



Proposed FAR 52.232-7 Changes; Payments Under Time and Material and Labor Hour Contracts

The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council are proposing significant changes to the *Payments under T&M and LH Contract* clause in the FAR.

The most important changes to the payment clause include a better definition of "materials", clarification of profit/fee on materials, and elaboration as to when subcontractor labor could be billed at prime contractor negotiated direct labor rates. The current description of T&M contracts in FAR Part 16.601 does not address subcontract costs and the recovery method of such costs. The proposed change would clearly define subcontract cost as part of direct materials, along with other direct costs and applicable indirect costs.

The most far-reaching and significant change that would impact smaller contractors will be implicit limitations on billing subcontractor personnel direct labor at the negotiated prime contractor labor rates. The proposed change to the payment clause would specify two methods in which subcontractor direct labor cost may be recovered. The method allowed by the prime contractor is determined by the contracting officer and the circumstances surrounding the individual procurement.

The first method allows payment of non-ancillary subcontractor labor at the contract fixed labor rates applicable to the labor hour portion of the contract. The catch is that the subcontractor must be listed in the payment clause of the



prime contract, meaning the subcontractor's involvement must be approved in advance by the contracting officer.

The second method would allow subcontractor labor to be recovered at actual expenses plus any applicable indirect costs, such as material handling (e.g., as other direct costs plus applicable indirect administrative costs). This method would require the contract's payment clause to indicate "none" as it relates to subcontractor labor.

Many Government contractors bill subcontractor direct labor hours at prime contractor negotiated rates with or without explicit contracting office authority. This practice has been questioned from time to time by DCAA, who ordinarily deems subcontractor labor costs to be a direct cost other than prime contractor direct labor. If this proposed rule is implemented into FAR, prime contractors will no longer have the unilateral option of billing subcontractor labor at their negotiated labor rates.

The proposed amendments to FAR 52.232-7 will also explicitly state that the government does not pay profit or fee to prime contractors on "materials" as they relate to government T&M and labor hour contracts. Primary advantages to the government

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that would result from implementation of this rule include:

1. Government's authority to limit subcontractor labor hours to be paid at contract fixed labor rates;
2. Specification of authorized subcontractors in the payment clause of the contract;
3. Contracting officer's approval of changes in subcontractor labor;
4. Specification that subcontractor labor hours paid at contract fixed labor rates are not also subject to material handling; and
5. Accountability of subcontractor labor hours held to the same standards as the accountability of prime contractor labor hours.

Related-Party Leases and Common Control

Owners of any Government contractor having an ownership or management interest in the facilities leased to that contractor should determine if restrictions in the lease costs are applicable. Under FAR 31.205- 36, allowable lease costs under a related-party scenario, where common control between lessor and lessee exists, may be limited to actual cost of ownership of those facilities.

Owners or other officials of Government contractors often times purchase building facilities and lease back those facilities to the Government contractor via a separate LLC type entity. Although the amount of the annual lease under such an arrangement may be reasonable when comparable to the general real estate market place, lease costs that can be passed on to Government customers will be limited to no more than the ownership costs when common control is deemed to exist.

The main problem is defining how Government contractors can go about determining if common control exists. Symptoms of common control may include a majority of ownership of the lessor by the lessee or active management and financial control of the leasing company by officials of the Government contractor. Common control may exist, however, even if the Government contractor has a minority ownership of the leasing company.

DCAA guidelines identified in the DCAA audit manual do not provide specific benchmarks for determining common control. However, the guidance does state that auditors should focus on (1) determining if there is active management of and establishment of financial policy of the lessor by the Government contractor, and (2) reviewing the terms of the lease to determine if they are reasonable.

Training Opportunities

Federal Publications Seminar

Professionals of Beason & Nalley, Inc. will provide training sponsored by the Federal Publications Seminars on two occasions prior to the end of 2005.

The course to be provided is, "Government Contract Accounting Systems Compliance", and will be instructed on **November 2-3, 2005 in Las Vegas, Nevada, and December 13 - 14 in Washington, D.C.**

For more information, go to www.fedpubseminars.com and look under the Government Contracts index tab for this course.

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Thirty-third Symposium on Government Acquisition and the Annual Eastern Briefing Conference

Recent Developments in Government Contracting is sponsored by The North Alabama Chapter Federal Bar Association in conjunction with the FBA Government Contracts Section, **November 2-3, 2005 in Huntsville, Alabama.**

For more information call 256.830.2222, or email: Cindy.VanRassen@smdc.army.mil

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Future Newsletter Editions

Beason & Nalley welcomes any feedback from the readers of this newsletter. We appreciate any suggestions that you may have as to future content, presentation and format, or interesting developments in the procurement community that would be of interest to our readers. Please provide any feedback or suggestions via our email address at dwalker@beasonnalley.com.

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