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G&A is an Expense and not a Fee

By Michael Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

Recently an ACO notified a contractor that the contractor could not apply its "G&A fee" to the reimbursable materials or other direct costs on a T&M (Time & Material) contract. The ACO cited FAR 52.232-7(b)(7) "the Government will not pay profit or fee to the prime contractor on materials". Apparently the ACO is unfamiliar with a T&M contract payment clause, FAR 52.232-7(b)(1)(ii)(D), and its distinction between allowable "applicable indirect costs" (which can include G&A), and an unallowable fee. Alternatively, the ACO is one of many who associates G&A with contractor mark-up (profit or fee) and/or non-value-added as if G&A is simply an additive factor unrelated to a pool/base/rate.

Unfortunately, this particular ACO isn't alone, nor is the G&A misconception unique to government contracting officers given that a number of contractors also tend to refer to G&A as "mark-up" differentiated from other allocable indirect costs (e.g. fringe benefits and overhead). In some cases, this misnomer can be traced to financial accounting for which G&A is a period expense reported separately from cost of goods sold; however, even then it is a "cost" and not fee/profit. This (contractor confusion) was evident in a recent CBCA case 4068 (Civilian Board of Contract Appeals) which dealt with the manner in which the fixed fee applied to labor hours/costs. In the body of the published decision an offeror submitted the following question (during the solicitation/source selection):

> Question: "The RFP states that subcontractors providing DPLH (direct productive labor hours) will be paid the fixed rate per DPLH specified in the schedule"….Does this mean that prime contractor mark-up on the subcontractor costs (such as G&A and fee) will not be allowed?"

THIS ISSUE:

> Answer: "Fee cannot be applied to any OCDs (ODCs). It is up to offerors to determine whether or not to apply their G&A to subcontractor rates (costs). Note that the solicitation specifically segregates the fixed fee from the loaded hourly rates"

In answering the offeror's question, the government appropriately separated fee from contractor G&A; the latter representing a cost, the former a true mark-up (fee not cost). The fact that G&A is the topic of CAS 410 (Cost Accounting Standard) is one more point of reference which clearly indicates that for government contracts, G&A is a "cost" not to be confused with a fee/profit.

With respect to the CBCA case, interesting facets or "the rest of the story", at issue was the Government interpretation that the fixed fee was actually a fixed rate (8%) to be applied to the fully burdened direct labor hours/costs. Thus, the "fixed fee" could be less if the required labor under-ran the estimated number of hours (DPLH) and costs. Additionally, unlike most T&M contracts, the DPLH was fully burdened, but without any fee; typically, the "T" component of a T&M contract is the price for labor hours (direct labor rates, fully burdened with applicable indirect costs plus profit or fee). The CBCA did make note of the fact that even the contractor confused the issue, only billing fee as an 8% additive to the DPLH labor dollars and only pursuing the full fixed fee as part of the claim. Additionally, the contract inexplicably included the T&M payment clause, FAR 52.232-7, which confused the issue, but it did not negate the contract specific terminology concerning the fixed fee. The decision in the CBCA case was the only possible decision, the contract clearly listed a fixed fee which was a fixed dollar amount and not a fixed rate to be applied to the fully-burdened labor dollars.

2017 NDAA (National Defense Authorization Act)

By Michael E. Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

The SASC (Senate Armed Services Committee) has drafted its version of the 2017 NDAA (which will be subject to debate within the Senate before the House and Senate reconcile their differing versions of the Act). It remains to be seen if the SASC proposal will be substantially changed and/or what will ultimately be retained within the reconciled 2017 NDAA and/or what will be retained that will trigger a President's Veto; hence the 2017 NDAA should be recognized as a draft subject to change. Of some note, the SASC version contains a plethora of sections (801-899) which could impact acquisition policy, but most are inwardly focused (e.g. reducing the number of general and flag officers by 25 percent as well as reducing the number of Senior Executives (SES) by 25 percent). Although some of the sections seem to be inwardly focused (operationally impacting DOD), there is one section which would ultimately impact DOD contractors; it is the requirement for DOD to pay a (funding) penalty for the use of cost-type contracts (2 percent for production contracts and 1 percent for R&D contracts). Directly related to this penalty, direction for DOD to use fixed-price contracts; in particular, fixed-price incentive contracts for R&D contracts (typically cost-type contracts).

As we've discussed in previous newsletters, studies have shown that program cost overruns are not predictably attributable to cost-type contracts versus fixed price contracts; nonetheless there continues to be a belief that cost-type contracts are inherently evil. There is one predictable outcome if contractors sign-up to fixed-price (firm or incentive) contracts for developmental (R&D) or other high risk contracts, there will be contracts where the contractor losses are significant and there will be no recourse for the contractor. As we speak, a large defense contractor continues to absorb losses on its development and testing of the new Air Force Refueling Tanker (a fixed-price incentive contract whose ceiling price is $4.9 billion with current cost projections of $.6.4 billion). On a much smaller scale, but equally alarming in terms of the Government's insistence on fixed price contracting in high risk situations, a contractor in Afghanistan who signed up for a firm-fixed price contract despite the fact that the solicitation identified the place of performance as a "war zone" for which hostile actions might be the basis for extending the period of performance, but at no increase in price. In attempting to perform to the statement of work, the contractor was also impacted by closures at the border with Pakistan coupled with equipment which was hijacked somewhere in route (from Pakistan). In failing on its appeal to the ASBCA, the contractor was reminded that it willingly

entered into a fixed price contract in full knowledge of the associated risks and fixed price meant fixed price.

ASBCA Decisions Impacting Contractor Cost Recoveries

By Michael E. Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

In the last three months, the ASBCA has issued some decisions (and some dismissals) of interest to defense contractors with auditable contracts (i.e. cost-type or T&M for which the final price is a function of the results of incurred cost audit or voucher reviews typically performed by DCAA). In addition to cost recovery, one of the decisions related to CPARs (Contract Performance Assessment Report) which impacts a contractor's ability to obtain future Government contracts. A synopsis of the decision on CPARs as well as some other recent decisions:

ASBCA 59911, 59912. In addition to seeking $76,672 in damages for an alleged government delay and work performed prior to a government stop work order, the contractor sought relief in the form of an ASBCA decision compelling the Air Force to revise the CPAR. Although the ASBCA previously ruled that it lacked jurisdiction to grant specific performance and injunctive relief, the contractor was granted leave to file an amended complaint (which turned out to be essentially the same as the original complaint). In its April 21, 2016 decision, the ASBCA reconfirmed that it has no authority to compel a Contracting Officer or Agency to revise the contractor specific CPAR. The message for defense contractors, if you want to challenge your CPAR evaluation or rating, don't file a complaint with the ASBCA.

ASBCA 60431, 60432. A government contractor continued its ASBCA appeals on two contracting officer final decisions (demand for payments of approximately $300,000) notwithstanding that the contracting officer had rescinded both final decisions (apparently final decisions are not necessarily final). The contractor had appealed the two decisions on the basis that the government claims were time barred by the six-year statute of limitations in the Contract Disputes Act (FAR 33.206) and in both cases, the contracting officer notified the contractor that she "hereby withdraws" the final decisions. Notably, the government never disclosed why it withdrew the final decisions nor did the government state whether it intends to reassert the claims. In continuing its appeals (in spite of the government withdrawing the decisions), the contractor wanted a decision which would close the door on any possible government action to reassert one or both claims. To that end, the contractor noted that the government refused to enter into a settlement agreement or to issue a letter stating that the government did not intend to reassert the claim(s).

There was some discussion of a similar case (58945, 58946) wherein a contractor pursued its appeal even though final decisions were rescinded and the government stated that it does not intend to reissue the contracting officers' decisions or otherwise disallow the costs (which had been) disallowed in those decisions.

In both ASBCA decisions, the ASBCA dismissed the contractors' appeals stating that the contracting officer final decisions have been unequivocally rescinded, there is nothing left of the merits to adjudicate and the appeals are moot. Although the ASBCA dismissal is without prejudice, we trust that the rescinded claims will not be reasserted by the government.

It remains to be seen if the contractors' continued appeals were an attempt to eliminate similar cost allowability issues in future years (similar set of facts with claimed costs, but in years awaiting audit). As it stands, the contractors have no protection from similar issues in later (to-be audited years) because the government chose to simply disengage on the very specific issues/years/costs, but with no commitment for the future years.

ASBCA 60276. This particular decision is a Summary Binding Decision by Administrative Judge Wilson which is associated with an ADR agreement which had been approved by the ASBCA. With no other details, the Summary Binding Decision (of the ADR agreement) found that the contractor's compensation costs for contract years 2004 and 2005 was reasonable (implicates FAR 31.205-6(b)). The contractor had sought a Board decision on the six-year statute of limitations (FAR 33.206); however, the contractor conceded that it was not applicable in the instant appeal.

Absent any other details, we can only speculate as to the issue(s); however, there is a high probability that the issue stemmed from a DCAA incurred cost audit, particularly, DCAA's highly prescriptive benchmarking of executive

compensation (the top five most highly compensated individuals for the contractor). In spite of two ASBCA decisions which conclusively stated that DCAA's methodology is statistically flawed, DCAA continues with exactly the same methodology. For example, DCAA will benchmark the cash compensation (salary and bonus) to similar data using up to three independent salary surveys; however, DCAA's compensation benchmark is the average of the three surveys (ignoring the fact that this method is statistically flawed). In recent discussions with DCAA's Mid-Atlantic Compensation Team (where DCAA used exactly the same methodology as was deemed statistically flawed by the ASBCA), the auditor (not an attorney) insisted that there was nothing relevant in the published ASBCA decisions.

The good news or at least implication, ASBCA 60276 and the associated ADR agreement (involving a contractor and the government ACO) suggest that the contractor prevailed in the entirety on an issue involving DCAA's statistically flawed benchmarking. Unfortunately, ASBCA 60276 is one more confirmation that DCAA believes that the concept of "auditor independence" (a requirement to be in conformance with government auditing standards) includes independence from published decisions. Stated differently, DCAA's unofficial mantra is "We prefer to believe what we prefer to be true".

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Arlington, VA

August 25-26, 2016 – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk
Arlington, VA

September 19-20, 2016 – Cost and Price Analysis in Government Contracts
Fort Worth, TX

October 24-25, 2016 – Accounting Compliance for Government Contractors
Sterling, VA

November 3-4, 2016 – Cost and Price Analysis in Government Contracts
Sterling, VA

Instructors:

- Mike Steen
- Scott Butler
- Cyndi Dunn
- Asa Gilliland
- Sheri Buchanan
- Darryl Walker
- Courtney Edmonson
- Cheryl Anderson
- Robert Eldridge

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CFO Roundtable

Redstone Government Consulting, Inc., Radiance Technologies, Inc., & Warren Averett will be sponsoring a CFO/Controller roundtable for Government Contractors.

All Government contractor CFO's or Controllers are invited to participate. The meetings will be held quarterly and will include lunch and networking from 11:30am – 1:00pm. The next meeting will be held on August 17, 2016 in Research Park at a location TBD. Participants will be notified via email announcements for all future locations and seminar topics.

The CFO Roundtable is **free** to attend. All participants will be invited to share topics of interest and the group will be interactive. Redstone GCI, Radiance Technologies, and Warren Averett will strive to provide speakers on topics that are of interest to the group each quarter. Please provide us your email address and we will notify you 30 days in advance of each meeting. RSVP's are required.

Sign up for CFO Roundtable here

About Redstone Government Consulting, Inc.

Our Company's Mission Statement: RGCI enables contractors doing business with the U.S. government to comply with the complex and challenging procurement regulatory provisions and contract requirements by providing superior cost, pricing, accounting, and contracts administration consulting expertise to clients expeditiously, efficiently, and within customer expectations. Our consulting expertise and experience is unparalleled in understanding unique challenges of government contractors, our operating procedures are crafted and monitored to ensure rock-solid compliance, and our company's charter and implementing policies are designed to continuously meet needs of clients while fostering a long-term partnership with each client through pro-active communication with our clients

In achieving government contractor goals, all consulting services are planned and executed utilizing a quality control system to ensure client objectives and goals are fully understood; the right mix of experts with the proper experience are assigned to the requested task; clients are kept abreast of work progress; continuous communication is maintained during the engagement; work is managed and reviewed during the engagement; deliverables are consistent with and tailored to the original agreed-to scope of work, and; follow-up communication to determine the effectiveness of solutions and guidance provided by our experts.

Specialized Training

Redstone Government Consulting, Inc. will develop and provide specialized Government contracts compliance training for client / contractor audiences. Topics on which we can provide training include estimating systems, FAR Part 31 Cost Principles, TINA and defective pricing, cost accounting system requirements, and basics of Cost Accounting Standards, just to name a few. If you have an interest in training, with educational needs specific to your company, please contact Ms. Lori Beth Moses at lmoses@redstonegci.com, or at 256-704-9811.

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