and whether those costs were expressly unallowable came to light. In the case below, it was decided that imposition of penalties was inappropriate since there was doubt about their unallowability.

Consultant Costs. Disallowance of consulting costs where penalties and interest were imposed was rejected because it was reasonable for the contractor to conclude the costs were allowable and the government did not prove they were expressly unallowable. Here the government argued that a contractor's business segment included consultant costs in its incurred cost submittals citing FAR 31.205-33(f) which requires three forms of support for the costs to be allowable: details of all agreements, invoices or billings and work product and related documentation. The contractor countered that the FAR does not require any documentation, only evidence on the nature and scope of the service provided. Though the three types of evidence listed should be provided auditor judgment is important where it should not insist on work product if other evidence is sufficient to determine the nature and scope of actual work performed. The record in this case showed the consultants were distinguished people with significant experience relevant to the work, written agreements existed, fees were reasonable and there was no evidence the fees were for illegitimate or illegal purposes. There was ample precedent that supported the holding that consulting costs were allowable when supported by other evidence even if there was no written work product. Here invoices described the work product and the contractor provided credible testimony to show the consultant's work. Comments on this case assert it is a very important decision because DCAA commonly requires all three sources of data and questions the costs if any one is missing.

Leased Aircraft Costs. The challenged costs involved fractional lease costs for aircraft used by the CEO. The appeal referred to FAR 31.001 that defines an "expressly unallowable" cost as "a particular item of type of costs which under the express provisions of an applicable law, regulation or contract is specifically named and stated to be unallowable." According to the Board no law or regulation specifically identified aircraft fractional lease costs as unallowable. While FAR 31.205-46(d) contemplates airfare costs in excess of the lowest standard coach fair and part (e)(2) gives the CO discretion to approve higher costs aircraft fractional lease costs are not expressly unallowable under the applicable cost principle.

Long Range Planning Versus Reorganization Costs. Regarding allowability of database costs, FAR 31.205-12 allows costs related to "generalized long range management planning" concerned with the future of the business while FAR 31.205-27 excludes organization and reorganization costs where the distinction between the two types of costs are unclear. Here the database was to be used both for generalize long range planning and specific mergers purposes. However, here, the company terminated design and build of the M&A application which was never used with any M&A target and hence the costs at issue were properly categorized as allowable economic and market planning costs *(Raytheon Company ASBCA No. 57743).*

Emails Complaining About Non-Payment of an Invoice Constitutes a Claim

Rover's contract was for supplying portable latrines in Afghanistan for six months start Nov. 2010. Beginning in Oct 2011 Rover sent a series of emails to the Army trying to obtain payment under the contract. At the CO's request in Nov 2012, Rover sent an invoice for payment it claimed was not made and the CO requested Rover correct a mistake in the invoice and submit along with it proof it actually performed the services and a formal narrative on company letterhead. Rover corrected and resubmitted the invoice but did not submit the requested proof or formal narrative. Rover appealed alleging its formal invoices had not been paid and the Army moved to dismiss the appeal for lack of jurisdiction arguing Rover failed to file a certified clam with the CO before filing an appeal under the Contract Disputes Act. The Board sided with Rover stating the Army's contentions failed to take into account the 24 emails submitted by Rover ruling its repeated communications with the Army converted its routine request for payment into a claim within the meaning of FAR 2.101. The Board also found that since the claim was for under $100,000 the CDA required no certification of the claim (*Rover Constr. Co., ASBA No. 60703).*

Evidence for Waiver Imposing Penalties on Expressly Unallowable Costs Must Be Submitted at Time of ICP Submittal

(Editor's Note. FAR 42.709-5(c) provides for a waiver for imposition of penalties on expressly unallowable costs when the contractor can show the inclusion of the unallowable

costs in its claims was inadvertent and that it has evidence it has relevant policies, training and a control system in place that helps ensure expressly unallowable costs are not included in ICPs. Despite this glaring exception we rarely find that such a defense against imposing penalties on expressly unallowable costs is successful. The following shows one condition required for its success.)

After the audit of its ICP the government found certain entertainment costs to be unallowable and sought penalties for the costs because they were expressly unallowable in accordance with FAR 31.205-14. Exelis argued the penalties were inappropriate since their inclusion in the ICP was "inadvertent" and that in accordance with FAR 42.709-5 it qualified for the exception to imposing penalties because it had adequate controls in place to prevent inclusion of such costs. The Board sided with the government holding the CO did not have to waive penalties for the entertainment costs because Exelis did not provide it any evidence that it had established the relevant policies, training and control system. Exelis argued unsuccessfully it was not required to submit such evidence to the CO and could instead submit it to the Board in the first instance. The Board stated that "to the cognizant officer's satisfaction" language in FAR 42.709-5 suggests a contractor must provide evidence to the CO where such evidence becomes effective only after it is presented where here the evidence was not effective until after the ICP was submitted and concluded Exelis did not have such policies and controls in place before it submitted the proposal *(Exelis, Inc. ASBCA 58966).*

High Incumbent Employee Retention Rate Not Supported by Proposed Rates

(Editor's Note. The following illustrates the need to be able to explain how proposed lower labor rates are justified to ensure proper contract performance.)

NASA awarded a cost type support services contract to Alphaport whose lower costs of $48.1 million was deemed advantageous over the incumbent contractor APT's bid of $57 million. APT protested saying Alphaport's claimed employee retention rate could not be defended. After examining salary data from salary.com and the Economic Research Institute NASA concluded Alphaport's direct labor rates were "within the average rate (in some cases slightly below average)" where APT said its low professional compensation levels raised doubts about their ability to retain a high percentage of incumbent APT employee such as engineers. The Comp. Gen. sided with APT saying only "conclusory statements" were made with no analysis or explanation was provided *(A-P-T Research Inc. Comp. Gen. Dec. B-413731).*

NEW CONTRACTORS

What Do They Mean By "Adequate Internal Controls"

DCAA auditors are focusing more of their time on reviewing contractors' accounting systems where much effort addresses "internal controls" but there is considerable confusion by contractors on what constitutes "internal controls" in government contract accounting. The increased emphasis stems partially from recent guidance established by the audit profession and specific emphasis from the government audit community. The latter stems from the fact that recent hiring freezes and otherwise decreasing resources requires more audit coverage with less people so greater productivity translates into more attention on contractors' internal controls so those with better controls generally require less labor intensive transaction testing.

DCAA occasionally issues guidance to its auditors on evaluating contractors' system of internal controls where we find it useful to recount these because it alludes to specific internal controls that will be evaluated. The most recent guidance is primarily in the form of a questionnaire - Internal Control Questionnaire or ICQ – which is be used by non-major contractors with government work between $15-$100 million where the form can be used on contractors with less work The ICQ is normally unfamiliar to contractors and is designed to help the auditor obtain an understanding of the contractor's internal controls and assess the "control risk" (auditors often ask contractors to fill out the form themselves). If the control risk is considered high, the auditor can decide to perform substantive tests of sensitive accounts and transactions or can go into more intensive testing of specific systems such as accounting, estimating, billing, etc in which there is further guidance for each system.

The ICQ is expected to be completed or updated as part of the auditors' periodic visits to the contractor and a new ICQ should be completed every year if a field visit is required as part of a current audit. The ICQ has four parts: Part A, Basic Organization provides general understanding of the contractor's organization structure, size and complexity. Parts B through D are intended to cover the five basic components prescribed by various audit standards (e.g. Yellow Book, AICPA) – control environment, contractor's risk assessment, information and communications, monitoring and accounting system control objectives and activities. In addition, completion of a FAR Cost Principle Assessment questionnaire is also included to ascertain a contractor's general screening of

unallowable costs (not discussed here but we will likely discuss screening unallowable costs in a future issue.).

The criteria for adequate controls seem to be heavily weighted on the existence of written policies and procedures. Contractors have often felt ambivalent about such written policies. Yes, their existence does establish policies for the company and "gets the word out" but their existence creates the basis for citing noncompliance when practice does not match policy. The increased emphasis on these written documents may change contractors' views.

Part B. Control Environment and Overall Accounting System. It asks:

- Are there current deficiencies identified by either external CPAs or other DCAA audits
- Are there adequate written policies and procedures addressing the general accounting system, screening unallowable costs, direct versus indirect charging practices, preparing incurred cost submittals and forward pricing proposals, allocation of indirect costs to contracts, approvals and documentation of journal entries, establishing account numbers and contract charge numbers and allocation of various credits (e.g. rebates, refunds, income)
- Are cost accounting records (e.g. job cost) reconciled and controlled by the general accounting system on a current basis i.e. postings made at least monthly.
- Are costs identified by contract

Part C. Contractor's Risk Assessment, Information and Communications and Monitoring

- *Risk assessment.* Is there a "risk assessment process" for relevant risks associated with preparing submissions to the government and are there any prior identification of risks of having noncompliant submissions
- *Information and Communication.* Are there written policies and procedures covering either manual or computerized controls over transactions and journal entries from the time they occur to the time they are included in the accounting records? Do the written policies and procedures address individual roles and responsibilities pertaining to controls over accounting information? Are the policies and procedures disseminated to employees and are there records of prior failures to implement these policies?
- *Monitoring.* Are there any ongoing monitoring procedures to ensure internal controls are followed (e.g. internal audits)?

Part D Accounting System Control, Objective and Activities

- *Labor System.* Is there a training program covering proper time charging? Are there written policies and procedures in place to identify labor documentation/ work descriptions that identify work to be performed? Are labor charges tracked to final cost objectives whether or not they are allowable or unallowable direct or indirect costs? Are there written timekeeping policies and procedures and do they reasonably assure labor hours are accurately recorded, corrections documented and proper approvals maintained?
- *Materials/Purchasing.* Does the contractor maintain written policies and procedures to describe the major manual or automated systems that cover the material management and accounting system?
- *Estimating.* Are there written estimating policies and procedures addressing employee training, assignment of authority and responsibility, cost estimate development and estimating system process, activity and functions.
- *Billing.* Do written billing policies exist addressing employee training, contract briefing to identify special billing provisions and limitations and management review of billings.
- *Planning/Budgeting.* Do written policies and procedures covering planning and budgeting exist which should include formal assignment of duties and description of the processes.
- *Compensation.* Do written compensation policies and procedures exist that address salary structure and administration, description of fringe benefits provided and a system for determining pay increases, bonuses and promotions?

QUESTION & ANSWERS

Q. We are a systems engineering, professional services firm and are considering breaking up our overhead rate into separate rates – one for fringe benefits and one for non-fringe benefit overhead costs. Is this common and are there any benefits for doing so?

A. Yes it is quite common to have a fringe benefit and overhead rate. As for benefits, it depends. For example, if the fringe benefits for direct labor "follow" the direct labor (i.e. are charged directly to the benefiting contract) then your direct charges may be higher and your overhead rate would be lower. Your customers may or may not like the changes depending on who gets charged the higher direct costs or who gets the benefit of the lower indirect rate.

Q. We accrue for our estimated state income taxes in the current year and I intended to reflect the accrual in both our incurred cost submittal and forward pricing rates.

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Our controller said the income taxes are unallowable. Who is right?

A. You and your controller are both right, or wrong, depending how you look at it. State income taxes, as opposed to federal income taxes, are allowable according to FAR 31.205-41, Taxes. Claiming the accrued taxes (that is, the estimated amount) on your incurred cost proposal would be improper – you need to include the *actual* taxes paid. For the forward pricing proposal, estimated taxes should be acceptable since forward pricing rates are primarily estimates of future expenses.

Q. We are hearing we need to be prepared to pass a contractors purchasing system review in order to receive any more contracts. We purchase approximately $70 million worth of material and supplies. Do we qualify for one of these reviews?

A. The Defense Contract Management Agency has dedicated special teams that conduct these reviews (one of our associates was a member of one of these teams). The threshold for conducting CPSRs occasionally changes where the most recent change was from $25 million to $50 million in purchases so it seems like you qualify. This threshold can be lowered if DCMA determines the risk level justifies a review (one of our clients met the old threshold of $10 million and has been told they are due for a review). There are numerous practices and policies that need to be in place (the famous 29 elements identified in DFARS 252-244-7001, additional ones that specific CPSR teams like to focus on) and you may want to consider having someone do a "mock" audit to determine whether you are likely to pass a review.

Q. I live about 300 miles from Denver and always fly in and out of Denver when flying home. I have two business trips planned with a few days in between and rather than flying home I was wondering if I can fly to Denver and stay there a few days before heading out on my next trip. What do the travel regulations say about this?

A. There have been a few appeals we have written about in the DIGEST that address your situation where it appears that you can charge the government for the Denver stay (hotel and per diem) as long as the savings of not flying home exceeds costs of the Denver stay.

Q. Our RFP says we need to have a compliant accounting system but our system has never been audited. What can we do?

A. It would be nice to be able to simply call your local DCAA office to conduct one but that is almost impossible. Usually the RFP is silent as to who must conduct the review so if that is the case you can hire a CPA to do so. (Make sure the CPA has experience with government contracts since audits of financial statements require different experience and knowledge where we are seeing considerable "creativity" in their opinions.) If the RFP states DCAA must assess the system, you have to contact the CO to request an audit realizing that an unaudited system is considered to be an inadequate system. Whether they are conducted by a CPA or DCAA, we are seeing a proliferation of audit opinions saying contractors' accounting systems are inadequate so we recommend having an experienced consultant conduct an abbreviated "mock" audit of your practices to avoid an "inadequate" opinion when the auditors come to town.

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