Your Presenters

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• Season 2 topics will include:
  – Year End Closing
  – Contract Types and Associated Risks
  – Indirect Rates
  – Timekeeping
  – **Introduction to the Cost Accounting Standards**
  – Incurred Cost Submissions
  – Unallowable Costs
  – Contractor Compensation
  – Labor Law Compliance
  – Budgeting and Provisional Rates
  – Accounting Systems
  – Procurement Systems
  – Estimating Systems
Agenda

- Purpose and evolution of the CAS
- CAS applicability and coverage
- Review and Discussion of the Standards
- CAS Disclosure Statement
- Current CAS Issues
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Cost Accounting Standards Overview
Why Do We Need CAS?

• Government spends over $500B annually in contracts for goods and services (Source www.usaspending.gov)

• Pricing of most contracts is fairly straightforward:
  – Competition
  – Commercial Items

• Cost and Pricing Challenges are challenging for:
  – Single/sole source contracts
  – Cost reimbursement contracts
  – Other contracts

• Complex nature of cost accounting practices tied to cost justified contract pricing
The Purpose of the CAS

• Promote uniformity
• Ensure consistency
• Facilitate administration, negotiation and settlement of contracts
Conditions in the 1960’s

- Defense Contractors had inconsistent cost accounting and estimating practices.
- Government believed that GAAP and regulations (ASPR at the time – predecessor to the FAR) provided too much flexibility in contract cost accounting.
- Defense spending and negotiated contracts were at high levels and increasing each year.
- Government and Contractors disagreed on the need for standards in cost accounting.
• Admiral Rickover and the Defense Production Act hearings in 1968

• Defense officials felt that a significant burden with no guidance or authoritative guidance available was placed on the COs and the Auditors

• Congress tasked GAO to determine if it was feasible to “apply uniform cost accounting standards” for negotiated contracts and subcontracts

• GAO report indicated that is was feasible to establish a set of cost accounting standards—at the appropriate level of detail.
Congressional Response: Two Statutes

- Public Law 91-379 -- Established the original Cost Accounting Standards Board (8/15/1970)
- Public Law 100-679 -- Reestablished the Cost Accounting Standards Board and expanded coverage to all negotiated contracts (11/17/1988)
Public Law 91-379

- **Statement of objectives** - *The primary objectives of the Cost Accounting Standards Board is to implement Pub. L. 91-379 by issuing clearly stated Cost Accounting Standards to achieve (1) an increased degree of uniformity in cost accounting practices among Government contractors in like circumstances, and (2) consistency in cost accounting practices in like circumstances by individual Government contractors over periods of time.*

- **Applied to negotiated defense prime contracts and subcontracts of $100,000 or more unless the price was based on catalog or market or law or regulation**

- **Allowed Cost Accounting Standards Board to grant additional exemptions**

- **Cost Accounting Standards Board went out of business on 9/30/1980 -however the Standards promulgated by the Board remained in effect**
Public Law 100-679

- Passed on 11/17/1988
- Reestablished a five member CAS Board - Two Government and Two Industry members and the Chairman of the OFPP.
- Increased threshold to $500,000 (Adjusted Since)
- CAS coverage expands to non-defense 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
• 10 exemptions to CAS
CAS Coverage in a Minute!

- Contracts are subject to CAS – not contractors!

Contract Subject to CAS?

10 Exemptions listed in 9903.201-1(b)

Modified vs. Full

$50 million threshold

Disclosure Statement

Full – yes – Modified - maybe
Exemptions from CAS Coverage FAR 9903.201-1

- Sealed bid contracts
- Negotiated contracts and subcontracts not in excess of TINA threshold - currently $750,000 (*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 (Continued)

• 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 US by a foreign concern

• Firm-fixed-price contracts or subcontracts awarded on the basis of adequate price competition without submission of cost or pricing data

* Patrol Hydrofoil Missile Ship (PHM)
• The CAS Board may waive any or all CAS requirements – upon request of an agency head

• The Head of an executive agency can waive CAS:
  – When less than $15M and makes a written determination that the segment is primarily involved in commercial items and has no CAS-covered work
  – When exceptional circumstances exist where a waiver is necessary to meet the needs of the agency
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
• 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
Changes in CAS Coverage During a Cost Accounting Period

• If one modified CAS-covered contract is awarded all CAS-covered contracts of that business unit will be modified during that cost accounting period

• If a $50 million award is received it must be full CAS-covered as will all subsequent CAS-covered contracts
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
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Cost Accounting Standards Administration
• 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
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 . . .

• If the ACO determines the change 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)
Cost Accounting Standards

• Basic Standards – Modified CAS
  – CAS 401: Consistency
  – CAS 402: Direct v. Indirect Costs
  – CAS 405: Unallowable cost
  – CAS 406: Cost accounting period

• Cost Allocation Standards
  – CAS 407: Standard Costs
  – CAS 414: Cost of Money
  – CAS 410: General & Administrative
  – CAS 403: Home Office expenses
  – CAS 418: Direct & Indirect
  – CAS 420: B&P and IR&D

• Asset Accounting Standards
  – CAS 404: Capitalization
  – CAS 409: Depreciation
  – CAS 417: Self Constructed Assets

• Compensation Standards
  – CAS 408: Compensated Assets
  – CAS 412 & 413: Pensions
  – CAS 415: Deferred Compensation

• Other Standards
  – CAS 411: Material Costs
  – CAS 416: Insurance Costs
Basic Standards – Modified CAS

- CAS 401 - Consistency
- CAS 402 - “Double counting”
- CAS 405 - Unallowable cost
- CAS 406 - Cost accounting period
• 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
• 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
• 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
• 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 407 - Standard costs
• CAS 414 - Cost of Money
• CAS 410 - General & Administrative
• CAS 403 - Home office expenses
• CAS 418 - Direct and indirect
• CAS 420 - B&P and IR&D
CAS 407, Use of Standard Costs for Direct Material and Direct Labor

• Standard cost must be entered into the formal books of account

• Standard costs and variances must be accounted for at the level of the production unit

• Practices with respect to setting and revising standards, use of standards and disposition of variances are stated in writing and consistently followed
• Contractors facility capital has to be allocated to appropriate cost pools.
• The cost of money rate is the Secretary of the Treasury Rate.
• The cost of capital committed to facilities shall be computed for each contract using the facilities capital cost of money factors computed for each cost accounting period.
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
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

3-Factor formula
• 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
Allocation of each type of indirect cost

• Associated with direct labor and material
  – direct labor hour or cost base
  – machine hour base
  – units of production
  – direct material

• Not associated with direct labor and material
  – first, a measure of resource consumption, then
  – a measure of output, finally
  – a surrogate
CAS 418 Requires That Cost Be Allocated To The Following

• Final cost objectives
• Goods produced for inventory or stock
• Cost centers used to accumulate costs identified with a process cost system
• Goods or services produced or acquired for other segments of the contractor and for other cost objectives of the business unit
• Self constructed assets
• 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
Asset Accounting Standards

- CAS 404: Capitalization
- CAS 409: Depreciation
- CAS 417: Self Constructed Assets
• Requires a written policy for capitalization
• Minimum service life of 2 years and $5,000
• Asset value includes cost of putting into service
• Special requirements for business combinations
CAS 409, Depreciation of Tangible Capital Assets

- Depreciable base = capitalized cost - residual value
- Estimated useful life must approximate the pattern of consumption of the asset
- Direct only if charges are based on usage and all assets of that class are treated the same
- Gain or loss charged or credited to the same pool that was charged for the depreciation
• The cost of money associated with self constructed assets will be included in the capitalized acquisition cost of the asset

• Secretary of the Treasury interest rate is used to compute the amount to be capitalized
Cost Accounting Standards

• Asset Accounting Standards
  – CAS 404: Capitalization
  – CAS 409: Depreciation
  – CAS 417: Self Constructed Assets

• Compensation Standards
  – CAS 408: Compensated Assets
  – CAS 412 & 413: Pensions
  – CAS 415: Deferred Compensation

• Other Standards
  – CAS 411: Material Costs
  – CAS 416: Insurance Costs
Compensation Standards

- CAS 408 - Compensated absences
- CAS 412 & 413 - Pensions
- CAS 415 - Deferred compensation
The cost of compensated personal absences will be allocated to the cost accounting period in which the entitlement is earned.

The cost for an entire accounting period will be allocated pro-rata to all final cost objectives.
CAS 412 & 413 – Pension Costs

• CAS 412 – Measurement of Pension Costs
• CAS 413 - Adjustment and Allocation of Pension Cost
• Defined Benefit Plans – Significant accounting requirements
• Defined Contribution Plans – Simple and straightforward
• CAS “Harmonization”
• Deferred compensation recognized in the period in which the employer incurs an obligation to pay

• If no obligation to pay the deferred compensation will be recognized when paid

• The measurement of deferred compensation is the present value of the future payments to be paid by the contractor
Other Standards

- CAS 411 - Material Costs
- CAS 416 - Insurance Costs
• Requires written policies and procedures
• The cost material can be directly charged provided the cost objective was specifically identified at the time of purchase or production
• Same costing method shall be used within the same business unit for similar categories of material
• The amount of insurance cost to be assigned to a cost accounting period is the projected average loss for the period plus insurance administrative costs

• Self-insurance vs. purchased insurance

• Insurance costs are to be allocated to cost objectives on a causal or beneficial relationship
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CAS 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:
  – http://www.dcaa.mil/cas.html
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
When do you file?

- Business unit selected to receive an award of $50 million or more must submit a Disclosure Statement before award.
- Any company which received net awards of $50 million in the preceding cost accounting period within 90 days after the end of the cost accounting period in which the threshold was breached.
Who Must File and Where?

- Any segment whose costs included in the price of a CAS covered contract exceed $750,000

Exceptions:

- exempt from CAS by FAR 9903.201-1
- if in the preceding cost accounting period CAS covered awards are less than 30% of sales and less than $10 million

Submitted to the ACO with a copy to the cognizant audit agency

Subcontractors:

- Either to the prime; or
- To their ACO and cognizant audit agency (generally the preferred way for a subcontractor to file)
Current CAS Issues
• Section 820 of the National Defense Authorization Act for Fiscal Year 2017
  – Authorization of Commercial Audits
  – Amendment to CAS Statute
  – Creation of Defense CAS Board (DCAS)
    (1) review the Cost Accounting Standards and recommend changes to the CAS Board;
    (2) implement the Cost Accounting Standards to achieve uniformity and consistency across DoD contracts; and
    (3) develop standards to ensure that commercial operations performed by DoD employees adhere to the Cost Accounting Standards or to GAAP
Join us next month for
An Introduction to the Incurred Cost Submission - Part II: Preparation and Adequacy Review on Tuesday, May 23rd
DHG’s 22nd Annual Government Contracting Update:
shaping today’s challenges into tomorrow’s success

When: May 4th, 2017

Where: The Hyatt Regency in Tysons Corner, VA

CPE: 8 hours (pending approval)

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