

Accounting Requirements

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Your Instructor



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Agenda

Federal Acquisition Regulations (FAR)

- Cost Allowability

Cost Accounting Standards (CAS)

- Cost Allocability

Current Regulatory Environment

How to Prepare for an Accounting System Audit

Federal Acquisition Regulations (FAR)

What Is Cost?

Total Cost

Direct vs. Indirect Cost

Allowable Cost

- Reasonableness
- Allocability
- Allowability
- CAS & GAAP
- Contract Terms

Cost Principles – FAR Part 31

Compliance Obligations

- Criteria for allocating costs
- Defines allowability of costs
- Requires exclusion of unallowable costs

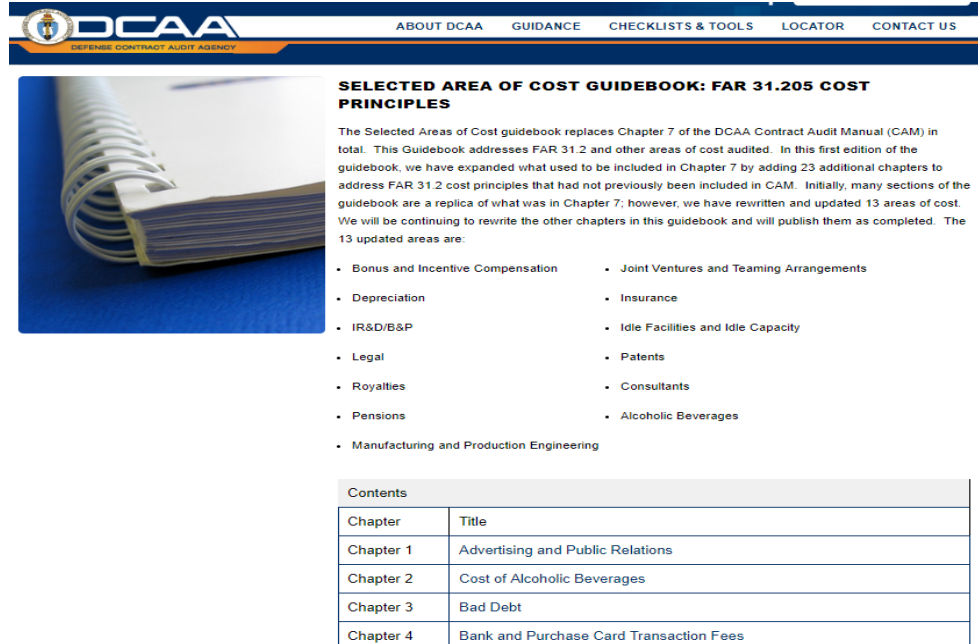
Penalties

- Disallowance of costs
- Penalties for unallowable costs
- Interest penalty

Cost Principles – FAR Part 31 – References

References

- DCAA.mil
 - Selected Areas of Cost
 - (75 chapters)



DCAA
DEFENSE CONTRACT AUDIT AGENCY

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SELECTED AREA OF COST GUIDEBOOK: FAR 31.205 COST PRINCIPLES

The Selected Areas of Cost guidebook replaces Chapter 7 of the DCAA Contract Audit Manual (CAM) in total. This Guidebook addresses FAR 31.2 and other areas of cost audited. In this first edition of the guidebook, we have expanded what used to be included in Chapter 7 by adding 23 additional chapters to address FAR 31.2 cost principles that had not previously been included in CAM. Initially, many sections of the guidebook are a replica of what was in Chapter 7; however, we have rewritten and updated 13 areas of cost. We will be continuing to rewrite the other chapters in this guidebook and will publish them as completed. The 13 updated areas are:

- Bonus and Incentive Compensation
- Depreciation
- IR&D/B&P
- Legal
- Royalties
- Pensions
- Manufacturing and Production Engineering
- Joint Ventures and Teaming Arrangements
- Insurance
- Idle Facilities and Idle Capacity
- Patents
- Consultants
- Alcoholic Beverages

Contents	
Chapter	Title
Chapter 1	Advertising and Public Relations
Chapter 2	Cost of Alcoholic Beverages
Chapter 3	Bad Debt
Chapter 4	Bank and Purchase Card Transaction Fees

Cost Allowability

Allowability – FAR 31.201-2

Definition

- Not unallowable
- Reasonable
- Terms of the contract
- Generally Accepted Accounting Principles

Contractor must maintain adequate accounting records – FAR 31.201(2)(c)

Contractor must apply consistent practices – FAR 31.201(2)(b)

Often subject to improper challenges due to poor chart of accounts or inadequate procedures

Accounting for Unallowable Costs – FAR 31.201-6

Contractor has a responsibility to account for unallowable costs

Must have a mechanism for identifying unallowable costs

- Policy & Procedures
- Chart of Account

Directly Associated Costs – FAR 31.201-6

A cost which is generated solely as a result of the incurrence of another cost, & which would not have been incurred had the other cost not been incurred

When an unallowable cost is incurred, its directly associated costs are also unallowable

- Example: Salary expenses of employees who participate in unallowable activities
- Generally salary & travel expenses

Polling question #1

- Contractor employees are required to record their time based on:
 - a) Contract funding
 - b) Chargeability
 - c) Nature of the hours worked
 - d) Supervisor discretion

Compensation – FAR 31.205-6

Allowable Compensation must be reasonable for work performed based on comparisons to

- Firms of the same size
- Firms in the same industry
- Firms in the same geographic area
- Firms engaged in non-government work

Closely held business scrutinized more closely

When elements are challenged – offsets may be considered between allowable elements of compensation within same job grade or level

Benchmark Compensation Cap History

The compensation cap is required by Section 39 of 41 U.S.C. § 1127, & represents the maximum compensation amount that a contractor can include as an allowable cost for covered contracts awarded before June 24, 2014

Statutory Formula Cap Amount	Fiscal Year	For Costs Incurred After
\$1,144,888	2014	1-Jan-2014
\$980,796	2013	1-Jan-2013
\$952,308	2012	1-Jan-2012
\$763,029	2011	1-Jan-2011
\$693,951	2010	1-Jan-2010
\$684,181	2009	1-Jan-2009
\$612,196	2008	1-Jan-2008
\$597,912	2007	1-Jan-2007
\$546,689	2006	1-Jan-2006
\$473,318	2005	1-Jan-2005
\$432,851	2004	1-Jan-2004

Benchmark Compensation Cap History (cont.)

Cap rules vary depending on the date of the contract award & the customer agency
For covered contracts awarded on or after June 24, 2014, a cap of \$487,000 applies pursuant to Section 702 of the Bipartisan Budget Act (BBA) of 2013

Compensation Cap Rule	Agency	Agency
	DOD/NASA/CG	Civilian agencies
Statutory formula cap, top five senior executives	Before Dec 31, 2011	Before Jun 24, 2014
Statutory formula cap, all contractor employees	On/after Dec 31, 2011, and before June 24, 2014	N/A
\$487,000* BBA cap, all contractor employees (*will adjust for inflation)	On/after Jun 24, 2014	

Benchmark Compensation Cap Update

Contractor Compensation Cap for Contracts Awarded on or after June 24, 2014

The statutory comp cap is supposed to be inflation adjusted annually & published by the Office of Federal Procurement Policy (OFPP)

The 2019, 2020, & 2021 comp cap updates were not published until July 2021

During that time, DCAA estimated the caps based on the statutory formula

<u>For Costs Incurred</u>	<u>Escalation ¹</u>	<u>Cap Amount ²</u>
1/1/2016 - 12/31/2023	5.1%	\$619,000
1/1/2016 - 12/31/2022	3.7%	\$589,000
1/1/2016 - 12/31/2021	2.4%	\$568,000
1/1/2016 - 12/31/2020	2.8%	\$555,000
1/1/2016 - 12/31/2019	2.8%	\$540,000
1/1/2016 - 12/31/2018	2.5%	\$525,000
1/1/2016 - 12/31/2017	2.3%	\$512,000
1/1/2016 - 12/31/2016	2.6%	\$500,000
6/24/2014 - 12/31/2015		\$487,000

Don't forget reasonableness!

Establish a compensation plan & document reasonableness before or as costs are incurred

Compensation – Challenges

Reasonableness of overall compensation

- T&M contracts: resume & labor category requirements
- Bonuses
 - Awards must be paid or accrued under an agreement entered into in good faith between the contractor & the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; &
 - Basis for the award is supported (metrics & documentation)

Employee Morale – FAR 31.205-13

Aggregate costs are allowable

- Improve working conditions
- Improve employee morale
- Improve employee performance

Gifts are unallowable – not awards recognizing employee achievements

Recreation is unallowable – except for sponsored teams or organizations

Entertainment Costs – FAR 31.205-14

Amusement

Diversions

Social activities

Tickets to shows & sporting events

Membership in social clubs

All unallowable

Travel Costs – FAR 31.205-46

Travel must be for official business

Approval expected

Airfare limitations – Coach travel & “lowest available fare”

Per diem vs. actual costs

Unallowable Costs

- Alcohol – Unallowable per FAR 31.205-51
- Travel in excess of FTR daily rate
- Lowest available airfare

Travel Costs Challenges

General rule of thumb: Travel cost should follow the labor cost, *i.e.*, direct if labor is direct

Lack of receipts

Reasonableness of cost

No justification of business purpose

Partial travel days

Public Relations & Advertising Costs – FAR 31.205-1

Advertising

- Use of media to promote the sale of products or services
 - Help wanted
 - Acquire materials
 - Dispose of scrap
- All unallowable unless
 - Required by contract
 - For disposal of contract-related scrap
 - Trade shows (export requirement)
 - Recruiting

Public relations

- Maintaining, protecting, & enhancing the image of a concern or its products; or reciprocal understanding & favorable relations with the public at large
- All unallowable unless
 - Required by contract
 - Responding to inquiries
 - Communication necessary to keep the public informed on matters of public concern
 - Open houses

Recruitment Costs – FAR 31.205-34

Cost of help wanted, employment office, travel costs, etc.

Generally allowable

Ads must be for specific positions required by the contract or be indirect positions

Other Cost Principles

Bad Debts – FAR 31.205-3 – Unallowable – including collection & legal costs

Contributions or Donations – FAR 31.205-8 – Unallowable

Fines, Penalties, & Mischarging Costs – FAR 31.205-15 – Unallowable

Interest & Other Financial Costs – FAR 31.205-20 – Unallowable

Lobbying & Political Activity Costs – FAR 31.205-22 – Unallowable (DCAA focuses on DC area offices for these costs)

Organization Costs – FAR 31.205-27 – Unallowable – Costs for effort affecting the capital structure of the company

Other Business Expenses – FAR 31.205-28 – Allowable – Shareholder meetings, soliciting normal proxy, preparing & publishing reports

Patent Costs – FAR 31.205-30 – Allowable only if required by contract or for general patent advice

Royalties & Other Costs for Use of Patents – FAR 31.205-37 – Allowable unless

- Government owns license or has free use or patent is invalid, expired, or unenforceable

Polling question #2

How does your organization allocate G&A?

- a) Total Cost Input (TCI)
- b) Value Add
- c) Single Element
- d) Not applicable

Cost Accounting Standards: Overview

The Purpose of the CAS

- Promote uniformity
- Ensure consistency
- Facilitate administration, negotiation and settlement of contracts

Relationship Between the FAR Cost Principles and the CAS

- Allowability

- Standards do not address allowability

- Allocability

- Standards deal with allocability
- Where there is a conflict between the cost principles and cost accounting standards, the standards prevail

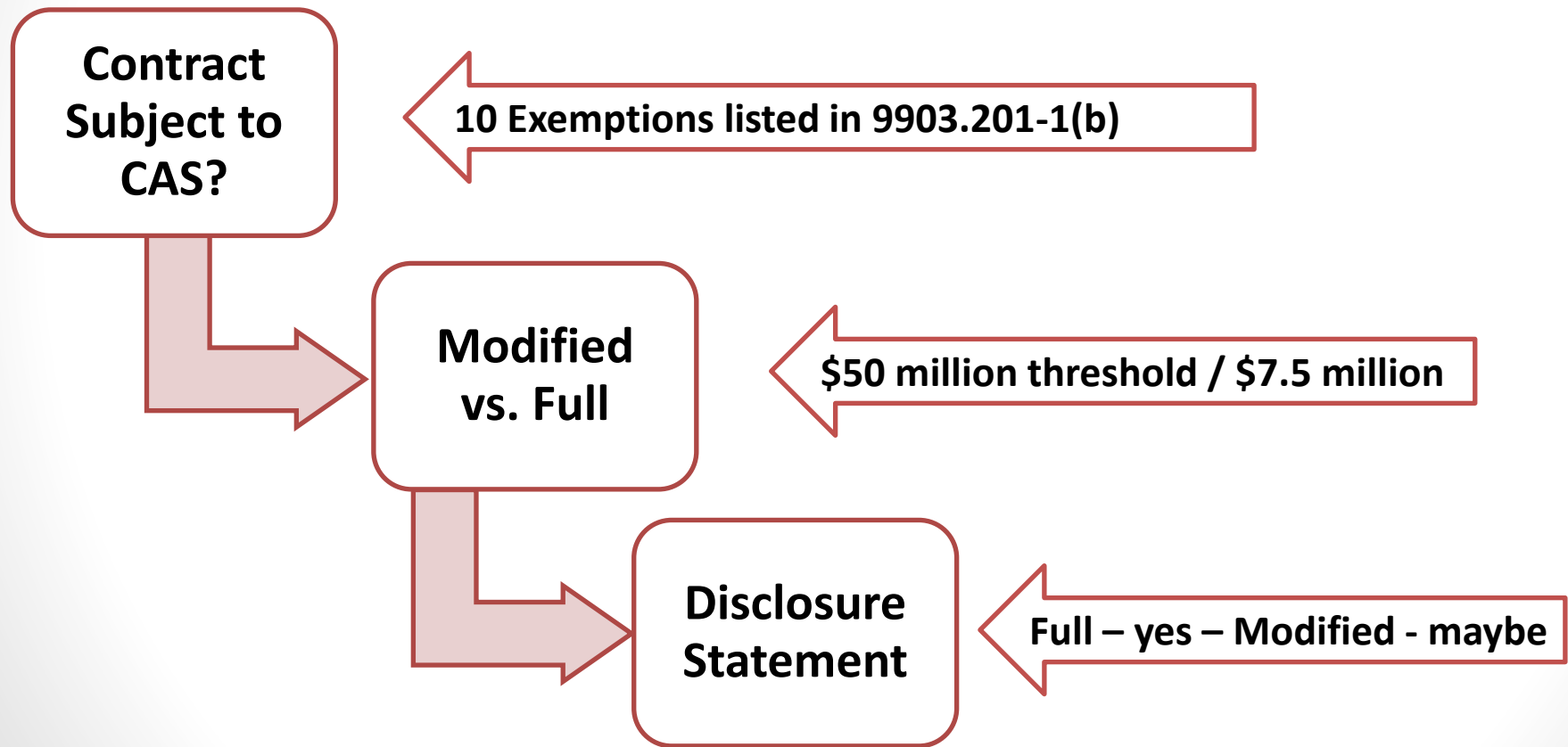
Cost Accounting Standards: Applicability

Cost Accounting Standards Coverage

- Done on a contract-by-contract basis
- CAS status is determined at time of award and will not change over the life of the contract
- CAS administration only tied to CAS-covered contracts
- 19 Standards
- 10 exemptions to CAS

CAS Coverage in a Minute!

- Contracts are subject to CAS – not contractors!



Exemptions from CAS Coverage FAR 9903.201-1

- Sealed bid contracts
- Negotiated contracts and subcontracts not in excess of TINA threshold - formerly \$750k / 2018 NDAA update to \$2M on July 1, 2018 (*orders between segments shall be treated as a subcontract*)
- Contracts and subcontracts with small businesses
- Contracts and subcontracts with foreign governments or their agents or instrumentalities or, insofar as the requirements of CAS other than 9904.401 and 9904.402 are concerned, any contract or subcontract awarded to a foreign concern
- Contracts and subcontracts where the price is set by law or regulation
- Firm fixed-price and fixed price with EPA (*provided the price adjustment is not based on actual costs incurred*) contracts and subcontracts for the acquisition of commercial items

Exemptions from CAS Coverage FAR 9903.201-1 (Cont'd)

- Contract or subcontracts of less than \$7.5M, provided that, at the time of award, the business unit is not currently performing any CAS-covered contracts or subcontracts valued at \$7.5M or greater
- Subcontractors on the NATO PHM* Ship program to be performed outside the U.S. by a foreign concern
- Firm-fixed-price contracts or subcontracts awarded on the basis of adequate price competition without submission of **certified** (effective March 30, 2018) cost or pricing data
- In cases where the prime contract is exempt from CAS under any of the exemptions at 9903.201-1 any subcontract under that prime is always exempt from CAS

Types of CAS Coverage

Full coverage

- Comply with all CAS in effect at the time of award and any subsequent CAS
- Subject to full coverage if:
 - + Receive a single CAS-covered contract of \$50 million or more
 - + Received \$50 million in CAS-covered contract awards in the preceding cost accounting period
- Requires flow-down to subcontractors

Modified coverage

- Comply with CAS 401, 402, 405 and 406
- Modified CAS applies if:
 - + The contract or subcontract award is less than \$50 million; and
 - + the business unit received less than \$50 million in CAS awards in the preceding cost accounting period
- Requires flow-down to subcontractors

FAR 52.230-3: Modified CAS

- Comply with CAS 401, 402, 405 and 406
- File a disclosure statement if required
- Follow consistently cost accounting practices
- Agree to an adjustment if contractor fails to comply with the applicable CAS

FAR 52.230-2: Full CAS Coverage

- Disclose in writing cost accounting practices
- Follow consistently cost accounting practices
- Comply with all CAS
- Agree to an equitable adjustment for changes to cost accounting practices
- Agree to an adjustment if the contractor is not in compliance with the CAS

Adjustments Under CAS

- Three types of adjustments under CAS:
 - Equitable adjustment under the Changes clause for required and desirable changes
 - An adjustment of contract price or cost allowance to recover increased costs paid for noncompliant cost accounting practices
 - A negotiated agreement that may not result in increased costs paid for unilateral changes

Cost Accounting Practice

- Used to allocate costs to cost objectives
- Used to assign costs to cost accounting periods
- Used to measure costs

Change to a Cost Accounting Practice

- Any alteration to a cost accounting practice whether or not the practice is covered by a disclosure statement
- Except:
 - The adoption of a new cost or a new function is not a change
 - Revising a practice that was before considered immaterial is not a change
- Frequently a source of dispute
 - Organizational changes
 - Changes to accounting methods or techniques

Cost Impact Process

Contractor must submit:

- A description of the change
- The total potential impact of the change on its CAS-covered contracts
- General dollar magnitude of the change
- 60 days before implementation...

If the ACO determines the change, it will have a material impact:

- The contractor must submit a cost impact proposal in the form and manner specified by the ACO
- Contract adjustments will be made only if impact is material

ACO review and determination

Contractor appeals process

When should changes be made?

- When a fundamental shift in business mix has occurred and it is forecasted to be permanent
- **Never** casually change a practice to accommodate a single RFP (unless it truly will represent a significant shift in business mix)

19 Cost Accounting Standards

- 401 - Consistency in Estimating, Accumulating, and Reporting Costs
- 402 - Consistency in Allocating Costs Incurred for the Same Purpose
- 403 - Allocation of Home Office Expenses to Segments
- 404 – Capitalization of Tangible Assets
- 405 – Accounting for Unallowable Costs
- 406 – Cost Accounting Period
- 407 – Use of Standard Costs for Direct Material and Direct Labor
- 408 – Accounting for Costs of Compensated Personal Absence
- 409 – Depreciation of Tangible Capital Assets
- 410 – Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives
- 411 – Accounting for Acquisition Costs of Material
- 412 – Composition and Measurement of Pension Cost
- 413 – Adjustment and Allocation of Pension Cost
- 414 – Cost of Money as an Element of the Cost of Facilities Capital
- 415 – Accounting for the Cost of Deferred Compensation
- 417 – Cost of Money as an Element of the Cost of Capital Assets under Construction
- 418 – Allocation of Direct and Indirect Costs
- 419 – Reserved
- 420 – Accounting for Independent Research and Development and Bid and Proposal Costs

Polling question #3

Does your company have CAS covered contracts?

- a) Yes
- b) No
- c) Not applicable

Basic Standards – Modified CAS

CAS 401: Consistency in Estimating Accumulating and Reporting Costs

- Contractor's practices in estimating costs must be the same used to accumulate and report costs
- Grouping of homogeneous costs for estimating purposes is not a violation of the standard provided that the actual costs are accumulated at a greater level of detail during performance

CAS 402: Consistency in Allocating Costs Incurred for the Same Purpose

- Costs that are defined as a direct cost must be a direct cost to all final cost objectives in like circumstances
- Costs that are defined as an indirect cost must be indirect with respect to all final cost objectives in like circumstances
- The customer willingness or unwillingness to treat a cost as direct or indirect is irrelevant

CAS 405: Accounting for Unallowable Costs

- Requires exclusion of unallowable costs (both expressly unallowable or mutually agreed as being unallowable) from billings, proposals or cost submissions
- Requires identification of costs that are unallowable as a result of a contracting officers final decision if an appeal is being made

CAS 406: Cost Accounting Period

- Contractor must use its fiscal year for its cost accounting period
- Transitional cost accounting period must be used if a contractor changes its fiscal year
- A change in cost accounting period is a change in a cost accounting practice

Cost Allocation Standards

CAS 410: Allocation of Business Unit G&A Expenses to Final Cost Objectives

- Requires the use of a cost input base
- Provides several options
 - Total cost input (total cost incurred - general and administrative expenses)
 - Value added (total cost input - direct material and subcontracts)
 - Single element
- DCAA partial to total cost input

CAS 403: Allocation of Home Office Expenses to Segments

- Costs have to be allocated on a base that reflects a causal or beneficial relationship
- Three steps to the allocation process:
 - Specific identification
 - Homogeneous cost pools
 - Residual expenses
 - + Three-factor formula
 - > Percent payroll dollars
 - > Percent operating revenue
 - > Percent average net book value of assets

CAS 418: Allocation of Direct and Indirect Costs

- Requires written policy
- Indirect costs have to be grouped into homogenous cost pools
- Categorizes two types of indirect costs:
 - Those associated with the supervision and management of direct labor and direct material
 - Those that are not associated with the supervision and management of direct labor and direct material

CAS 420: Accounting for IR&D and B&P Costs

- IR&D and B&P costs shall be accumulated in individual projects
- IR&D and B&P costs are to bear all allocable expenses except for business unit general and administrative expenses
- IR&D and B&P incurred at the home office will be allocated to business units on a causal or beneficial relationship

Disclosure Statement

What is a disclosure statement?

- A written description of cost accounting practices used to measure, allocate and assign costs
- Segments, business units and home offices
- Significant amounts of administration
- Disclosure Statement Form, CASB DS – 1 can be found at: https://www.whitehouse.gov/wp-content/uploads/2017/11/CASB_DS-1.pdf

What does the DS cover?

- General information
- Direct costs
- Direct versus indirect costs
- Indirect costs
- Depreciation and capitalization practices
- Other costs and credits
- Deferred compensation and insurance cost
- Corporate or group expenses

Current Regulatory Environment

Current Regulatory Environment

DODIG-2014-084 & DODIG-2015-139 reports

- Failure to make timely final determinations regarding business systems.
- Ensure withholdings are implemented timely.

National Defense Authorization Act (NDAA) of FY 2017

- Section 820 - Authorization of Commercial Audits of Indirect Costs effective October 2018 under certain conditions.
- Section 893 - Amendments to Contractor Business Systems Requirements
 - Clarify business system requirements.
 - Allow for third party independent auditor attestation to the internal control assessment of the contractor, pursuant to Sarbanes-Oxley, that its business systems conform to DoD business system requirements.

Recent sample RFP language:

- “Additionally, the Offeror shall provide a current (within 18 months of proposal submission date) CPA opinion confirming that the Offeror's accounting system is compliant as certified above or evidence of DCAA approved accounting system (within 4 years of proposal submission date).”

How to Prepare for an Accounting System Audit

Be Prepared

- Know the Criteria
 - SF 1408 / DFARS 252.242-7006
- Perform a Gap Analysis
 - Internal or Third Party
- Continuous Improvement
 - Periodic reviews / updates