Transforming the Profession:
Anticipating and Adapting to Change

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The Cost Accounting Standards and Consequences of Noncompliance

Breakout Session E05

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Tuesday, December 15
1:45pm – 3:00pm
Agenda

1. Consequences Of Noncompliance
2. Cost Accounting Standards
3. CAS Applicability
4. Disclosure Statements
5. CAS Administration & Cost Impacts
6. Recent Events
Common Consequences of Noncompliance With CAS

• Incurred Cost Submissions (“ICSs”)/Indirect Rate Years
  – Prevention of ICS audit completion, potentially leaving indirect rate years open (final indirect rates may be indeterminable, unless unilaterally decided by the Government)

• Contract Closeout
  – Noncompliance with CAS could prevent/delay timely closeout of contracts
Common Consequences of Noncompliance With CAS (cont.)

• Potential Business System Implications
  – Certain business systems require compliance with applicable laws (e.g., CAS)
  – failure to comply with CAS may be construed as noncompliance with applicable law

• Competitive Positioning
  – Noncompliance with CAS puts companies at a competitive disadvantage
Other Consequences of Noncompliance With CAS

• Contract Terminations (Terminations For Convenience)
  – A major outcome of a contract termination for convenience is to determine and settle any amounts due to/from the contractor to the Government
  – If there are CAS compliance issues, there may be unknown contractor liabilities which could prevent/delay timely closing of a terminated contract until resolved
Other Consequences of Noncompliance With CAS (cont.)

• Certain Business Systems Must Provide Reasonable Assurance Of Compliance With “Applicable Laws” (e.g., CAS)
  – For example, an “Acceptable Accounting System means a system that complies with the system criteria in [DFARS 252.242-7006(c)] to provide reasonable assurance that applicable laws and regulations are complied with…” [DFARS 252.242-7006]

• Inability to identify CAS covered contracts for purposes of administering CAS rules could be construed as a noncompliance with CAS (a law) and could therefore result in an inadequate business system
Other Consequences of Noncompliance With CAS (cont.)

- Inadequate Business System Implications
  - Harm to cash flows in the form of payment withholds on CAS covered contracts (five or ten percent depending on circumstances)
  - ‘Other action’ may be taken by the contracting officer within terms of the contract
  - Competitive positioning considerations
Other Consequences of Noncompliance With CAS (cont.)

• Liability Exposure In A Merger Or Acquisition
  – Companies merging with or acquiring another business or acquiring contracts from another business may be exposed to liability as a successor in interest if:
  • The business acquired/merged with has contracts with instances of CAS noncompliance
  • The contracts acquired have instances of CAS noncompliance
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Cost Accounting Standards

- Concepts And Principles (Modified CAS): CAS 401, 402, 405, and 406
- Allocation: CAS 403, 407, 410, And 418
- Identification & Assignment: CAS 408, 411, 412, 413, 415, 416, And 420
- Tangible Capital Assets: CAS 404, 409, 414, And 417
Cost Accounting Standards (cont.)

- Federal Acquisition Regulation ("FAR") Part 31 Incorporates Several Cost Accounting Standards By Reference
  - Examples include FAR 31.205-6(j) (CAS 412 and 413) and FAR 31.205-10(b) (CAS 414 and 417)
  - When there are required cost accounting practice changes (e.g., pension harmonization) which impact non-CAS covered contracts by means of FAR Part 31, what is the appropriate course of action?
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CAS Applicability and Coverage

Step 1: Is The Contract Exempt Or Covered?
Determine if a CAS exemption applies to the contract/subcontract being negotiated/awarded. (Use the ‘CAS Exemptions’ table in the green section of the following slide’s flowchart from DCMA)

Step 2: Is The Coverage Full Or Modified?
If not exempt, determine if contract/subcontract is subject to full or modified CAS coverage. (Use the blue section of the following slide’s flowchart.)

Step 3: Does The Covered Contract Require A Disclosure Statement?
Determine if a CASB disclosure statement is required. (Use the pink section of the following slide’s flowchart.)
CAS Coverage And Disclosure Statement Determination

**Start**

- Does contract/subcontract meet one of the listed CAS exemptions?

  - Yes → **Contract or subcontract is exempt from CAS**
    - If current award $7.5 million or more, or is the business unit currently performing a CAS-covered contract or subcontract valued at $7.5 million or more?
      - Yes → **Award is CAS covered**
      - No → **Contract or subcontract is exempt from CAS**
  - No → **Contract or subcontract is exempt from CAS**

**CAS Exemptions – 48 CFR 9903.201-1(b)**

- Negotiated contract/subcontract not in excess of the Truth in Negotiations Act threshold
- Contract/subcontract price is set by law or regulation
- Sealed bid contract
- Firm-fixed-price contract/subcontract for the acquisition of commercial items
- $7.5 million trigger contract test has not passed (see criteria in Q#2 of flowchart)
- Contract/subcontract with foreign governments, their agents, or instrumentalities and except for CAS 401 & 402, foreign concerns
- Subcontract under the NATO PHM Ship Program to be performed outside of the United States by a foreign concern
- Contract/subcontract with a small business
CAS Coverage And Disclosure Statement Determination (cont.)

**Award is CAS covered**

- **Yes**
  - Is the current award $50 million or more?
    - **Yes**
      - Did the business unit receive $50 million or more in net CAS covered awards in the **preceeding** cost accounting period?
    - **No**
  - **Yes**
    - Has the business unit received a **single** CAS-covered contract/subcontract of $50 million or more during the **current** cost accounting period?
  - **No**

**Contract/subcontract subject to full CAS coverage (all 19 standards)**

**Business Unit Disclosure Statement Required**

**Home office allocating costs to one or more disclosing segments must also submit Part VIII**

**Contract/subcontract subject to modified coverage (CAS 401, 402, 405, 406)**

- **Yes**
  - Did the company together with its segments receive $50 million or more in net CAS-covered awards during the **preceeding** cost accounting period?
    - **Yes**
      - Are the business unit CAS-covered awards during the prior year less than $10 million and less than 30% of total segment sales?
        - **Yes**
          - **Disclosure Statement is not required**
        - **No**
          - Home office allocating costs to one or more disclosing segments must also submit Part VIII
CAS-Coverage Implications on Cost Impact

- Changes to disclosed or consistently practiced Cost Accounting Practices results on cost impacts on both full and modified CAS-covered government contracts.

- Noncompliance exposure may be limited to applicable contracts (e.g., a CAS 403 noncompliance would require a cost impact calculation for a contract that is subject to full CAS).
Applicability To ID/IQ’s

- Not Specifically Mentioned In CAS Board Regulations
- Often Impossible To Determine The Value Of ID/IQ Contract At Time Of Award, Particularly In Case Of Multiple Awards
- The Government Seemingly Determines The “Value” Of An ID/IQ Contracts By Relying On FAR 1.108(c):
  - “Unless otherwise specified, a specific dollar threshold for the purpose of applicability is the final anticipated dollar value of the action, including the dollar value of all options. If the action establishes a maximum quantity of supplies or services to be acquired or establishes a ceiling price or establishes the final price to be based on future events, the final anticipated dollar value must be the highest final priced alternative to the government, including the dollar value of all options.”
Applicability To ID/IQ’s (cont.)

- Position Runs Contrary To Both The CAS Working Group Paper 76-2 (Application of CAS to Contract Modifications And To Orders Placed Under Basic Agreements) And FAR 2.101
  - FAR 2.101 states that “job orders or task letters under basic ordering agreements” are considered contracts, **not** the ordering vehicle (e.g., an ID/IQ contract) itself
Applicability To Foreign Concerns

• CAS Applicability:
  - Exempt from most Cost Accounting Standards: “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.” [48 CFR 9903.201-1 (4)]

• CAS Coverage:
  - “Contracts with foreign concerns subject to CAS shall only be subject to Standard 9904.401, Consistency in Estimating, Accumulating, and Reporting Costs, and Standard 9904.402, Consistency in Allocating Costs Incurred for the Same Purpose.” [48 CFR 9903.201-2 (e)]
Applicability To Foreign Concerns (cont.)

• While foreign concerns are exempt from the majority of Cost Accounting Standards, 48 CFR 9903.201-4(f) requires disclosure (if the foreign concern meets certain requirements) of actual cost accounting practices.

• 48 CFR 9903.201-4(f) additionally requires consistency in following cost accounting practices (note that actual cost accounting practices would include practices which may not be disclosed).

• Practically, these requirements greatly increase exposure to foreign concerns for noncompliance with the CAS and create increased requirements for CAS administration rules stipulated in FAR Part 30.
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Disclosure Statement Requirements

• A business unit selected to receive a CAS-covered contract of $50 million or more must submit a disclosure statement before award.

• In addition, a company with it segments received net CAS-covered awards of $50 million or more in its most recent accounting period must submit a disclosure statement before award of its first new CAS-covered contract after accounting period.
Changes to Disclosure Statements

• Revisions to the Disclosure Statement Are Needed When There Is A Change Or Alteration In A Cost Accounting Practice As Defined in 48 CFR 9903.302-1. [48 CFR 9903.302-2]


• DCAA CAM Chapter 8, Section 8-202h:
  – “[O]nly pages containing such revision shall be resubmitted.”
  – “[T]he contractor should mark each page “Revision Number_” and “Effective Date_”…”
  – “[I]nsert a revision mark (e.g., “R”) in the right hand margin of any line that is revised.”
Changes to Disclosure Statements (cont.)

• In Accordance with FAR 52.230-6, the contractor must submit proposed accounting changes to the CFAO. It is then the responsibility of the CAS auditor as to whether accounting changes made by a contractor require a revision to the disclosure statement. [DCAM CAM Chapter 8, Section 8-303.3a]

• When a disclosure statement revision is required but not made, a noncompliance report will be issued. [DCAM CAM Chapter 8, Section 8-303.3b]
Disclosure Statements-
Applicability to Foreign Concerns

• Required in negotiated contracts when the contract is with a foreign concern and the contract is not otherwise exempt. [48 CFR 9903.201-4 (f)]

• Requires the contractor to comply with 9904.401 and 9904.402, to disclose (if it meets certain requirements) actual Cost Accounting Practices, and to follow consistently disclosed and established Cost Accounting Practices. [48 CFR 9903.201-4 (f)(1)]
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Overview Of FAR 30.6 – CAS Administration

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Sources Of Guidance:
FAR 30.6 CAS Administration
DCAA CAM, Chapter 8, Section 8-503 Guidance on Evaluation of Cost Impact Proposals
Responsibility And Materiality

1. The **Cognizant Federal Agency Official (CFAO)** is responsible for CAS administration for all CAS-covered contracts and subcontracts.

2. The CFAO shall determine whether a change in Cost Accounting Practice (“CAP”) or Noncompliance has occurred, and how any resulting cost impacts are resolved.

3. The CFAO shall determine whether the cost impact is material or immaterial.
   
   1. Realistically, higher profile contractors (especially those with high dollars of DoD contracts) should not anticipate frequent determinations of immateriality.
Requirements For Submission Of Cost Impact Proposal

FAR 52.230-6(c) Requires That Contractors Submit Cost Impact Proposals For The Following:

1. Required CAP Change:
   - Change required to comply prospectively with a new or modified CAS, or
   - Change required for contractor to remain in compliance with CAS.
   - May result in price or cost increases or decreases.

2. Unilateral CAP Change:
   - Contractor elects to make change that the CFAO has not determined to be desirable.
   - No increased costs may be paid by the Government.
Requirements For Submission Of Cost Impact Proposal (cont.)

3. **Desirable CAP Change:**
   - Contractor elects to make change that the CFAO determined to be desirable and not detrimental to the Government.
   - May result in increased or decreased costs.

4. **Noncompliance:**
   - Contractor fails to comply with CAS or to consistently follow disclosed or established CAP.
   - Two types of noncompliance:
     - Estimation
     - Cost Accumulation
Cost Impact Proposal

• Must Be Submitted Within 60 days (Or Other Mutually Agreed-Upon Date):
  – After the proposed change is determined adequate and compliant,
  – After date of the contractor’s agreement with the initial finding of noncompliance, or
  – After date the contractor is notified by the CFAO of a determination of noncompliance.

• Must Include A List Of CAS-Covered Contracts/ Subcontracts That Are, Or Will Be, Affected By The Change Or Noncompliance.

• Two Proposal Formats Used To Calculate The Cost Impact.
  1. General Dollar Magnitude (“GDM”)
  2. Detailed Cost-Impact (“DCI”)
Cost Impact Proposal - GDM

- Provides Information To The CFAO On The Estimated Overall Impact Of A Change In Cost Accounting Practice On Affected CAS-Covered Contracts And Subcontracts That Were Awarded Based On The Previous Cost Accounting Practice.

- May Use The Following Methods To Determine Impact:
  - A representative sample of CAS-covered contracts/subcontracts;
  - For each contract group, the change in indirect rates multiplied by total estimated contract base; or
  - Any other method that provides a reasonable approximation of the total increase or decrease in cost accumulations for all affected fixed-price and flexibly-priced contracts and subcontracts.
Cost Impact Proposal – GDM (cont.)

- May Be In Any Format Acceptable To CFAO, But Format Must Show:
  - Impacts by Executive agency for each contract group (fixed-price vs. flexibly-priced).
  - For unilateral changes and noncompliance, the increased or decreased costs (in aggregate) to the Government for each contract group.
  - Total overpayments and underpayments for each contract group made by the Government during the period of noncompliance.
  - Identification of all affected CAS-covered contracts /subcontracts when requested by the CFAO.
Cost Impact Proposal - DCI

- CFAO May Require DCI If A GDM Is Not Adequate.
- Contractor May Elect To Submit DCI In Lieu Of A GDM Proposal.
- DCI Shows Impacts On Each Affected CAS-Covered Contract And Subcontract.
  - CFAO and contractor may agree to limit impact to contracts/subcontracts over a certain dollar threshold.
- Same Minimum Format Requirements As GDM.
- DCIs Oftentimes Are Far More Complicated To Prepare Than GDMs.
Cost Impact Process

Calculating Cost Impact – DCAA’S Five-Step Process

1. Compute increased/decreased cost estimates and/or accumulations for CAS-covered contracts/subcontracts.

   • Cost Accounting Practice Changes
     – Prospective from the CAP change date to the end of contract performance.

   • Noncompliance In Cost Accumulation
     – Impacts only flexibly priced contracts and subcontracts and only for the period which cost accumulation was noncompliant

   • Noncompliance In Cost Estimating
     – Impacts fixed-price contracts/subcontracts (and fixed, target, and incentive fees on flexibly-priced) for entire period of performance for each affected contract/subcontract.
Cost Impact Process (cont.)

DCAA’S Five-Step Process (Cont’d)

2. Combine contract impacts within each contract group (fixed-price vs. flexibly-priced).
   - T&M contracts have both a fixed price and flexibly priced component.

3. Determine the net increased/decreased cost paid by the Government for each contract group.
   - Increases in costs accumulated on flexibly priced awards = increased costs; decreases in costs accumulated or if price is inflated by estimate on fixed price awards = increased costs.
   - Include profits, fees, and incentives.
     - Certain items which are not based on cost (such as award fees) generally would not be considered in the computation of a cost impact.
Cost Impact Process (cont.)

DCAA’s Five-Step Process (Cont’d)

4. Combine cost impacts of each contract group together to determine increased or decreased costs “in the aggregate.”
   • Increased costs in the aggregate will be recovered by the Government, except for desirable and required changes.
   • Decreased costs in the aggregate will not be recovered by the contractor, except for desirable and required changes.
   • Interest is applicable to overpayments related to noncompliances.

5. Settlement alternatives:
   • Contract adjustments,
   • Indirect rate adjustments, and
   • Cash payment.
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Recent Events – Example 1

• The Armed Services Board of Contract Appeals’ (“ASBCA”) recent decision regarding “expressly unallowable” costs under the CAS and FAR that strictly limit the Government’s attempts at expansive determinations.
  – “Expressly unallowable” costs under the CAS and the FAR are narrow and discrete.
  – Based off of plain definition.
Recent Events – Example 1 (cont.)

• “Expressly unallowable” cost “…**must** be an item of cost or a type of cost that is specifically named and stated as unallowable by law, regulation, or contract.”

• These costs must be identified as unallowable in “direct and unmistakable terms.”

• Findings → certain bonus and incentive compensation costs were not expressly unallowable:
  – FAR 31.205-1
  – FAR 31.205-22
  – FAR 31.205-27
Recent Events – Example 1 (cont.)

• Findings (cont.):
  – FAR 31.205-1: bonus and incentive compensation costs are neither salary nor fringe benefits.
  – FAR 31.205-6(p): bonus and incentive compensation costs are “different types of compensation” → therefore not fringe benefits.
  – No violation of CAS 405’s requirement that expressly unallowable costs “be identified and excluded from any billing, claim, or proposal,” nor was the contractor subject to any penalty under FAR 42.709-1 for the inclusion of expressly unallowable costs in an indirect cost proposal.
  – Quantum of the government’s claim for unallowable costs has been greatly reduced.
Recent Events – Example 2

- ASBCA’s recent decisions on a number of issues involving cost impacts resulting from changes in cost accounting practices under US government contracts, including several changes made effective on the same day.
Recent Events – Example 2 (cont.)

• CAS 9903.306(b) → the ASBCA held that it "runs afoul of the prohibition in [the CAS statute]" on recovering greater than the aggregate increased cost to the government.
Recent Events – Example 2 (cont.)

• The ASBCA expanded on rationale established in recent decision in The Boeing Company, ASBCA No. 57549, 13 BCA ¶ 35,437.

• Prior to the decision, the Government would disallow contractors “offsetting” increased costs paid as a result of changes in cost accounting practices against decreased costs paid for other changes in cost accounting practices made effective the same date.
  – FAR 30.606(a)(3)(ii)
  – Amended in 2005
  – For changes in cost accounting practices after the FAR change, the ASBCA held that the FAR provision was valid and applicable.
Recent Events – Example 2 (cont.)

• Boeing Standard → applicable to contracts predating the FAR amendment.

• FAR 30.606 → applicable to contracts after the FAR change.

• Other areas addressed:
  
  (a) Desirable Changes  
  (b) Interest  
  (c) Materiality  
  (d) “30 Percent Increment”
Sources

- Example 1 - Raytheon Co., ASBCA Nos. 57576 et al. (June 26, 2015)

- Example 2 - Raytheon Co., Space & Airborne Sys, ASBCA Nos. 57801 et al. (May 7, 2015)

- Example 2 - Boeing Company, ASBCA No. 57549, 13 BCA ¶ 35,437
Questions
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