

## Filling the Pool

*Topic:* Government (Cost Allocation on Government Contracts)

*Characters:* Bob, staff internal auditor at a medium-sized company  
Jan, senior internal auditor, Bob's supervisor

Bob, a CPA, is an internal auditor at a medium-sized company for which cost-reimbursable defense and other contracts with the federal government compromise 40 percent of its business. Bob's current task is to review items and amounts which have been assigned to the general and administrative (G&A) cost pool as a basis to support the allocation rate. These costs are allocated to government contracts and commercial business based on the percentage of the direct labor content of each category. The allocation rate is based on budgeted G&A amounts and applied as the contracts are completed. Government auditors subsequently verify whether the G&A pool costs are reasonable and allowable charged to contracts.

This is Bob's first assignment to this type of work. In sampling items in the current pool, he found several that struck him as questionable for charging to government contracts. They included items such as flowers and catered food for various occasions, employee travel to commercial trade shows, and depreciation on company recreational equipment. He found no evidence of similar items in last year's workpapers. Not sure of the materiality of the items, he consulted Jan, his supervisor.

Jan informed Bob that he didn't understand how the G&A cost pool worked. She told him that she had done the internal audits of the pool the last two years. She did not consider the types of items Bob found as material; thus, when she found similar items, she excluded them from consideration. However, she argued, the items were legitimate business costs and, in the aggregate, helped fill the G&A pool. Just because they didn't appear to be related to government contracts was not a good reason to exclude the cost. Further, filling the pool was necessary to get a good budgeted G&A rate for future years' contracts. Although the company's G&A rates, like those of its competitors, had increased steadily over the year, the actual rates have always been less than budgeted. Further, the government auditors probably wouldn't even bother to check the pool for individual items since the actual rate is better than budget this year. In fact, last year they just looked at her workpapers to substantiate many of the charges to the pool. Finally, if all the seemingly unrelated items were left out of the government might think the company had been "padding the budget" in prior years. She advised Bob to forget the items, just as she had. Her last comment was, "We'll all be better off if you do."

Jan's reaction was troubling to Bob. Despite her arguments, he wondered whether it was right to "fill the pool" with questionable costs.

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