Companies who sell commercial items on General Services Administration (GSA) Schedules must remit an Industrial Funding Fee (IFF) to GSA based on a percentage of sales. How should a company record the fee?

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This article addresses a company's accounting for the Industrial Funding Fee (IFF) for government contract purposes. Similar considerations discussed in this article are also pertinent for financial accounting purposes. The basic accounting issue is whether this fee is a cost or a reduction of revenue.

<u>What does this fee (IFF) represent?</u> The IFF reimburses GSA for procurement and administrative costs incurred to operate the GSA Schedules Program. One of the arguments against the IFF being a cost is that the purpose of the fee is to reimburse GSA for their costs. This might impact how the GSA accounts for the fee, but this fact is not relevant to a company's cost accounting. If a company pays GSA a fee to sell goods or services based on a percentage of the sales price and also pays an agent a fee to sell goods or services based on a percentage of the sales price, what relevance is there to whether this fee is (a) only a cost recovery with no profit, (s) predominantly profit or (3) all profit? The company's cost accounting for this out-of-pocket fee should be consistent, i.e., the identical.

Compare the GSA Schedule selling technique to a fee paid by a manufacturer to a distributor, where a distributor acts as an outsourced sales force and receives a percentage of sales price as payment for their distribution or selling services. Clearly, this distribution or selling cost is a bona fide expense even if calculated as a percentage of sales price paid by a third party.

Also, compare this to any non-GSA Schedule sale which could be made possible by a variety of selling and marketing techniques, including responding to individual Solicitations, conducting direct selling efforts, hiring an agent paid on a commission basis, publishing catalogs and price lists, publishing prices on a website, etc. All of these techniques generate generally allowable selling and marketing costs. (Advertising might also be used to sell goods and services but these costs would be unallowable.[1])

In particular, if a company hires an agent for the purpose of selling its goods and services, the resulting sales commission is an allowable cost.[2] According to two significant decisions on commission costs,[3, 4] that commission will most likely be categorized as an indirect cost. The argument that a sales commission should be a direct cost has been discredited by the courts rationale and the proper application of the cost

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[1] FAR 31.205-1, Public Relations and Advertising Costs.
[2] FAR 31.205-38, Selling Costs.
[3] Aydin Corporation (West) v. Sheila E. Widnall, Secretary of the Air Force, (July 24, 1997), United States Court of Appeals for the Federal Circuit, No. 96-1267, July 24, 1997.
[4] Daedalus Enterprises, Inc., ASBCA No. 43602.

principles in the Federal Acquisition Regulation. Specifically any expense, including sales commissions, should be allocated to benefiting cost objectives.[5] A long line of court decisions[6] support the concept that the potential reduction in indirect cost rates due to increased volume is a sufficient benefit to other than the contract for which the commission was paid to be an allowable (allocable) indirect cost.

What does this fee (IFF) not represent? The cost is not a discount for prompt payment, it is not a discount for volume purchases, it is not a discount for favored customers—the fee is a selling cost. The fee is not a surrogate for company contract administration costs—an argument sometimes put forth. For a company, the fee is a payment for selling services whether or not the selling expense is a mere reimbursement of costs of the provider of the service or covers costs and a profit to the provider of the service. Company contract administration costs would include processing contract modifications, preparing quarterly reports on sales and fee payments, etc. These activities may occur regardless of the sales and fee amounts.

What are some of the alternative accounting treatments for this fee?

1. Reduction of Revenue. This accounting treatment results in a reduction of revenues and reduces visibility into the nature of the transaction. This accounting treatment also results in the sale of an item to a GSA customer and a non-GSA customer not being recorded as the same revenue even though the price to the customers is the same. The fact that this fee structure is intended to be invisible to the customer; however, the fee is not invisible to the company making the sale and remitting the fee to GSA. This accounting treatment does not appear to be a good accounting alternative for financial reporting. The inequity of accounting for the fee as a revenue reduction is apparent because the Schedule contract would be allocated a proportionate share of the selling costs for all other work and also 100% of the fee/commission for the Schedule sale. The Daedalus[7] decision in particular objected to this end result.

Some government auditors conclude that if the IFF is not recorded as an expense, but as a revenue offset, this is conclusive evidence that the fee is not an allowable cost—because it is not a cost! The nature of the transaction should be determinative of the proper cost accounting treatment rather than how the transaction may or may not have been recorded.

If the fee is not included in the pricing of the Schedule, the above argument is clearly valid. The fee may be included in the GSA Schedule price, but is not required to be included and many companies do not include the fee in the GSA price. However, if the fee is included in the Schedule price permitted by GSA, there is an argument for account for the fee as a revenue reduction. Even if the fee is included in the price, it is not a foregone conclusion that revenue reduction is the best accounting treatment. Many

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[5] FAR 31.201-4, Determining Allocability.

[6] For example, General Dynamics Corp., Convair Div., ASBCA No. 7963; General Dynamics Corp., Electric Boat Div., ASBCA No. 18503; Blue Cross & Blue Shield Association, ASBCA No. 41255.

[7] Daedalus Enterprises, Inc., ASBCA No. 43602.

commercial companies attempt to negotiate additional revenues for such things as expedited delivery, shipping costs and similar items on a case-by-case basis and properly account for this as (enhanced) revenue for that sale. In other words, a cost is accounted for as indirect, but if an individual customer can be induced into paying extra for some aspect of the product or service, it is included in the price and revenue. (Note these additives are not constrained by a cost based environment that would require freight to be priced and costed consistently as either direct or indirect costs.)

2. Direct Cost. The recording of selling costs as a direct cost is not advisable because not all sales efforts are successful. Where does one allocate the cost of an unsuccessful sale attempt? This accounting treatment would effectively render the cost of an unsuccessful selling effort unallowable due to being a direct cost associated with a contract that never was awarded. Furthermore, Cost Accounting Standard 402 on consistency in direct and indirect costs would not allow successful sales efforts to be charged direct and unsuccessful sales efforts to be charged indirect. Again, the inequity of accounting for the fee as a direct cost is apparent because the Schedule contract would be allocated a proportionate share of the selling costs for all other work and also 100% of the fee/commission for the contract.

3. Unallowable Indirect Cost. There is no basis in FAR Subpart 31.2 for concluding that these costs are unallowable. Specifically, the costs are not in excess of what a prudent businessperson would spend in a competitive environment.[8] The costs are not precluded by contract terms.[9] The costs are not deemed unallowable by any specific cost principle.[10] The costs are not in violation of any provision of GAAP or CAS.[11]

Finally, the fifth requirement for cost allowability, allocability[12], is also not an issue. In the Aydin decision the court concluded that the contractor's sales commission expenses had a beneficial relationship to its government contracts sufficient to establish allocability. This has long been an issue with some government personnel who do not accept the consistent Board and court decisions that conclude that selling efforts expand the business base, which lowers indirect cost rates for all work including government contracts (and thus benefits all work).

It has even been argued that, in effect, the fee is not allocable to any contract! It has been suggested that the cost should be treated as a "phantom cost" and not included in any cost pool or base. Thus, despite the CAS Board's view of full absorption costing[13], this cost would simply be declared not allocable to anything and presumably charged against cost of sales or directly to the company's bottom line.

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8 FAR 31.201-3, Determining Reasonableness.
9 FAR 31.201-2(a)(4), Determining Allowability.
10 FAR 31.205, Selected Costs.
11 FAR 31.201-2(a)(3), Determining Allowability,
12 FAR 31.201-4, Determining Allocability.
13 CAS Statement of Objectives, Policies and Concepts.

4. Allowable Indirect Cost. Although the CAS Board has stated that selling and marketing expenses are not General and Administrative costs; however, *"Contractors who have included selling costs in a cost pool separate and apart form the G&A expense pool may continue that practice…"*[14] At the time of this statement, the CASB intended to write a separate Cost Accounting Standard on selling and marketing costs. No such Standard was written and none is likely at this time. Futile attempts to draft such a Standard appeared to be directed to requiring separate government versus commercial selling cost pools, direct charging of some (but not all) selling expenses and other equally impractical and unsound accounting methodologies.

The most equitable and supportable cost accounting treatment for the Industrial Funding Fee is as an allowable indirect cost (G&A if the company has a separate G&A cost pool).

[14] CAS 410, Preamble of April 16, 1976.