

GOV'T CONTRACT COST ACCOUNTING 101

SBIR CONFERENCE

Oahu, Hawaii
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Gov't Contract Cost Accounting 101

AGENDA

- Government-approved , adequate accounting system
- Types of costs
- Defense Contract Audit Agency (DCAA): Purpose and guidance
- Compliant timekeeping procedures
- Indirect rates - Overhead and G&A

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GLOSSARY OF TERMS

- **Allocable costs** – A cost whose relative benefits make it assignable or chargeable to one or more of the cost objectives agreed to between contractual parties.
- **Allowable costs** - Any costs for which the Government will reimburse the contractor for work performed on a Government contract. Can be billed to the Government contract.
- **Defense Contract Audit Agency (DCAA)** –Under the authority, direction, and control of the Under Secretary of Defense (Comptroller), is responsible for performing all contract audits for the Department of Defense (DoD), and providing accounting and financial advisory services regarding contracts and subcontracts to all DoD Components responsible for procurement and contract administration. These services are provided in connection with negotiation, administration, and settlement of contracts and subcontracts. DCAA also provides contract audit services to some other Government Agencies.
- **Direct Costs** – Costs that can be specifically identified to a contract.
- **General and Administrative (G&A)** - Indirect expenses that are necessary for plant wide support, such as overall management and supervision, accounting, and the general conduct of business. Indirect expenses may include a company's general and executive offices, executive compensation, the cost of staff services such as legal, accounting, public relations, financial, and similar expenses and other miscellaneous expenses related to overall business
- **Federal Acquisition Regulations (FAR)** - Primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services with appropriated funds

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GLOSSARY OF TERMS

- **Indirect Costs** – Costs which are not readily identifiable directly to a particular contract or deliverable article. Indirect costs are accumulated into logical cost groupings and allocated to the benefiting contract, program or product on a consistent basis.
- **Job Order** - aka contract
- **Overhead** - Costs incurred which cannot be identified specifically with a single product or service are allocated over direct charges by the application of indirect rates (overhead rates).
- **Unallowable costs** – Any costs that cannot be included in prices, cost reimbursements, or settlements under a Government contract. Cannot be billed to a Government contract.

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ACCOUNTING SYSTEM ADEQUACY

- DCAA conducts audits to determine adequacy of a contractor's accounting system for collecting and billing costs on a Government contract.

Pre-award accounting system survey

- **Proper segregation of direct vs. indirect costs**
 - All costs incurred for the same purpose, in like circumstances, must be identified consistently as either direct or indirect.

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DIRECT COSTS

VS

INDIRECT COSTS

FAR 31.202

FAR 21.203

Direct costs can be specifically identified to a particular final cost objective.

Indirect costs cannot be specifically identified to a single final cost objective, but are identified with two or more final cost objectives.

- Engineering design in support of a particular contract
- Preparation of a cost report that is a contractual requirement

- General purpose employee training
- Employee recognition events

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EXERCISE 1

Considering your business, identify 10 examples each of direct and indirect costs.

Document on flip charts.

Discuss with class

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ACCOUNTING SYSTEM ADEQUACY

- **Identification and accumulation of direct costs by contract**
- **Logical and consistent method for allocation of indirect costs to intermediate and final cost objectives**
 - **FAR 31-201-4 – Determining Allocability**
 - A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits or other equitable relationship.
 - Specifically incurred for the contract
 - Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received, OR
 - Is necessary to overall operation of business although a direct relationship to any particular cost objective cannot be shown.

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ACCOUNTING SYSTEM ADEQUACY

- ❑ Accumulation of costs under general ledger control
- ❑ Timekeeping system identifies employees' labor by intermediate or final cost objectives
- ❑ Labor distribution system charges direct and indirect labor to the appropriate cost objectives
- ❑ Interim (at least monthly) determination of costs charged to a contract through routine posting to books of account
- ❑ Exclusion from costs charged to Govt contracts of amounts that are not allowable
 - Unallowable costs (FAR Part 31)
 - Bad debts
 - Contingencies
 - Contributions or donations
 - Entertainment
 - Lobbying
 - Alcoholic beverages
 - Fines and penalties

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ACCOUNTING SYSTEM ADEQUACY

- ❑ **Identification of costs by contract line item and units (as if each unit or line item was a separate contract) if required by the proposed contract.**
- ❑ **Segregation of preproduction costs from production costs**

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TYPES OF COST

- **Allowable Costs** - Any costs for which the Government will reimburse the contractor for work performed on a Government contract. Billable to the Government.
 - Minimum requirements for costs to be allowable and reimbursable
 - Cost must be allocable to the contract (must benefit the contract)
 - Cost must be reasonable (generally recognized as a normal cost)
 - Cost must be compliant with CAS (if applicable), FAR and contract terms

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TYPES OF COST

- **Unallowable Costs** - Costs that the U.S. Government considers non-reimbursable expenses, as identified in FAR Part 31. Non-billable to the Government.
 - FAR 31.205-1 Advertising Costs
 - FAR 31.205-3 Bad Debt Costs
 - FAR 31.205-6 Compensation for Personal Services
 - FAR 31.205-7 Contingencies
 - FAR 31.205-8 Contributions or Donations
 - FAR 31.205-14 Entertainment Costs
 - FAR 31.205-15 Fines and Penalties
 - FAR 31.205-18 Independent Research and Development Costs
 - FAR 31.205-19 Insurance Costs
 - FAR 31.205-20 Interest and Other Financial Costs
 - FAR 31.205-22 Legislative Lobbying Costs
 - FAR 31.205-27 Organization Costs
 - FAR 31.205-30 Patent Costs
 - FAR 31.205-35 Relocation Costs
 - FAR 31.205-37 Royalty Costs
 - FAR 31.205-41 Taxes
 - FAR 31.205-46 Travel Costs
 - FAR 31.205-51 Alcoholic Beverages

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Allowable	vs	Unallowable
Roundtable discussions designed to improve employee morale		Group outing to a sports event
Employee incentive compensation based on an established plan or policy		Birthday gifts given to employees
Cost of membership in a trade organization		Cost of membership in a social organization
Cost of an employee's meals while on business travel to a customer program review		Cost of alcoholic drink at dinner while on business travel to a customer program review

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EXERCISE 2

Identify 10 examples each of allowable and unallowable costs.

Document on flip charts.

Discuss with class

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DEFENSE CONTRACT AUDIT AGENCY (DCAA) AUDITS

- DCAA was established to perform contract audits for Department of Defense (DoD) and provide accounting and financial advise, in connection with the negotiation, administration and settlement of contracts. Also perform contract audits for other Government agencies .

- DCAA Contract Audit Manual – Provides policies and procedures by which they follow.

- **Federal Acquisition Regulation (FAR)**
 - Issued by agencies of the Federal Government to the acquisition process
 - Created to provide uniform policies for government acquisitions.
 - **Cost Principles Guide FAR 31.201 – 31.205**
 - **FAR 31.203 – Indirect Costs**
 - **FAR 31.201-7 – Construction & Architect-Engineer Contracts**
 - **FAR 31.202 – Direct Costs**
 - **FAR 31.201-4 – Determining Allocability**
 - **FAR 31.201-5 – Credits**
 - **FAR 31.201-6 – Accounting for Unallowable Costs**

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DEFENSE CONTRACT AUDIT AGENCY (DCAA) AUDITS

- **Cost Accounting Standards (CAS)**
 - Addresses measurement, assignment, and allocation of costs to Government contracts.
 - CAS applies to most cost type contracts
 - Several **Exceptions** – Two are:
 - Negotiated contracts or subcontracts under \$500K
 - **Contracts & subcontracts with small businesses**

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DEFENSE CONTRACT AUDIT AGENCY (DCAA) AUDITS

- Material systems – Reviews purchase orders (PO)
 - Is there a contract requirement?
 - Was item received?
 - Was item used on the contract it was purchased on?
 - Was invoice paid? Value on invoice vs PO

- Internal controls
 - Who has access to accounting system?
 - Are accounting personnel appropriately trained? (training records)

- Billing systems – Reviews vouchers
 - Were billings done in accordance with contract requirements? (e.g. appropriate approvals received on purchases prior to billing)
 - If costs on invoices are allocated to several contracts, is the allocation basis supported with documentation?
 - Are there overpayments? If so, are they addressed promptly?

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DEFENSE CONTRACT AUDIT AGENCY (DCAA) AUDITS

- Incurred cost
 - Are costs reasonable?
 - Are costs allowable?
 - Are costs allocable?
 - Are direct and indirect costs correctly recorded?

- Timekeeping system
 - Can employee produce a work authorization for his/her activities identifying the appropriate charging guidance?
 - Has employee properly recorded his/her time at the end of the work shift?
 - Has employee pre-recorded his/her time?
 - Are employees trained on proper time keeping?

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TIMEKEEPING PROCEDURES AND CONTROLS

- All employees must understand their responsibility in accurately recording time charges.
- Internal controls criteria:
 - Segregation of responsibilities for labor-related activities
 - Must have clear, written procedures & policies
 - Internal labor audits must be conducted and actions must be taken against violations.
 - Employees must be made aware of the controls in place
- **Timekeeping policies and procedures**
 - Must document the employees responsibilities
 - Record time on a daily basis
 - Record correct distribution of time by project/contract.
 - If manual system, all changes to the timecard must be lined through with the employee's initials beside the changes. If electronic system, then changes must be documented by the system.

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TIMEKEEPING PROCEDURES AND CONTROLS

- Supervisor should approve and sign all timecards
- Supervisor cannot complete an employee's timecard unless the employee is absent
- Should state that the type of the activity determines the proper charging of time (not availability of funding, type of contract, etc)
- Should state the responsibility of the employee is accurate and complete preparation of timecards and that improper preparation may lead to disciplinary actions
- **Labor Floor Checks**
 - DCAA auditors periodically perform physical audits of time-charging practices of employees.
 - Usually unannounced
- **Penalties for labor mischarging**
 - May be subject to criminal charges
 - Liability
 - Employees who fill in and sign timecards with false information
 - Supervisors who approve timecards with the knowledge that they contain the false information.
 - Managers and officers who know those facts and make the claim anyway by submitting the invoice based upon the false timecard.
 - The company

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INDIRECT RATES

WHAT ARE THEY AND WHY DO WE USE THEM?

- ❑ Overhead and General & Administrative rates
- ❑ Represent a value for a category of costs
- ❑ Used to allocate indirect costs across multiple cost objectives
- ❑ Used to estimate indirect costs in proposals
- ❑ Used to manage indirect costs
- ❑ Mechanism to recover indirect costs

THE WAY IT'S CALCULATED IS THE WAY IT'S APPLIED

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INDIRECT RATES

Overhead - Costs incurred which cannot be identified specifically to one final cost objective are allocated over direct charges by the application of indirect rates (overhead rates).

FORMULA:

Overhead rate = Overhead Expenses/ Overhead Base

Common types of Overhead Rates:

- Material overhead
- Engineering overhead
- Labor overhead
- Manufacturing overhead

**EXPENSE POOL CAN ONLY INCLUDE ALLOWABLE
EXPENSES**

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INDIRECT RATES

General and Administrative (G&A) – Indirect expenses of a general nature applicable to total business activity, such as overall management and supervision, and accounting.

FORMULA:

$$\text{G\&A rate} = \text{G\&A Expenses} / \text{G\&A Base}$$

G&A Base Types:

- Total Cost Input Base
- Value-Added Cost Base = Total cost input base less material and subcontract costs

EXPENSE POOL CAN ONLY INCLUDE ALLOWABLE EXPENSES

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EXERCISE 3

ASSUMPTIONS:

Direct Material Costs	\$	100
Direct Labor Costs	\$	150
Overhead	\$	165
G&A Costs	\$	85

Overhead is applied to direct labor only

G&A is applied to direct material, direct labor and overhead (Total Cost Input Base)

CALCULATE THE OVERHEAD AND G&A RATES

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EXERCISE 3

ASSUMPTIONS:

Direct Material Costs	\$	100
Direct Labor Costs	\$	150
Overhead	\$	165
G&A Costs	\$	85

Overhead is applied to direct labor only

G&A is applied to direct material, direct labor and overhead (Total Cost Input Base)

CALCULATE THE OVERHEAD AND G&A RATES

EXPENSE ITEM	TOTAL COST		DIRECT MATL	DIRECT LABOR	OVERHEAD	G&A
Direct Material	\$ 100		\$ 100			
Labor (Direct)	\$ 150			\$ 150		
Overhead	\$ 165				\$ 165	
G&A	\$ 85					\$ 85
Total Expenses	\$ 500		\$ 100	\$ 150	\$ 165	\$ 85
Overhead Rate	Expense/Base = OH/Direct Labor = 165/150 = 110%					
G&A Rate	Expense/Base = G&A/(Direct Labor+Direct Matl+OH) = 85/(100+150+165) = 20.5%					

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EXERCISE 4

ASSUMPTIONS:

Direct Material Costs	\$	100
Direct Labor Costs	\$	150
Overhead	\$	165
G&A Costs	\$	85

Overhead is applied to direct labor only

G&A is applied to direct material, direct labor and overhead (Total Cost Input Base)

\$25 of G&A costs are unallowable

CALCULATE THE OVERHEAD AND G&A RATES

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EXERCISE 4

ASSUMPTIONS:

Direct Material Costs	\$	100
Direct Labor Costs	\$	150
Overhead	\$	165
G&A Costs	\$	85

Overhead is applied to direct labor only

G&A is applied to direct material, direct labor and overhead (Total Cost Input Base)

\$25 of G&A costs are unallowable

CALCULATE THE OVERHEAD AND G&A RATES

EXPENSE ITEM	TOTAL COST		DIRECT MATL	DIRECT LABOR	OVERHEAD	G&A
Direct Material	\$ 100		\$ 100			
Labor (Direct)	\$ 150			\$ 150		
Overhead	\$ 165				\$ 165	
G&A	\$ 85					\$ 85
Total Expenses	\$ 500		\$ 100	\$ 150	\$ 165	\$ 85
Unallowables	\$ (25)					\$ (25)
Adjusted Cost	\$ 475		\$ 100	\$ 150	\$ 165	\$ 60
Overhead Rate	Expense/Base = OH/Direct Labor = 165/150 = 110%					
G&A Rate	Expense/Base = G&A less unallowables / (Direct Labor + Direct Matl + OH) = 60 / (100 + 150 + 165) = 14.5%					

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EXERCISE 5

ASSUMPTIONS:

Direct Material Costs	\$	100
Direct Labor Costs	\$	150
Overhead	\$	165
G&A Costs	\$	85

Overhead is applied to direct labor only

G&A is applied to direct material, direct labor and overhead (Total Cost Input Base)

\$25 of G&A costs are unallowable

\$50 of Overhead costs are unallowable

CALCULATE THE OVERHEAD AND G&A RATES

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EXERCISE 5

ASSUMPTIONS:

Direct Material Costs	\$	100
Direct Labor Costs	\$	150
Overhead	\$	165
G&A Costs	\$	85

Overhead is applied to direct labor only

G&A is applied to direct material, direct labor and overhead (Total Cost Input Base)

\$25 of G&A costs are unallowable

\$50 of Overhead costs are unallowable

CALCULATE THE OVERHEAD AND G&A RATES

EXPENSE ITEM	TOTAL COST		DIRECT MATL	DIRECT LABOR	OVERHEAD	G&A
Direct Material	\$ 100		\$ 100			
Labor (Direct)	\$ 150			\$ 150		
Overhead	\$ 165				\$ 165	
G&A	\$ 85					\$ 85
Total Expenses	\$ 500		\$ 100	\$ 150	\$ 165	\$ 85
Unallowables	\$ (75)				\$ (50)	\$ (25)
Adjusted Cost	\$ 425		\$ 100	\$ 150	\$ 115	\$ 60
Overhead Rate	Expense/Base = OH less unallowables / Direct Labor = 115 / 150 = 76.7%					
G&A Rate	Expense/Base = G&A / (Direct Labor + Direct Matl + OH before unallowables are removed) = 60 / (100 + 150 + 165) = 14.5%					

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References

- Defense Contractor Audit Agency - www.DCAA.mil
 - Publications
 - Information for Contractors
 - FAR Cost Principles Guide

- Federal Acquisition Regulations - www.gsa.gov/far