



**DCAA**

DEFENSE CONTRACT AUDIT AGENCY

# Introduction to DoD Contracts with Commercial Organizations

# Discussion Points

- Regulations and Cost Principles
- Why Brief Solicitations and Contracts
- Additional Resources Available on the DCAA Internet

# Federal Acquisition Regulations

The Federal Acquisition Regulations System is established for the codification and publication of uniform policies and procedures for acquisition by all executive agencies. The Federal Acquisition Regulations System consists of the Federal Acquisition Regulation (FAR), which is the primary document, and agency acquisition regulations that implement or supplement the FAR.

# Defense Federal Acquisition Supplement

Defense Federal Acquisition Regulation Supplement (DFARS) is a supplement to the FAR that provides DoD-specific acquisition regulations that DoD government acquisition officials and those contractors doing business with DoD must follow in the procurement process for goods and services.

# FAR Part 31 Contract Cost Principles and Procedures

FAR Part 31 contains cost principles and procedures for:

- The pricing of contracts, subcontracts, and modifications to contracts and subcontracts whenever cost analysis is performed; and
- The determination, negotiation, or allowance of costs when required by a contract clause.

# FAR Part 31.2 Contracts with Commercial Organizations

FAR 31.2 contains cost principles and procedures for contracts with commercial organizations. It includes area such as-

- 31.201-1 Composition of total cost
- 31.201-2 Determining allowability
- 31.201-3 Determining reasonableness
- 31.201-4 Determining allocability
- 31.201-5 Credits

# FAR Part 31.2 Contracts with Commercial Organizations

- 31.201-5 Credits
- 31.201-6 Accounting for unallowable costs
- 31.201-7 Construction and architect-engineer contracts
- 31.202 Direct costs
- 31.203 Indirect costs
- 31.204 Application of principles and procedures
- 31.205 Selected costs. (addresses 52 specific areas of costs)

# FAR 31.201-1 Composition of Total Costs

- The total cost of a contract is the sum of the direct and indirect costs allocable to the contract.
- While the total cost of a contract includes all costs properly allocable to the contract, the allowable costs to the Government are limited to those allocable costs which are allowable pursuant to Part 31, solicitation terms, and applicable agency supplements.

# FAR 31.201-2 Determining Allowability

A cost is allowable only when the cost complies with all of the following requirements:

- Reasonableness.
- Allocability.
- Cost Accounting Standards, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
- Terms of the contract.
- Any limitations set forth in FAR 31.2.

## FAR 31.201-3 Determining Reasonableness

- A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.
- No presumption of reasonableness shall be attached to the incurrence of costs by a contractor.

# FAR 31.201-3 Determining Reasonableness

- The burden of proof is on the contractor to establish that cost is reasonable.

## FAR 31.201-4 Determining Allocability

A cost is allocable to a government contract if it:

- Is incurred specifically for the contract;
- Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

# FAR 31.201-6 Accounting for Unallowable Costs

Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract.

# FAR 31.201-6 Accounting for Unallowable Costs

- Costs specifically designated as unallowable per written decision furnished by a contracting officer shall be identified if included in or used in computing any billing, claim, or proposal applicable to a Government contract.
- This identification requirement applies also to any costs incurred for the same purpose under like circumstances as the costs specifically identified as unallowable.

# FAR 31.201-6 Accounting for Unallowable Costs

- The practices for accounting for and presentation of unallowable costs must be those described in 48 CFR 9904.405, Accounting for Unallowable Costs.
  - The most common approach is to segregate unallowable costs in separate accounts maintained for this purpose in the regular books of records.

# FAR 31.202 Direct Costs

- Direct cost means any cost that is identified specifically with a particular final cost objective.
- Direct costs are not limited to items that are incorporated in the end product as material or labor.

# FAR 31.202 Direct Costs

- No **final cost objective** shall have **allocated** to it as a direct cost any cost that has been included in an **indirect cost pool**.
- Direct costs of the contract shall be charged directly to the contract.

# FAR 31.203 Indirect Costs

- An indirect cost means any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective.
- An indirect cost is not to be allocated to a final cost objective if other costs incurred for the same purpose in like circumstances have been included as a direct cost of any other final cost objective.

# FAR 31.203 Indirect Costs

- FAR requires a logical and consistent method for the accumulation and allocation of indirect costs to intermediate and final cost objectives.
- The term indirect cost covers a wide variety of cost categories and the costs involved are not all incurred for the same reasons.

# FAR 31.203 Indirect Costs

- The number of indirect cost accounts in a single company can range from one to hundreds.
- The indirect structure needs to be tailored to your company and how it operates.
- In general, indirect cost accounts fall into two broad categories:
  - Overhead
  - General and Administrative

# FAR 31.203 Indirect Costs

Examples of Overhead indirect cost rates include:

- Material Overhead
- Manufacturing Overhead
- Engineering Overhead
- Site Overhead

# FAR 31.203 Indirect Costs

The General and Administrative costs are management, financial, and other expenses related to the general management and administration of the business unit as a whole. To be considered a G&A expense of a business unit, the expenditure must be incurred by, or allocated to, the general business unit.

Examples of G&A expenses include:

- Salary and other costs of the executive staff of the corporate or home office
- Salary and other costs of such staff services as legal, accounting, public relations, and financial offices
- Selling and marketing expenses

# FAR 31.203 Indirect Costs Allocation Base

- Indirect costs should be allocated based on benefits accrued to intermediate and final cost objectives.
- Allocation base must be reasonable.
- There must be a relationship between the selected allocation base and the pool costs.
- For example, training costs in the overhead pool are not necessarily caused by a particular cost objective, but the cost objectives might benefit from the training of employees. In that case, training would be related and benefit the labor dollars incurred on contracts/final cost objective.

# Allocation Base

In general, typical allocation bases for Overhead and G&A are:

## Overhead

- Direct Labor Dollars
- Direct Labor Hours
- Direct Material Dollars

## G&A

- Total Cost Input (Total direct and indirect costs minus G&A)
- Value Added (Total Cost Input less subcontracts and direct materials)
- Single Cost Element (e.g. Direct labor dollars)

# Overhead Rate Example

## Overhead Pool

Acct. No.	Description	G/L	Adj	Claimed	OH Base:
7001	Salaries & Wages	33,060		33,060	Direct Labor 633,012
7002	Postage & Handling	6,235		6,235	
7004	Small Equipment	878		878	
7011	Equipment Rental	27,150		27,150	
7016	Repairs/Maintenance	1,681		1,681	
8421	Leave	20,181		20,181	
8425	Severance Pay	32,419	(23,023)	9,396	
8427	Taxes	23,612		23,612	
8431	Workers' Compensation	3,311		3,311	
8435	Health Insurance	31,097		31,097	
8440	Life Insurance	6,833		6,833	
8445	Pension Plan	58,320	(8,612)	49,708	
8450	Miscellaneous	612		612	
	<b>Total OH Pool</b>	245,389	(31,635)	213,754	

$$\frac{\text{OH Pool}}{\text{OH Base}} = \text{OH Rate}$$

$$\frac{213,754}{633,012} = 33.77\%$$

# G&A Rate Example

## General & Administrative Pool

Acct. No.	Description	G/L	Adj	Claimed
8001	Salaries & Wages	90,007		90,007
8320	Legal Fees	1,744		1,744
8501	Travel	12,987	(1,295)	11,692
8503	Entertainment	484	(484)	-
8505	Advertising & Promotion	354	(287)	67
8522	Bad Debts	3,018	(3,018)	-
8527	Interest Expense	1,001	(1,001)	-
8521	Leave	2,321		2,321
8527	Taxes	3,815		3,815
8535	Health Insurance	8,912		8,912
8540	Life Insurance	1,087		1,087
8545	Pension Plan	12,318	(1,883)	10,435
8550	Miscellaneous	3,357		3,357
<b>Total G&amp;A Pool</b>		141,405	(7,968)	133,437

### G & A Base:

Direct Labor	633,012
Direct Travel	34,563
Direct Material	842,981
Other Direct Costs	172,105
Subcontracts	944,841
OH Expenditures	245,389
<b>Total G&amp;A Base</b>	<u>2,872,891</u>

### G&A Rate

$$\frac{\text{G\&A Pool } 133,437}{\text{G\&A Base } 2,872,891} = 4.64\%$$

# Briefing Solicitations and Contracts

# Briefing Solicitations and Contracts

- Briefs generally includes a synopsis of all pertinent contract provisions
- Solicitation terms and Contract clauses are reviewed to determine the specific requirements for each contract and the allowability, allocability, and reasonableness of costs to be billed to the government

# Why Brief Solicitations and Contracts?

- Without briefing the solicitation, you could fail to comply with the solicitation terms resulting in delays in contract award or not being awarded a contract.
- Once the contract is signed, the contractor is expected to fully comply with all terms and conditions of the contract.
- Without fully understanding what was agreed to in the contract, contractual issues can occur throughout the life of the contract.

# Contract Clauses

## Important Contract Clauses

- 52.215-2 Audit and Records-Negotiation
- 52.216-7 Allowable Cost and Payment

# FAR 52.215-2 Audit and Records-Negotiation

- This clause relates to the Contracting Officer and their representatives access to contractor records.
- Records include books, documents, accounting procedures and practices, and other data, regardless of type and regardless of whether such items are in written form, in the form of computer data, or in any other form.

## FAR 52.215-2 Audit and Records-Negotiation

- When certified cost or pricing data is required in connection with any pricing action provides the right to examine and audit all of the Contractor's records, including computations and projections

# FAR 52.215-2 Audit and Records-Negotiation

- In cost-reimbursement, incentive, time-and-materials, labor-hour, or price redeterminable contract, or any combination of these, the Contractor shall maintain records.
- Provides for the right to examine and audit all records and other evidence to evaluate all costs claimed to have been incurred or anticipated to be incurred directly or indirectly in performance of this contract.

## FAR 52.215-2 Audit and Records-Negotiation

- This right of examination shall include inspection at all reasonable times of the Contractor's plants, or parts of them, engaged in performing the contract.

# FAR 52.215-2 Audit and Records-Negotiation

- The clause identifies how long records must be maintained.
- It also describes the situations when the clause must be flowed down to your subcontractors

## 52.216-7 Allowable Cost and Payment

- This clause is inserted in solicitations and contracts when a cost-reimbursement contract or a time-and-materials contract (other than a contract for a commercial item) is contemplated.

## 52.216-7 Allowable Cost and Payment

- This clause lays out the terms related to items such as:
  - Invoicing – payments to the contractor as work progresses
  - Reimbursing Costs – defines what a cost is in relation to reimbursing costs

## 52.216-7 Allowable Cost and Payment

- Billing Rates – Indirect rates set by the contracting officer or authorized representative for reimbursement until final rates are set.

## 52.216-7 Allowable Cost and Payment

- Final Indirect Rates— indirect cost rate established and agreed upon by the Government and the contractor are not subject to change.
- Contractor must submit final indirect cost rate proposal within 6-months after the end of their fiscal year.
- Clause identifies requirements of an adequate proposal

## 52.216-7 Allowable Cost and Payment

- Billings must be adjusted to reflect final rates within 60 days of settlement of final indirect rates.
- Once the final indirect rates are established for all the years of the contract, the contractor has 120 days to submit a completion invoice or voucher.

## 52.216-7 Allowable Cost and Payment

- Audit – At any time or times before final payment, the Contracting Officer may have the Contractor's invoices or vouchers and statements of cost audited and reduced by amounts found by the Contracting Officer not to constitute allowable costs or adjusted for prior overpayments or underpayments.

# Additional Resources Available on DCAA Internet

# DCAA Internet Resources

## [www.dcaa.mil](http://www.dcaa.mil)

- Audit Process Overview – Information for Contractors Manual
- DCAA Preaward Accounting System Checklist
- DoD Contract Proposal Adequacy Checklist
- DoD Forward Pricing Rate Adequacy Checklist
- DCAA Incurred Cost Adequacy Checklist
- Incurred Cost Electronically (ICE) Model
- Links to Acquisition Regulations
- Small Business Seminar Slides

# Available Presentations

- Accounting System Requirements
- Contract Briefs
- Incurred Cost Submissions
- Monitoring Subcontracts
- Proposal Adequacy
- Provisional Billing Rates
- Public Vouchers
- Real-time Labor Evaluations
- Audit Process

# Contact Information

- DoD Office of Small Business Programs  
<https://business.defense.gov/>
- DCAA  
[dcaa-oal-smallbusinessfocalpoint@dcaa.mil](mailto:dcaa-oal-smallbusinessfocalpoint@dcaa.mil)

# Questions/Comments

