GCA Report

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NEW DEVELOPMENTS

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

The Treasury Secretary has set a rate of 2.375% for the period July through December 2017. The new rate is a decrease from the 2.50% rate applicable to the first six months of 2017. 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).

Thornberry Introduces Bills to Change IT and Online Purchases

House Armed Services Committee Chairman Max Thornberry introduced a bill to be folded into the 2018 National Defense Authorization Act to improve how the Pentagon handles intellectual property (IP) and data rights. It instructs acquisition officials to consider what data will be needed to maintain a program and if it is needed, to negotiate rights to it early in the procurement process. Many contracts lawyers are saying that securing IP and data rights before a contract is awarded will save taxpayers money because the best time to secure these rights is when firms are competing for contracts when they might even be inclined to offer the rights for free rather than waiting, say until year five, after it was awarded when the pricing for such rights will be much higher. Data rights have traditionally fallen into three broad categories – limited/ restricted use rights, government use rights and unlimited use rights where the change is expected to create a more "nuanced approach."

In a separate move, Thornberrry introduced another bill to be folded into the 2018 NDAA to buy certain commercial items from online marketplaces such as Amazon.com business portal, W.W. Grainger or Office Depot. Thornberry said that all parts of the government will get a better deal when the buying community is bigger than DOD for items exceeding the current $5,000 micropurchase threshold.

New Opportunities

(Editor's Note. We present this information to point to many subcontracting opportunities.)

Companies that did not receive Phase 1 awards for the Army's $37.4 billion professional services contract known as Responsive Strategic Sourcing (RS3) will still be considered for Phase 2 award. Predecessor contract work was reported under NAICS codes 541330 (Engineering Services) and 541712 (R&D in Physical, Engineering and Life Sciences – Not Biotechnology) where now RS3's technical requirements will span 225 functional categories divided across four broad submarkets – Engineering Services, Logistics Services, RDT&E and Acquisition and Strategic Planning. Though all agencies can use the contract, those with significant security work will be the primary users. Bloomberg reported that 55 of the 387 companies that did submit bids won slots on RS3 which included such major companies as ManTech International, Booze Allen, BAE Systems and CSRA while some incumbent contractors did not receive Phase 1 awards such as CACI, Northrup Grumman and Raytheon. The amendment, issued June 7, will give 332 companies that were not included in the first round a chance to win an RS3 slot. Three other major engineering and R&D focused vehicles will be competing with RS3 for these services – SeaPort-e (ending in 2019), GSA's OASIS and OASIS SB and GSA's Professional Services Schedule.

DOD is scheduled to start fiscal year 2018 with an Oct. 3 final RFP for $28 billion Information Analysis Center multiple award contracts. The Pentagon will use the IAC MAC to procure studies, complex analyses, engineering and services that generate scientific and technical information. The IAC will combine work that was previously performed on three separate MACs – Cyber Security Technical Area Tasks (CS TATS), Defense Systems Area Tasks (DS TATS) and Homeland Defense and Security Area Tasks (HD TATS). Unlike these predecessor contracts, the IAC MAC is expected to

provide its contract holders significantly more revenue by using it to meet the Pentagon's command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR) requirements which represent about $13 billion of annual spending.

Ten vendors were awarded positions on the GSA's $50 billion, 15 year Enterprise Infrastructure Solutions (EIS) multiple award contract. The award is for GSA's Network Services 2020 strategy to provide "one stop shop" for upgrading their telecommunications infrastructure. Four incumbents are AT&T, Verizon, CenturyLink and Level 3 Communications. The six additional EIS contracts went to BT Federal, Core Technologies, Granite Telecommunications, Harris Corp., Manhattan Telecommunications and MicroTech. EIS replaces several predecessor contracts.

The Army's Redstone Arsenal in Huntsville, AL will shift work currently performed on 15 expiring small business engineering task orders under the System Engineering and Technical Assistance Contract (SETAC10) worth more than $200 million to the General Services Administration's One Acquisition Solution for Integrated Services – Small Business (GSA OASIS SB) contract vehicle. SETAC10 was awarded in 2013 to nine vendors who have received $474 million from the Army where 14 out of 15 task orders, worth $212 million will expire by Dec 20 where the transition to OASIS SB will be staggered over 18 months. OASIS SB contract holders will be in strong positions to compete for these SETAC task orders.

GAO Issues Report on Long Term TDY Lodging Costs

The General Accounting Office recently issued a report on the subject of flat rate per diem for long term temporary duty. The report is a required follow up to a 2014 DOD change to the Joint Travel Regulation that reduced locality rates payable for each full day that employees were on long term temporary duty travel (TDY) for assignments between 31-180 days. Though the JTR does not officially apply to non-government employees and FAR 31.205-46, Travel costs was not changed, commentators on this report nonetheless state it will likely be used to evaluate contractors' practices of paying employees for long term TDY, asserting the excess costs will be considered "unreasonable" in accordance with catchall FAR 31.201-3, Reasonableness, if other reasons cannot be found.

Contractor Group Puts Forth Advice in Case of a Shutdown

Federal contractors are being told to keep one thought in mind should the government shut down in coming months – keep working unless told not to by your CO. The Professional Services Council would not estimate chances for a shutdown (others have put it at 10-20 percent) but contractors need to prepare in several ways. Comments include (1) each agency has their own shut down rules and rules for whether work is halted are decided on a program-by-program basis (2) contract funds can be made available if the president determines that national security is at stake or when a program is funded through a multi-year source (3) COs play a key role who are conduits of information and work closely with other COs where though offices, databases and email will be shut down they can provide contractors with timetable information and permissible activities (4) advice to contractors include (a) if "stop work" orders are issued employees and subcontractors need to be quickly informed (b) contractors should keep a detailed account of changes that are required due to the work stoppages and (c) should mitigate harm to employees, furloughing them only as a last resort where first they should be reassigned to different projects if possible, provide training or encourage use of their vacation time.

Legislation to Approve HUBZone and Women Owned Small Business Improvements

August 2, the Senate Committee on Small Business and Entrepreneurship approved bipartisan bills to (a) require the SBA to develop new cybersecurity training programs for small businesses (b) increase the amount of time that a geographic area may keep its status as an Historically Underutilized Business Zone (c) allow state governors to petition the SBA for the creation of new HUBZones and (d) direct the SBA to study the participation of women-owned and other designated small businesses in federal multiple award contracts. The HUBZone changes would let governors create HUBZons in places where the unemployment rate is 120 percent of the national average, require the SBA to act on HUBZone applications within 60 days and lower the threshold of employees who must live in a HUBZone to 33 percent and increase from three to seven years the length of time a geographic area may retain HUBZone status after it no longer meets eligibility criteria. The focus on HUBZones and WOSB is because HUBZone awards in 2016 were only 1.67 percent compared to a requirement to award 3 percent and WOSB firms had a 21 percent lower chance of winning a federal contract and are less likely to be awarded contracts according to a Dept. of Commerce study.

Legislation Seeks to Limit Use of LPTA Procedures Government Wide

A recent legislation proposal would restrict civilian agencies from using lowest-priced, technically acceptable

(LPTA) source selection procedures to noncomplex procurements and commodity purchases. LPTA has had a controversial history where for several years agency and congressional policy statements have encouraged them to limit use of LPTA procedures while DOD has praised its use asserting it can reduce costs and provide streamlined, simplified procedures. Considerable objections by industry groups criticized use of the LPTA procedures as constituting a "race to the bottom" on price and innovation where they may be appropriate for commodities purchases but not for best value procurements of "knowledge based or other types of professional services." Subsequent DOD memos have stated LPTA is appropriate only when there are well defined requirements, risk of contract nonperformance is minimal, price is a significant factor in source selection and there is neither value, need nor willingness to pay for higher performance while the 2017 National Defense Authorization Act expanded on these memos where LPTA procedures will be avoided for procurements of IT services, cybersecurity services, systems engineering, technical assistance services, personal protective equipment, knowledge based training or logistics services in contingency operations. The recent legislative amendment by Mark Meadows (R-NC), H.R. 3019, would impose the same restrictions on civilian agencies.

Non-Traditional Contractors are Still Wary of Selling to DOD

A new GAO report concludes that though Pentagon offers lucrative opportunities it is still having trouble appealing to companies that have not traditionally done business with it. The report stated several challenges are deterring innovative companies from contracting with the government including (1) the complexity of the DOD acquisition process where in the commercial world companies are used to communicating directly with people who have authority to discuss their needs, gauge whether their products can satisfy those needs and are awarded a contract within months (2) intellectual property rights concerns where there is worry of losing their IP rights (3) an unstable economic environment (4) government specific terms and conditions and need to establish accounting systems for certain contracts (5) long contracting timelines where it takes two years to obtain funding for major weapons systems where then protests further delay things and (6) inexperienced DOD contracting workforce. A telling example cited showed it took 25 full time employees 12 months and millions of dollars to prepare a DOD proposal compared with 3 part time employees, 2 months and only thousands of dollars to prepare a commercial proposal for a similar item. No recommendations for improvements are stated *(GAO-17-464)*.

Industrial Conglomerates Facing Demands to Go Smaller While Others Seek to Get Bigger

Top defense contractors are having different responses to increasing investors' urgings for industrial conglomerates to dismantle their companies. Honeywell, maker of cockpit controls, thermostats, catalysts for oil refineries, hand held computers and warehouse automation systems, is facing calls to divest its aerospace unit from investor Dan Loeb and General Electric is experiencing pressures from Nelson Peltz to divest and cut costs. United Technologies is sounding a different message saying it has already sold one major business while splitting off such businesses as jet engines, elevators or air conditioners will not create any value where it extracts savings and can absorb greater investment costs through its vast scale. It is, in fact, taking a different tack where it is seeking to bulk up with the acquisition of its key supplier, Rockwell Collins, resulting in creating an equipment supplier "the world has not seen before."

IDIQ Contracts Remain Popular

The General Accounting Office issued an interesting report on awarding indefinite delivery/indefinite quantity contracts from 2011 through 2015. IDIQ contracts remained steady at about one third of total contract obligations, at $130 billion annually. DOD, DHS, HHS and VA were the main users. About two thirds of government-wide IDIQ obligations were for services and a third for products. Though the FAR states a preference for multiple award IDIQs the majority of dollars, approximately 60 percent, were obligated through single source IDIQs. About 70 percent of single-award IDIQ and more than 85 percent of order obligations under multiple award contracts were competed.

Comments on the statistics include (1) reasons for extensive use of IDIQ contracts were COs noted it was easier and faster to place an order under an IDIQ than to solicit and award a separate contract as the need arose, price and technical approach can still be evaluated at time of placing an order, IDIQ contracts were easier to administer where it was more efficient to track funds and requirements of different customers through orders rather than modification to contracts, IDIQ contracts use served a broader customer base such as multiple commands, other federal agencies and foreign military sales, not needing to specify an exact quantity or timing at time of contract award allowed program managers to accommodate unforeseen needs by issuing orders and closeout of orders was much faster as each order can be closed out individually after last payment rather than

waiting until the entire contract is complete (2) reasons for lack of competition on orders included only one contractor could meet the need, a noncompetitive order was needed to satisfy a contract's minimum guarantee or there was an urgent need and (3) reason for issuing single source IDIQs were such contracts were used for interrelated tasks where there was a need to build knowledge over time. It seems like IDIQ contracts fill many needs and are here to stay *(GAO-17-329).*

FAR Class Deviation Removes Fair Pay and Safe Workplaces Final Rule

The Civilian Agency Acquisition Council (CAAC) issued a class deviation from the FAR to stop implementation of the Fair Pay and Safe Workplaces final rules. Since Congress "disapproved" of Executive Act Order 13675 signed by Pres. Obama, which required government contractors to disclose certain violations of labor laws, the FAR Council and Dept. of Labor issued proposed rules and guidance implementing the EO. According to the CAAC, many sections of the FAR rule were already enjoined by a federal district court in Texas that precluded inclusion of the FAR provisions in any solicitations or contracts where now the new class deviation applies to remaining sections of the FAR including addressing paycheck transparency requirements in the EO which were not enjoined by the court. The government has initiated a FAR Case 2017-0015 to remove all elements of the rule from the FAR as "null and void."

CASES/DECISIONS

"No Harm, No Foul" Argument Prevails

(Editor's Note. The following case provides a good challenge to questioned costs by the government for non-compliant accounting practices when those practices result in less or equal costs claimed than the compliant practices.)

From 2006-2014, for government accounting purposes, Northrup funded its post-retirement benefits (PRB) costs and charged the government using a method consistent with IRS rules. The government asserted Northrup did not compute the PRB costs in accordance with FAR 31.205-6, Compensation of personal services and Federal Accounting Standards 106 and hence questioned $253 million of these costs. For this period, Northrup actually charged the government less than what it would have using the FAS 106 methodology. The Board ruled though Northrup did violate the FAR its methodology did not result in any damage to the government and hence it was entitled to the $253 million because there was no evidence shown that its accrued costs exceeded costs it would have incurred using the compliant method. As a side note, some commentators have noted that the government specifically reviewed and approved of Northrup's accrued method every year during earlier years where this fact pattern would have supported the argument for waiver, estoppel or retroactivity but recent court changes have virtually eliminated this argument *(Northrup Grumman Corp. ASBCA No. 60190)*

Can't Recover For Tax Increases

(Editor's Note. The following case demonstrates the need to include all expected expenses to be incurred in proposing fixed price contracts.)

Sonoran's gross revenue increased by $6 million after the Air Force selected it to provide training services to F-16 crews in New Mexico and Arizona. New Mexico has a revenue based tax where the additional tax of $66K that was charged to its G&A pool was not included in its original price and it sought a price adjustment for the increased tax under the Service Contract Act price adjustment clause and the contract's changes clause. The SCA price adjustment clauses require government compensation if a new Labor Dept. wage determination increases contract costs but state gross receipts taxes are not among the list of qualifying expenses under the SCA. The Board ruled against Sonoran saying the Air Force contract doesn't entitle it to an increase in taxes assessed by New Mexico. It stated the SCA price adjustment clause did not entitle Sonoran to compensation because it does not cover general and administrative expenses nor under the changes clause which provides adjustments only if a change causes an increase in performance *(Sonoran Technology and Professional Svcs., ASBCA Nos. 61040).*

Commercial Item Termination Clause Governs what Termination Costs are Recoverable

(Editor's Note. The following illustrates what costs are allowable under a termination settlement for commercial items.)

ESC worked on a 2008 contract to provide software services to DOD and won a follow-on commercial item contract in 2012. The contract included the termination clause for commercial items (FAR 52.212-4) and inadvertently included the standard termination clause for non-commercial items (FAR 52.249-2). Though the government seeks to make contractors whole under all terminations the commercial items clause makes recovery essentially price based while the standard clause is cost based where they also differ on government audit

rights, use of a contractor's record keeping system and compliance with cost principles and CAS. The Board ruled the commercial item termination clause should govern here. As for specific termination cost recoveries:

1. Software licenses. ESC sought $1.03 million for part of the cost of its 2008 software licenses arguing it purchased them "specifically for the government" and was not valid for another entity. The Board ruled against ESC saying the licenses purchased in 2008 were "perpetual and valid forever" where the purchases were made well before the 2012 contract was awarded.

2. Contract performance. Since compensation under the commercial item clause includes payment of a percentage of the contract price reflecting the percentage of work performed before termination, ESC sought $180K for one-month worth of work before termination. The Board ruled the proposed one month period included days prior to the contract base period and hence rejected the $180K.

3. ESC developed software. ESC sought $2.26 million for software developed and placed on the DOD computer where DOD refused to return the software and continued using it. ESC priced it out using both a market value and alternatively, development costs. The Board rejected the claim asserting though the development cost approach was the correct way to value the software, it was nonetheless developed for the 2008 contract and hence not entitled to the development costs.

4. Severance Pay. The Board rejected the proposed amount of severance costs ruling a termination settlement can include mandatory severance payments but not voluntary payments as was the case here.

5. Employee proposal preparation costs. The Board rejected ESC's claim for recovery of employee costs to prepare the proposal ruling a contractor may not rely solely on testimony to support a claim for charges under a commercial item termination but that a contractor must cite contemporaneous documentation supporting the claimed costs.

6. Legal and consulting costs. ESC sought costs it incurred to prepare its settlement proposal where the Board ruled they were too high saying a terminated contractor may not recover proposal preparation fees for claims that are not recoverable. Here, because the Board ruled ESC could not recover the value of software, the legal and consulting fees related to valuing the software were not recoverable *(ESCgov. Inc. ASBCA No. 58852).*

No Bait and Switch if Substitute is Equal or Better Than Replaced Key Person

DKW contended in its protest of an $81.6 million contract that the six contractor team TAULUN engaged in an improper "bait and switch" because it planned to substitute the program manager with another upon receiving the order. The GAO disagreed stating the potential replacement had equal or better qualifications. It ruled that substituting personnel with equal or better qualifications cannot have a material effect on evaluation results *(DKW Communications Inc., B-414476).*

Contractor Information is Not Protected Under FOIA

(Editor's Note. The following case has troubling implications for contractors wanting to protect confidential, competitive information in government contracts.)

Two public interest organizations working on detention and deportation issues brought suit under the Freedom of Information Act (FOIA) against the US Immigration and Customs Enforcement Agency (ICE) and Dept. of Homeland Security (DHS) seeking to compel the release of unit prices, bed-day rates and staffing plans in government contracts with detention facility contractors. ICE argued that the information was protected from disclosure under the FOIA exemption 4 which precludes release of information which covers "trade secrets and commercial or financial information obtained from a person and privileged or confidential." The exemption 4 has notably been successfully invoked to prevent, for example, release of line item prices from contracts on the grounds such releases will cause "substantial competitive harm." The District Court started its analysis innocuously enough stating that for exemption 4 to apply "the information must be a trade secret or commercial or financial in character; must be obtained from a person and; it must be privileged or confidential" regardless of the source of the information. However, the Court concluded that the terms of government contracts are not obtained from contractors or persons regardless of the source of the information where under that rationale, no information that is contained in a government contract is entitled to exemption 4 protection. In rejecting ICE and DHS's position, it ruled they did not show that release of information would cause substantial harm to the competitive positions of the contractors and the fact the contractors did not intervene in the case to protect their interests which had they done so would have provided more persuasive evidence of competitive harm *(Detention Watch Network v U.S. Immigration & Customs Enforcement 215, F.Supp.3d 256).*

Delay Compensation Was Allowable in Prior Year

Quimba paid compensation earned in one year two and a half months later after the end of the fiscal year where the costs were recorded. It delayed payment because the government did not pay invoices in the earlier year due to a delay of DCAA approving its accounting system and indirect rates. The government disallowed the costs in the earlier year stating it presumed the payment of services were paid under a deferred compensation plan where the FAR version of 31.205-6(b)(2)(i) in place during that period stated allowable compensation must be tax deductible where IRS rules state costs were deductible in the year of payment. Quimba presented IRS rules that said this presumption may be rebutted if the preponderance of facts and circumstances demonstrate it was impracticable, either administratively or economically, to avoid the deferral of compensation and such impracticality was unforeseeable at the end of the taxable year. The Court ruled the contractor's deferral of compensation was unintended, unavoidable and unforeseeable where there was no reason for the contractor to believe the accounting system update and approval process would take the entirety of one year and deferral was the only option that allowed the contractor to continue performance of the contract. The Court ruled the facts of Quimba's circumstances fell within the limited exception of the timing rules of the IRS where the compensation was deductible in the prior year and therefore allowable under the FAR provision *(Quimba Software Inc. v. U.S. FedCl, 61CCF).*

NEW/SMALL CONTRACTORS

Conducting a "Mock Audit" Can Prevent A lot of Headaches

(Editor's Note. The government is requiring auditors to review contractors' accounting systems more often, at least once every three years in most cases. The objective is to avoid an "inadequate" opinion since a variety of undesirable actions can occur such as failure to be awarded a contract based on cost and pricing data, suspension of payments, need to demonstrate adequacy at a later date, etc. One of our frequent consulting engagements is to conduct a "mock audit" of clients' accounting practices where we put on our "audit hat" and conduct a review of their accounting practices to identify weakness that can result in adverse findings during an actual audit. The advantages of contractors conducting their own audits or asking other independents to do so are many: (1) identifies weaknesses beforehand so there is ample time to take corrective action (2) supports the perception that you maintain strong internal controls since a key element of such controls is to obtain an independent assessment of practices and (3) can reduce the scope of government auditors' work, especially when you choose to provide workpapers to auditors since auditors are inclined to use the work of others (it is particularly helpful if the person conducting the audit is a CPA and has practical knowledge of government accounting requirements). Though we have addressed this issue in the past, types of opinions one can expect has changed and number of written policies considered adequate has proliferated.

Adequate Accounting system

When auditors discuss adequate accounting system they usually do not mean the accounting software you choose but rather your ability to identify, segregate and report on costs of distinct final cost objectives. "Final cost objective" may mean a contract or subcontract but it may also mean contract line items or individual task or delivery orders within contracts depending on what are the specific requirements of the contract. Basically, you need to demonstrate your accounting system (no matter what type of packaged software you use) is an adequate project accounting system capable of identifying and reporting full costs on a project basis, particularly for government contracts.

Elements of Adequate Accounting Practices

At a minimum, contractors need to demonstrate they could pass a pre-award accounting survey that is commonly conducted by the Defense Contract Audit Agency. The criteria identified in this survey, which are identified in Standard Form 1408, applies not only to new contractors who are likely to undergo such a survey before being awarded a contract but the same criteria is used to evaluate contractors during subsequent accounting system reviews. More detailed reviews is often required for some larger contractors but this survey is required of all when the government wants to be assured a contractor can account for specific project costs. The criteria includes:

1. Direct costs ("touch" labor, material, subcontractors) are properly segregated from indirect costs.

2. Direct costs are (or can be) identified and accumulated by final cost objective (e.g. grant, contract, subcontract and task or delivery order).

3. Logical and consistent method of allocating indirect costs to contracts. Allocation of costs need not necessarily be part of the financial accounting system but, for example, is accomplished on spreadsheets for those contracts needing adequate costs (e.g. cost or T&M

contracts, fixed price contracts where there are progress billings or will be used to price follow-on work, etc.).

4. Identification of contract costs in general ledger. That is, the costs that are separately identified in a cost ledger are reconcilable (i.e. visible) in accounts included in the general ledger.

5. Timekeeping system is capable of identifying employees' labor by contract.

6. Interim (monthly) determination of contract costs through posting to books of account.

7. Exclusion of unallowable costs.

8. Identification of costs by contract line item.

9. Must demonstrate cost-type contracts can meet limitation of cost and payment clauses and fixed price contracts can meet progress billing requirements. Also, if records are sufficient to ensure reliable data is available for pricing follow-on work.

Conducting the Mock Audit

1. *Request all written policies and procedures related to government accounting system.* This applies to the elements discussed above, not too often voluminous accounting software or detailed manuals. Demonstration that contractors have adequate internal controls in place is key where written policies and procedures are often considered the measurement of adequate internal controls. There has been a surge of what is considered sufficient written polices where the critical policies and procedures used to be limited to five - distinguishing direct versus indirect costs, screening unallowable costs, allocating indirect costs, timekeeping and expense reporting. Now it has been expanded to include bonuses, professional services, employee morale, executive and non-executive compensation, monitoring rates through the year, adjusting provisional indirect rates when different run rates are observed, how limitations of funding requirements (e.g. notification when 75% of authorized contract value is expended) are complied with, billing and even estimating.

2. *Conduct interview.* The "mock auditor" should sit down with the key government accounting person(s) and conduct a detailed interview on how the system works from the time a source document is received (e.g. vendor invoice, employee timesheet) through the accounting system to job cost reports and billings to the government. Examples of relevant reports (e.g. labor distribution, other direct costs by project, etc.) should be requested and examined. The results of these interviews and inquiries should be written up, either as a narrative or as a flowchart. In addition to covering all the elements discussed above, additional topics should be determined beforehand corresponding to the type of industry the contractor is in and requirements of key contracts either awarded, being bid on or expected to be proposed in the near future.

3. *Trace a sample of recent invoices through the system.* Select one or two invoices on high dollar cost type work or job cost records from other high dollar government work and trace reported costs back through the system.

a. Trace the invoice to a job cost report identifying costs. If invoice and job cost records don't match, provide reconciliation.

b. Trace job cost report to intermediate reports like labor distribution, project material and other direct costs. DCAA is particularly interested in reconciling job cost labor expenses to labor distribution reports that, in turn, tie to labor hours identified on timesheets.

c. Reconcile direct job costs to general ledger accounts. If G/L accounts separately identify direct and indirect costs that's great; otherwise the direct costs identified in job costs should be included in specific accounts in the general ledger.

d. Trace a sample of high dollar direct costs to source documents. For labor, trace hours to timesheets and hourly rates to payroll records. For sample of high dollar ODCs, trace to source documents such as vendor invoices and expense reports. Reconcile any discrepancies.

e. Examine selected timesheets and expense reports to ensure they are consistent with written policies. If there are no written policies, ensure they are adequate according to required prescriptions set forth in the DCAA Contract Audit Manual.

If no cost type contracts exist, be aware that auditors will want to see actual documents when they come, not be content with theoretical capabilities to meet these requirements in the future. We often recommend that cost type "dummy" contracts be created where cost reports and documents can be generated for, at least, for two quarters for an auditor to inspect.

4. *Prepare workpapers.* Compile workpapers where, at least, an evaluation of each major element of an accounting survey is identified. Ensure each significant observation is identified and each conclusion is logically tied to adequate documentation. If the contractor's system is likely to be considered adequate, either as it is now or after certain

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specific items are fixed, then be sure the workpapers are in logical and proper order so that an auditor may review them.

5. *Write a report.* Prepare a report that includes an executive summary and details of each major section. We prefer to use an observation-evaluation-recommendation format but other formats are fine. Both positive and negative evaluations should be clearly spelled out and corrective action needed to receive an "adequate" opinion highlighted.

We find that contractors unanimously consider the benefits of the "mock audit" to be worth the effort (and cost).

QUESTIONS & ANSWERS

Q. Currently, we are attempting to be more competitive in pricing and would love to come up with a division of our company for Customer Service Field Representatives (CSFRs). These CSFR's are not housed in our Chicago facility and we are hoping to scale down their fringe benefits to avoid having the high overhead costs the rest of our company bears. We are of course researching the 401-k and health care side of this division and it appears that we would need a separate entity with separate (unrelated) management if we want to offer a scaled down version of the 401-K. In the absence of setting up this new entity, I am looking at different methods for changing our cost structure. Currently, we have three indirect rates (OH with Direct Labor Cost as the base, Material Handling and G&A using Total Cost Input). I would like to add a separate Overhead rate and call it "Special Overhead" rate. This indirect rate would consist of the indirect costs related to the CFSR's. My questions are: what do you think of this approach? Does this new rate need to be approved by DCAA/DCMA prior to use? In the Incurred Cost Schedule can I allocate those costs to the contracts that use the CFSR's alone? For bidding purposes, I am assuming we would burden the Direct Labor Rates for the CFSR with the special.

A. The options you present are quite reasonable. A separate business unit or a separate lower overhead rate that eliminates certain facilities and fringe benefit costs are both reasonable approaches to achieve your pricing strategy and if done correctly, can be accepted. As for notifying DCAA and DCMA, if you are not CAS covered there is no formal requirement to notify the government of the changes until you either submit your next incurred cost proposal or a forward pricing proposal incorporating the changes. However, considering the changes are significant, it probably makes sense to inform them to, hopefully, avoid problems when you actually are bidding on new work. Yes, for bidding and incurred cost purposes, you may apply the new rate exclusively to the CFSR employees (after all, that is the purpose of having the new rate).

Q. We submitted provisional billing rates in November but DCAA has neither acknowledged receipt of them nor begun a review. What should we do?

A. The least risky action is to use your prior year accepted rates. However, if the provisional billing rates are more desirable and you want to use them in the next year then it gets a little more tricky. Yes, you can notify DCAA of your new rates and begin using the new rates but you risk having them rejected (unless they are the same as the prior accepted rates) where they can say you

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can use only approved rates. FAR 42.704 establishes that whoever is responsible for establishing final indirect rates is also responsible for provisional billing rates so you may want to contact your ACO citing this as why you are going to them.

Q. I have a client with a CO who apparently does not understand what a cost plus contract is. He is using the proposed budgets (we are into year 3) to determine salary caps for every employee working on this cost type contract which identified lower rates than those we have actually incurred for many of our labor categories. I have told him he is turning this contract into a T&M award and his response is "tough". Do you have any info on CPFF contracts?

A. It looks like the CO is confusing a cost type with a time-and-material contract. I would try informing him of the distinction between cost type contracts and fixed price and T&M (use our key word search for 20 years' worth of articles or quoting the FAR might be enough). Budgets are used to establish funding levels and provisional billing rates not appropriate compensation levels for incurred cost purposes on cost type contracts.