



PACA Pulse

SUMMER 2012

PROFESSIONAL AEROSPACE CONTRACTORS ASSOCIATION OF NEW MEXICO

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PULSE EDITOR

Ross Crown
764.5402
RCrown@LRLaw.com

EDITORIAL SUPPORT & DESIGN

Ro Saavedra
830.2345
RoSaavedra@msn.com

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PACA and AFRL Host the 26th BFI

The 26th Annual Briefing for Industry (BFI) national conference co-sponsored by PACA and the Air Force Research Laboratory (AFRL) attracted just shy of 400 attendees representing government contractors and governmental defense entities. It was held at the Hotel Albuquerque on August 20-22 and chaired by the indomitable **Ron Unruh** for the 16th consecutive year!

PACA President **Patricia Knighten** kicked off the opening ceremonies. The BFI Program Committee procured notable dignitaries to speak that included AFRL Commander, **Major General William McCasland**, who provided an overview of AFRL to open day one, and **Major General Garrett Harencak**, Commander Air Force Nuclear Weapons Center (NWC), who provided a lively presentation on the NWC and deterrence.

Eric Mechenbier, PACA Vice President and BFI Committee member, served as Master of Ceremonies for day two which included a warm welcome from **Colonel John C. Kubinec**, 377th Air Base Wing Commander, Kirtland Air Force Base, followed by **Dr. Kelly Hammett**, Chief Engineer of the Directed Energy Directorate for AFRL who commenced the program presentations.

The **Honorable John E. Krings**, the first Undersecretary of Defense appointed by President Reagan, delivered the Luncheon Keynote Address on Tuesday, August 21. Previously, Secretary Krings served in various capacities including Director of Operational Test and Evaluation of the U.S. Department of Defense, Director of Navy and Marine Corps programs for McDonnell Douglas where he served for 30 years, and Director of Flight and Operations and Chief Test Pilot for F-15 and F-18 programs. He

was also a U.S. Air Force and Air National Guard pilot.

Secretary Krings provided his historical up-close and personal perspective of the development of the aerospace industry since he started flying "soon after the earth cooled." He began with the first Demon plane, which he described as possessing more ratchet than thrust, and concluded with the introduction of unmanned aerial vehicles, which he considers to be the biggest change

in aviation. He detailed how the evolving "purpose" of the plane has driven the most changes. He commended the many Operational Test and Evaluation personnel

and U.S. Senate Defense Committee members who are so committed to the same defense mission that "you couldn't tell what side of the aisle they were on." One's political doctrine was of no consequence in meeting defense goals. His views of today's defense industry contractors, however, aren't as promising. "They have shifted too far into the profit side of building defense weapons," he said. "We can't build tanks and weapons without a mission goal." According to Secretary Krings, contractor integrity is compromised and it's vital that it be restored, but will take time to reverse the risky profit driven culture that has arisen over time.



John E. Krings

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26th BFI *continued*

Secretary Krings also expressed his concern with how difficult and cumbersome battle space management has become since the early days of his career. At the core of these changes are the vast number of participants and equally vast computer/software applications that change drastically and quickly. “The size, magnitude is becoming so huge and complex that it’s becoming too difficult to manage,” he stated. He shared his unease with the cyber threat that he described as “huge.” He believes that too many interdependent parties have too much top security information that is vulnerable due to the unimaginable capabilities of cyber hackers.

Major General

David J. Eichhorn,

Commander of the Air Force Operational Test and Evaluation Center at Kirtland AFB, delivered the luncheon keynote address on the second day. General Eichhorn reports directly to the Air Force Chief of Staff regarding the test and evaluation of more than 76 major programs valued

in excess of \$650 billion being assessed at 12 different locations. He directs the activities of more than 625 civilian and military people, as well as 225 contractors. As a member of the test and evaluation community, General Eichhorn coordinates directly with the offices of the Secretary of Defense and U.S. Air Force Headquarters while executing realistic, objective, and impartial operational testing and evaluation of Air Force, coalition and joint war fighting capabilities. He has flown the B-52D/H, B-1B, F-111 and T-38, serving as an instructor pilot and aircraft commander. He has accumulated more than 6,100 hours in more than 47 aircraft types.

The General’s presentation was as entertaining as it was informative. He showed clips from popular contemporary movies to drive home his points regarding the necessity and importance of testing in saving time and money over the life of a program. While the scenes from Indiana Jones, Star Wars, and The Avengers were light and entertaining, General Eichhorn’s message was serious and sobering, namely that drastic funding cuts due to the escalating deficit has required that testing today be about “connecting the dots to do more without more.” He states that business today is about “fighting the war with what we have, not with what



we want to have.” And having to do more with less money is only half of the challenge according to General Eichhorn, as concurrent with dwindling funds is quickly multiplying data. Similar to the point made by Secretary Krings on the previous day, it’s difficult and cumbersome to crunch the growing mountains of data fast enough.

The prudent industry standard, according to General Eichhorn, is to test early and often as he stated, “the value of testing is in the potential to reduce bad decisions early and thus reduce excessive costs.” As testing itself informs when it’s time to stop testing, the Operational Test and Evaluation Center has to be set up as a learning organization.

The two-day program also included presentations by **Colonel William Cooley**, Commander of Phillips Research Site and Material Wing Director; **Dr. John Wilcox**, Director of the Munitions Directorate; **Dr. Thomas W. Hussey**, Chief Scientist for the Air Force Office of Scientific Research; **Colonel Michael Platt**, Edwards Research Site Commander; **Dr. Katherine Stevens**, Director of the Materials and Manufacturing Directorate; **Major General Garrett Harencak**, Commander of the Air Force Nuclear Weapons Center; **James Kloeppel** from Los Alamos National Laboratory; and **Christine Anderson**, Executive Director for Spaceport America, among other luminaries.

Attendees of the BFI were provided great networking opportunities; outstanding social events; top-shelf access to senior leaders; four excellent keynote speakers; eighteen government organizations offering details regarding over 200 upcoming acquisitions with a total value of \$2.5 billion; and access to the Air Force Small Business Innovative Research program and government support agencies. The BFI Committee hopes that each attendee found some takeaways during this session, whether it was a new teaming arrangement, a new opportunity to chase, or just new friends and acquaintances. Mark your calendars for the 27th Briefing For Industry, August 19-21, 2013.

Ron Unruh offers his utmost appreciation to all presenters, speakers, exhibitors, attendees, and BFI committee members for contributing to an informative and fruitful conference. A complete set of the event’s briefings and attendee list will be posted on the PACA website. •

Call for PACA Profiles

We are interested in your company! Are you interested in your company being profiled in the PACA Pulse? If so, please contact Ross Crown at **764.5402** or **RCrown@LRLaw.com**. All requests will be considered.

Upcoming Luncheon Speakers



■ **September 18 - Dr. Joseph Jani, Director of the Air Force Office of Scientific Research, presently supporting the Air Force Optical Site at Maui.**

The Air Force Office of Scientific Research is one of ten Directorates within the Air Force Research Laboratory. AFOSR manages the entire basic research investment of the Air Force. This research is high-risk but high-payoff, with the intent of producing revolutionary scientific breakthroughs for the Air Force. To achieve this goal, AFOSR funds about 1000 grants to 5000 researchers at 200 universities. The other nine AFRL Directorates and industry laboratories are also funded. The University of New Mexico happens to be among the top 20 funded universities. AFOSR has a 50-year history of dramatic successes.

Dr. Joseph Jani began his technical career as a junior officer at the Air Force Special Weapons Center on KAFB. After transitioning to civilian status at the Air Force Weapons Laboratory, he became involved with the prediction of the effects of nuclear weapons on satellites. He developed an organization that became the national resource for satellite survivability. During this period he also completed his Doctorate in the Chemical and Nuclear Engineering Department at UNM. When the Air Force Phillips Laboratory was created, he became its Chief Scientist. Following that, he became the first Director of the Air Force Office of Scientific Research as part of the Air Force Research Laboratory. He has since retired to a part time job in Hawaii and is serving as a consultant on numerous Air Force Basic and Applied Research programs. He commutes between Hawaii and New Mexico.

■ **October 16 - Scott Cook, Director, Small Business Office, Air Force Nuclear Weapons Center, Kirtland AFB.**

Scott Cook is new to Kirtland AFB and starting off strong. He has worked for several Federal agencies, and decided to come to New Mexico after visiting his two college-age children attending school in Santa Fe.

The Small Business Office at the Air Force Nuclear Weapons Center is responsible for implementing DOD and Air Force small business policies, programs, and procedures. Specific programs include: Small Business; Veteran and Service Disabled Veteran-Owned Small Business; Small Disadvantaged Business; Historically Underutilized Business Zone; Woman-Owned Small Business; and Historically Black Colleges and Universities/Minority Institutions.

The office works to enhance acquisition opportunities for small businesses in support of the Air Force mission and is the initial point of contact for businesses seeking contracting

opportunities within the installation. Mr. Cook meets with local business associates providing them information about contracting with the base on every second Tuesday of each month.

The Small Business Office performs the overall contractor relations function for Kirtland and also serves as the liaison with the Small Business Administration at the local and national levels.

We meet the 3rd Tuesday of each month at **Tanoan Country Club** (Rolling Hills entrance east of Eubank off Academy). Registration begins at 11:30 a.m. followed by lunch at noon. Members are admitted free and the guest fee is \$15.

To RSVP, register online at www.pacanm.org. Include your name, guest's name, and menu selection. Please RSVP by noon on the Friday before the week of the meeting. •

Speaker Suggestions Welcomed

By Stuart Purviance

Don Nash and I try to get the best and most appropriate, interesting, and educational speakers for our monthly PACA membership luncheons. This is done in consultation with our President, Patricia Knighten, board members, and others.

We would like to see more suggestions for speakers from PACA members. Please contact either one of us with your speaker ideas:

- **Stuart Purviance**, kpcabq@aol.com
- **Don Nash**, denash1616@aol

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President's Corner

By Patricia Knighten

As I write this article, it is the weekend following a fantastically successful Briefing for Industry (BFI). There were so many positive comments about the presentation quality, support from the Air Force, and the general professionalism of the event. The BFI committee is led by PACA's own **Ron Unruh** and he is supported by a group of PACA volunteers and staff from our co-sponsor, Air Force Research Laboratories. Thanks to Ron and the BFI team for an awesome event — once again!

We have seen a few Board of Directors and committee member changes. Shirley Bailey accepted an out-of-town assignment and had to vacate her position as PACA's Small Business Officer. Shirley did a wonderful job in her position, and unfortunately, it was all too brief. Her commitment to the small business community is most admirable as is her knowledge of the elements that affect small businesses. We will miss her and wish her well. We are pleased to welcome **Lenny Bean** as our new Small Business Officer.

Maran Vedamanikam stepped down from the Membership Chair position after several years of exceptional volunteer service on the PACA Board of Directors and on committees. **Ginny Buckmelter** has accepted the appointment to the Membership Committee Chair.

And, what is the PACA BOD doing for you? We are undergoing a review and update of By Laws and Standing Rules to assure that the processes and guidelines are in place to accurately reflect today's operations and to facilitate the onboarding of new volunteers. As you all surely realize, there were many gaps in operations within both PACA and BFI after the unexpected passing of Dick Trask. In performing our job as a Board, a key responsibility is to assure the successful continuity of the organization's mission. We are working to address our preparedness to assure seamless transitions and succession in the future and to manage risks related to continuity of operations in the event we face the loss of other key volunteers. I feel fortunate to have **Ross Crown**, our legal advisor, to lead the committee for By Laws and Standing Rule review. This is a "heads-up" that we may be asking for your vote regarding



Patricia Knighten

certain By Laws changes within the next few months.

Our new website design is underway and we expect to have it up and running by our December 7 Holiday Party!

Inspired by the intent to honor Dick Trask and our good fortune to have a long list of PACA founders and long standing volunteers, a "special" announcement will be made at our lunch meeting on September 18 — don't miss it! I look forward to seeing you all soon! •

Welcome NEW MEMBERS

- **F. Brent Abbott** , Surrey Satellite Technology US, Cave Creek, AZ
 - **Anthony Androsky**, BRTRC, Fairfax, Virginia
 - **Toby Aylesbury**, QinetiQ North America, Canton, MI
 - **Steve Conyne**, AEGIS Technologies Group Inc.
 - **Fred Fagan**, COLSA Corporation, Huntsville, AL.
 - **Scott Gilson**, COLSA Corporation, Colorado Springs, CO
 - **Timothy Gray**, Space Vector Corp., Chatsworth, CA
 - **Jim Ladwig**, Nova Corporation, Monument, CO
 - **John Laing**, SPARTA Inc., Colorado Springs, CO
 - **Scott Licoscas**, Teledyne Scientific & Imaging, LLC, Camarillo, CA
 - **Phil Macklin**, Universities Space Research Association, Columbia, MD
 - **Jeffrey Morgan**, The Boeing Company, Seattle, WA
 - **Bob Pacheco**, Banda Group International, LLC
 - **Stephen Poppe**, Fraunhofer Center, College Park, MD
 - **Rod Potter**, System High Corp., Colorado Springs, CO
 - **Pauline Prater**, Nova Corporation
 - **Charley Rhodes**, Libration Systems Management
 - **Tim Roark**, The Boeing Company
 - **Greg Sanford**, LoadPath
 - **Gyan Saxena**, Dataman USA LLC, Centennial, CO
 - **Annette Seda**, Qualis Corporation
 - **Michael Silvestro**, BAE Systems, Rockville, MD
 - **Richard Singer**, Orbital Sciences Corporation, Dulles, VA
 - **Jim Tibaud**, Textron Defense Systems, Wilmington, MA
 - **Kent Wood**, Booz Allen Hamilton
- Note: City and state are not designated for new local members.*

Legal Insights: Recovery of Unabsorbed Home Office Overhead

By Ross Crown

Last year, the U.S. Court of Federal Claims issued an opinion discussing recovery of unabsorbed home office overhead in *The Redland Company, Inc. v. United States*, 97 Fed. Cl. 736 (2011). This decision is worth noting because it serves as a mini-treatise on unabsorbed home office overhead, *i.e.* what it is, when contractors may be entitled to recover such costs and how they must go about proving these damages.

In this case, Redland filed a complaint under the Contract Disputes Act seeking compensation on various claims arising from a paving contract with the Air Force. Performance was to begin soon after contract award. On December 1, 2000, Redland received a notice to proceed from the contracting officer. On that same date, however, the contracting officer issued a second order suspending work until further notice. This suspension lasted almost four years. Eventually, the suspension was lifted on October 18, 2004. Redland then completed all of the work under the contract.

In its complaint, Redland asserted a variety of claims. Among them, Redland sought to recover unabsorbed home office overhead for the time period during which the start of work was suspended. Redland asked the court to grant summary judgment on this claim.

Nature of Unabsorbed Home Office Overhead

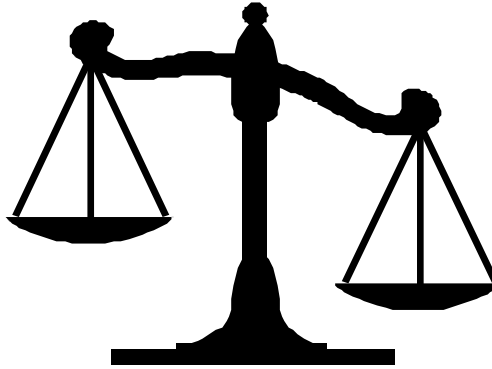
The court began its analysis of Redland's right to recover unabsorbed home office overhead by discussing the nature of these costs. As recited by the court, home office overhead is among a contractor's indirect costs, costs that are expended for the benefit of the whole business and cannot be attributed or charged to any particular contract. A contractor recovers its indirect costs, such as home office overhead, by allocating a share of these costs to each of its contracts. The share allocated to an individual contract is proportional to the amount of direct costs incurred under that contract.

When the government suspends performance of a contract, however, the contractor ceases to incur direct costs under that contract. If, during the period of suspension, the government requires the contractor to be on "standby," in other words ready to begin work immediately or on short notice, the contractor may be unable to take on replacement work. In that circumstance, the contractor can no longer immediately recover the proportional share of home office overhead originally allocated to the suspended project. That share of the contractor's home office overhead is said to be "unabsorbed" during the period of suspension.

Calculating Unabsorbed Overhead

The U.S. Court of Appeals for the Federal Circuit, which hears appeals from both the Court of Federal Claims and

the boards of contract appeals, has established the *Eichleay* formula as the exclusive method for calculating a contractor's home office overhead during a period of government-caused delay after the start of performance. This formula is derived from *Appeal of Eichleay Corp.*, ASBCA NO. 5183, 60-2 BCA ¶ 2688 (1960), *aff'd on recon.*, 61-1 BCA ¶ 2894 (1961). The *Eichleay* method for calculating unabsorbed overhead is as follows: First, to find allocable contract overhead, multiply the total overhead costs incurred during the contract period times the ratio of billings from the delayed contract to total billings of the contractor during the contract period. Second, to determine the daily contract overhead rate, divide the allocable contract overhead by days of contract performance. Finally, to ascertain the amount recoverable, multiply the daily contract overhead rate times the days of government-caused delay.



Entitlement to Unabsorbed Overhead

The court went on to discuss entitlement. To establish a *prima facie* right to *Eichleay* damages, the contractor must prove the following three elements:

1. There was a government-caused delay or suspension of uncertain duration;
2. The delay extended the original time for performance of the contract, or that the contractor finished on time but nonetheless incurred additional unabsorbed overhead expenses because it had planned to finish even sooner; and
3. The government required the contractor to remain on standby during the period of suspension, waiting to begin work immediately or on short notice.

Once the contractor has proved these three elements, the "burden of production" shifts to the government to show that it was not impractical for the contractor to take on replacement work and thereby mitigate its damages. If the government meets its burden of production, then the contractor bears the burden of persuasion that it was impractical for it to obtain sufficient replacement work.

Proving Claim for Unabsorbed Overhead

Applying these requirements to Redland's claim, the court determined that Redland did not prove its claim for unabsorbed overhead and thus denied summary judgment. For one thing, the contractor was not entitled to *Eichleay* damages because Redland had not started performance prior to issuance of the suspension order. The Federal Circuit has stressed that *Eichleay* damages are only available when the government-caused delay occurs after performance has begun.

The court also found that even if Redland had started work

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before the suspension was imposed, the contractor still could not recover *Eichleay* damages because it could not establish each of the three elements of entitlement to unabsorbed overhead. Specifically, although the facts were clear that the contracting officer issued a written order suspending all of the work on the contract for an uncertain duration and that the delay extended the period of performance beyond what was originally anticipated, Redland could not establish the third element of entitlement to *Eichleay* damages, that it was required to remain on standby during the period of suspension. The court rejected Redland's argument that because the suspension order was silent as to whether the contractor was required to be ready to resume work immediately or on short notice, the contractor had to assume it was required to remain on standby. Rather, the court ruled that absent a suspension order expressly putting the contractor on standby, it is the contractor who bears the burden of proving that it was required to resume work immediately or on short notice. Because it is unlikely that a contracting officer will issue a suspension order containing an express requirement that the contractor remain on standby, a contractor usually has to prove the standby requirement through indirect evidence. Redland was unable to present sufficient evidence that it remained ready to resume work immediately or on short notice during the four year suspension.

Lessons for Recovering Unabsorbed Overhead

The Redland case is a helpful reminder that although contractors often seek to recover unabsorbed home office overhead, the circumstances in which they are entitled to do so are typically limited to periods of government-caused delay after contract performance has begun. This decision also shows that the most difficult hurdle to clear in proving entitlement to *Eichleay* damages is demonstrating that the contractor was on standby during the period of suspension. As the court noted, since contracting officers are not likely to expressly require contractors to remain on standby, when a suspension occurs, contractors must pay attention to whether they are, in fact, on standby and how they will demonstrate that status to the satisfaction of the government, or if necessary, the court. One method may be to respond to an order of suspension by placing the contracting officer on notice that the contractor intends to remain on standby and detailing the manner in which it is doing so. If the contracting officer does not respond to this notice by directing the contractor to stand-down, then the contractor may find the lack of such direction useful in proving entitlement to unabsorbed home office overhead. •

Ross is a partner in the Albuquerque office of Lewis and Roca LLP. This article is intended for general information only and should not be construed as legal advice or opinion. Any questions concerning your legal rights or obligations in any particular circumstance should be directed to your lawyer.

PACA Launches Annual Sponsorship Program

Support to the organization in the form of sponsorships helps make PACA a success as well as fund higher education scholarships. Each year, when PACA has available revenue, the organization presents checks to various universities for scholarship funds to be used by students majoring in engineering or scientific disciplines. So sponsorships of PACA not only provide a means for advertising your company to the right audience, but they enable our country's universities to educate the next generation of valued engineers and scientists.

All sponsoring companies must include a PACA member in good standing. Please contact Dar Johnson if you have questions about sponsorships at 505-400-1639 or d_r_johnson@comcast.net.

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- Two guests for the sponsored lunch.
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- You will be introduced as the luncheon sponsor and be allowed to present a 5 minute overview of your company. Corporate brochures/tri-folds may be placed on the luncheon tables. A luncheon sponsor will not be able to sponsor another luncheon for twelve months.

Alert: New DCAA Position

By Tony Royle, CPA

As many of you may know, the Defense Contract Audit Agency (DCAA) has an audit initiative occurring this year towards reducing the backlog of Incurred Cost submissions that have been piling up. Therefore, many government contractors have already been contacted, or will soon be, by the DCAA to conduct an Incurred Cost audit. One issue with the backlog of audits is that DCAA audits are in arrears. Many government contractors are only now being contacted by DCAA to conduct an Incurred Cost audit of 2008 and for some government contractors maybe even of earlier years. This presents a number of problems for a government contractor. If the DCAA is auditing 2008 and finds an adjustment, the adjustment may very well impact not only 2008, but also succeeding years. Auditing in arrears has the effect of magnifying any proposed adjustments.



Example

DCAA audits 2008 and finds an adjustment to your company's G&A rate which causes an adjustment to your cost type contracts of \$20,000 in favor of the government. Let's assume that your accounting system remains the same from 2008 through mid-2012. Instead of a \$20,000 adjustment, a government contractor may very well be looking at adjustments for 2009, 2010, 2011, and part of 2012 as well for a total adjustment exposure of \$90,000 (\$20,000 times 4.5 years).

DCAA's New Position

Now that the DCAA audit background has been established, let's take a look at DCAA's new position. I refer you to the Defense Contract Audit Agency Manual (DCAAM) Section 7-1403.6 entitled "Special Considerations - Revenue Based State Taxes." According to DCAA, this section applies to government contractors in New Mexico, as stated in the first sentence of the section. What does "revenue based state taxes" refer to? The New Mexico gross receipts tax.

Typically, most accounting systems account for New Mexico gross receipts tax as a payable on the balance sheet. A contractor collects the tax and then remits it to the state. The payable increases as tax is collected or billed and when the tax is paid the payable zeroes out again. In a typical accounting system, the New Mexico gross receipts tax does not get reported on the income statement. A government contractor then computes indirect rates and prepares their Incurred Cost report using data compiled primarily from their income statement. From the income statement information a government contractor compiles their "total costs" in calculating their total cost input (TCI) base.

If we analyze DCAAM Section 7-1403.6 carefully, what the DCAA is saying is that the New Mexico gross receipts tax should be added as an "other direct cost" (ODC) and also included in the total cost input base for G&A when a government contractor computes rates. This is contrary to how most government contractor's accounting systems are set up.

DCAAM Section 7-1403.6(c) states: "Revenue based G&A taxes are overall costs of doing business in the nature of G&A expenses. However, these taxes, if material, should not be accounted for in the G&A pool." Further, DCAAM Section 7-1403.6(d) states: "Revenue based state taxes should be included in the total cost input base for G&A allocation."

In recent Incurred Cost audits (July and August, 2012) the

DCAA has identified and proposed adjustments using this approach to computing rates (adding the New Mexico gross receipts tax to the TCI base and also treating it as an ODC). The DCAA has indicated that they will now propose adjustments if the amounts are material. Informally, the local DCAA office has said they were aware of DCAAM Section 7-1403.6, but local DCAA office policy was not to follow it. Apparently that has been the position of the local DCAA office for a number of years.

Nationally, the DCAA has come under fire by Congress and the GAO for a lack of audit quality. In response to the criticism, the DCAA has implemented a number of changes across the board to increase the quality of their audits. As part of the increased quality control mandate, the National DCAA office has directed the local DCAA office to follow DCAAM Section 7-1403.6. This position of treating the New Mexico gross receipts tax in the TCI base is one that many government contractors in New Mexico may not currently be doing.

How does this affect your company as a government contractor? If your business is not including New Mexico gross receipts tax in its TCI base, then your G&A rate will go down since your TCI base has been increased by the amount of New Mexico Gross receipts tax added to it. Then, it's all going to depend on the type of contracts you have and whether or not they are subject to New Mexico gross receipts tax. Matters are further complicated when contracts being adjusted are already closed out. A government contractor may owe money back to the government on cost type contracts, but be precluded from collecting money the government owes them on closed out time and material or fixed price contracts.

Lastly, several unanswered questions remain for government contractors that have not included the New Mexico gross receipts tax in its TCI and are looking at proposed DCAA adjustments. For example,

- Has the government now changed your accounting method?
- Is a change in accounting method that is retroactive within the government's authority?
- What are your rights as a government contractor if the DCAA proposes a material adjustment? •

Tony Royle is a partner in the Albuquerque office of the public accounting firm of Moss Adams LLP. He specializes in services to government contractors. For further information, Tony can be reached at 878-7200.