



Bridging
PARTNERSHIPS
Small Business Symposium

April 15-16, 2015

TRAC- 6600 Burden Blvd., Pasco, WA 99301- Tri-Cities, WA

**Presenting the Numbers:
Accounting Systems for
Government Contractors**

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Adjunct Accounting Faculty at WSU Tri-Cities.

CFO for Woman Owned Small Business.

Auditor - Defense Contract Audit Agency.

Created Pricing & Analysis Group in the UK.

Opinions Expressed Are My Own

Agenda

- Accounting systems vs software
- Accounting system reviews
- Allowable vs unallowable costs
- Direct vs indirect costs
- Indirect costs and rate computations
- Time keeping and labor distribution
- Labor and fringe benefit costs
- Other costs
- Certified Cost or Pricing Data
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Accounting System vs Accounting Software

- An accounting system is the way a company keeps its books.
- The system can be manual or electronic, or a combination of the two.
- Accounting software is a computer program that records and processes accounting information.

Accounting Software

- Neither DCAA nor the government “approves” accounting software.
- Most accounting software can be used for government contracting purposes.
- QuickBooks is the most widely used software for government contracts.

Accounting System

The contractor's policies, procedures, and controls established to gather, record, classify, analyze, summarize, interpret, and present accurate and timely financial data for reporting in compliance with applicable laws, regulations, and management decisions.

Accounting System

Internal controls are crucial to:

- Ensure proper recording of costs.
- Properly segregate unallowable costs.
- Ensure accurate labor recording.
- An audit will test to see if controls prevent erroneous data from being charged to the government.
- Good controls = less audit testing.

Accounting System Review

- An accounting system review will determine if an accounting system is “adequate” for award of a cost reimbursable subcontract.
- May be performed by the Defense Contract Audit Agency (DCAA) or a prime contractor cost/price analyst.
- Adequacy is a pass/fail determination

Evaluation Criterion

- An acceptable accounting system is one that provides reasonable assurance that applicable laws and regulations are complied with, is reliable, minimizes risk of misallocations and mischarges and is consistent with billing procedures.
- Standard Form 1408 is a checklist of 14 criteria used to determine adequacy.

Basic Accounting Requirements

- System must be compliant with Generally Accepted Accounting Principles (GAAP).
- Costs must be accumulated under general ledger control.
- Routine (at least monthly) posting of books of account.

Government Accounting Requirements, Including:

- Federal Acquisition Regulations (FAR).
- Department of Energy FAR Supplement (DEAR).
- Cost Accounting Standards (CAS) (not applicable to small business).
- Specific Subcontract Requirements.

Allowable Costs

- A cost is allowable only when the cost complies with all of the following requirements:

- (1) Reasonableness.
- (2) Allocability.
- (3) Terms of the subcontract.
- (4) Limitations specified in FAR 31.205.
- (5) CAS (if applicable) or GAAP.

Allowable Costs - Reasonableness

- A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.
- If a cost is challenged, the burden is the contractor's to establish that such cost is reasonable.

Unallowable Costs - Allocability

- (a) The cost is incurred specifically for the contract;
- (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or,
- (c) Is necessary to the overall operation of the business.

Allowable per FAR 31.205

- Provides guidance on the allowability of 49 areas of cost.
- Some costs are always unallowable (alcoholic beverages, lobbying, losses on other contracts).
- Some costs are allowable, subject to specified limitations (public relations, advertising, compensation).

Accounting for Unallowable Costs

- Unallowable costs must be identified and excluded from any billing, claim or proposal, including indirect cost pools.
- When an unallowable cost is incurred, its directly associated costs (any cost that would not have been incurred had the unallowable cost not been incurred) are also unallowable.

Accounting for Unallowable Costs

- Auditors spend considerable time looking for unallowable costs.
- Identify unallowable costs and show how you excluded them to demonstrate understanding and compliance.
- A process to allow employees to charge an unallowable account when appropriate reduces mischarging.

Direct vs Indirect Costs

- Direct costs of the contract shall be charged directly to the contract.
- Other costs incurred for the same purpose in like circumstances must not be included in any indirect cost pool to be allocated to the contract.
- Indirect costs are those remaining after direct costs have been charged.

Direct vs Indirect Costs

- Consistency in charging costs as direct or indirect is essential and is also closely examined by auditors.
- Clear, well documented instructions for accounting staff should be prepared.
- Once a policy is established, resist efforts by clients to charge costs differently on one contract than on others.

Indirect Costs

- Indirect costs should be accumulated by logical cost pools, considering the reasons for incurring such costs.
- Cost pools are then allocated over a base of costs benefitting from the pool costs.
- For example, fringe benefit costs should be allocated to all labor costs.

Indirect Costs

- The indirect rate equals the cost pool divided by the base.
- For most small businesses, two indirect rates should be sufficient – a fringe benefit rate and a General & Administrative (G&A) rate.
- A separate overhead rate is normally only needed for manufacturing firms.

Indirect Costs

- The fringe benefit rate is normally computed over a base consisting of total labor costs. The rate is applied to all labor, including G&A.
- The G&A rate is usually computed and applied over a base consisting of total costs including unallowable costs (unless excluded from the G&A pool).

Indirect Costs

- For firms with direct charging employees assigned long term to client facilities and others working from the home office, separate home office and field overhead rates may be appropriate. The home office rate would include facility costs not allocable to employees in client facilities.

Indirect Costs

- The goal is to allocate 100% of indirect costs to final cost objectives (contracts, indirect/overhead projects and unallowable costs).
- Pool and Base should reflect a causal/beneficial relationship.
- Resist urge to create additional indirect cost pools unless actually needed.

Indirect Costs

- Indirect rates (Fringe, G&A, etc.) should be computed based on a full year of data.
- Comparison of several year's actual rates, trends and expected changes in base or pool costs should be used to forecast future rates.

Indirect Costs

- Estimated indirect rates should be recomputed for each new proposal, taking into account any additional indirect cost that would be added to the pools because of the new work and factoring in the increase in the base caused by the new work.

Timekeeping and Labor Distribution

- Accurate recording of employee time, whether direct to a contract or to an indirect account, is essential.
- Time should be recorded by the employee daily and approved by a supervisor.
- Any changes should be explained, documented and confirmed by the employee.

Timekeeping and Labor Distribution

- Employees should be trained on proper timekeeping procedures and the need to accurately record their time. The training should be documented.
- Supervisors should be trained in their role in verifying and approving time records submitted for their employees.

Timekeeping and Labor Distribution

- Provide clear instructions to the employee on which job to work on and charge to.
- I recommend that all hours worked be recorded, including uncompensated overtime.
- The government is concerned that they will be billed for hours for which the employee is not compensated or that employees will bill 100% to the government and perform other work during the uncompensated overtime.

Timekeeping and Labor Distribution

- DCAA or prime contractor analysts may conduct unannounced labor floor checks.
- Employees are interviewed and asked to explain how they record their time, how they ensure they are charging the appropriate contract/account and how they make changes to their time record if necessary.
- Well trained employees following consistent, compliant procedures easily pass.

Labor Costs

- Employee compensation must be reasonable for the work performed.
- Establish and document a clear and consistent compensation policy for establishing initial pay rate and process for determining increases, including market surveys.
- For salaried employees, establish policy on uncompensated overtime.

Labor Costs

- Use offer letters with employee signature of acceptance to document agreement on wages and benefits, especially for conditional offers pending contract award.
- Care must be taken when setting wages for owners or relatives of owners. Must represent value of work.

Fringe Benefit Costs

- Usually includes all mandatory payroll taxes (FICA, SUTA, FUTA, L&I).
- Includes employer share of health and life insurance, 401K contributions, training, educational reimbursement, paid time off, bonuses and other benefits provided.
- Document policy on employee eligibility for benefits,

Travel Costs and the FTR

- Travel costs usually must follow the Federal Travel Regulations (FTR).
- FTR establishes maximum allowable lodging* and fixed daily allowance for Meals & Incidental Expenses (M&IE).
- Receipts are required for lodging and business expenses not included in the M&IE per diem. (*Some exceptions)

Travel Costs and the FTR

- Airfare costs are limited to the lowest fare available to the contractor.
- Sometimes actual and reasonable costs may be authorized, but that requires considerable additional documentation and justification.
- Auditors and contract administrators always look at travel costs.

Other Direct Costs (ODCs)

- Usually limited to those costs identified in the contract (e.g. travel costs).
- Must be careful to follow direct vs indirect cost policy.
- Usually requires additional documentation.
- Must be for costs directly benefitting the contract, otherwise treat as indirect.

Certified Cost or Pricing Data

- Proposals that exceed \$700,000 and that are not awarded based on competition usually require submission of certified cost or pricing data.
 - Current, accurate and complete information must be provided and certified by the contractor.

Certified Cost or Pricing Data

- The certification, required by the Truth in Negotiations Act (TINA), states that the contractor has provided **“all facts available at date of agreement on the price of a contract...that a prudent buyer or seller would reasonably expect to affect price negotiations significantly.”**

Certified Cost or Pricing Data

- Under TINA, judgments are not considered cost or pricing data (e.g. estimated labor escalation factors).
- Verifiable information supporting those judgments, which are integrated into a bid estimate, do meet that definition (e.g. historical labor escalation trends).

Certified Cost or Pricing Data

- Certified cost are not significantly different than “costs other than certified cost or pricing data”, except for the signed certificate.
- If it is later determined that the most current, accurate and complete information was not provided, cost recovery and penalties are possible.

Key Points

- **Allowable**
- **Consistent**
- **Documented**
- **Reasonable**

Questions?

I am available after the session to answer any specific questions or to discuss items of concern. You can also reach me at:

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