

Learning about FAR Cost Principles Too Late

Written by Nick Sanders
Monday, 05 November 2012 00:00



Apogee Consulting, Inc. is a small business focused on providing assistance to contractors that are having trouble complying with the myriad administrative requirements of a typical government contract, especially those challenges that come with defense contracts. We help contractors deal with their first DCAA audit; or, perhaps their second DCAA audit if the first audit did not go as planned. We help contractors deal with developing (or enhancing) accounting and other business systems to better match their company's strategic direction. We help with proposals; we help with negotiations. We help with accounts receivable, and we help with terminations.

We're not as cheap as some, and we are certainly not as expensive as many. We think we create a fair value for our price.

But some contractors don't call us, and they don't call anybody else, either. They try to go it alone, relying on in-house expertise that may or may not exist, to provide assurance that they are managing their contracts adequately and executing them in a compliant manner. Some contractors get their first defense contract and think they are going to apply their time-honored management practices to it, never realizing how much more stringent the defense requirements are going to be on them.

Other contractors receive their first cost-plus contract and fail to realize that their world has just changed. We see this in the SBIR program, where successful contractors move from (fixed-price) Phase 1 contracts to (cost-type) Phase 2 contracts ... never realizing that the

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management approach that worked out so well on Phase 1 is going to be woefully inadequate when applied to Phase 2.

Vern Edwards calls these companies “clueless would-be contractors” and has dedicated a [blog article](#) of his own about the phenomenon. He wrote—

Many small to medium sized companies go into government contracting without any idea of what they are getting themselves into. That might be okay with very small sales, but, otherwise, contracting with the U.S. government is the most complex business in the world. It's right up there with trading derivatives. There are countless rules and contract clauses, many of which are exceedingly hard to understand.

In that blog article (link above), Vern offered “14 tips for the Truly Clueless Would-Be Government Contractors who think that winning a government contract is the yellow brick road to riches.” You really ought to read those fourteen tips, because following them could save you a *lot* of money downstream.

We touched on this notion, in [this blog article](#) about the recent [ASBCA decision](#) on the *Inframat*

appeal. Inframat appealed a Contracting Officer's decision disallowing costs questioned by DCAA as being unallowable, and which imposed some \$21,000 in “level one penalties” associated with submitting those “expressly unallowable” costs in its certified proposal to establish final billing rates.

(Note: If you are unclear what an “expressly unallowable” cost might be, or what a “level one penalty” might be, or what a “certified proposal to establish final billing rates” might be, then you might just be one of those contractors Vern was talking about. *Which is fine.* Ignorance is not a crime! But your failure to comply with your contractual requirements just might be a crime. Something to think about, perhaps?)

What we said at the time about Inframat and similar contractors bears repeating, we think. We wrote—

... here's the bottom-line for small businesses entering the defense marketplace: If you focus on contract execution and don't pay attention to the back-office administrative requirements,

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your story will not end happily. You could easily end up paying the U.S. Government far more than it paid you ...

Yet another potential landmine that you could trigger would be failing to deal with this 'unallowable cost' thingee that's addressed in FAR Part 31. ... If you are a small business, you may only have a vague idea as to what the FAR is—let alone have sufficient expertise in navigating the identification and segregation of unallowable costs (and the calculation of acceptable indirect cost rates). We suggest you had better learn more about this area—and quickly. The ability to properly account for unallowable cost implicates not only the adequacy of your accounting system, but also the adequacy (and accuracy) of your annual proposal for final billing rates. If you blow the proper accounting for unallowable costs, you are going to make DCAA very happy—because they will get to issue an audit report with lots and lots of questioned costs in it.

It may sound self-serving, but we honestly believe that if you are clueless regarding government contract cost accounting, then it would be a very good idea to hire a subject matter expert to assist you in that area. ... Quimba's problems with DOD need not typify that of every small business, but if you don't at least *come close* to getting the contract accounting and billing correct, you are going to have similar problems.

It is not going to be pretty.

With those Cassandra-like warnings setting the stage, let us now turn our attention to the [recent ASBCA decision](#)

in the appeal of

Thomas Associates, Inc

. The ASBCA's decision in

Thomas Associates, Inc.

(TAI) was quite reminiscent of its decision on the

Inframat

appeal. Indeed, the ASBCA Judge cited to

Inframat

in the decision.

Like *Inframat*, TAI was not represented by outside counsel. Like *Inframat*, TAI was a small business (TAI was an 8(a) contractor). Like *Inframat*, TAI had a cost-type contract. Like *Inframat*, TAI was audited by DCAA, who questioned \$33,890 in "expressly unallowable overhead costs" and \$4,498 in "expressly unallowable G&A costs." Like *Inframat*, DCAA recommended level one penalties—roughly \$13,000 in TAI's case.

TAI included the following in its certified proposal to establish final billing rates:

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\$9,908 “for a Pintail Point corporate deluxe membership,” which included such activities as “sporting clay instruction, shooting, tournaments, a full-day fishing trip, a night at “Manor House Bed & Breakfast,” a one-time use of a banquet room and five rounds of golf.” DCAA questioned those costs as being unallowable entertainment costs, but TAI thought they should be allowable as a “wellness/fitness center to improve employee morale, fitness, and teamwork under FAR 31.205-13.”

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\$9,848 for an employee party at the Chesapeake Bay Beach Club, plus \$700 for a limousine to carry employees to the party. TAI thought these costs should be allowable employee morale expenses under FAR 31.205-13, because it was an employee recognition event.

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\$1,500 for the U.S. Naval Academy’s “Unified Jazz Ensemble,” who performed at the aforementioned Christmas party.

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\$139 for providing flowers to employees to acknowledge “significant events.”

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\$16,215 for office rental costs in excess of what ownership costs would have been. TAI thought these costs should be allowable because the overall rent per square foot was in line with comparable offices in the area.

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Do we need to tell you that TAI failed to persuade the ASBCA Judges on any aspect of its arguments? To put it bluntly, TAI's arguments were absurd and it should have been embarrassed to make them. (Perhaps that's why it had to represent itself? Perhaps TAI couldn't find an outside attorney who could maintain a straight face while arguing those positions in court?)

With respect to the requested waiver of FAR-imposed penalties, TAI (like Inframmat) did not prevail on that point either. TAI sought waiver of the penalties based on "financial hardship" as well as the fact that the DCAA audit findings was "a learning experience for us"—and that TAI subsequently improved its policies and procedures "to preclude these types of costs from being included in our incurred cost submissions."

The ASBCA Judges wrote that TAI's argument ignored the FAR and that the basis of its argument was "unpersuasive." The Judges wrote—

There is no evidence that TAI submitted the five expressly unallowable costs in 2004 'inadvertently' or due to 'unintentional error, notwithstanding the exercise of due care,' as prescribed by FAR 42.709-5(c)(2). Thus, the ACO properly denied TAI's 29 April 2010 waiver request.

TAI's appeal was denied in all particulars. As well it should have been.

Look, here's the deal. When you sign a contract with the U.S. Government, you are responsible for complying with all aspects of your contract—even those pesky "clauses incorporated by reference" found in Schedule I. This is especially true when you're contracting with the Department of Defense. If you do not understand those clauses, don't be embarrassed. It takes years of experience (and trial and error) to gain any appreciation of the requirements that those clauses mandate. If you are new to government contracting, there's no reason you should be expected to understand them or to know how to comply with them. There's no shame in ignorance when you're at the bottom of the learning curve.

But government contracting is not very forgiving. There's really no time to learn on the job or to make mistakes. Your company's bottom-line—and perhaps its future—is at stake. Maybe you're an excellent contracts manager but not so deep in accounting or property control or EVMS. Maybe you're a great accountant, but purchasing and contract administration are

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skillsets that are out of your league. That's the way it is, and you need to accept it. You need to get over the notion that your authority and/or subject matter expertise is somehow undermined because you don't know everything about everything having to do with government contracting. The fact that your subject matter expertise has limits does not impact at all on the areas in which you do have that expertise. It just means you have some learning ahead of you.

So if you are facing new or challenging requirements, pick up the phone and call in a trusted business advisor who can help you out. And this is not about Apogee Consulting, Inc. There are many other advisors out there, and you should contact one of them as soon as you identify your needs.

It's going to be a very wise investment, we assure you.