GCA REPORT

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TO OUR GCA SUBSCRIBERS

Shortly after starting our consulting practice 25 years ago, Government Contract Associates established the GCA REPORT soon followed by the GCA DIGEST. Having been in those positions ourselves, we knew there was a need to provide government contractor financial, accounting and contracts professionals timely information on new developments, court decisions and "hot topics" that could be read in a small amount of time at minimal expense. The success of these two newsletters was pleasantly unexpected and we treasure the relationships we have formed with our subscribers over the years. But now we have decided to focus our time exclusively on our consulting engagements where we have made the decision to turn over publication of the newsletters to Dixon Hughes Goodman who will be publishing the REPORT and DIGEST after the next DIGEST issue. We have worked with DHG for many years where we carefully selected them to resume providing subscribers with timely and relevant information. We thank our subscribers for their years of loyalty and excellent feedback and ask you to feel free to continue asking us as well as DHG your excellent questions. Any payments should still be remitted to GCA until DHG assumes publishing responsibilities with the next issue of the REPORT.

NEW DEVELOPMENTS

DCAA Issues Guidance on Tailoring Audit Programs

The Defense Contract Audit Agency recently issued guidance to its auditors reminding them they can tailor standard audit programs to meet the objectives and circumstances of their specific assignments. Agency policy requires auditors to use the most current version of its audit programs when beginning any audit. (*Editor's Note. It's a good idea to become familiar with these audit programs when DCAA is beginning an audit to identify the steps they will be taking.)* DCAA supervisors are responsible for ensuring that the audit team clearly understands the purpose and scope of the audit and an adequate audit program is developed and tailored specifically to the assignment. Tailoring may include adding new steps, eliminating unnecessary steps or simply modifying the program based on initial supervisory guidance.

When a new assignment is started auditors are reminded to apply professional judgement in developing the tailored audit steps, taking into account the significance of proposed amounts and known risk factors. If the audit team determines a section of the audit program is not relevant during the initial risk assessment phase of the audit (e.g. no need to follow the "Direct Material" section when no material costs are proposed) it is not necessary to include that section in the audit program. The guidance also tells auditors to follow similar procedures if the auditor determines changes are needed during the audit where auditors should coordinate with their supervisors and document the results in their workpapers *(MRD 18-PIC-005(R)*.

Final Rule Clarifies Commercial Item Exemption in CAS

The CAS Board has issued a clarification to 48 CFR 9903.201-1(b)(6) to state "Contracts and subcontracts authorized in 48 CFR 12.207 for the acquisition of commercial items" are exempt from the cost accounting standards.

The CAS Board has updated the exemption several times to reflect statutory changes and clarify the intent of the regulation. The change remedies the inconsistency that had developed between the list of contract types recognized for use in acquiring commercial items set forth in the FAR and the exemption in CAS.

FAC 2005-100 Issues Final Rules on Sick Leave and Disclosure of Compensation Info

The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council have issued Federal Acquisition Circular 2005-100, which contains three final rules amending the Federal Acquisition Regulation:

Item I—Paid Sick Leave for Federal Contractors;
Item II—Non-Retaliation for Disclosure of Compensation Information; and
Item III—Technical Amendments.

- **Paid Sick Leave for Federal Contractors**

FAC 2005-1000 converted the interim rule in FAR Case 2017-001 to a final rule, without change. The interim rule amended the FAR to implement Executive Order (EO) 13706 and a Department of Labor final rule issued on September 30, 2016, both entitled "Establishing Paid Sick Leave for Federal Contractors." The rule implements the regulations at 29 CFR Part 13 that requires contractors to allow all employees performing work on or in connection with a contract covered by the EO to accrue no less than 56 hours (7 days) or more of paid sick leave each year.

The rule adds FAR Subpart 22.21 – to prescribe policies and procedures that implement the sick leave requirements. The subpart includes applicable definitions, specifies the government's policy on sick leave, and identifies applicable contracts and exclusions. The Subpart also provides information on basic paid leave requirements, requirements for multiemployer plans or other funds, plans, or programs and sets forth the procedures for enforcing the paid sick leave requirements.

The rule does not provide an exemption for contracts at or below the simplified acquisition threshold or commercial item contracts.

- **Non-Retaliation for Disclosure of Compensation Information**

The publication also converted the interim rule in FAR Case 2016-007 to a final rule, without change. The interim rule implemented EO 13665, Non-Retaliation for Disclosure of Compensation Information. The interim FAR rule also implemented a final rule issued by the Office of Federal Contract Compliance Programs (OFCCP) of the Department of Labor, entitled "Government Contractors, Prohibitions Against Pay Secrecy Policies and Actions." The rule prohibits discriminating against employees and job applicants who inquire about, discuss, or disclose the compensation of the employee or applicant or another employee or applicant.

The rule requires that Federal contractors and subcontractors disseminate this nondiscrimination provision, using language prescribed by the Director of OFCCP, including incorporating the provision into existing employee manuals or handbooks and posting it. The rule states that there is no significant impact on small entities imposed by the final rule.

DoD Removes Technical Interchange Requirement for Allowability of IR&D Costs

The Department of Defense (DoD) issued a final rule that, effective immediately, removes the requirement in Defense Federal Acquisition Regulation Supplement (DFARS) 231.205–18(c)(iii)(C)(4) that major contractors conduct a "technical interchange" with a "technical or operational Government employee" prior to generating independent research and development (IR&D) costs for IR&D projects initiated in fiscal year 2017 and later, in order for those costs to be allowable.

The requirement applies to major contractors, who are defined as contractors whose covered segments allocated a total of more than $11 million in IR&D and bid proposal costs to covered contracts during the preceding fiscal years. The requirement was repealed after a determination by the DoD Regulatory Reform Task Force determined that the DFARS coverage was outmoded and recommended removal, since requiring a technical interchange between the Government and major contractors is unnecessary. The objective of the interchange can be met through other means.

DOL Sends 445 Contractor Audit Alerts

The Labor Department's contractor enforcement agency notified 445 federal contractors that they have been selected for an audit of "compliance evaluation." The letters are a "courtesy notification" or a precursor to the official Office of Management and Budget notifications, which informs the contractor of an impending audit. The purpose of the letter is to provide the contractor's EEO staff at least 45 days advance notice to prepare for the compliance review and encourage contractors to take advantage of OFCCP compliance assistance offerings.

DoD Removes DFARS "Contractor Employee Clause"

DoD is amending the DFARS to remove the DFARS clause 252.247-7006, Removal of Contractor's Employees, and the associated clause prescription at DFARS 247.270-4. The DFARS clause served as an agreement from the contractor to only use experienced, responsible, and capable people to perform the work under a contract. The clause also advised the contractor that the contracting officer may require the contractor to remove from the job employees who endanger persons or property or whose employment is inconsistent with the interest of military security.

The information conveyed in DFARS clause 252.247-7006 is directly related to performance of the work under a relevant contract. The DoD Regulatory Reform Task Force established under EO 13777 determined that it is more appropriate for the Government to define what it considers an experienced, responsible, and capable employee to be in a performance work statement, not a contract clause, because those requirements may change depending on various factors of the work being performed. If the need to remove employees from performing under the contract exists, it should be identified in the performance work statement. The removal and replacement of employees directly relates to the contractor's ability to perform and staff the work under the contract. As such, the DoD deemed the subject clause is unnecessary and removed it from the DFARS.

SAM Final Rule

The System for Award Management (SAM) registration process was updated to clarify when an offeror must register in SAM. FAR 52.204-7 instructed offerors to compete reps and certs by registering in SAM prior to submitting an offer and FAR 4.1102 stated that SAM registration must be completed by the time of award.

FAC 2005-101 clarifies that offerors must register in SAM prior to submission of an offer.

Good Bye $1 Coin?

FAC 2005-101 eliminates FAR 37.116 and the clause at FAR 52.237-11, Accepting and Dispensing of $1 Coin from the FAR.

SBA Takes on Ownership and Control of SDVOBs

As required by the 2017 National Defense Authorization Act, the SBA issued a final rule regarding eligibility rules for Service Disabled Veteran Owned Businesses (SDVOB). This rule is contained in 13 CFR Part 125.

The new SBA rule contains many definitions for the SDVOB Program. The rule specifies that service-disabled veterans must control the company's daily business operations – defined as including but not limited to marketing, production, sales and administrative functions of the firm, as well as the supervision of the executive team, and the implementation of policies.

The rule allows non-service disabled veterans to have a say over specific extraordinary actions:

- Adding a new equity stakeholder;
- Dissolution of the company;
- Sale of the company;
- The merger of the company; and
- Company declaring bankruptcy.

The rule also details who the SBA considers owns and controls a SDVO SBC (Service Disabled Veteran Owned Small Business Concern)

DoD Withdraws Contentious Performance-Based Payments and Progress Payments Proposed Rule

DoD issued a proposed rule under DFARS Case 2017-D019 to implement Section 831 of the National Defense Authorization Act for Fiscal Year 2017. Congress wanted the DoD to address the preference for performance-based payments, and to streamline the performance-based payment process. In addition, DoD proposed to change the DFARS to revise progress payments and performance-based payments policies for DoD contracts. Part of the rule included potential increases or decreases to progress payment rates based on subjective performance criteria.

These proposed changes caused a swift and strong opposition from industry and members of Congress. At the public hearing on the proposed rule, representatives from the Professional Services Council, the Aerospace Industries Association and the National Defense Industrial Association came out against the rule, raising concerns and objections regarding the potential impact of the rule. Among other concerns, the industry groups argued that the rule would significantly impact cash flow and adversely impact the defense supply chain and ongoing research and development programs, and ultimately drive up costs for defense contracts.

On September 27, 2018, Representative Thornberry and Senator Inhofe sent a letter to Deputy Secretary of Defense Shanahan with "significant reservations about" the proposed changes. The letter stated that the changes go well beyond the statutory requirements and are not consistent with the intent of Congress. Additionally, the letter expressed grave concerns about the harm that this rule could cause to innovation investment, small businesses, and stable workforces in the defense industrial base. DoD was reminded that performance based payments are an important element of acquisition reform from the 1994 Federal Acquisition Streamlining Act (FASA), with a goal of achieving better outcomes for the taxpayer and reducing unnecessary burdens by establishing a more commercial payments process. *"However, the Department became increasingly focused on measuring cost as an output rather than taxpayer outcomes. By enacting Section 831, Congress intended to reestablish as a policy objective a focus*

on measuring outcomes for the taxpayer and rewarding contractors for meeting those performance objectives, rather than merely the expenditure of dollars associateed with progress payments." The letter concluded with a statement that the new rule is fundamentally flawed and a call for the rule to be rescinded, and for the DoD to revisit the intent of Congress consistent with Section 831. On October 4, 2018, the DoD withdrew its proposed rule in order for DoD to conduct additional outreach with industry regarding contract financing methods.

DOL Announces 2019 Minimum Wage Increases for Federal Contractors

The Dept. of Labor announced the updated minimum wage rates that must be paid to workers performing work on or in connection with federal contracts covered by Executive Order (EO) 13658, Beginning January 1, 2019, federal contractors must pay covered workers at least $10.60 per hour and the minimum cash wage for tipped employees will increase to $7.40 per hour.

Contractors were initially required to pay covered workers at least $10.10 per hour as of January 1, 2015. For 2018, federal contractor minimum wage is $10.35 per hour and the minimum cash wage for covered tipped employees performing work on or in connection with covered contracts is $7.25 per hour.

CASES/DECISIONS

A "Cloud of Uncertainty" Equated to a Reconsideration Default Termination Notice

The ASBCA determined that an appeal from a termination for cause was timely, because the record showed the contracting officer reconsidered, or gave the appearance of reconsidering, the termination decision. The government moved to dismiss the appeal stating that the contractor did not file its appeal within 90 days of receiving the final decision. The finality of the CO's determination was determined to be ineffective based on the communications with the contractor over the 90 day period. The contractor presented evidence showing it reasonably or objectively could have concluded the CO's decision was being reconsidered.

The ASBCA concluded that written and oral communications with the government created a "cloud of uncertainty" as to the status of the termination. A CO email stated that the government "is willing to accept delivery of items under the contract .... You should contact this office ... to discuss questions or reasonable proposals concerning the Termination for Cause."

The government repeatedly attempted to discuss with the contractor "reasonable proposals" concerning delivery, and the parties discussed the merits of the termination during three teleconferences. This communication demonstrated that there was substantial evidence that the government's actions were either in fact a reconsideration or at least reasonably led the contractor to believe the government was reconsidering the decision. *(Aerospace Facilities Group, Inc.,* ASBCA, 18-1 BCA ¶37,105)

Software Development Costs Were "Exclusively at Private Expense"

Boeing's motion for partial summary judgment with regard to software development costs was granted by the ASBCA because costs charged to technology investment agreements (TIAs) constituted software developed "exclusively at private expense."

The TIAs did not make a blanket grant of government purpose rights in non-deliverable software. Boeing sought determinations, as a matter of law, that software developed with costs charged to a TIA pursuant to 10 USC 2358 constituted software developed "exclusively at private expense" as that term is defined at DFARS 252.227-7014(a)(8), and that the TIAs did not make a blanket grant of government purpose rights in non-deliverable software developed with costs charged to the TIAs. (*Boeing Co.*, ASBCA, 18-1 BCA ¶37,112)

Penalties and Interest for Unallowable Costs Affirmed

Raytheon and the Government requested the ASCBA to reconsider its decisions in Raytheon Company, ASBCA No. 57743 et al., 17-1 BCA 36,724 (*Raytheon II*). Raytheon requested the ASBCA reconsider its ruling that salary costs are part of expressly unallowable lobbying costs. The ASBCA denied the request stating that "We find no error of law or other reason to reconsider our decision in *Raytheon II* regarding lobbying salary costs and we deny Raytheon's motion for reconsideration."

The Government requested that the ASBCA reconsider its decision that Raytheon's aircraft factional lease costs were not expressly unallowable and subject to level one penalties and interest. The government also contended that level two or double penalties and interest are appropriate under FAR 42.709-1(a)(2) and other FAR and Statutory provisions. The Board denied the government's request stating "We find no error of law or other reason to reconsider our decision in *Raytheon II*

regarding aircraft fractional lease costs and we deny the government's motion for reconsideration." (*Raytheon Co.*, ASBCA 57743, 18-1 BCA ¶37,129)

Contractor's Release Was Executed Under Duress and is Unenforceable

A release signed by the contractor was unenforceable based on a recent, lengthy opinion issued by the Armed Services Board of Contract Appeals (ASBCA). Ultimately, the contracting officer's threat–made to a contractor with cash-flow issues–amounted to coercion, and invalidated a settlement agreement that awarded the contractor much less than it probably should have received.

The ASBCA held that because the Corps caused North American Landscaping, Construction and Dredge, Co. Inc. (NALCO) cash flow difficulties and breached the contract, "NALCO's failure to perform due to financial difficulties is excusable." Under these circumstances, the Corps "had no right to terminate for default and therefore no right to threaten to terminate for default. Such threats can be coercive."

Coercion requires a showing that the government's action was wrongful – "i.e. that it was "(1) illegal, (2) a breach of an express provision of the contract without a good faith belief that the action was permissible under the contract, or (3) a breach of the implied covenant of good faith and fair dealing."

In this decision, the ASBCA traced that actions leading up to the threats and determined that the Corps had violated the implied covenant of good faith and fair dealing. Although the contracting officers actions Corps' actions weren't illegal, the ASBCA did find that the Corps violated an express provision of the contract, FAR 52.249-10, Default (Fixed-Price Construction) without a good faith belief that the action was permissible under the contract. The Board concluded that "having found two of the three indicia of coercion, we find that NALCO was coerced into signing Modification No. P00003 and its release is unenforceable."

While the facts in this case demonstrate coercion, there are many other decisions that provide that the Government can be a tough negotiator, and most settlements aren't invalidated because of coercion or duress. The amount of detail contained in this case – all 57 pages – lay out the pattern of specific facts that demonstrate that the ASBCA felt that "the government's general behavior throughout the award and performance of the contract to be abhorrent." A contracting officer can be tough – but they cannot be unfair. (*North American Landscaping, Construction and Dredge Co., Inc.*, ASBCA Nos. 60235, 60236, 60237 & 60238, 18-1 BCA ¶95,550)

Cost Allowability – Compliance with GAAP

United Launch Services, LLC was denied a motion for summary judgement on its claims that the Government breached its obligation to pay for deferred costs because of the existence of a genuine factual dispute. The disputes included whether the deferment of the costs complied with the Cost Accounting Standards and generally accepted accounting principles (GAAP), the payment terms violated applicable regulations and a disagreement between the parties regarding whether or not the costs were lawfully payable under the contract. (*United Launch Services, LLC, et al. v. U.S.* FedCl, 62CCF ¶81,473)

Commercial Item Availability

The US Court of Federal Claims granted an injunction prohibiting the Army from awarding a system development contract because they failed to comply with the requirements of 10 USC 2377. The appeal centered on the Federal Acquisition Streamlining Act (FASA) requirement that federal agencies, to the maximum extent practicable, procure commercially available technology to meet their needs. The Army issued its solicitation without performing market research to determine if commercially available items met its requirements. (*Palantir USG, Inc. v. U.S.*, CA-FC, 62CCF ¶881,472

Contract Modifications Violated Rule of 2 and CICA

The US Court of Federal Claims heard a protest of a decision by the Department of Veterans Affairs (VA) to modify four existing contracts for the distribution of medical and surgical supplies. The contracts were modified to expand the scope of work to include supply as well as distribution. The plaintiffs are suppliers of medical and surgical items and allege that the change will result in loss of opportunity to compete to sell their products to the VA.

The Court determined that the actions of the VA were an "end run" around the Competition in Contracting Act (CICA) and also ignore the VA's Rule of Two requirements established in *Kingdomware Techs, Inc. v. United States* (136 S. Ct. 1969, 1976-77(2016). Although the Court agreed that procurement laws were violated, "because the balance of the harms favors the government, we cannot grant an injunction." (*Electra-Med Corp., et al. v. U.S.*, et al., FedCl, 62 CCF¶81,492.

NEW/SMALL CONTRACTERS

DCAA CRITERIA FOR AN ADEQUATE PROPOSAL

(Editor's Note. We find both new and veteran contractors need a checklist of what constitutes an adequate proposal in order to minimize chances a proposal is rejected. DCAA has revised over the years what it considers an adequate cost proposal (one of us actually helped prepare a checklist when we were a DCAA auditor) but we find Chapter 9-200 of the DCAA Contract Audit Manual, with some explanation, is a good checklist to go by.)

The following is intended to identify those "pricing deficiencies" in a proposal that auditors and negotiators consider sufficiently important to avoid beginning to negotiate a contract, let alone award them. We will identify and briefly discuss what they consider unacceptable and suggest what contractors can do to avoid such conclusions. Chapter 9-200 of the DCAM lists eleven common deficiencies that either alone or in combination are to be considered sufficiently poor for negative opinions. These eleven deficiencies are:

1. Significant amounts of unsupported costs.

2. Material differences between the proposal and supporting data resulting from the proposal being out of date or available historical data for the same or similar items not being used.

3. Large differences between detailed amounts and summary totals.

4. When materials are a significant portion of the proposal, no bill of materials or other consolidated listing of the individual material items and quantities being proposed.

5. Failure to list parts, components, assemblies or services that will be performed by subcontractors when material amounts are involved.

6. Major differences between resulting unit prices proposed being based on quantities substantially different from the quantities required.

7. Subcontract assist audit reports indicate problems with access to records, unsupported costs and indirect expense rate projections.

8. No explanation or basis for pricing inter-organizational costs.

9. No time-phased breakdown of labor hours, rates or basis of proposal for significant labor costs.

10. No indication of basis for indirect cost rates.

11. The contractor does not have budgets beyond the current year to support indirect expense rates proposed for future years.

1. *Unsupported costs.* By "unsupported" costs, the auditor means insufficient documentation to form a basis of determining if a cost is allowable. For incurred cost proposals, it is pretty straightforward – a transaction is supported by a labor recording document, invoice or other documentation created at the time the transaction was recorded (e.g. journal entry). For cost estimates, "support" is more problematic because an estimated cost has not occurred. It is quite common, however, for some auditors and price analysts to hold the same standard of supporting documents as would exist for incurred costs even though an estimated cost is largely judgmental.

Nevertheless, some form of support for the cost is required. For items previously produced, detailed support should be available. If circumstances are not expected to significantly change then historical indirect cost rate would be considered reasonable support. "Engineering estimates", though considered "merely judgmental" is commonly accepted especially when the person doing the estimate has credibility.

2. *Differences between proposed costs and supporting data due to support being out of date.* If factual data is used by a contractor in its estimates, then that data should be current when the proposal is being prepared. After that time, the contractor should ensure the data used is current up to the time of price agreement. Ensuring the data is current should not be confused with the unjustified position of some auditors that a proposal needs to be updated. Numerous decisions by Boards of Contract Appeals have established that if a contractor updates its cost or pricing data but does not update its proposal per se the contractor has met its obligations.

The type and format of updated information has also been extensively litigated and is often a point of contention between auditors and contractors. For example, a contractor is not required to submit data in a requested format if it is not readily available. Or, for example, the years of historical production data needed to support an estimate has been litigated where a contractor's submission of two years' worth of data was considered adequate when the government was seeking more years. What is considered sufficient can differ in each circumstance and the contractor should be prepared to justify its estimates by facts and resist unreasonable requests for more.

3. *Differences between detailed amounts and summary totals.* It is clear that if summary totals do not reconcile to detailed amounts in the proposal there can be problems. Less clear is when the data may exist somewhere (e.g. a shoe box, indecipherable spreadsheet) and is believed to "be all there" but effort is required to reconcile the amounts. If it is very time consuming or impossible to reconcile due to lack of detail a reviewer is usually justified in concluding the totals do not match the detailed amounts. In other cases where auditor's unsuccessful attempts to reconcile totals to detailed cost data not used in preparing the proposal becomes not a reconciliation issue but an instance of an auditor substituting their judgment for the contractor's judgment and a judgement of inadequacy should be resisted and discussed at negotiations.

4. *Absence of bill of materials or other consolidated listing of individual material items.* The absence of such a listing could be legitimate grounds for a determination of inadequacy when the materials are known in sufficient detail at the time of price proposal. In other cases, such as the design, development and construction of a new item, there is insufficient knowledge of what are the necessary materials and a bill of material is not realistic. Auditors, used to reviewing proposals with nice neat bill of materials may automatically reject a proposal without one so either a bill of materials should be sought or detailed reasons should be offered for why one is not possible.

5. *Failure to list parts, components, assemblies or services.* FAR Table 15-2 instructions for supporting proposals lists these items to be provided if they exist. Like the discussion under bill of materials, they should be provided if they exist and if the nature of the contract makes their provision unrealistic (e.g. design, development, construction of items) then detailed reasons for their absence should be available if asked.

6. *Differences in proposed unit prices based upon differences in required quantities.* Auditors and price analysts closely examine whether proposed unit prices reflect the quantity discounts the proposed contract would offer. They usually assume the unit prices should reflect savings as if the quantities will be purchased at one time while there may be many reasons why this is not appropriate (e.g. just-in-time inventory approach). When this is not the case, an auditor's opinion of inadequacy should be challenged and reasons for the different approach identified.

7. *Problems with record access by subcontractors.* The prime should be very familiar with FAR Part 12 exemptions (e.g. adequate price competition, catalogue or market price, commercial item, etc.) from requiring cost and pricing data to determine whether they are applicable to a subcontractor. If one of the exemptions do not apply, then a prime or upper-tier subcontractor may want to reconsider using a subcontractor for pricing purposes if auditors use the subcontractor's inability to justify its proposal on a cost basis as a problem. Be aware that DCAA has recently decided to focus on whether subcontract proposals are reviewed for price reasonableness.

8. *Pricing inter-organizational costs.* As mentioned above, the business unit preparing the proposal should be familiar with FAR Part 12 exemptions from submitting cost and pricing data from another organizational unit of the company. If one of the exemptions do not apply and cost and pricing data is required, the business unit must be able to justify its cost buildup. If this is problematic, then the proposing unit should consider another source for its proposal to avoid the possibility of an audit of the subcontractor business unit or alternatively, not proposing indirect costs on the transferred dollars.

9. *Time phased breakdown of hours, rates or basis of proposal.* The time phased requirement means that direct labor hours should be estimated by month, quarter or year and that direct labor rates also identified by time period. Contractors should be prepared to justify escalation rates, particularly if they exceed three percent. Whenever possible, an offeror should use labor categories that are established by its own system. If the solicitation asks for different labor categories, care must be taken to ensure a reconciliation of labor categories is documented.

10. *Indirect cost rates.* An offeror should indicate how the proposed indirect cost rates are computed, what are the cost elements used and how they are applied. Rates that are different than those incurred in the previous period should be supported by budgets. Elimination of any unallowed costs should be evident. For example, the cost should be identified and then clearly eliminated rather than merely not including it. If a solicitation requires proposing an indirect rate (e.g. fringe benefit rate) that does not correspond to the accounting practice of the contractor, the proposal should clearly show the computation as well as evidence double counting does not exist.

11. *Multiyear budgets.* Since most firms develop budgets for only one year, this is the one deficiency that we seldom see auditors taking a hard line. If different rates are proposed then they should be documented. If the proposal is unusually large and is expected to be a significant part of the business base, auditors will want to see the impact of the contract on multiple years and some projections would be required. Less formal steps than normal budgets can be used to make these projections.

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QUESTIONS & ANSWERS

Q. Our president has purchased some property to use for our facilities and we are wondering whether we can charge the government a market based amount as rental costs even if it would be less than the amount we are paying on our mortgage. If these are unallowable, would we be subject to a penalty for claiming unallowable costs.

A. FAR 31.205-36 (b)(3) makes it clear that if the property is owned by a related party the amount charged as rent cannot exceed the cost of ownership (e.g. depreciation, taxes, insurance, facilities capital cost of money and maintenance). Interest on the mortgage is not allowable but though many contractors forget to charge it, they are entitled to the cost of money on the total assets (building, land) whether or not it is in the form of a mortgage or self-financed. A recent case, Thomas Associates (ASBCA No. 57795) ruled that unallowable rental costs that exceeded the costs of ownership were subject to penalties because they were "expressly unallowable" in accordance with the above FAR cost principle.

Q. How do we go about creating a new G&A rate for a new contract that has significant non-labor expenses? Our current rate is too high since there is little value added by the company.

A. Several options come to mind on how to treat this new contract. (1) you can simply choose to offer a lower G&A rate than you would otherwise be entitled to (2) you can take this opportunity to change your indirect rate structure where, for example, you might adopt a material/subcontract handling rate. There are various disclosure rules depending on whether your contracts are CAS covered but you should be prepared to justify the new structure and show the cost impact on your other contracts or (3) create a special allocation for this one contract. We have written several articles on special allocations so we suggest either using our word search feature at our website or call us to discuss your situation.

Q. We are thinking about changing our work period to a nine day payroll period every two weeks. Are we going to have problems with the government?

A. The change you are considering is quite common where even most federal government employees have the option of choosing 8, 9 and 10 day two week payroll periods. You, of course, need to ensure any practice you adopt is consistent with the National Labor Relations Board rules.

Q. Recent changes to US (FASB ASC842) and international accounting standards are calling for new rules for capitalizing financial and operating leases. This represents a significant change over federal accounting rules covering operating leases. How will these changes affect the way we account for operating leases for government cost and pricing purposes?

A. Good question. Unfortunately, I do not have a definitive answer yet. We have not seen any proposed changes to relevant rules such as FAR 31.205-11(h) or CAS 404 so we say the same treatments for capital versus operating leases are still in place. However, unless contracts are covered by the cost accounting standards, generally accepted accounting principles generally dictate proper treatment (with some exceptions) so you could argue the FASB changes would apply. There should be some guidance issued by DCAA or other bodies but so far none has been issued that we are aware of.

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