Okay, we promised to discuss issues associated with subcontracts under T&M prime contracts in this Part of the analysis of the T&M contract type. Instead, we want to talk about this **recent decision** at the Armed Services Board of Contract Appeals (ASBCA). Trust us, it will fit in to the Part 1 discussion on the Government's problems administering and managing this contract type.

The ASBCA decision addressed an appeal by the GaN Corporation. GaN held a sole source contract (awarded pursuant to the SBA's 8(a) program) to provide "interior design support for office and barracks furnishings" for the U.S. Army Engineering Support Center, Huntsville (USACEH). The contract called for orders to be issued on either a firm, fixed-price (FFP) basis or Labor Hour (LH) basis, based on "firm fixed price rates" established for individual labor categories.

GaN accounted for labor hours under the "total time" method. Thus, GaN employees recorded all hours worked, whether compensated or uncompensated. For salaried employees—whose hourly rate was calculated based on 2,080 labor hours in a year—this created "uncompensated overtime" (UCOT) hours, where more than 2,080 hours were recorded in a single year. In its proposal to USACEH, GaN stated—

Our accounting and timesheet procedures will require the recording of uncompensated overtime and its allocation to all charge numbers worked throughout the pay period. As such, because ofthe contract type, all hours worked, whether compensated or uncompensated, will be charged and billed to the contract.

The Contracting Officer (CO) notified GaN that its billings under the LH orders awarded to it included hours for which its employees were not being paid. This finding was based on an "internal review of the contract" performed (we assume) by auditors of the Army Audit Agency. In addition, the CO asserted that GaN's invoices did not include required documentation to substantiate labor expenses, as required by the contract's payment clause (52.232-7). The CO stated, "The contractor never states that it actually paid the employee for those hours [billed]."

GaN and its CO continued to correspond, with GaN asserting that it was permitted to bill the Government for all direct labor hours recorded by its employees to the order, regardless of whether or not those labor hours were compensated. The CO continued to assert that "If your firm does not incur certain costs for your employees, pursuant to FAR 52.232-7, these costs are not billable to the Government under the labor hours provisions of the contract." Eventually, the CO issued a final decision demanding some $72,000 in alleged "overpayments," which

GaN appealed to the ASBCA.

The ASBCA Judge found for GaN, writing—

The government contends that under the plain meaning of the Payments clause and the contract billing procedures, appellant overbilled the government regarding the labor for 'unexpensed hours' worked by the above-mentioned GaN employees. As such, its withholding was justified. … It argues that, except for the labor rates being fixed, the contract is a variant of a Time and Materials (T&M) contract and is tantamount to a cost reimbursement contract …. The government states that the central issue is whether appellant, under a labor hour task order, is entitled to charge the government for the employees 'unexpensed and uncompensated' overtime when the contract in effect made them all hourly workers …. Because appellant's 'novel and unsupportable interpretation allows the contractor to pocket undue windfall profits at taxpayer expense,' the government avers that we 'should not countenance such a 'weird and whimsical result''. …

The government appears to think that the various references to actual payment and cost mean that the contractor cannot recover for hours unless the employees were paid on an hourly basis. We disagree.

Because the Government misinterpreted the contract type as "tantamount to a cost reimbursement contract," it mistakenly thought that GaN had to incur a labor cost in order to invoice it. In fact, the contract type was closer to an FFP type, in that the price for labor hours was fixed and the contractor's labor costs were simply irrelevant to the established price. But as we have seen, the real answer is that the contract type was Labor Hour, which (like T&M) is its own unique type and should not be analyzed by looking at the rules for other contract types.

The GaN decision did not reference what DCAA has to say about uncompensated overtime, but it well might have. Section 6-410 of the DCAA Contract Audit Manual (CAM) discusses UCOT. It starts out by stating, "The Fair Labor Standards Act (FLSA) requires employers to compensate hourly workers for hours worked in excess of 40 hours per week, but the FLSA does not require employers to pay overtime to salaried employees. Salaried or exempt employees are paid a salary to provide a service."

The CAM lists three UCOT accounting methods that are considered "acceptable" for use. These three methods include:

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Compute a separate average labor rate for each labor period, based on the salary paid divided by the total hours worked during the period, and distribute the salary cost to all cost objectives worked on during the period based on this rate.

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Determine a pro rata allocation of total hours worked during the period and distribute the salary cost using the pro rata allocation. For example, if an employee was paid on a weekly basis and worked 25 hours on one cost objective and 25 hours on another cost objective, each cost objective would be charged with one-half of the employee's weekly salary.

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Compute an estimated hourly rate for each employee for the entire year based on the total hours the employee is expected to work during the year and distribute salary costs to all cost objectives worked on at the estimated hourly rate. Any variance between actual salary costs and the amount distributed is charged/credited to overhead.

In addition, the CAM discussed two other methods that “require further evaluation” in order to determine whether or not the method use is acceptable. The two additional methods are:

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Distribute the salary cost to all cost objectives based on a labor rate predicated on an 8-hour day/40-hour week and credit the excess amount distributed to overhead.

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Determine a pro rata allocation of hours worked each day and distribute the daily salary cost using the pro rata allocation …

So it is clear that—contrary to the Government's argument that GaN's position was "novel and unsupportable," and resulted in an "undue windfall"—the fact of the matter is that GaN had several UCOT cost accounting methodologies from which to choose, and not all of them required salaried employees to receive actual payment for hours worked in excess of 40 per week or 2,080 per year. It's too bad that the USACE Contracting Officer allowed him/herself to be intimidated by internal auditors into creating this dispute with the USACE's 8(a) contractor, since the Government's position contrary to the plain reading of the appropriate regulatory framework.

In the next article in this series, we'll take the promised look at subcontracting under T&M contracts.