



Contractor Internal Audit Directors (CIAD) Conference
"Speak Up In Spokane"

Cost Accounting Standards: An M&O's Problematic Five

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Famous Quote

“In today’s regulatory environment, it’s virtually impossible to violate rules. It’s impossible for a violation to go undetected, certainly not for a considerable period of time.”

---Bernie Madoff, October 20, 2007---

Determining Allowability



FAR 31.201-2(a): A cost is allowable only when the cost complies with ALL of the following requirements:

- 1) Reasonableness**
- 2) Allocability**
- 3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances**
- 4) Terms of the contract**
- 5) Any limitations set forth in this subpart (cost principles)**



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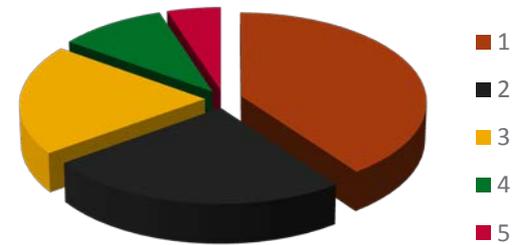
Determining Reasonableness

FAR 31.201-3: A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person **(using their own money)** in the conduct of competitive business.



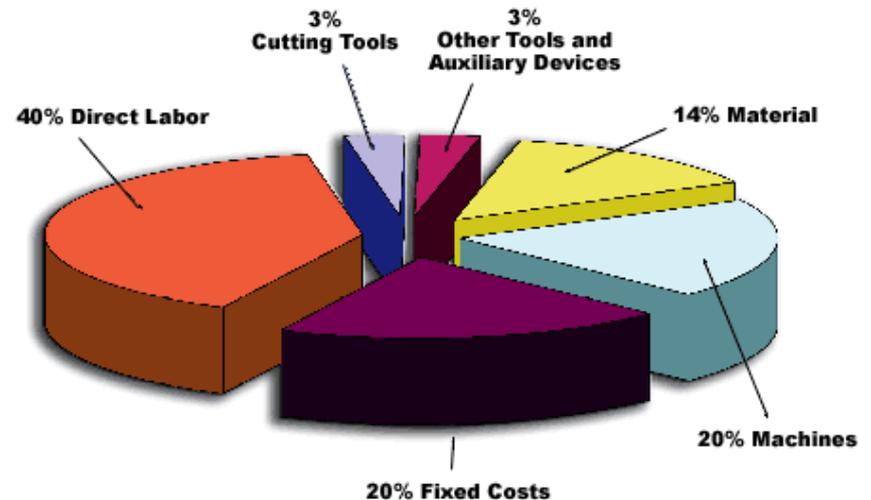
Determining Allocability

FAR 31.201-4: A cost is **allocable** if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—



Determining Allocability

A Cost is allocable if it:
a) Is **incurred specifically** for the contract
(direct)



Determining Allocability

A Cost is allocable if it:

- b) Benefits both the contract and other work, and can be distributed to them in **reasonable proportion** to the benefits received; (overhead)



Determining Allocability

A Cost is allocable if it:

- c) Is **necessary to the overall operation** of the business, although a direct relationship to any particular cost objective cannot be shown.



(G&A)

Contract Clause

Clause I-XX, FAR 52.230-2: ...the Contractor, in connection with this contract, shall—

- 1) By submission of a Disclosure Statement, disclose in writing the Contractor's cost accounting practices...
- 2) Follow consistently the Contractor's cost accounting practices...
- 3) Comply with all CAS... (400 series)
- 4) (Equitable adjustment...)
- 5) Agree to an adjustment of the contract price or cost allowance, as appropriate, if the Contractor or Subcontractor fails to comply with an applicable Cost Accounting Standard...

30.201-5 Waiver

The Head of an Agency may waive CAS if:

- (1) The contract or subcontract value is less than \$15,000,000, and the segment of the contractor or subcontractor that performs—
- (i) Is primarily engaged in the sale of commercial items; and
 - (ii) Has no contracts or subcontracts that are subject to CAS.

30.201-5 Waiver

(2) The head of the agency determines that exceptional circumstances exist whereby a waiver of CAS is necessary to meet the needs of the agency. Exceptional circumstances exist only when the benefits to be derived from waiving the CAS outweigh the risk associated with the waiver.



30.201-5 Waiver

- **Each agency must report any waivers granted on a fiscal year basis, not later than 90 days after the close of the Government's fiscal year.**
- **When neither of the above conditions exist, a waiver request must be prepared in and submitted to the CAS Board.**

Typical Contract Cost Elements

Directs	Direct Labor	\$XXX
	Fringe (Allocated to Labor)	XXX
	Materials	XXX
	Other Direct Costs (ODCs)	XXX
	Subcontracts	XXX
Indirects	Overhead	XXX
	General & Administrative	XXX
	Fee	<u>XXX</u>
	Total Price	<u>\$X,XXX</u>

Direct Costs: Trend towards variable.

Indirect Costs: Trend towards periodic fixed.

Typical Contract Cost Elements

Government Cost Model



What is a rate?

Cost Pool

Allocation Base



Cost Accounting Quiz

A direct cost...

- a. is an expense that can be traced to or identified with a specific cost center or cost objective
- b. is an expense incurred in joint usage and therefore difficult to assign to or with a specific cost center or cost objective
- c. trends toward inversely variable per unit of production
- d. trends towards fixed or uniform per unit of production

An indirect cost...

- a. trends toward periodic fixed
- b. is generally allocable to more than one cost center or cost objective
- c. trends toward fixed or uniform per unit of production
- d. trends toward inversely variable per unit of production



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Cost Accounting Risk in M&O Subcontract Environment

Subcontract Type:

**Firm Fixed Price
(FFP)**

Risk to our



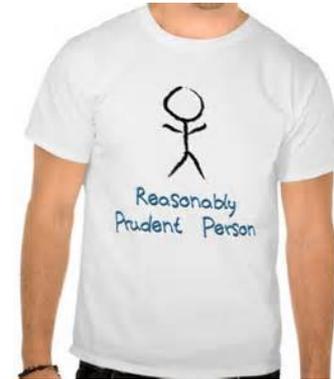
Negotiation of the
FFP.

Cost Accounting Risk in M&O Subcontract Environment

Subcontract Type:

Cost Reimbursable & Cost Sharing Contracts

Risk to our



Shifting of costs from commercial work, Government FFP, or other Government Cost Reimbursable work that exceeds limitations (costs or funds), to Government Cost Reimbursable contracts; shifting of direct costs to all of the above to indirect pools.

Cost Accounting Risk in M&O Subcontract Environment



Risk to our

Subcontract Type: Time & Materials (T&M)

Shifting of costs from commercial work, Government FFP, or other Government Cost Reimbursable work that exceeds limitations (costs or funds), to indirect pools during preaward to negotiate the fully loaded hourly rates. Postaward shifting of labor hours from commercial and Government FFP work to T&M work.

Cost Accounting Risk in M&O Contract Environment (CPFF, CPIF, & CPAF)

1. Appropriation Law: Obligation Control Levels (OCL) and/or Budget and Reporting (B&R) Codes

Risk to our

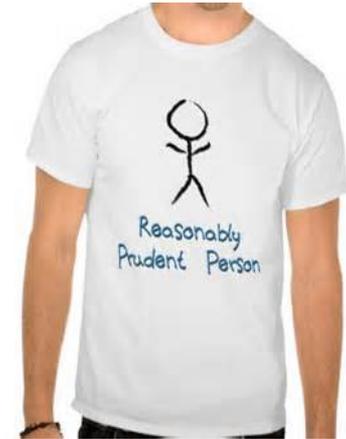


Shifting of costs from OCL/B&Rs that exceed fund limitations to OCL/ B&Rs that have not exceeded fund limitations; shifting of direct costs to indirect and/or shifting of indirect costs to direct.

Cost Accounting Risk in M&O Contract Environment (CPFF, CPIF, & CPAF)

2. Work for Others (WFO), both Federal and non-Federal

Risk to our



Shifting of WFO costs to primary sponsor (DOE); shifting of WFO direct costs to indirect pools.

Cost Accounting Risk in M&O Contract Environment (CPFF, CPIF, & CPAF)

**3. Line Item
Construction,
Lab/Plant/Site
Directed Research
and Development
(LDRD/PDRD/
SDRD), Service
Centers**

Risk to our



**Special indirect rates;
shifting of direct costs to or
from other projects; shifting
direct costs to indirect
and/or shifting indirect
costs to direct.**

Cost Accounting Risk in M&O Contract Environment (CPFF, CPIF, & CPAF)

4. Earned Value Management System (EVMS), Cost Management Initiatives (CMI), National Work Breakdown Structure (NWBS)

Risk to our



Comparing actual costs of work performed (ACWP) to budgeted costs of work performed (BCWP) or baselines. Projecting inaccurate estimates to complete (ETC) and/or Estimates at Completion (EAC).

Introducing the 19 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
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 G&A 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
416	Accounting for Insurance Costs
417	Cost of Money as an Element of the Cost of Capital Assets Under Construction
418	Allocation of Direct and Indirect Costs
420	Accounting for IR&D and B&P Costs



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CAS 401

Consistency in Estimating, Accumulating, and Reporting Costs

Purpose: To ensure that each contractor's practices used in estimating costs are consistent with cost accounting practices used in accumulating and reporting costs.

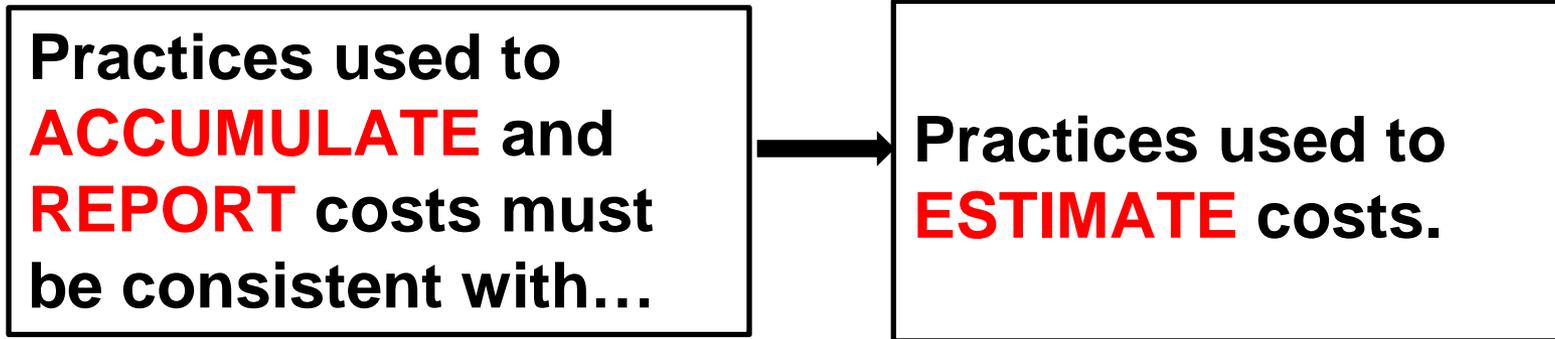
CAS 401

Risks: Failure to comply with CAS 401 could result in:

- Inconsistencies between how costs are estimated, accumulated, and reported.
- Misleading comparisons and irreconcilable differences between estimated and actual costs.
- Use of undisclosed or non-compliant accounting practices.

CAS 401

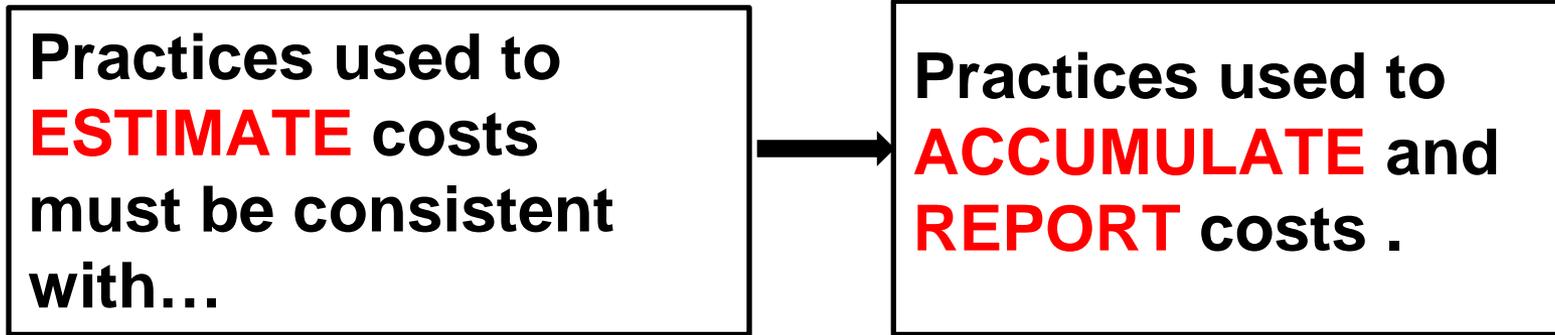
Requirement:



- Such comparisons provide one important basis for financial control over costs during contract performance and aid in establishing accountability for cost in the manner agreed to by both parties at the time of contracting, and
- The comparisons also provide an improved basis for evaluating estimating capabilities.

CAS 401

Requirement:

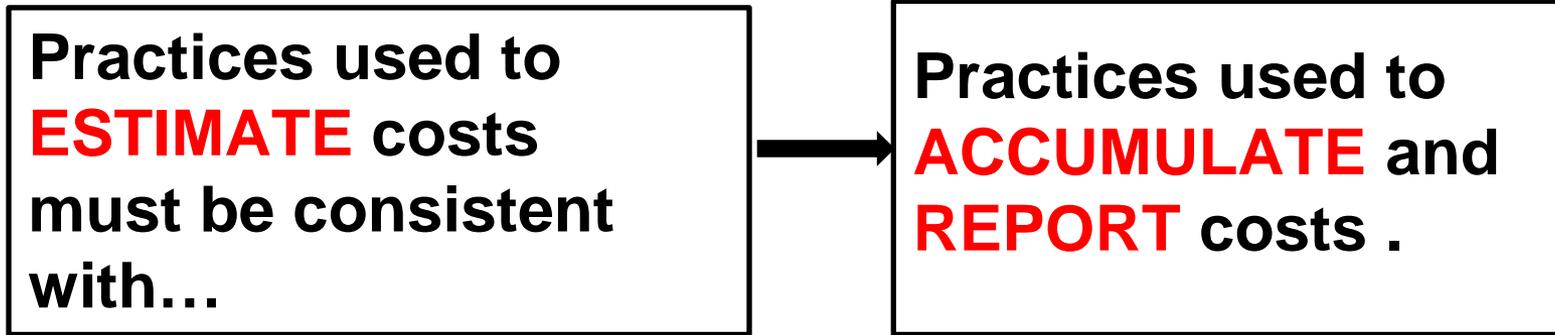


When it is not practicable to estimate costs by individual elements/ functions, the standard allows the accumulating and reporting of costs in greater detail than used for estimates, however:

- The groupings used for estimates must be homogeneous, and
- Costs must be presented in such detail that any significant estimates can be compared to the actual costs accumulated and reported.

CAS 401

Requirement:



- Such comparisons provide one important basis for financial control over costs during contract performance and aid in establishing *accountability* for cost in the manner agreed to by both parties at the time of contracting, and
- The comparisons also provide an improved basis for evaluating estimating capabilities.

CAS 401

In all cases, the contractor must be consistent with respect to:

1. How costs are **classified** as direct or indirect;
2. The **composition** of indirect cost pools; and
3. The method of **allocating** indirect costs.

CAS 401

To correct a CAS 401 non-compliance, the contractor must either:

- 1. Change the way it estimates costs; or**
- 2. Change the way it accumulates and reports costs.**

CAS 401

Practice used in estimating cost:	Practice used in accumulating and reporting cost:	Compliant with CAS 401?
1. Contractor estimates labor using an average direct labor rate by labor category.	1. Contractor records direct labor to projects based on the actual costs for each individual and collects such costs by labor category.	
2. Contractor estimates an average cost for minor standard hardware, nuts, bolts, etc.	2. Contractor records the actual costs of such items based on paid invoices.	

CAS 401

Practice used in estimating cost:	Practice used in accumulating and reporting cost:	Compliant with CAS 401?
3. Contractor estimates managerial labor as direct labor on the contract.	3. Contractor accumulates managerial labor in overhead pool.	
4. Contractor estimates G&A allocated to an ARRA-funded project using its budgeted G&A rate.	4. Contractor accumulates and reports G&A allocated to the ARRA-funded project using a special G&A allocation rate that is netted and calculated for G&A elements that actually benefit the ARRA-funded project.	

CAS 402

Consistency in Allocating Costs Incurred for the Same Purpose

Purpose: To ensure that each type of cost is allocated only once and on only one basis to any contract or other cost objective.

CAS 402

Risks: Failure to comply with CAS 402 could result in:

- Inconsistent treatment of direct and indirect costs.
- Double counting of like costs incurred under similar circumstances.
- Arbitrary or inequitable distribution of direct and indirect costs.

CAS 402

Compliance with CAS 402 is necessary to ensure consistency in the allocation of direct vs. indirect costs, guard against the overcharging of some cost objectives, and preclude the double counting of costs. (CAS 402-20)



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CAS 402

Requirement: CAS 402 requires that all costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives.

CAS 402

Requirement: The contractor cannot:

- allocate a cost indirect, if other costs incurred for the same purpose under like circumstances, are charged direct to that or any other cost objective; or
- allocate a cost direct, if other costs incurred for the same purpose under like circumstances, are included in any indirect cost pool to be allocated to that or any other cost objective.



CAS 402

Requirement: The contractor must:

- Distinguish in writing between direct and indirect costs (Disclosure Statement), and
- Identify costs that are sometimes accounted for direct and sometimes accounted for indirect, and clearly explain the specific criteria and circumstances for making such distinctions.

CAS 402

Double Counting: CAS 402 was issued to prevent “double counting”. Double counting occurs when costs incurred for the same purpose, in like circumstances, are charged both direct and indirect. Double counting does not mean that the contractor recorded the same cost twice in the books. This is called “double charging.”

CAS 402

To correct a CAS 402 non-compliance, the contractor must:

1. Remove the like cost from the indirect pool and charge all like costs direct to benefiting cost objectives, or
2. Include all like costs in the indirect pool for allocation to benefiting cost objectives, and do not charge the like cost as a direct cost.



CAS 402

Test your knowledge: A contractor's disclosed accounting practice is to allocate all procurement related expenses as G&A costs. On October 1, the contractor will start construction on a large line item funded project, for which it is expected that four buyers will be hired to work exclusively. Because the buyers were hired to work exclusively on this project, the contractor intends to account for their labor as direct costs to the project. Is this permitted under CAS 402?



Likely not. A change in volume alone is not an “unlike circumstance.”

CAS 402

Test your knowledge: A contractor's disclosed accounting practice is to charge DOE funded security directly to its own final cost objective. The contractor has several WFO customers which also benefit from the enhanced security, and accordingly bills its WFO customers an additional G&A surcharge for the security. Is this permitted under CAS 402?



No. Different customer is not an “unlike circumstance.” WFO Surcharge must likewise be charged to its own final cost objective.

CAS 402

Test your knowledge: An M&O's disclosed accounting practice is to allocate Institution-wide fire protection as G&A. Recently, the M&O had to hire 3 additional firemen for a special post to provide protection against a reserve of highly flammable chemicals used entirely for a particular program. The contractor wants to charge the program direct for the 3 firemen as well as indirect for its share of the general plant-wide fire protection. Is this permitted under CAS 402?



Yes. The special post fire protection personnel are incurred in an “unlike circumstance” from the general fire protection personnel and they benefit only the specific program.

CAS 418

Allocation of Direct and Indirect Costs

Purpose:

- Provide for the consistent determination of direct and indirect costs;
- Establish criteria for accumulating indirect costs in indirect cost pools;

CAS 418

Allocation of Direct and Indirect Costs

Purpose:

- Provide guidance relating to the selection of an appropriate allocation base; and
- Ensure that indirect costs are allocated to cost objectives based on a causal and beneficial relationship.

CAS 418

Risks: Failure to comply with CAS 418 could result in:

- Inequitable allocation of indirect costs;
- Arbitrary/inconsistent classification of direct and indirect costs;
- Failure to achieve full cost recovery; and
- Inaccurate OCL/B&R/project cost reporting.

CAS 418

Selection of an Allocation Base:

The first step is to determine what's included in the contractor's indirect cost pool.

1. For indirect cost pools that include a material amount of the costs of management and supervision of activities involving direct labor and direct materials, the selected base must be one that best represents the activity being managed or supervised;

CAS 418

Selection of an Allocation Base:

The first step is to determine what's included in the contractor's indirect cost pool.

2. For indirect cost pools that do not include a material amount of the costs of management and supervision of activities involving direct labor and direct materials, the selected base must be based on the beneficial or causal relationship between the cost pool and the benefiting cost objectives, using the following hierarchy:

CAS 418

Selection of an Allocation Base:

- A direct measure of resource consumption, if practical, otherwise;
- An output measure, if practical, otherwise;
- A surrogate measure that varies in proportion to the services received.

CAS 418

Test your knowledge: At the end of each fiscal year, an M&O performs a variance analysis of its fringe and overhead allocation rates with actual rates. In accordance with its Disclosure Statement, indirect cost variances are netted and closed to the G&A Pool. Is this permitted under CAS 418?



No. Material fringe and overhead variances must be allocated to cost objectives based on a causal/beneficial relationship.

CAS 418

Test your knowledge: During the two-week pay period, a salaried exempt scientist worked 100 hours in her lab (she loves her job). She worked 50 hours on NNSA-funded research, 20 hours on WFO funded research, 10 hours on Institutional training for timekeeping (G&A), and 20 hours as the PI on her LDRD project. Because the M&O's payroll system only allows input of 80 hours per week, and because she was never able to get to her LDRD project until after regular working hours, she accordingly decided to donate as free time her 20 hours worked on LDRD. Is this permitted under CAS 418?



CAS 418



No. The allocation base must represent the activity being managed or supervised.

CAS 418

Test your knowledge: The contractor's single overhead pool includes the cost of both manufacturing and engineering activities. The manufacturing activity does not appear to have the same or similar beneficial or causal relationship to cost objectives as the engineering activity. Is this permitted under CAS 418?



No. Indirect costs must be allocated to cost objectives based on a causal and beneficial relationship.

CAS 410

Allocation of G&A Expenses to Final Cost Objectives:

Defines a G&A expense as any management, financial, and other expense that is incurred by or allocated to a business unit which is for the general management and administration of the business unit as a whole.

CAS 410

Allocation of G&A Expenses to Final Cost Objectives:

- G&A pool does not include those expenses that have a beneficial or causal relationship to cost objectives that can be more directly measured by a base other than one representing the total activity of the business.

CAS 410

Allocation of G&A Expenses to Final Cost Objectives:

- Pooled G&A expenses can only be allocated to final cost objectives.

Exceptions:

1. Insignificant items
2. Can combine with separately identified non-G&A items if the allocation base for both is appropriate and the same.
3. Special allocations (case by case basis)

CAS 410

CAS 410 permits only three G&A allocation bases:

1. Total Cost Input (TCI)
2. Value-added Cost Input (TCI less materials and subcontracts)
3. Single Cost Element Cost Input (direct labor, materials, etc)

There are no other acceptable G&A cost allocation bases!

CAS 410

Test your knowledge: A TCI M&O has a number of large line-item funded construction projects with large amounts of subcontract costs. The M&O believes this causes a disproportionate allocation of G&A to line item projects and proposes a reduced G&A rate for all of its line item projects. Is this permitted under CAS 410?



No. Special allocations to classes of projects or specific cost elements or types of expenses is not permitted.

CAS 410

Test your knowledge: An M&O excludes from its total cost input base the labor costs of its science employees' research for its parent company's special project, which is not part of the M&O contract scope. Is this permitted under CAS 410?



No. All actions which represent the total productive activity of the M&O should be included in the G&A allocation base.

CAS 410

Test your knowledge: A subcontractor uses a value added base to allocate G&A expenses. The value-added base includes total costs less subcontracts, materials, and all costs associated with its subcontract administration and purchasing overhead. Is this permitted under CAS 410?



No. Does not meet the CAS definition of a value-added cost input base.

CAS 410

Test your knowledge: A value-added G&A base M&O includes Purchasing and Subcontract Administration in its G&A pool. Is this permitted under CAS 410?



No. G&A pool shouldn't include costs that have a beneficial/causal relationship to cost objectives that are more directly measured by bases other than one representing the total activity of the business.

CAS 405

Accounting for Unallowable Costs:

Purpose: ensure that unallowable costs are properly **identified**, and provide the criteria for the **treatment** of unallowable costs within an entity's cost accounting system.

CAS 405

CAS 405 does not govern the **allowability** of costs, which is a FAR/Contracting Officer determination.

CAS 405

A cost may be allocable, but it may not necessarily be allowable on a government contract (FAR 31.201-2).

CAS 405

The designation of a cost as allowable or unallowable should have no bearing on how costs are **allocated.**

CAS 405

Risks:

- Government contracts absorbing unallowable costs' allocable burdens;
- Government contracts absorbing the costs of directly associated unallowable costs; and
- Inaccurate project/contract cost estimating and reporting.

CAS 405

If an unallowable cost is part of the pool, then the unallowable cost must be removed from the pool for purposes of cost allocations.

CAS 405

If an unallowable cost is part of allocation base or bases, then the cost must remain in the base or bases in order to draw its fare share of indirect costs.



CAS 405

“Clean pool. Dirty base.”



CAS 405

CAS 405 Concern:

1. Fringe Rate: Contractor fails to remove unallowable fringe cost from the pool.

Results: Fringe rate is overstated. Government absorbs unallowable fringe cost.

CAS 405 Adjustments:

Fringe pool – Unallowable Fringe Labor Base

Unallowable cost must be removed from the pool.

CAS 405

CAS 405 Concern:

2. Overhead Rate: Contractor fails to remove unallowable cost from O/H pool and fails to apply O/H to the unallowable fringe cost.

Results: O/H rate is overstated. Government absorbs O/H allocable to the unallowable fringe

CAS 405 Adjustments:

O/H pool – unallowable O/H
Labor + Fringe + Unallowable Fringe

Unallowable O/H must be removed from the pool.
Unallowable Fringe must remain in the O/H allocation base.

CAS 405

CAS 405 Concern:

3. G&A Rate: Contractor fails to remove unallowable cost from G&A pool and fails to apply G&A to the unallowable fringe and O/H costs.

Results: G&A rate is overstated. Government absorbs G&A allocable to the unallowable fringe and its allocable O/H

CAS 405 Adjustments:

G&A pool – unallowable G&A

**Labor + Fringe + O/H + all
Unallowable Fringe & O/H**

***Unallowable G&A must be
removed from the pool.
Unallowable Fringe & O/H must
remain in the G&A allocation
base.***

CAS 405

Test your knowledge: A M&O excludes the non-reimbursable portion of its key employees salaries from its fringe allocation base. Reimbursable salaries are included in the fringe allocation base. Is this permitted under CAS 405?



No. Unallowable salaries must remain in the fringe allocation base in order to draw their fair share of fringe costs.

Disclaimers

No monkeys were harmed during the preparation of these slides!



Disclaimers

“You have not succeeded in solving all my problems. Indeed, I feel that you have not completely solved any of them. Your solutions I have found only served to create a whole set of new problems. In many ways I am more confused than ever, but I believe that I am confused on a much higher level about more important things.”

**Anonymous Former CAS
Workshop Student**

Questions?

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