

Properly accounting for cost transfers between affiliated entities under common control—commonly known as “interorganizational transfers” or “intracompany transfers”

—is a difficult task.

For revenue recognition purposes, profit on such transfers needs to be eliminated during consolidation. For government contract cost accounting purposes, profit needs to be eliminated as well.

As one textbook on the subject states—

If it is determined that common control exists, transfers of goods and services must be made at cost. This rule was established to avoid the pyramiding of profits that would be possible if profits were allowed on intracompany transfers.

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transfers between such firms at other than cost, however, can be made under special circumstances. (
Pricing and Cost Accounting: A Handbook for Government Contractors
, by Darrell
Oyer
)

Looking at the FAR, the Cost Principle on Material Costs (31.205-26) has this to say—

(e) Allowance for all materials, supplies and services that are sold or transferred between any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control shall be on the basis of cost incurred in accordance with this subpart. However, allowance may be at price when—

(1) It is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary or affiliate of the contractor under a common control; and

(2) The item being transferred qualifies for an exception under [15.403-1](#) (b) and the contracting officer has not determined the price to be unreasonable.

(f) When a commercial item under paragraph (e) of this subsection is transferred at a price based on a catalog or market price, the contractor—

(1) Should adjust the price to reflect the quantities being acquired; and

(2) May adjust the price to reflect the actual cost of any modifications necessary because of contract requirements.

So now that we all understand the rules, we have a contextual foundation to understand a May 27, 2010 [announcement](#) by the Department of Justice. The DOJ reported that Bell Helicopter Textron agreed to pay the United States a total of \$16,570,018 “to resolve civil claims arising from the company’s cost charging practices.”

According to the DOJ press release, the company’s “billing of the costs of certain subcontracts, work transfers, and other transactions with its subsidiaries, divisions, and affiliated companies had resulted in overcharges to the government.”

Bell Textron Pays for Mischarging Interorganizational Transfers

Written by Administrator
Friday, 28 May 2010 00:00

Importantly, the company voluntarily reported its accounting problems. DOJ reported that Bell Helicopter Textron first reported its overbillings in 2004. DOJ stated—

The company submitted a report in 2006 describing its conduct and the financial impact on the government and paid the government \$12,851,248. While the government was investigating and analyzing the conduct the company disclosed, Bell submitted additional reports detailing similar intra-company transactions with Bell Helicopter Textron Canada Limited that resulted in overcharges.

Because the company had voluntarily reported its misconduct and cooperated with the DOJ in the investigation, its settlement was limited to damages actually incurred by the government. Had the circumstances been different, up to treble damages might have been sought.

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So the lesson is clear. Do things right if you can. But if you can't—be forthright with the government.