

Cost Impact Studies

*Written by and dedicated to the memory
of Terry M. Willis, MBA, CPA*

There are two types of coverage under the Cost Accounting Standards: full and modified. Full coverage applies to a business unit of a contractor that receives a single CAS covered contract or subcontracts of \$50 million or more, or was awarded net covered CAS contracts of \$50 million or more during the proceeding cost accounting period. A business unit subject to full coverage must follow each of the Cost Accounting Standards.

A business unit that has received a covered contract of less than \$50 million may elect to be covered by modified CAS coverage. Modified coverage requires compliance only with CAS 401, CAS 402, CAS 405, and CAS 409 and is strongly the preferred option if available.

Under the Cost Accounting Standards, contractors who are covered are required to do the all of the following:

1. Disclose in writing their cost accounting practices by completing a Disclosure Statement.
2. Follow their disclosed practices consistently in estimating, accumulating and reporting costs.
3. Comply with all of the individual CAS requirements in effect on the contract award date.
4. Agree to an adjustment of the contract price when the contractor fails to comply with existing Standards or with their own disclosed practices.

Types of Cost Accounting Changes

Desirable Required Changes are those changes a contractor makes to disclosed cost accounting practices which are determined to be desirable by the government, even if the change results in increased cost to the government on existing contracts or subcontracts. Most desirable changes occur when the contractor's contract volume increases and they become fully CAS covered instead of being covered at the modified CAS level. Another path that will result in a desirable change is when a cost accounting change must be made for the contractor to remain complaint. This is known as an equitable adjustment change. Also some restructuring changes may be considered desirable by the government when such changes result in a higher cost for a short period of time but produce significant cost savings over the life of the contract. These changes are very narrowly focused and conditioned on written approval from the Secretary of Defense. Desirable restructuring changes are usually reserved for circumstances where business combinations are deemed necessary to preserve a critical contracting capability which would otherwise be lost or the projected savings from the change will be twice the projected cost of the change.

Unilateral Changes are those changes a contractor must make when changing from one compliant cost accounting practice to another. A determination of a desirable change is usually made when there is no net increase in prices to the government from the change in cost accounting practice. Major cost

accounting system upgrades and chart of account realignments are usually treated as unilateral changes. Cost impact studies, at least at a gross cost magnitude level; usually have to be accomplished for all unilateral changes for the government to accept the changes.

Non-Compliant Changes result when the contractor's cost accounting practices are determined to be non-compliant with their Disclosure Statement cost accounting practices or with an applicable Cost Accounting Standard. Such non-compliant changes will usually require the preparation of a detail cost impact study to determine the amount of the increased cost paid by the government as a result of the non-compliant practice.

The Defense Contract Audit Agency (DCAA) will forward the finding of non-compliant practices to the responsible Administrative Contract Officer who will make a determination of the materiality and advise the contractor if a cost impact proposal must be submitted within 60 days after the determination of non-compliance. In most cases the 60 day window will not be sufficient time for the contractor to complete and properly review the cost impact study. The Defense Management Agency (DCMA) routinely grants considerable extension time for the completion of the cost impact study. However, a request for extension should be in written form and addressed to the ACO and should request the approval for the extension in writing as well. Failure to accomplish this may result in contract payment withholds. DCAA will estimate a general dollar magnitude of the non-compliance in their audit. If the cost impact study has not been

completed within the 60 day time limit and no formal extension has been granted the government may start withholding monies from the payments on all CAS covered contracts at 10% until the amount of the gross dollar estimate made by DCAA is reached.

Can DCAA's audit finding of non compliance be challenged?

The short answer of course is Yes! Contractors who experience success in challenging DCAA's audit finding in this regard shoulder the burden of proof. They must develop a strong factual basis to support the argument that their current cost accounting method and practice is indeed reflected in their Disclosure Statement as well as showing the government did not incur any additional cost because of the non-compliance circumstances. Careful writing of Disclosure Statements help resolve this problem before it occurs.

Any challenge of course must be directed to the Administrative Contract Officer and done very timely after the DCAA audit report has been issued. The most successful responses will be experienced by influencing the contract officer before the determination of non-compliance is officially made.

What is a Cost Impact Study?

There is no prescribed format for a cost impact study. However, it must be prepared in sufficient detail which permits determination, evaluation, and negotiation of the cost impact upon each separate CAS covered contract and subcontract during the period of non-compliance. At a minimum the cost impact study must contain the following

data elements for it to be considered sufficient, complete and auditable:

1. Contract number
2. Name of awarding agency
3. Effective dates of performance
4. Confirmation that the contract is CAS covered.
5. Detail analysis of billings using non-compliant circumstances
6. Detail analysis of billings based upon compliant practices
7. Complete analysis of cost impact and explanation of any cost differences determined to be caused by non-compliant practices.

Sometimes the ACO will provide additional direction or guidance in their letter advising of a non-compliance. When such instructions or directions are provided they should be carefully considered and evaluated by the contractor. Since cost impact studies can become highly complex and involved the contractor should never set forth accomplishing a study without obtaining the ACO's agreement that the methodology and approach selected will be acceptable. Failure to secure this agreement may cause problems later when the cost impact study is audited by DCAA and they disagree that is a valid study and addresses all the non-compliant circumstances.

Should I obtain Professional Assistance?

For any routine cost impact studies where the objective is to develop a high level gross magnitude dollar impact the answer may well be no. However, the majority of detail cost impacts consume immense amounts of resources and time leaving most compliance functions

unable to properly manage the cost impact process and keep up with regular scheduled compliance activities. Additionally, having outside professional assistance will often help DCAA and DCMA to be more accepting of the work that is performed. This often leads to a better final result and settlement allowing the issue to be closed much quicker and with less cost to the contractor.

In Memoriam: Terry M. Willis was the founding principal of Corporate Solutions LLC, a consulting practice providing professional assistance to government contractors. Terry passed away in 2007. He was one of ECG's best Government Accounting Associates.