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Value-added G&A: enhance your competitiveness and profitability

Contractors can adopt a value-added general and administrative (G&A) rate when proper cost accounting procedures justify its use. The treatment of G&A expenses supporting sub-contract and material costs can have a significant impact on contract costs. As such, contractors can maximize cost recovery and increase competitiveness.

Value-added G&A rates are an excellent alternative to an overhead pool of expenses distributed over direct labor and a G&A pool of expenses distributed over the total cost input (TCI) for companies with significant subcontract and/or material costs under appropriate circumstances.

The relevant guidance for computation of the G&A rate is contained in cost accounting standard (CAS) 410 and working group items (WGI) 78-21 and 78-21A. Defense Contractor Audit Agency (DCAA) has typically read much of CAS 410 and the working group items into FAR 31.203(c) which is applicable to all government contracts.

Under CAS 410, the cost input base used to represent the total activity of a business unit during a cost accounting period may be either total cost input, value-added cost input or a single element of cost input (i.e. labor). The latter is rarely used.

WGI 78-21 states that a cost input allocation base should be selected which best represents the total activity of the business unit. Perfect reflection of total activity may not be reasonably expected from any of the three cost input bases available in the standard.

The relevant circumstances to be considered should be those experienced in a typical cost accounting period rather than unique circumstances existing at one time.

Confusion arises when, because of significant material/subcontract components on contracts, the TCI is not a representative base. Contractors must determine if the value-added cost input base should be used to allocate G&A expenses. Related questions are:

1. Which costs should be excluded from the value-added base?

CAS 410.50(J) Special Allocation of G & A Expenses

- Provides an alternative to permanent revision or indirect rate structure
- Allocates more/less G & A expenses to certain contracts which receive significantly more/less benefit from those expenses
- Requires contracting officer approval
- Requires that an amendment to the disclosure statement is in place

2. Which expenses, 1f any, should be excluded from the G&A pool before allocation to the value-added base?
3. How is a subcontract or material overhead rate developed and applied?

WGI 78-21 states that the value-added base shall be used where inclusion of material and subcontract costs would significantly distort the allocation of G&A expenses and when costs other than direct labor are significant measures of total activity.

Purification of the G&A expense pool is suggested as the first reasonable alternative to minimize any potential inequities, which may surface before proposing the value-added rate. It is important to realize that the distortion must exist in the relationships of varying costs to the total activity of the business unit versus merely having varying amounts of each element of cost used in the production of goods and services.

To establish which "typical" G&A expenses are to be excluded from the G&A expense pool before allocation to the value-added G&A base, take the following steps:

- Determine which costs are being excluded from the TCI G&A base
- Determine which expenses, if any, support these costs on either a causal or beneficial basis. If significant, these expenses should be excluded from the G&A expense pool and included in the subcontract handling or material overhead indirect expense pools. Typical expenses in this category are indirect labor such as accounts payable, subcontract administration, purchasing and receiving, and associated fringe and facility costs as well as non-labor costs such as accounting and legal fees. The two most common indirect rate structures selected based on the appropriate causal/beneficial relationship of expenses are shown below. (DCAA generally prefers the first approach, consistent with WGI 78-21)

Some DCAA offices have been adamant about not establishing a separate indirect expense pool to be applied to subcontract and/or materials under the theory that it is a second G&A pool and therefore not allowed. DCAA has particular concerns if "body shop-type" subcontract labor is excluded from the G&A base, when, in fact, the labor is used to supplement the normal work force and generally bears the same relationship to indirect expenses as the contractor's own labor. Generally, DCAA believes that excluding subcontract or material costs from the G&A base is contrary to FAR 31.203(c) in that it unnecessarily fragments the G&A base.

To have the best chance of approval for a value-added G&A rate and, if appropriate, a material overhead or subcontract handling rate, the contractor should complete the following before proposed implementation:

- Prepare an analysis of the subcontract and/or material content of all contracts in-house and prepare to show that those costs make-up significant varying percentages of all contracts in-house
- Prepare an analysis of all indirect expenses which bear a causal/beneficial relationship to direct charge subcontracts or materials
- If a CAS disclosure statement is in place, prepare a proposed amendment and a corresponding rough order of magnitude cost impact
- Document the methodology used when allocations of certain non-labor costs are made
- Submit documentation to the appropriate audit agency or procurement office for approval
- Establish a discrete charge number to charge labor to material overhead or sub-contract handling pools through daily timesheets
- Evaluate the methodologies used to allocate costs annually to ensure they are representative

