

THE EFFECT OF CAS ON YOUR COMPANY'S STRUCTURE

March 10 and 11, 2020

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AGENDA

- Discuss common CAS issues related to M&A activity & restructuring
- Identify strategies for minimizing or addressing the potential CAS impact of a business structure change
- Provide a framework for transitioning from non to full-CAS coverage
- Provide updates on changes recommended by the Section 809 Panel and recent CAS Board Meetings



CHANGES IN COST ACCOUNTING PRACTICES



CHANGES IN COST ACCOUNTING PRACTICES

Organizational Changes

- Internal
 - Establish new departments, units, groups, divisions.
 - Eliminate departments, units, groups, divisions.
 - Merge departments, units, groups, divisions.
- External
 - Purchase assets or a business.
 - Sell assets or a business.
 - Mergers
 - Investments



CHANGES IN COST ACCOUNTING PRACTICES

Organizational Changes

- May cause a change in cost accounting practice.
- Change in cost accounting practice is a change in the method or technique used for:
 - Allocation of costs to cost objectives.
 - Assignment of costs to cost accounting periods.
 - Measurement of costs.
- May need to prepare a Cost Impact to show Government the monetary impact.
- When there is a change in cost accounting practice the affected contracts are subject to cost or price adjustments.



THREE TYPES OF CHANGES



Required
Change



Unilateral
Change



Desirable
Change



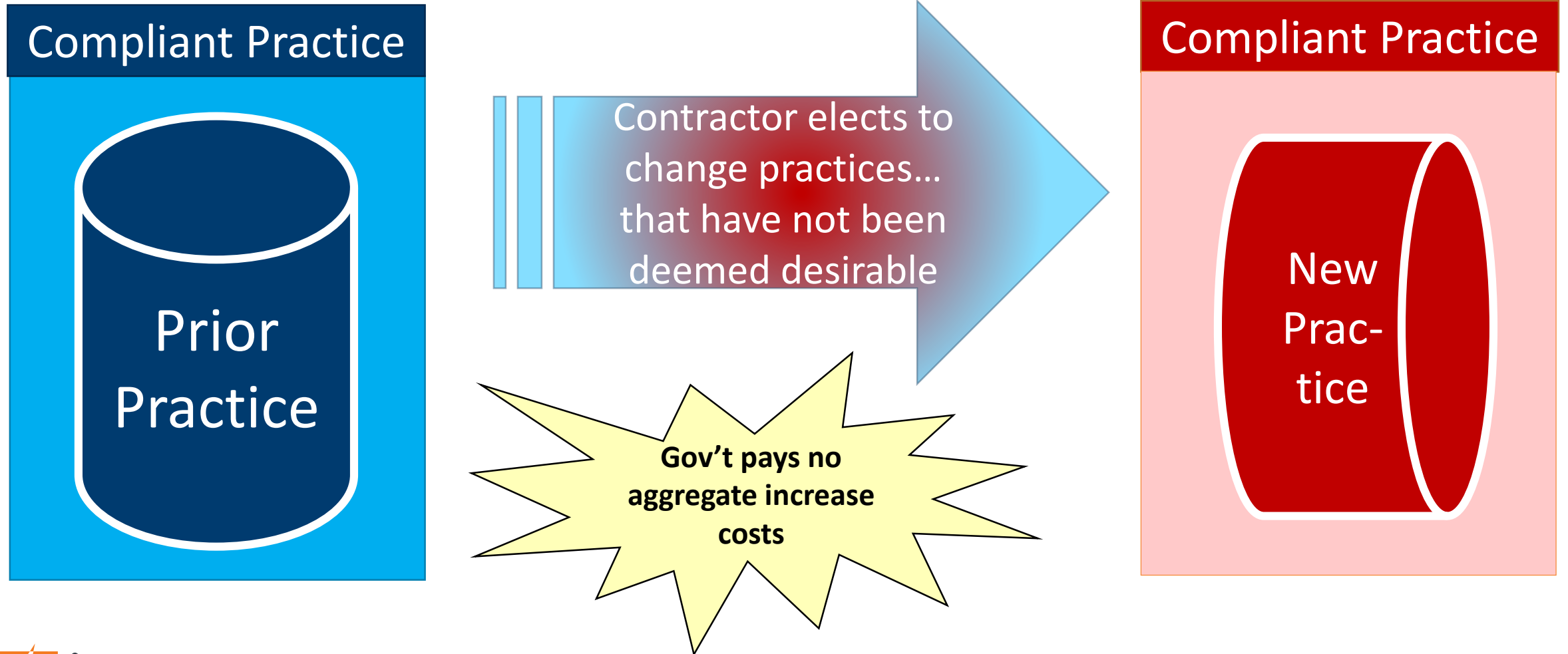


REQUIRED CHANGE BY THE CIRCUMSTANCES





UNILATERAL CHANGE BY THE CONTRACTOR





DESIRABLE CHANGE BY THE CONTRACTING OFFICER





CHANGES IN COST ACCOUNTING PRACTICES

Organizational Changes

- *Perry v. Martin Marietta Corporation (MMC)*
 - Appeal from a ASBCA decisions MMC won
 - MMC consolidated three home offices into two and moved some functions to headquarters.
 - MMC performed a Cost Impact and DCAA audited it - No material impact to Government
 - FAA CO noted that their contracts were allocated more costs under the new structure.
 - The area in question was the transfer of management functions and costs from the terminated home office to an existing home office and indirect pool.
 - FAA CO deemed it a cost accounting practice change.
 - After first appeal the cognizant DOD CO decided it was a cost accounting practice change.
 - Second appeal the ASCBA finds reorganization itself is not a cost accounting practice change



CHANGES IN COST ACCOUNTING PRACTICES

Organizational Changes

- *Perry v. Martin Marietta Corporation (MMC)*
 - The Government argued a “method or technique” includes a change in the size and composition of the segment base and pools.
 - The Court relied on an illustration from 48 CFR 9903.302(c)(3).
 - Contractor merges two segments that use different practices for overhead.
 - Before merger Segment A used DL hours and Segment B used DL dollars.
 - After merger Contractor uses DL dollars.
 - Segment A costs objectives have a different base and a change in accounting practice.
 - Court concluded from the illustration that organizational change itself is not a change in cost accounting practice.
 - The Court relies on Preamble J of the CAS 3-10-78 amendments for further support.



CHANGES IN COST ACCOUNTING PRACTICES

Organizational Changes

- Preamble J of the CAS 3-10-78 amendments
 - The Board acknowledged it is desirable for contractors to make changes to organizational structure or methods of performing work and products produced.
 - Implement new technology
 - Better management
 - Address changes in business environment
 - “These business changes by themselves are not changes in cost accounting practices. Such changes may, however, cause a change to a contractor’s cost accounting practices.”
 - Should be analyzed on an individual basis.
 - Based on facts and circumstances and using criteria in the regulations.
- Court concludes “change to a cost accounting practice” refers to “changes in proportional measurement, assignment, or allocation of costs.”
 - “Organizational changes alone do not create a change in cost accounting practice.”



CHANGES IN COST ACCOUNTING PRACTICES

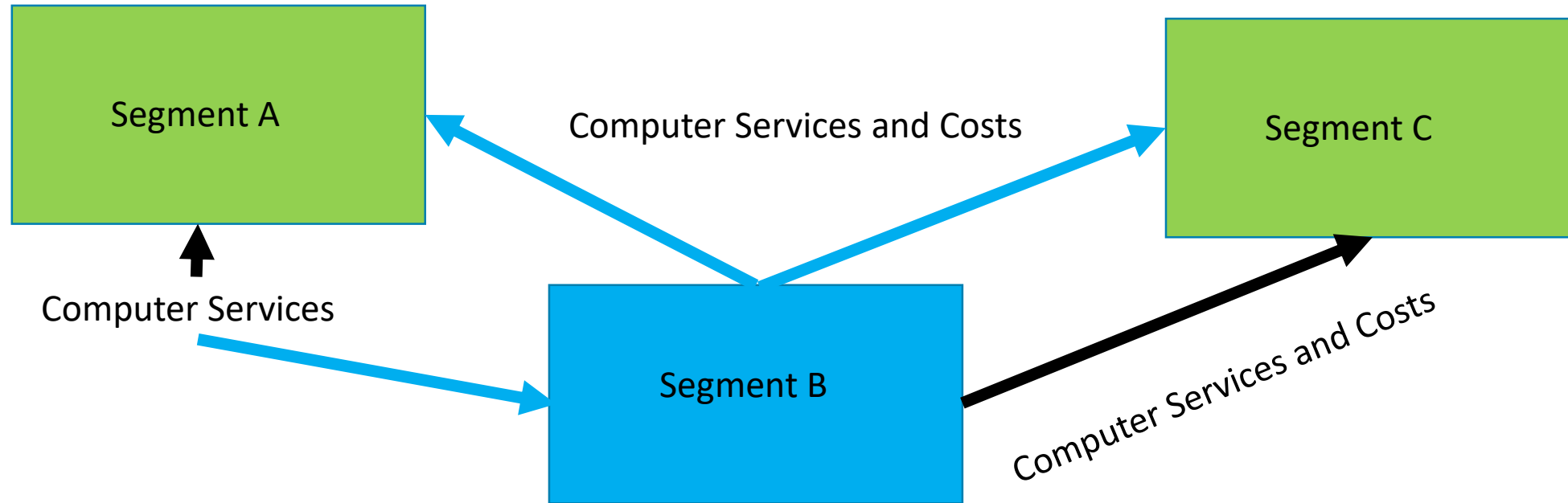
Changes in Direct v. Indirect Cost Allocations

- Allocation of costs to cost objectives includes both direct and indirect allocations.
- Techniques used to determine if a cost is direct or indirect are cost accounting practices.
- A change cost accounting practice will occur if an allocation practice changes from direct to indirect or vice versa.
 - Example: A company reorganizes its engineering group. First line supervision costs were charged to engineering overhead (indirect) and are now charged direct to cost objectives.
 - Example: Company has three segments- A, B, and C. Segment A performs their own computer services. Segment B performs computer services for both B and C. Contractor transfers the Segment A computer services to Segment B. After the transfer Segment B performs all of the computer services and allocates to the benefitting segment. This is a change from direct to indirect for Segment A and no change for Segments B and C.



CHANGES IN COST ACCOUNTING PRACTICES

Direct v. Indirect Example





CHANGES IN COST ACCOUNTING PRACTICES

Composition of Cost Pools

- Indirect cost pools composed of functions and activities
 - For example, supervision, purchasing, inspection, insurance, and security
 - A function is an activity or group of activities identifiable in scope and has a purpose or end to be accomplished. 48 CFR 9903.303-2(a)
- Changing the functions or activities of a pool can become a change in accounting practice.
- Combining pools
 - Pool composition usually changes with combination of functions
 - Can be within segment or home office, between segments, home offices, or both.



CHANGES IN COST ACCOUNTING PRACTICES

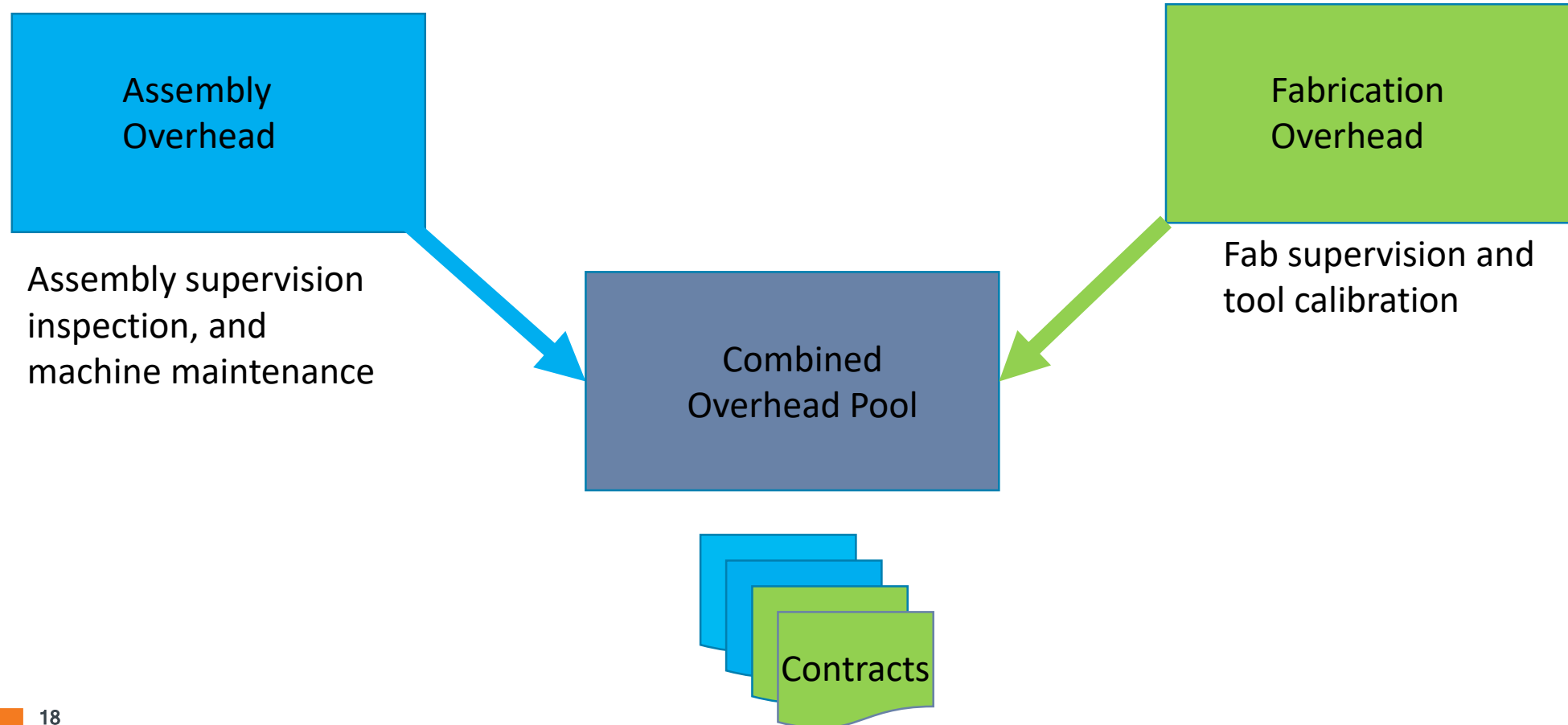
Combining Cost Pools

- Company 1 purchases Company 2
 - Segment A of Company 1 has an assembly overhead pool.
 - The assembly overhead pool is for assembly supervision, materials inspection, and machine maintenance.
 - Company 2 did fabrication and other work for Company 1.
 - Company 2 is a new Segment B in Company 1.
 - New Segment B's fabrication pool is for fabrication supervision and tool calibration.
 - New fabrication pool of the new Segment B is combined with the assembly pool of Segment A
 - Change in pool composition - Functions not generally the same for former assembly pool cost objectives nor former fabrication pool cost objectives.
- Take away - Analyze rationale for combining pools.



CHANGES IN COST ACCOUNTING PRACTICES

Combining Pools Example





CHANGES IN COST ACCOUNTING PRACTICES

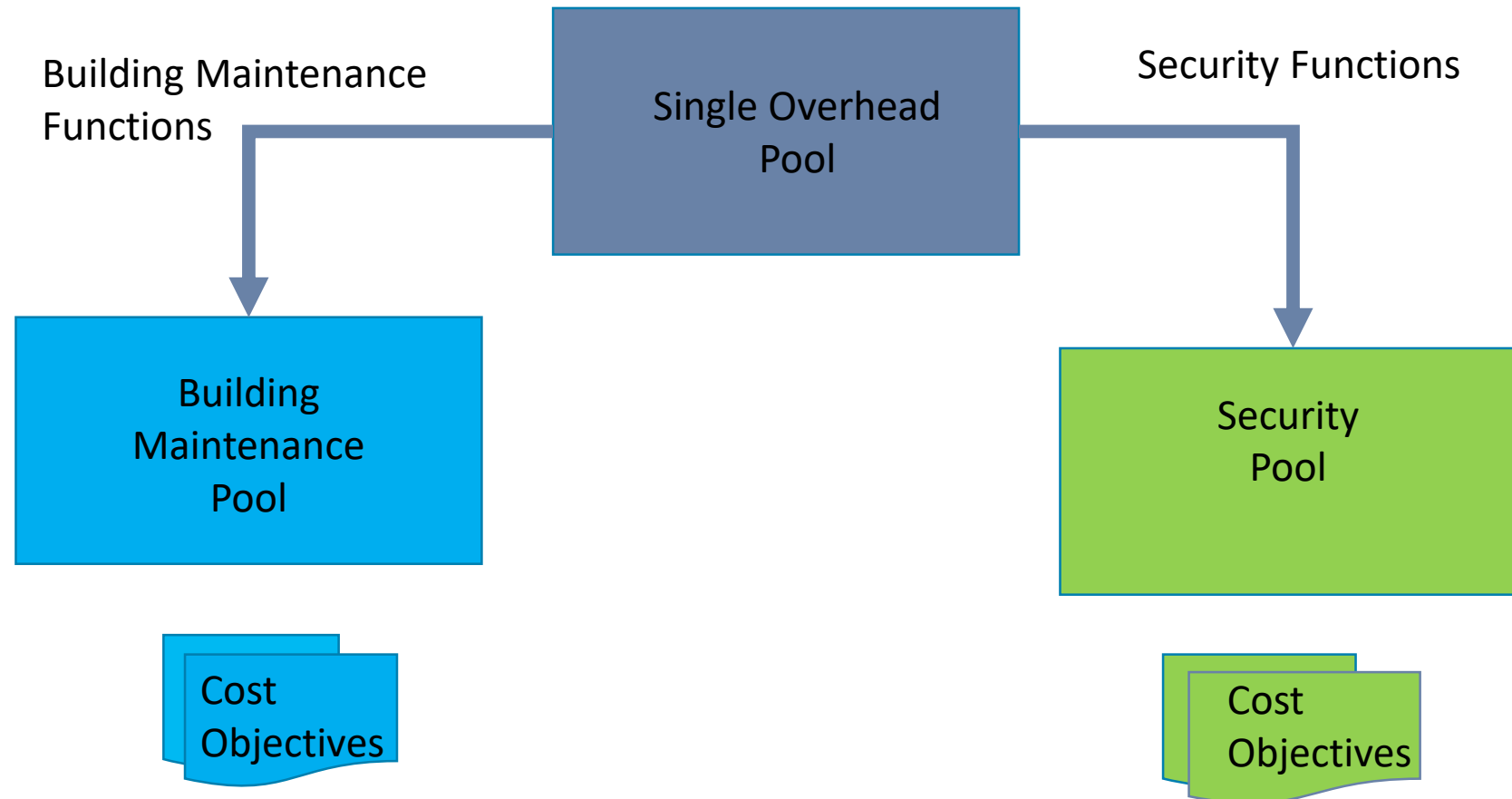
Composition of Cost Pools

- Dividing pools
 - Pool composition usually changes with division (new pools have different functions)
 - Changing the functions or activities of a pool can become a change in accounting practice.
- Example
 - Segment B has a single overhead pool.
 - Two functions, building maintenance and security.
 - Segment B divides the single overhead pool into two indirect cost pools.
 - Pool 1 includes the building maintenance function.
 - Pool 2 includes the security function.
 - Change in pool composition based functions of Pool 1, Pool 2, and the former single pool.



CHANGES IN COST ACCOUNTING PRACTICES

Dividing Pools Example





CHANGES IN COST ACCOUNTING PRACTICES

Composition of Cost Pools

- Transfer of functions
 - Not a change in pool composition for transferring pool if it receives allocable share of the transferred function from the receiving pool.
 - Not a change in pool composition for receiving pool if it contained the transferred function.
 - Can be within segment or home office, between segments, home offices, or both.
 - Changing the functions or activities of a pool can become a change in accounting practice.
- Example
 - Engineering Pool has production engineering supervision.
 - Production Pool does not have production engineering supervision.
 - Contractor transfers production engineering supervision to Production Pool.
 - Change in pool composition for both Pools.



CHANGES IN COST ACCOUNTING PRACTICES

Composition of Allocation Base

- A change in the allocation base is a change in cost accounting practice.
 - Change from direct labor dollars to direct labor hours.
 - Change from total cost input to value added.
- A change in the composition of the allocation base.
 - A change in the elements of the allocation base.
 - Direct labor dollars to direct labor dollars plus fringe benefits.
 - A change in the activities included in the allocation base.
 - Systems engineering labor dollars to systems and design engineering labor dollars.
- A change solely in the volume is not a change in composition or activities of the base.
 - Purchase Company X and add it to an existing home office allocation base.



CHANGES IN COST ACCOUNTING PRACTICES

Initial Adoption of an Accounting Practice/Elimination of a Cost or Cost of a Function

- 48 CFR 9903.302-2(a) states initial adoption of a cost accounting practice is not a change in cost accounting practice.
 - Partial or total elimination of a cost or cost of a function is not a change
 - Transfer of a function from segment to segment or with a home office is not a creation or elimination of a function.
 - Merger of segments or home offices is not the creation or elimination of a function.
- Example: Contractor creates security function in Segment C.
 - No change in cost accounting practice.
 - Brand new function and can allocate costs to contracts.



CHANGES IN COST ACCOUNTING PRACTICES

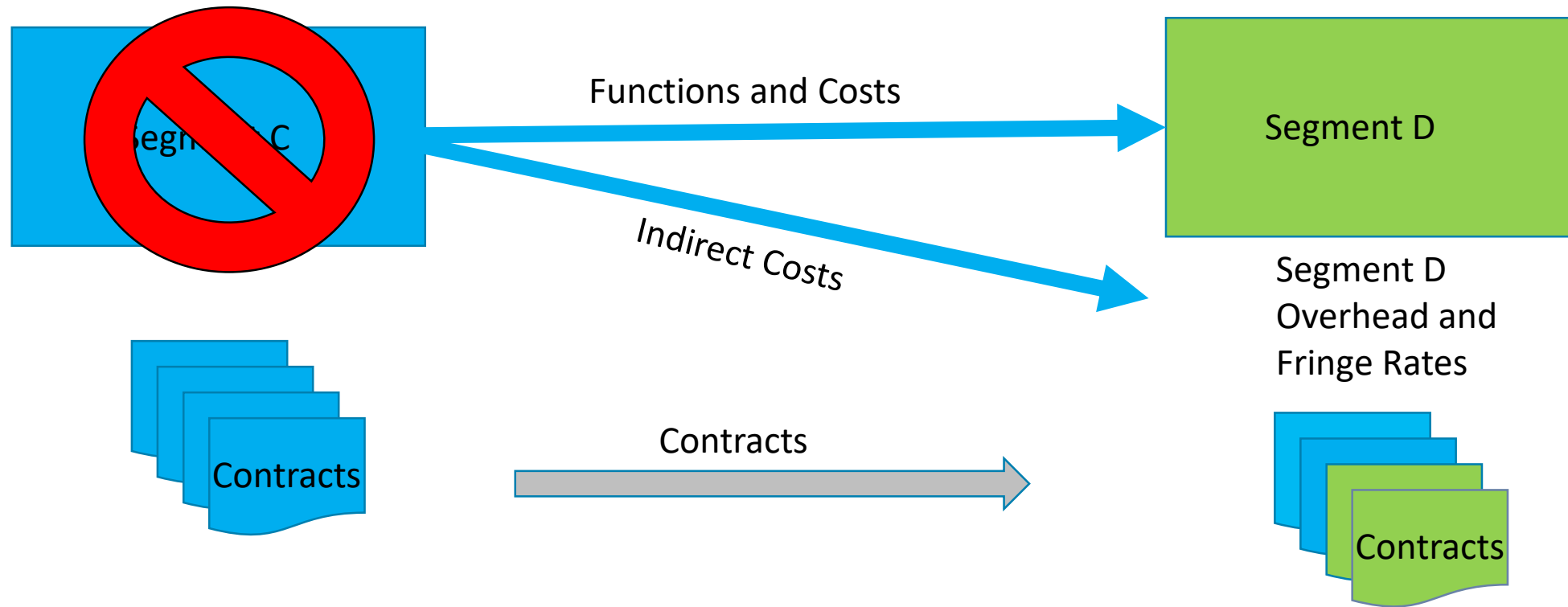
Initial Adoption of an Accounting Practice/Elimination of a Cost or Cost of a Function

- Example: Contractor moves security function from Segment C to Segment D.
 - Not an elimination in Segment C
 - Not an initial adoption in Segment D
 - Is it a change in accounting practice?
 - It depends on how it is allocated to contracts in Segment D v. Segment C.
 - Allocation base change?
- Example: Contractor eliminates Segment C.



CHANGES IN COST ACCOUNTING PRACTICES

Elimination of Segment C





CHANGES IN COST ACCOUNTING PRACTICES

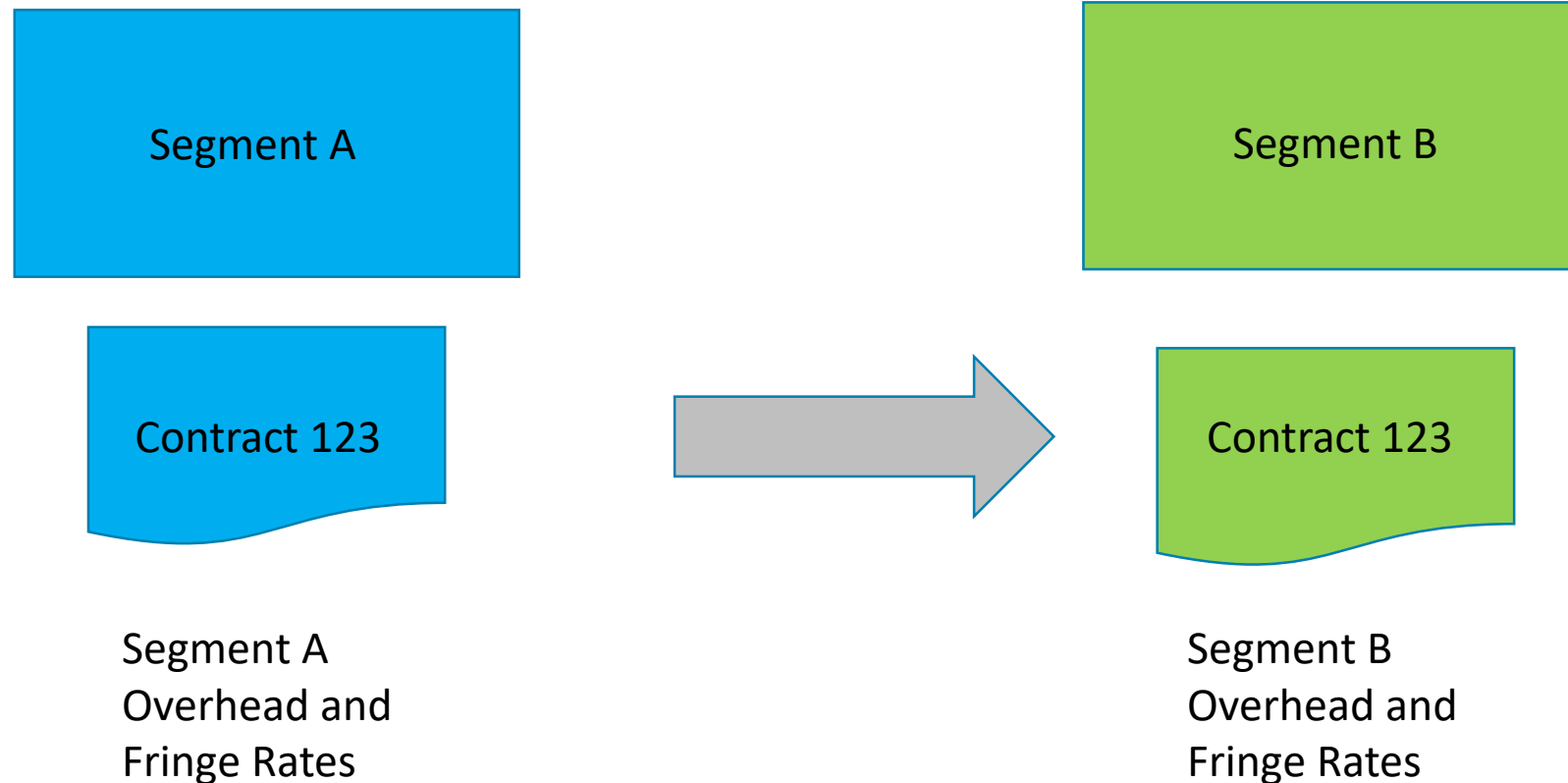
Transfers of Contracts

- Transfer of work from one existing segment to another.
 - Not a cost accounting practice change.
 - Not a CAS 401 noncompliance.
- Example: Contractor transfers work from Segment A to Segment B.
 - No changes in Segment A or B cost accounting practices.
 - Segments have different overhead pools.
 - Segments have different cost elements.



CHANGES IN COST ACCOUNTING PRACTICES

Transfer of Contracts





CHANGES IN COST ACCOUNTING PRACTICES

Transfers of Contracts

- Contractor transfers work from Segment A to Segment B.
 - Contract won't incur costs in the same manner as originally estimated.
 - Allocated Segment B Overhead instead of Segment A Overhead.
 - Different cost elements might apply such as intra company transfers.
 - Deemed a business decision for CAS purposes.
- Take Away - Sometimes it is better to move the work rather than change the structure.



CHANGES IN COST ACCOUNTING PRACTICES

Affected CAS Covered Contracts

- Contracts on which the cost accounting practice occurred or impacts.
 - Could be only one contract such as when one practice is used to estimate and one practice to accumulate and report costs
 - Contractor estimates by cost function (i.e. drafting, production engineering, software engineering).
 - Contractor accumulates all engineering in one undifferentiated account.
 - Could be one or many contracts
 - Contractor merges two overhead pools with different bases. (DL \$ and DL hours)
 - Resulting pool uses DL dollars.
 - Affected contracts are only those allocated costs from the pool using DL hours
- Take Away - May have an opportunity to select base with lowest cost impact.



TRANSITIONING INTO FULL-CAS COVERAGE



TRANSITIONING INTO FULL-CAS COVERAGE

Ensure your Company does not meet one of the CAS Exemptions

- Last chance to double-check your potential exemptions
 - Sealed bid contracts
 - Negotiated contracts & subcontracts <\$2M
 - Small businesses
 - Contracts & subcontracts with foreign governments
 - Where price is set by law or regulation
 - Acquisition of commercial items
 - Contracts less than \$7.5M (and not currently performing any other CAS-covered contract over \$7.5M)
 - FFP contracts awarded on the basis of adequate price competition without submission of certified cost or pricing data



TRANSITIONING INTO FULL-CAS COVERAGE

CAS-related Clauses and Contractor Responsibility

- Contractor has responsibility to comply with full/modified CAS under contracts with the CAS clause
 - Contractor should regularly track and monitor its CAS-covered contracts and know when it receives the “trigger” contract.
 - The Government will not notify the Contractor with regards to requirement to be CAS-compliant (but will hold the Contractor to compliance)
- Clause 52.230-2, “Cost Accounting Standards”
 - Requires contractor to:
 - Comply with all 19 Cost Accounting Standards
 - Disclose actual cost accounting practices
 - Follow disclosed cost accounting practices consistently



TRANSITIONING INTO FULL-CAS COVERAGE

CAS-related Clauses and Contractor Responsibility

- Clause 52.230-3 *“Disclosure and Consistency of Cost Accounting Practices”*
 - Requires contractor comply with modified CAS coverage (CAS 401/402/405/406)
 - Disclose (if certain requirements are met) actual cost accounting practices
 - Consistently follow its established cost accounting practices
- Clause 52.230-6 *“Administration of Cost Accounting Standards”*
 - Applies to contracts with either of the two previous clauses
 - Specifies rules for administering CAS requirements and procedures to be followed in cases of failure to comply



TRANSITIONING INTO FULL-CAS COVERAGE

Identify your CAS Segment

- CAS defines a segment as:
 - One of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service...
- How is your business managed?
 - What is the reporting structure?
 - Accounting systems/reports
 - Organizational chart
 - P&L oversight and accountability
 - How are budgets created?



TRANSITIONING INTO FULL-CAS COVERAGE

Identify your CAS Segment, continued

- Government vs. Commercial? By product/service?
 - Pros for keeping Govt. / Comm. Businesses separate:
 - Easier to maintain compliance when all Govt. ops are within one segment
 - Commercial Ops can operate in ways that allow flexibility in Commercial environment without worrying about CAS compliance (CAS 401/402)
 - Cons for separation
 - May require two or more distinct frameworks to ensure firewall for Comm/Govt. operations (two purchasing departments, two engineering departments, etc.)
 - May not achieve cost savings / efficiencies by working together



TRANSITIONING INTO FULL-CAS COVERAGE

How Many Segments are Affected?

- In addition to the segment receiving the “trigger” contract for full-CAS coverage, there may be other segments affected
- The Corporate Home Office, and any intermediate home offices (IHOs) that allocate expenses to the CAS segment(s) will be required to complete certain sections of the CASB Disclosure Statement
 - These cost allocations will also need to be CAS compliant



TRANSITIONING INTO FULL-CAS COVERAGE

How Many Segments are Affected?

- Intercompany Work Orders (IWOs) between segments over the Truthful Cost or Pricing Data Act threshold of \$2 million:
 - If work order under CAS contract is over \$2M, costs are CAS-covered.
 - If work order is >\$2M, and does not qualify for a CAS exemption, a Disclosure Statement is required of that segment unless the segment's CAS-covered awards are less than 30% of total segment sales for the period and less than \$10M.
 - Ideally, if IWOs are required, you will want to closely manage the amounts issued per year to avoid CAS-coverage and/or a requirement for a CASB Disclosure Statement.



TRANSITIONING INTO FULL-CAS COVERAGE

Designing a CAS-compliant Indirect Rate Structure

- Map out existing Indirect Rate structure
- Review structure for cost allocability
- Keep costs native if possible
 - Reduces Government's ability to audit commercial bases and practices (e.g. Company-wide fringe rates)
- Simplified structure usually allows for greater flexibility
 - Ensure structure will be able to handle the Company's strategic vision for the coming years



TRANSITIONING INTO FULL-CAS COVERAGE

Creating your first CASB Disclosure Statement(s)

- Once you become fully-CAS covered, you will be required to submit a Disclosure Statement (Form CASB DS-1) to your ACO to formally document and disclose in writing your cost accounting practices
 - See FAR part 52.230-2 Cost Accounting Standards for additional information
- Preparation of a Disclosure Statement is time consuming, but not difficult
 - Parts of the Disclosure Statement:
 - Part I - General Information
 - Part II - Direct Costs
 - Part III - Direct vs. Indirect Costs
 - Part IV - Indirect Costs
 - Part V - Depreciation and Capitalization Practices
 - Part VI - Other Costs and Credits
 - Part VII - Deferred Compensation and Insurance Cost
 - Part VIII - Home Office Expenses



TRANSITIONING INTO FULL-CAS COVERAGE

Creating your first CASB Disclosure Statement(s)

- Ensure sufficient detail is provided within the applicable “Continuation Sheets” to explain the nuances associated with your cost accounting practices.
- Great care should be taken when completing a Disclosure Statement because it will be reviewed by DCAA and any future changes to your accounting practices will require a revision to your Disclosure Statement
- Cost accounting practice changes may also require a General Dollar Magnitude (GDM) or Detailed Cost Impact (DCI) proposal, which could be a time consuming process, resulting in potential cost or price adjustments to covered contracts.



TRANSITIONING INTO FULL-CAS COVERAGE

Updating Policies and Procedures

- Accounting
 - Typically, accounting-related policies and procedures are updated concurrently with creating the CASB disclosure statement
 - Accounting policies and procedures should be adjusted to ensure practices are CAS compliant
 - Major stakeholders should be involved in the process of updating policies and procedures, as well as the eight sections of the Disclosure Statement
 - Human Resources
 - Corporate Home Office
 - Information Technology
 - Program Managers
 - Procurement
 - Pricing
 - Etc.



TRANSITIONING INTO FULL-CAS COVERAGE

“Badging” Employees, and Who Should Charge Time?

- Now that the Indirect Rate Structure has been developed, you’ll need to perform a review of personnel within the segment to ensure labor costs are included in the proper pools and bases
 - Each person should have a “home”
 - Engineering Direct Labor, Engineering OH Labor, G&A, Facilities
 - Key attributes
 - Part-time vs. Full-time
 - On-site vs. Off-site
 - Physical location (may be remote)
 - Who needs to record time?
 - Any employee who will be charging to a final cost objective
 - Includes contracts, IR&D projects, B&P efforts
 - Employees outside of the segment that will be charging direct to final cost objectives or to indirect projects



TRANSITIONING INTO FULL-CAS COVERAGE

“Badging” Employees, and Who Should Charge Time?

- Labor should be charged to intermediate and final cost objectives based on a timekeeping document (paper or electronic timecards) completed and certified by the employees and approved by the employees' supervisors.
- Employees should fill out timesheet on a daily basis and include all hours worked including uncompensated overtime
- Labor cost distribution records should reconcile to payroll records and labor distribution records should trace to and from the job cost ledger and G/L accounts.



TRANSITIONING INTO FULL-CAS COVERAGE

Home Office Costs

- Home office costs of commercial organizations or business that are not CAS-covered may be allocated using a variety of methods:
 - Intercompany agreements (i.e., a rate per person, or per metric (sales dollars, etc.)
 - Cost pools used may be used, but may not be homogeneous (lumping legal & IT costs),
 - Allocation bases may not be cost drivers (allocation over % of total profit)
- Often, there is a fair amount of costs being allocated to segments where there is no causal or beneficial relationship
- CAS 403, “Allocation of home office expenses to segments” establishes criteria for the allocation of home office expenses to segments based on the causal or beneficial relationship of expenses and the receiving segments.



TRANSITIONING INTO FULL-CAS COVERAGE

Home Office Costs, continued

- Basic CAS requirements for home office expenses:
- **CAS 403-40(a)(1)** requires that home office expenses be allocated directly to segments to the maximum extent practical.
 - Specific insurance coverage
 - Special project expenses (IT equipment, etc. purchased for a segment)
- **CAS 403-40(a)(2)** requires that expenses that are not directly allocated shall be grouped in logical and homogeneous expense pools.
 - IT departmental costs
 - Human Resource costs



TRANSITIONING INTO FULL-CAS COVERAGE

Home Office Costs, continued

- **CAS 403-40(a)(3)** requires allocation of any remaining or residual home office expenses to all segments.
 - CEO/CFO/staff
 - Legal Department
 - Accounting Department
- Objective is to minimize the amount of “residual” expenses
- Residual expenses shall be allocated using 3-factor formula if the total amount of such expenses exceeds certain thresholds
 - Average of:
 - Segment's payroll as a % of the total
 - Segment's operating revenue as a % of the total
 - Segment's average net book value (tangible assets plus inventories) as a % of total



TRANSITIONING INTO FULL-CAS COVERAGE

Perform Internal Assessment of DFARS Business Systems

- CAS-covered contracts (applies to both modified and full-CAS coverage) may also have the business system clause, which may require contractor business systems to meet specified criteria outlined in each of the following business system clauses if included in your contracts:
 - 252.242-7006 - Accounting System
 - 252.234-7002 - Earned Value Management System
 - 252.215-7002 - Cost Estimating System
 - 252.242-7004 - Material Management and Accounting System
 - 252.245-7003 - Property Management System
 - 252.244-7001 - Purchasing System



TRANSITIONING INTO FULL-CAS COVERAGE

Perform Internal Assessment of DFARS Business Systems

- A gap analysis should be performed to determine where the contractor is deficient with regards to meeting the specified criteria for each applicable business system
- Manuals should be reviewed for completeness and compliance with the applicable system criteria
- Any required changes should be communicated to applicable personnel and training should be provided to all those affected by the changes
- System Manuals, policies and procedures, as well as the CASB Disclosure Statement should be in alignment to reflect any required system changes



TRANSITIONING INTO FULL-CAS COVERAGE

Government may Withhold Payment for Significant Deficiencies

- The Contractor Business Systems clause (252.242-7005) allows the Contracting Officer to withhold payment of 5% of amounts due from progress and performance-based payments if significant deficiencies are contained within a business system
- CO will also require the contractor to withhold five percent from its billings on cost-reimbursement, labor-hour, and T&M contracts until all significant deficiencies have been corrected.
- These withholdings may increase to 10% if significant deficiencies are noted in multiple business systems
 - Withholdings get reduced down to 2% upon submission of acceptable Corrective Action Plan; withholdings are discontinued after CO determination that significant deficiencies have been corrected



CAS BOARD & SECTION 809 PANEL UPDATES



CAS BOARD & SECTION 809 PANEL UPDATES

809 Panel - CAS Recommendations

- Create an independent Cost Accounting Standards Board within the Executive Branch (Rec. 29, Section 4, Vol. 2)
- Reshape CAS program requirements to function better in a changed acquisition environment (Rec 30, Section 4, Vol. 2)
 - Decouple CAS-covered contract monetary threshold from TINA monetary threshold and set monetary threshold at \$25 million (trigger contract exemption would be eliminated)
 - Raise thresholds for full CAS coverage and Disclosure Statement
 - From \$50M to \$100M
 - Condition for not requiring DS from segment that has CAS-covered contracts less than \$10M and less than 30% of sales should be eliminated



CAS BOARD & SECTION 809 PANEL UPDATES

809 Panel - CAS Recommendations, continued

- Reshape CAS program requirements to function better in a changed acquisition environment (Rec 30, Section 4, Vol. 2), continued
 - Revise commercial item exemption as proposed by CASB in 2012
 - Expand CAS exemption to include “*any fixed price type contract whose price is based on price analysis without the submission of certified cost or pricing data*”
 - Provide guidance for CAS applicability to hybrid contracts and IDIQ contract vehicles
 - Exclude exempted portion of hybrid contract from CAS; evaluate each order under IDIQ vehicle for CAS



CAS BOARD & SECTION 809 PANEL UPDATES

809 Panel - CAS Recommendations, continued

- What's the Status?
 - In 2019, OMB submitted a legislative proposal on raising the CAS applicability threshold from \$2M to \$15M.
 - OMB officials indicated that they would continue to analyze effects of additional threshold changes.
 - Congress has yet to enact the proposal into law.



CAS BOARD & SECTION 809 PANEL UPDATES

GAO's Report on the CAS Board

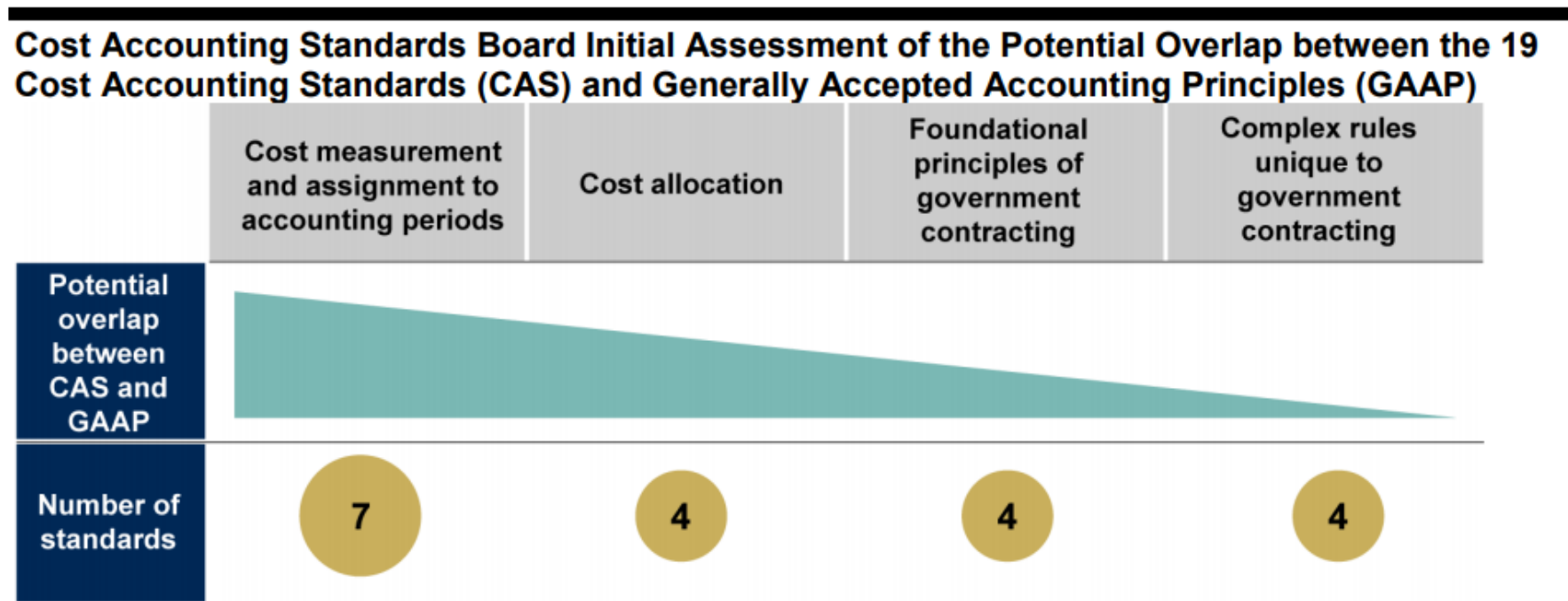
- In February, GAO issued its report on the CAS Board's recent activities
 - March 2019, CASB issued Staff Discussion Paper
 - Outlined set of 5 guiding principles to assess whether proposed CAS changes are necessary and would reduce burden while protecting the Government's interest
 - Reduce CAS requirements where possible
 - Consider whether the proposed action would reduce burden on contractors overall
 - Consider whether other CAS or Federal rules would protect the Govt's interest in case of gaps created by relying on GAAP
 - Monitor future changes to GAAP and the FAR to identify and evaluate impact on CAS; revise CAS as necessary
 - Monitor future significant disputes related to the conformance to GAAP and evaluate whether the Board should address them through clarifying guidance or rulemaking.
 - Identified a roadmap that prioritized the Board's proposed review of the standards
 - Included a preliminary comparison of two of seven standards identified as having the most overlap with GAAP
 - CAS 408 - Accounting for Costs of Personal Absence
 - CAS 409 - Depreciation of Tangible Capital Assets



CAS BOARD & SECTION 809 PANEL UPDATES

GAO's Report on the CAS Board

- The following table groups the Cost Accounting Standards by Objective



Source: GAO presentation of Cost Accounting Standards Board information. | GAO-20-266



CAS BOARD & SECTION 809 PANEL UPDATES

GAO's Report on the CAS Board

- The CAS Board has met 17 times since February 2018, and for the most part has published quarterly agendas
- Per OFPP, the Board is in the process of developing its first required annual report to Congress, which will be provided sometime during GFY20.
- CAS Board members communicated to GAO representatives:
 - Board is reviewing and assessing public comments on staff discussion paper
 - Board will consult with FASB to answer technical questions and ensure the Board has an accurate understanding go GAAP coverage as they compare GAAP with CAS.
 - Additional staff discussion papers will be published to the Federal Register as they are completed



QUESTIONS? CONTACT US



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