Nowhere to Run, Nowhere to Hide: Disclosure Statements and Cost Accounting Standards

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Please Read

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OBJECTIVES

• Brief Introduction to Cost Accounting Standards (CAS)
• CAS-coverage Applicability
• Understanding the CASB-DS-1 Form
• Best Approaches in Disclosing Cost Accounting Practices
• Discussing the proposed DoD CAS Board (Section 820 of the 2017 National Defense Authorization Act)
Brief Introduction to CAS
WHAT IS THE PURPOSE OF CAS?

Cost Accounting Standards (CAS) are a set of standards that are “designed to achieve uniformity and consistency in the cost accounting practices governing measurement, assignment, and allocation of costs to contracts with the United States Government.”

48 CFR 9901.302(b)
COST ACCOUNTING STANDARDS
HISTORY

- 1968 Congressional hearings raised concerns over the lack of cost control and consistency in Defense contract cost accounting practices

- 1970 Congress passed Public Law 91-379 which formed the Cost Accounting Standards Board (CASB), the CAS board functioned for a decade promulgating 19 standards, and numerous interpretations

- 1992 the Cost Accounting Standards (CAS) was recodified into the Federal Acquisition Regulation (FAR) and made applicable to all negotiated Government contracts
COMPARING CAS AND FAR

• CAS deals with the measurement, assignment and allocation of costs, which is allocability, not allowability.

• FAR cost principles address the allowability and reasonableness of costs.

• Costs may be allocable (properly accounted for as a contract charge) to a contract under CAS but not be allowable and reasonable under the FAR cost principles.
Do I really have to comply with CAS?
EXEMPTIONS FROM CAS

- Sealed bid contracts.
- Negotiated contracts/subcontracts (including interdivisional work orders) <$750,000.
- Contracts/Subcontracts with Small Business Concerns
- FFP/Fixed Price with EPA, T&M, Labor Hour contracts/subcontracts for the acquisition of Commercial items
- Contracts/Subcontracts where price is set by law or regulation
- Contracts/Subcontracts with foreign governments or their agents (401/402 apply)

- Contract <$7.5M provided entity does not already have a CAS contract >$7.5M
- FFP Contract awarded on the basis of adequate price competition without submission of certified cost or pricing data.
- NATO PHM Ship program subcontracts performed outside the US
DARN, I’M NOT EXEMPT, NOW WHAT?

• Current award $50M or more; OR

• Did the business unit receive $50M or more in net CAS-covered awards in the preceding cost accounting period?; OR

• Did the business unit get a $50M or more CAS-covered contract during the current cost accounting period?; OR

• If YES – the business unit is FULLY COVERED and Business Unit Disclosure Statement is required
YES! I DON’T HAVE TO DO A DISCLOSURE STATEMENT, BUT…

• The company is subject to Modified Coverage (CAS 401/402/405/406)

OH NO, THERE’S A CATCH ISN’T THERE?

• Did the company together with its segments receive > $50M during the preceding cost accounting period?

• Then, the company must prepare a Business Unit Disclosure Statement for each business segment, unless…

• The segment CAS-covered award during the prior cost accounting period are <$10M and <30% of total segment sales
An Overview of the Standards and How They Link to the Disclosure Statement
COST ACCOUNTING STANDARDS - CATEGORIZED

Basic CAS Concepts:
• CAS 401 — Consistency in estimating, accumulating & reporting
• CAS 402 — Consistency in allocating costs for same purpose
• CAS 405 — Accounting for unallowable costs
• CAS 406 — Cost accounting period

Compensation:
• CAS 408 — Compensated personal absence
• CAS 412 — Composition and measurement of pension costs
• CAS 413 — Adjustment and allocation of pension costs
• CAS 415 — Deferred compensation

Allocation of Costs:
• CAS 403 — Allocation of home office expenses to segments
• CAS 410 — Allocation of business unit G&A to final cost objectives
• CAS 418 — Allocation of direct and indirect costs
• CAS 420 — Accounting for IR&D/B&P costs
COST ACCOUNTING STANDARDS - CATEGORIZED

Assets:
- CAS 404 — Capitalization of tangible capital assets
- CAS 409 — Depreciation of tangible capital assets
- CAS 414 — Cost of money as an element of the cost of facilities capital
- CAS 417 — Cost of money as an element of the cost of capital under construction

Other Standards:
- CAS 407 — Use of standard costs
- CAS 411 — Accounting for material costs
- CAS 416 — Accounting for insurance costs
Four Fundamental CAS Concepts
- 48 CFR 9904.401 -
CONSISTENCY IN ESTIMATING, ACCUMULATING & REPORTING COSTS

- Permeates throughout the Disclosure Statement
- Comparable transactions are treated alike
- Estimating* = Actual for Accumulating & Reporting
  - Estimating unallowables like you account for them (Item 1.6.2)

* Less detail for insignificant costs

- 48 CFR 9904.402 -
CONSISTENCY IN ALLOCATING COSTS INCURRED FOR THE SAME PURPOSE

- Allocated only once and on only one basis to any project
- Describe criteria for determining when cost incurred for the same purpose, in like circumstance (Items 3.1.0)
- Treatment of functions, elements, or transactions (Items 3.2.1, 3.2.2, 3.2.3)
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<td>- Specifically identified in accounting records?</td>
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<td>- On separate memo entries or workpapers?</td>
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<td>- Other?</td>
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<tr>
<td><strong>How are unallowable costs estimated?</strong> <em>(Item 1.6.2)</em></td>
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<td>- Specifically identified?</td>
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<td>- Other method?</td>
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<td><strong>Cost Accounting Period</strong> <em>(Item 1.7.1)</em></td>
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Allocation of Costs

Elements of Cost

Cost
- Material
  - Direct
  - Indirect
- Labour
  - Direct
  - Indirect
- Expenses
  - Direct
  - Indirect
  - Factory/Works Overheads
  - Administration Overheads
  - Selling & Distribution Overheads
48 CFR 9904.403 – ALLOCATION OF HOME OFFICE EXPENSES TO SEGMENTS

• Corporate/Intermediate Home Office
  – Direct Allocation to Segments
  – Logical grouping into homogeneous expense pools
  – Residual Expenses (i.e. 3-Factor Formula)

• *Centralized Services* use a hierarchy allocation approach
  – Representing beneficial or causal relationship (i.e. usage, output, surrogate)

• 18 Allocation Base Codes
  – D/S Items 8.3.0, 8.3.1, 8.3.2, 8.3.3
  – Cost of Sales, Prime Cost, Processing Cost, Usage, etc.
48 CFR 9904.410 – ALLOCATION OF BUSINESS UNIT G&A EXPENSES TO FINAL COST OBJECTIVES

• Represent “total activity of the business”
• Describe G&A Pool the major functions, activities and elements of cost
• Allocated “only” to project/contract at the lowest level
  – “Final accumulation points” (i.e. without intermediate)
• Allocation base (total, value-added, single element cost input, and special*) – explicit costs
• 18 Allocation Base Codes: (some differences from Part 8)
  – D/S Items 4.2.0, 4.5.0 – Special Transactions
  * Allowance for special allocation when other projects benefits significantly different
• Understanding what’s driving **indirect costs**
  – Every cost object must bear its proper share
• Significant vs. insignificant **indirect labor costs** of managing or supervising direct labor and material costs
  – Hierarchy: Indirect labor costs = Labor hrs./$, machine-hours, units of production, materials cost
  – Hierarchy: Non-labor costs = resource consumption (i.e. input), output, surrogates
• Overhead versus Service Center & Expense Pool
• Allocation Base Code, Category and Rate Codes
  – D/S Items 4.1.0, 4.3.0, 4.4.0, 4.5.0
48 CFR 9904.420 – Accounting for IR&D and B&P

• Defining B&P and IR&D within the Disclosure Statement
• Tracked as separate individual projects
• B&P costs means: preparing, submitting, or supporting any B&P effort
  – Except for effort sponsored by grant or required under contract (See also 9904.402-61)
• Treated like direct project costs incurred for the purpose of allocating overhead and other costs, except G&A
• Home office versus G&A allocation – organizational chart and proper characterization of business units, segments, home offices, divisions, etc.
• D/S Items 4.6.0 and throughout
Compensation
ACCOUNTING FOR COSTS OF COMPENSATED PERSONAL ABSENCE

- Vacation (Item 6.1.1)
- Holiday (Item 6.1.2)
- Sick (Item 6.1.3)
- Credits for Unused/Unpaid Leave (Item 6.1.4)

Broken out by:
- Hourly
- Salaried – Non-Exempt
- Salaried - Exempt
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<td>• When accrued/partially or not funded?</td>
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<td>• Forfeitures/Dividends?</td>
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- 48 CFR 9904.412 - COMPOSITION AND MEASUREMENT OF PENSION COST

- 48 CFR 9904.413 - ADJUSTMENT AND ALLOCATION OF PENSION COST

- Organized by Types of Pension Plan (Items 7.1.0, 7.1.1, 7.1.2, 7.1.3)
  - Defined Contribution
  - Defined Benefit
  - Qualified/Non-Qualified
- Where are costs accumulated?
- For Defined Benefit:
  - Actuarial Cost Method Used
  - Actuarial Assumptions
  - Market Value of Funding Agency Assets
  - Basis for Cost Computation
Tangible Assets & Cost of Money
### 48 CFR 9904.404 - Capitalization of Tangible Assets

- **What gets expensed vs. capitalized?**
- Both: Minimum-service-life >2 yrs and minimum-acquisition-cost <$5K
- “Asset accountability unit” – identify & track assets
- Treatment of “repairs & maintenance”
- **Company Policy = D/S**
  - D/S Items 5.5.0, 5.6.0, 5.7.0

### 48 CFR 9904.409 - Depreciation of Tangible Capital Assets

- **Method, Useful Life, Property Units, Residual Value**
- Records to support prior assets – must be based on historical experience
- Reliance on IRS guidelines is temporarily allowed
- **Company Policy = D/S**
  - D/S Items 5.1.0, 5.2.0, 5.4.0
- 48 CFR 9904.414 - COST OF MONEY/ FACILITIES CAPITAL

- Cost of capital committed to facilities means an imputed cost
- Form CASB-CMF
- Identify each indirect cost pool related to the facility cost incurred
- **Company Policy = D/S**
  - D/S Items 4.7.0

- 48 CFR 9904.417 - COST OF MONEY/ CAPITAL ASSETS UNDER CONSTRUCTION

- Interest earned on T-Bill Rates
- Weighted average for different rates over extended period in same FY
- Determined each cost accounting period during construction
- **Company Policy = D/S**
  - D/S Items 1.5.0
Other Standards
- 48 CFR 9904.407 -
USE OF STANDARD COSTS FOR DIRECT MATERIAL AND DIRECT LABOR

• Direct Material (Items 2.2.1, 2.2.2, 2.4.1-2.4.4)
  • How are variances handled?
  • How often are standards revised?

• Direct Labor (Items 2.6.1-2.6.4)
  • How are variances handled? (By Labor Category)
  • How often are standards revised?
ACCOUNTING FOR INSURANCE COSTS

- Post Retirement Benefits Other Than Pensions (Item 7.2.0-7.2.2)
  - Method to determine costs (Accrual, Pay-as-you-go, Purchased, Self-Insurance, etc)
  - Actuarial methods/assumptions

- Employee Group Insurance (Item 7.3.0-7.3.1)
  - Where/How Costs Accumulated?
  - Purchased?
  - Self Insurance?
    - Projected Average Loss
    - Insurance Administration Expenses
- Direct Not from Inventory (Item 2.2.1)
- Direct from Inventory (Item 2.2.2)
- Timing of Charging (Item 2.3.0)
  - Order placement
  - Material and invoice received
  - Invoice payment
  - Other
Best Approaches in Disclosing Cost Accounting Practices
-- DO NOT RUSH --

Approach to Disclosure

• Remember you are presenting the Company to the ACO and Auditors

• Involve all stakeholders to gain understanding, provide input, discuss options, review drafts
  – i.e. HR, Operations, Finance, Accounting, Program Managers, Procurement, Pricing, etc.

• Start the process at least 6 to 12 months prior to seeking CAS-covered award
BEST PRACTICES AND APPROACHES TO DISCLOSURE

Approach to Disclosure

• Consistency between various Parts and Subparts
• Explain areas that may be different from the standard
• Define words or expressions as needed
• Use “Continuation Sheets”
  – Careful consideration describing different circumstances for treating items sometimes direct and sometimes indirect
  – Narrative answers should be clear and concise, avoid ambiguities, include same item codes referenced
BEST PRACTICES AND APPROACHES TO DISCLOSURE

Administrative Items

• Not all Parts are applicable
• Describing items on the “Continuation Sheet” for each Part as applicable
• Formatting – Good Copy (i.e., table alignment)
• Use a different font color
• Make sure to end each Part with “End of Part”
• Privileged and confidential information on each page
• Date and revision number on each page
• Sign and date – not the same as “effective date”
BEST PRACTICES AND APPROACHES TO DISCLOSURE

Amending Disclosure Statement

• Each amendment must contain a “cover sheet” indicating the revision number and effective date, signed

• Revised Parts must contain “revision number” and “effective date” in the Item Description block with “R” for each line item changed

• Accompanying letter should describe the change and whether or not you believe it was accounting practice change and why

• Include GDM if applicable

• Submit within 60 days prior to the change
National Defense Authorization Act (NDAA) 2017
Section 820 – FAR Revisions (Title 41 USC)

• Revisions to CAS statute
  – Rely on commercial standards, accounting practices and systems by conforming CAS to GAAP
  – Paid professional staff (executive secretary, 2 staff members)
  – Publish agenda and submit annual report to congress
  – Increases eligibility waiver from $15m to $100m
Section 820 – DFARS Revision (Title 10 USC)

• Creation of Defense CAS Board (DCASB)
  – 7 Members (rather than 5) Chair DoD CFO
  – Reviewing and Recommending changes to CAS
  – Exclusive authority to implement CAS for DoD
  – Develop standards for Government employees (consistent with commercial operations) at DoD based on CAS and GAAP
    ▪ What “commercial operations” do Government employees perform?
Section 820 – DFARS Revision (Title 10 USC)

• Audit Process
  – Requires DCAA to accept (without performing additional audits) a summary of findings prepared by a commercial auditor, who:
    ▪ Performed similar type of audit of allowability, measurement, assignment, period and allocation of costs
    ▪ Followed GAAS (i.e. commercial auditing standards)
  – DCAA may audit direct costs unless contractor “predominantly” has cost-type contracts
  – Effective October 1, 2018
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