It's been ten years since I first tackled government contract accounting issues associated with joint ventures. (*See* "Accounting, Cost and Pricing Issues in Strategic Alliances and Teaming Agreements," Strategic Alliances and Teaming on Government Contracts: Winning Combinations for the Next Century
, American Bar Association, 2000.) At that time, my co-authors (Jim Check and Jason Aiken) and I asserted that "The structural form and, more importantly, the substance of an alliance arrangement will bear significantly on determining whether costs are allowable and how they are allocated."

We discussed three primary scenarios—

1. Each alliance member will incur all costs individually and no costs will be

incurred by the alliance (the “unpopulated alliance” scenario).

2. The alliance will incur all costs and no alliance member will incur any costs (the “populated alliance” scenario).

3. Each alliance member will incur some costs as an individual entity, while some costs will be incurred by the alliance (the “hybrid alliance” scenario).

In the first scenario above, all costs (including costs of the alliance’s infrastructure such as program management, billing, audit support, etc.) are incurred by an alliance member and included on that member’s billings to the alliance entity. The alliance entity is simply a shell without any of its own costs, employees, or control systems. In the second scenario, the alliance is brought to life by infusing it with working capital, employees, and control systems. The alliance implements all necessary business systems, including payroll processing, purchasing, property control, etc. The alliance will develop its own indirect rate structure and calculates is own indirect cost rates, based on the direct and indirect costs it incurs. In such circumstances, the alliance may require its own Disclosure Statement. Finally, in the third scenario there are at least two structures involved—that of the alliance entity and those of the alliance members. Alliance members may operate as both owners and subcontractors, depending on how the work is allocated.

Although there are several different forms of “alliance” (including teaming agreement or Special Business Unit), the most prevalent type is the joint venture. Joint ventures (JVs) offer the opportunity to present a single, unified face to a customer, to create a separate cost structure and benefit packages, and to utilize the alliance members’ past performance information for purposes of winning a proposal.

The DCAA Contract Audit Manual (CAM) discusses audit issues associated with JVs at 7-1800. According to the CAM—

A joint venture, proposed and established as a separate business entity, should have its own set of books and supporting documentation sufficient for an audit trail. Transactions should be recorded consistent with the joint venture agreement, and care must be taken to ensure that the joint venture bears its equitable share of the costs. A joint venture, proposed and established as a separate business entity, should have its own set of books and supporting documentation sufficient for an audit trail. Transactions should be recorded consistent with the joint venture agreement, and care must be taken to ensure that the joint venture bears its equitable share of the costs.

More recently, in its role as adjudicator of bid protests, the GAO has addressed the need for a JV to have an adequate accounting system suitable for cost reimbursement contracts, as well as whether a JV needs to file a CASB Disclosure Statement.

In PMO Partnership Joint Venture (**B401973 .3** , 1/14/2010), the Department of Transportation (DOT) rejected PMO's offer because it considered the JV's indirect cost structure to be "unacceptable." In the words of the hired auditor (BMC)—

Indirect cost rates were not projected for the PMO Partnership and used in the cost proposal in accordance with FAR 31.203. Instead the indirect cost rates for each partner were used separately in the cost proposal. A budget should have been developed for the partnership entity and projected indirect rates should have been calculated from the budget and used in the cost proposal. As a result the indirect costs included in the cost proposal are questioned . . .
The cost proposal should be for the PMO Partnership Joint Venture Entity and should not list the costs for each partner separately. The PMO Partnership Joint Venture is a separate entity in and of itself and that is how the costs should be presented in the cost proposal. . . .

Because the JV's indirect structure was found unacceptable (and by the way noncompliant with CAS 401), the entity's offer was rejected and PMO protested the contracting officer's decision. As a preliminary matter, DOT's argument that the JV had violated CAS 401 was dismissed because the JV was a qualified small business concern, and thus exempt from the requirements of CAS 401. In addition, GAO noted that the Government had "not explained why the particular overhead rate structure proposed by PMO-JV would lead to an inconsistency in the application of cost accounting practices or a loss of financial control over costs during contract performance." Accordingly, the protest was sustained.

Similarly, in McKissack+Delcan JV II (**B401973.2** , 1/13/2010) the JV's offer to DOT was rejected because the JV member maintaining the accounting records (Delcan) would utilize Canadian GAAP instead of US GAAP. Moreover, "The proposal submitted to the Government does not show that the joint venture is an independent entity. An independent joint venture for Government contracting purposes would have employees committed from each company and the indirect rate structure would be unique to the joint venture. . . . In addition, the indirect rate structure proposed is Delcan's; the proposal should contain an indirect rate structure specific to McKissack & Delcan Joint Venture II." However, as the protest evolved the Government abandoned its initial position(s) and ended-up with the same arguments it used with respect to PMO, namely that the JV's "accounting system is inadequate because MD-JV's failure to submit a unique indirect rate for the joint venture violates CAS 401." As with PMO, the protest was sustained.

In both protests above, DCAA failed to appreciate that a JV need not be "populated" and might simply consist of the costs of its members. On the other hand, companies wishing to enter into a JV or other strategic alliance should be mindful of the blind spot(s) in DCAA's audit approach, and take care to link proposed indirect costs to the form and substance of the alliance entity they have chosen.

Finally, in Northrop Grumman/Textron (**B400837** , 2/17/2009) the two companies protested award of the Joint Light Tactical Vehicle (JLTV) contract to the GTV Joint Venture (a JV between General Dynamics Land Systems and AM General) because (among other things) GTV failed to submit a CASB Disclosure Statement for the JV. GAO noted that "GTV's proposal indicated that 100 percent of the contract costs would be accounted for by subcontracts with the two joint venture members, apportioned between them equally. GTV indicated in its proposal that a CAS disclosure statement had previously been submitted, and specifically cited in this regard disclosure statements submitted by AM General and GDLS."

GAO relied on the DCAA audit guidance that states—

The need for a joint venture CAS Disclosure Statement depends upon the characteristics of the venture itself. The determination must be made on a case-by-case basis. Where the joint venture is the entity actually performing the contract, has the responsibility for profit and/or producing a product or service, and has certain characteristics of ownership or control, a Disclosure Statement should be required. Where the venture merely unites the efforts of two contractors performing separate and distinct portions of the contract with little or no technical interface, separate joint venture disclosure may not be required.

Because “GTV’s proposal in fact incorporated CAS disclosure statements applicable to the contemplated contract effort” the protest was denied.

To sum up, there are undeniable attractions to forming a joint venture or similar alliance to pursue government business. But doing so presents difficulties—not the least of which is ensuring alignment between the form/structure of the alliance and its cost structure, and navigating the submission of CASB Disclosure Statements. Based on recent GAO decisions, auditors will not be sensitized to the possible forms of the alliance, and may misevaluate what is presented, unless pains are taken to clearly show how proposed costs are consistent with how costs will be accumulated and billed after contract award.