FAR PART 31 & COST ACCOUNTING STANDARDS (CAS)

An Overview
Agenda

• Why is this important?
• Scope & Applicability – FAR Part 31, CAS
• Review FAR Part 31 – Common Issues
• Cost Accounting Standards
  • Background
  • CAS Coverage Requirements & Exemptions
  • CAS Disclosure Statements
  • Overview of CAS Standards
## Scope & Applicability

<table>
<thead>
<tr>
<th>FAR Part 31</th>
<th>Cost Accounting Standards</th>
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<tbody>
<tr>
<td>Applies to all federal contracts</td>
<td>Modified or Full CAS applies only if thresholds are met</td>
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<tr>
<td>Determines Allowable Costs</td>
<td>Governs cost accounting practices</td>
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<td></td>
<td>- Measurement</td>
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<td>- Assignment</td>
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<td>- Allocation</td>
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<td>Governed by Procuring Agencies</td>
<td>Governed by CAS Board</td>
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</table>

**When FAR and CAS are in conflict, CAS prevails.**

***Most CAS standards are incorporated, in whole or in part, in the FAR Part 31 cost principles***
Types of Noncompliance – FAR & CAS

- Disclosed practices not in compliance with CAS and/or FAR.
- Actual practices of estimating costs not in compliance with CAS and/or FAR and/or Disclosure Statement.
- Actual practices of accumulating or reporting costs not in compliance with CAS and/or FAR and/or Disclosure Statement.

**Best Practice:** Maintain written policies and procedures, and follow them!
FAR PART 31

Background & Common Issues
“A cost is allowable only when the cost complies with all of the following requirements”

Reasonableness  
FAR 31.201-3

Allowability  
FAR 31.201-2

Allocability  
FAR 31.201-4
Accounting for Unallowable Costs
FAR 31.201-6

- The following costs must be identified and excluded from billings, claims and proposals by reducing the related indirect cost pools:
  - Expressly unallowable costs
    - Costs named or stated to be unallowable by law, regulation or contract
  - Mutually agreed unallowable costs
  - Directly associated costs
    - i.e. time spent pursuing unallowable activities (bad debt collection)
    - Materiality consideration
### Examples: Expressly Unallowable Costs

<table>
<thead>
<tr>
<th>FAR Cost Principal</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>Bad Debts</td>
<td>Actual or Estimated, Including Directly Associated Costs (i.e. legal, collection)</td>
</tr>
<tr>
<td>Contributions/Donations</td>
<td>Cash, Property, or Services</td>
</tr>
<tr>
<td>Entertainment</td>
<td>Amusement, Social Activities</td>
</tr>
<tr>
<td>Fines &amp; Penalties</td>
<td>Violation of Laws, Mischarging Costs</td>
</tr>
<tr>
<td>Interest</td>
<td>Interest on Borrowings, Refi Costs</td>
</tr>
<tr>
<td>Goodwill</td>
<td>Acquisition Price &gt; FMV</td>
</tr>
<tr>
<td>Alcohol</td>
<td><strong>Be Sure to Track!</strong></td>
</tr>
<tr>
<td>Losses on Contracts</td>
<td>Excess of Cost &gt; Billings</td>
</tr>
<tr>
<td>Lobbying</td>
<td>Salaries &amp; Fees</td>
</tr>
<tr>
<td>Contingencies</td>
<td>Based on potential future events, immeasurable costs</td>
</tr>
</tbody>
</table>
The following is a general overview of various cost principles. Participants may refer to the applicable Federal Acquisition Regulation section(s) for more details.
Public Relations and Advertising - FAR 31.205-1

- Allowable if required by contract

- Unallowable costs include:
  - Motion pictures, videotapes, brochures, handouts, magazines, etc., designed to call favorable attention to the contractor
  - Trade Shows that do not promote exports of sales of products sold to the Government
  - Models, souvenirs, coffee mugs, imprinted clothing, etc.
  - Memberships in civic and community organizations

- Activities designed to improve working conditions, employer-employee relations, employee morale and performance

- Allowable costs can include:
  - Health clinics and wellness/fitness centers
  - Employee counseling services
  - Certain food and dormitory services losses; award dinners, compensation or recognition awards

- Unallowable costs include:
  - Gifts to employees
  - Tickets to sports events
  - Club dues and most recreation costs
Independent Research & Development & Bid & Proposal Costs

- Independent research & development ("IR&D") costs include:
  - Basic research
  - Applied research
  - Development
  - Systems and other concept formulation studies

- Bid & proposal ("B&P") costs are the costs incurred in preparing, submitting, and supporting bids and proposals on potential contracts

- IR&D and B&P costs are generally **ALLOWABLE** if allocable and reasonable

**Tax Tip:**

R&D Tax Credits Are Available!
Material Costs - FAR 31.205-26

• Material Costs are **ALLOWABLE** subject to the following requirements:
  • Costs adjusted for credits (e.g., trade discounts, rebates, refunds)
  • Reasonable Inventory adjustments (during contract performance period)

• **Best Practice:** Maintain a consistent inventory physical count policy. Inventory controls are critical!

• Inter-organizational transfers -- at actual cost or price -- using the following limitations:
  • Established practice of price transfer
  • Contracting officer determines reasonableness
Relocation Costs - FAR 31.205-35

- Certain costs **ALLOWABLE** with certain limitations:
  - Travel for family and effects
  - Closing costs on disposition of old home
  - Cost of finding a new home (advance travel), temporary lodging
  - Lease cancellation costs

- Certain costs **UNALLOWABLE**:
  - Loss on sale of home
  - Costs related to purchasing a new home
  - Continuing mortgage principal payments on old residence being sold, etc.

*Note: If the relocated employee resigns within 12 months, the contractor must credit or refund the relocation costs to the Government.*
Idle Facilities and Idle Capacity Costs — FAR 31.205-17

- Such costs include Repairs & Maintenance, Rent, Property Taxes, etc.

- Idle facility costs are unallowable unless:
  - Necessary to meet fluctuations in workload
  - Allowable for a reasonable period ordinarily not to exceed one year

- Idle capacity is an allowable cost of doing business provided capacity is necessary & reasonable
Patent Costs - FAR 31.205-30

• Following costs are allowable if incurred based on Government contract requirements:
  • Costs of preparing invention disclosures and reports
  • Costs for searching the art to the extent necessary to make the invention disclosures
  • Costs connected with filing a U.S. patent application

• General counseling services related to patent matters are also allowable

• Patent costs not required by a Contract are unallowable, with the exception of general counseling services
Rental (Lease) Costs - FAR 31.205-36

• Allowable Costs:
  • Rental costs under operating lease if reasonable

• Related Party Leases
  • Rent expense for property under common control, to the extent that they do not exceed the normal costs of ownership, such as depreciation, taxes, insurance, facilities capital cost of money, and maintenance.
Taxes - FAR 31.205-41

- State and local income taxes are allowable

- Unallowable taxes include:
  - Federal income and excess profits tax
  - Taxes on property not used in Government work
  - Income tax accruals for differences between taxable income and pre-tax income
Trade, Business, & Professional Activities – FAR 31.205-43

• The following types of costs are **ALLOWABLE**:

  • Memberships in trade, business, technical, & professional organizations
  • Subscriptions to trade, business, professional, or other technical periodicals
  • When the principal purpose of a meeting, convention, conference, symposium, or seminar is the dissemination of trade, business, technical or professional information or the stimulation of production or improved productivity, costs of:
    • Organizing, setting up, and sponsoring the meetings, conventions, symposia, etc.
    • Attendance by contractor employees, including travel costs
Travel Costs - FAR 31.205-46

• Valid/allowable business purpose for the trip – adequate explanation/documentation

• Cost of lodging, meals and incidental expenses limited to daily maximum per diem rates published by Government for use by Government employees
  • Exceptions permitted if sufficiently documented, but recurring need for exceptions requires advance agreement with Government

• Use of “Lowest Logical airfare”

• Document any exceptions

• Cost of employee personal use of company-owned automobiles is unallowable
Best Practice:  
Advance Agreements — FAR 31.109

• Contractor & CO may negotiate treatment of special or unusual costs & methods
  
  • Should be negotiated in writing
  • Contains a statement of scope and duration
  • May be used for one, a group or all contracts
  • Cannot be inconsistent with FAR cost principles, e.g., may not make “interest” costs allowable

• **Examples:** Use charges for fully depreciated assets, pre-contract costs, costs for using patents, idle facility costs, plant reconversion costs, travel & relocation, etc.
FAR PART 31
Executive Compensation Issues
Compensation for Personal Services — FAR 31.205-6

- Compensation must be reasonable for work performed based on comparisons to:
  - Firms of the same size
  - Firms in the same industry
  - Firms in the same geographic area
  - Firms engaged in non-Government work
- Closely held business scrutinized more closely
Compensation for Personal Services — FAR 31.205-6 (cont)

• Bonuses, incentive pay and stock options
  • Must be based on an established plan, policy or employer/employee agreement
  • When paid in stock:
    • Valued at fair market value on measurement date
    • Based on production, cost reduction or efficient performance

• Deferred Compensation Plans
  • Based on current/future performance
  • To provide key people with incentive
Executive Compensation
FAR 31.205-6

- Executive compensation
  - Presently applies to executives at Corporate HQ, PLUS executives at each Intermediate home office and each segment
  - Compensation now defined as “total amount of salaries, bonuses, deferred compensation and employer contributions to defined contribution pension plans for the FY, whether paid, earned, or otherwise accruing, as recorded in the … cost accounting records…”
  - Compensation in excess of benchmark compensation is unallowable
  - Ceiling for FY 2011 $763k!
Executive Compensation Dispute – Board of Appeals Decision

• On January 18th, 2012:
  • Courts ruled in favor of a contractor
  • Ruled DCAA’s method for calculating reasonableness of executive compensation was “fatally flawed”
  • If no appeal is made, DCAA will need to revise its method for evaluating “reasonableness” of executive compensation
  • Contractors should challenge results of recent DCAA executive compensation reviews
DCAA Executive Compensation Reviews

How to Avoid Exec Comp Issues – 5 Steps to Success!

- Engage with the CO
- Engage with the DCAA as early as possible in the ECR process
- Maintain accurate company performance data
  - Is Company performance above average? Shoot for 75th Quartile!
  - Sales growth, return on sales, return on equity compared to peer group
- Maintain accurate position descriptions
- Set executive compensation by committee
  - Document & support all decisions
  - Setup compensation committee which reports to board
COST ACCOUNTING STANDARDS (CAS)

Overview
CAS Overview

• CAS standards are designed to achieve uniformity and consistency in the cost accounting principles followed by defense contractors and subcontractors under Federal contracts as a condition of contracting.

• Governed by 5 member CAS Board (public & private industry)

• Once a contract is CAS covered, it will always be CAS covered.

• A contract retains its status (full or modified) throughout its life. Consequently, an organization's change in contract coverage awards from modified to full, or vice versa, does not affect the status of existing contracts.
CAS Applicability

MANDATORY FOR USE BY:

• All executive agencies and by contractors and subcontractors in estimating, accumulating, and reporting costs in connection with pricing and administration of, and settlement of disputes concerning, all negotiated prime contract and subcontract procurements with the United States Government in excess of the Truth in Negotiations Act (TINA) threshold ($700k), other than contracts or subcontracts that have been exempted by the Board's regulations.
Is the Contract CAS Covered?

START

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

Yes

Contract or subcontract is exempt from CAS

No

Is 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

Negotiated Government contract/subcontract for 700,000 or less

Sealed bid contract

Firm-fixed-price contract/subcontract awarded on the basis of adequate price competition without submission of cost or pricing data

Contract/subcontract with foreign governments, their agents, or instrumentalities. Exemption does not extend to contract/subcontract with foreign concern which is subject to CAS 401/402.

Firm-fixed price, fixed-price with EPA (except for adjustment based on actual costs), T&M and labor hours contract/subcontract for the acquisition of commercial items

Subcontract under the NATO PHM Ship Program to be performed outside of the United States by a foreign concern

Contract/subcontract price is set by law or regulation

Contract/subcontract with a small business

Contract/subcontract less than $7.5 million, provided the contractor is not currently performing any CAS-covered contracts/subcontracts of $7.5 million or more
CAS Exemptions

- Sealed bids
- Not in excess of $700,000 (TINA Threshold)
- Small business concerns
- Foreign governments
- Foreign concerns (CAS 401 & 402 only)
- Prices set by law or regulation
- FFP & FFP incentive awards commercial Items
- FFP adequate price competition without cost or pricing data
- No CAS-covered awards $7.5M or more
CAS Coverage

• Before exemptions or even the CAS can apply the contractor must be performing at least one CAS covered contract of $7.5 million or more. Unless such a contract exists, the CAS requirements are not "triggered". Thus, the $7.5 million threshold acts as a trigger mechanism for CAS coverage.

• As long as the contractor performs the $7.5 million CAS covered contract, all of its negotiated contracts in excess of the Truth in Negotiations Act (TINA) threshold and not otherwise exempt are CAS covered. Once the contractor completes its $7.5 million contract and has no other CAS covered contracts of that magnitude then none of its new awards will be CAS covered.
Full v. Modified CAS Matrix

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 preceding cost accounting period?

Yes

Has the business unit received a single CAS-covered contract/subcontract of $50 million or more during the current cost accounting period?

Yes

Contract/subcontract is 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.

No

No

No

No

Contract/subcontract subject to modified coverage (CAS 401, 402, 405, 406) or contract/subcontract with foreign concerns subject to CAS 401 and 402

Did the company together with its segments receive $50 million in net CAS-covered awards during the preceding cost accounting period?

Yes

Are the segment CAS-covered awards during the prior cost accounting period less than $10 million and less than 30% of total segment sales?

Yes

Disclosure Statement is not required

No

No
Full v. Modified CAS

• Full CAS coverage applies to a contractor business unit that:
  
  - (1) Receives a single CAS-covered contract award of $50 million or more; or
  
  - (2) Receives $50 million or more in net CAS-covered awards during its preceding cost accounting period.

• Full CAS coverage requires a contractor to comply with all 19 cost accounting standards.

• Modified CAS coverage requires only that the contractor comply with CAS 401, 402, 405 and 406
FLOWDOWN PROVISIONS

- The CAS clauses at FAR 52.230-2(d) and FAR 52.230-3(d) (for full and modified coverage, respectively) require a contractor to include the substance of the CAS clause in all negotiated subcontracts (at any tier) into which the contractor enters. This is commonly referred to as the "CAS flow down clause."
CAS Disclosure Statement – General Disclosures

• Measurement method or technique, e.g.,
  • Historical costs, market value or present value
  • Standard cost or actual cost
  • Designation of costs included/excluded from capital assets

• Assignment to cost accounting periods
  • Accrual basis or cash basis accounting

• Allocation method or technique
  • Criteria for classifying direct/indirect costs
  • Composition of pooled indirect costs
  • Composition of allocation base for indirect costs

www.whitehouse.gov/omb/procurement_casb
CAS 401 - Consistency in Estimating, Accumulating, and Reporting Costs

<table>
<thead>
<tr>
<th>PURPOSE</th>
<th>REQUIREMENT</th>
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<tbody>
<tr>
<td>To ensure that the contractor’s practices used in estimating costs for</td>
<td>Cost accounting practices must be consistent in regard to the following</td>
</tr>
<tr>
<td>a proposal are consistent with cost accounting practices used to</td>
<td>areas:</td>
</tr>
<tr>
<td>accumulate and report costs.</td>
<td>• Classification of elements or functions of costs as direct or indirect;</td>
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<tr>
<td></td>
<td>• The indirect cost pools to which each element or function of costs charged</td>
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<tr>
<td></td>
<td>or proposed to be charged; and</td>
</tr>
<tr>
<td></td>
<td>• Methods of allocating indirect costs to the contract.</td>
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Note: Applies under full and modified CAS coverage.
# CAS 402 - Consistency in Allocating Costs Incurred for the Same Purpose

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<thead>
<tr>
<th>PURPOSE</th>
<th>REQUIREMENT</th>
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<tbody>
<tr>
<td>Requires that each type of cost be allocated only once and on only one basis to any contract or other cost objective. Criteria for determining the allocation of costs to a product, contract, or other cost objective should be the same for all similar objectives.</td>
<td>No final cost objective shall have any cost allocated as an indirect cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective, and vice versa.</td>
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</table>

The standard helps prevent overcharging & double-counting

Note: Applies under full and modified CAS coverage.
### CAS 405 – Accounting for Unallowable Costs

<table>
<thead>
<tr>
<th>PURPOSE</th>
<th>REQUIREMENT</th>
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<tbody>
<tr>
<td>Establishing guidelines covering:</td>
<td>Costs expressly unallowable, or mutually agreed to be unallowable, shall be identified and excluded from any billing, claim, or proposal to the Government.</td>
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<tr>
<td>Identification of costs specifically described as unallowable; and</td>
<td>Costs directly associated with unallowable costs that would not have been incurred if not for the incurrence of the unallowable costs are also unallowable.</td>
</tr>
<tr>
<td>The cost accounting treatment to be accorded such identified unallowable costs.</td>
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Note: Applies under full and modified CAS coverage.
## CAS 406 – Cost Accounting Period

<table>
<thead>
<tr>
<th>PURPOSE</th>
<th>REQUIREMENT</th>
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<tbody>
<tr>
<td>To provide criteria for the selection of the time periods to</td>
<td>Contractor shall use its fiscal year as cost accounting period.</td>
</tr>
<tr>
<td>be used as cost accounting periods.</td>
<td>A transitional period other than a year not to exceed 15 months may be used</td>
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<td>when a change in fiscal year occurs.</td>
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<td>An annual period other than the fiscal year can be used if mutually agreed</td>
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<td>upon.</td>
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</table>

Note: Applies under full and modified CAS coverage.
COST ACCOUNTING STANDARDS

Full CAS Coverage Only
Cost Accounting Standards

• 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

• 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
Cost Accounting Standards

• 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
Thank you.