

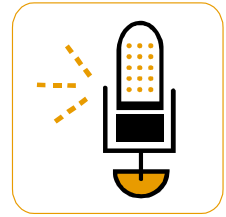
Pacific Northwest Consultants, LLC

Special Interest Articles

Selected FAR Cost Principles. See Page 2.

Insurance Costs. See Page 4

Sarbanes-Oxley and DCAA. See Page 5



Cost Accounting Standards

A lot of government contractors and bidders panic when they hear the term "CAS". They believe it means more regulations, red tape, and endless documentation. In reality, CAS standards promote good accounting and the CAS disclosure statement merely documents the contractor's accounting practices (see the following article).

CAS has three levels of coverage; full, modified, and none. The thresholds for full and modified are

\$50 million and \$7.5 million respectively. These thresholds refer to a contract of that amount or contracts totaling that amount in the preceding year.

CAS applies only to negotiated contracts. Sealed bids, awards based on adequate price competition without submission of cost or pricing data, contracts in which the price is set by law or regulation, and commercial items are all exempt.

Also, contracts under \$500 thousand, contracts awarded to small businesses, and contracts executed and performed outside of the US are exempt.

Under modified coverage, contractors must comply with four standards; 401, 402, 405, and 406. Under full coverage, contractors must comply with all 19 CAS standards.

In future issues, we will delve into the requirements of these standards.

CAS Disclosure Statement

A Disclosure Statement is a written description of a contractor's cost accounting practices and procedures. In general, it is required for fully CAS covered contractors (\$50 million) and prior to the award of a CAS covered contract of \$50 million or more. Corporate offices or other home offices that allocate costs to one or more disclosing segments must complete a Part VIII.

Once submitted, the contracting officer will

request auditors to determine adequacy. Generally this determination assures that the Disclosure Statement has adequately disclosed the practices required to be disclosed by the CAS Board's rules, regulations, and standards. The Government's objective is to obtain an adequate description so during this review, contractors are usually given the opportunity to revise any identified deficiencies.

There are eight sections to

a disclosure statement; general information, direct costs, direct vs indirect costs, indirect costs, depreciation and use allowances, other costs and credits, deferred compensation and insurance costs, and home office expenses.

We have linked on the home page of our website, www.pacificnwc.com, a flowchart, courtesy of DCAA, to help you determine your level of CAS coverage and disclosure statement responsibility.

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Recent Changes to FAR Cost Principles

For More Information:

These cost principles and all other FAR cost principles are covered in our Introduction to FAR Cost Principles Course. To schedule training for your organization or for dates of scheduled courses, email training@pacificnwc.com.

Relocation Costs

A final rule that took effect on October 31, 2005, revised FAR 31.205-35 to permit contractors the option of being reimbursed on a lump-sum basis for three types of employee relocation costs: finding a new home, travel to the new location, and temporary lodging.

However, in response to concerns that the cost principle would permit the reimbursement of unreasonable costs, the

drafters added a provision requiring that the lump-sum costs be "adequately supported by data on the individual elements (e.g. transportation, lodging, and meals) comprising the build-up of the lump sum amount to be paid based on the circumstances of the particular employee's relocation."

In addition, to ensure that contractors that elect to reimburse employees on a lump-sum basis do not

claim costs for additional, after-the-fact payments to employees whose actual expenses exceed the lump-sum amount, the amended cost principle states that when reimbursement on a lump sum basis is used, any adjustments to reflect actual costs are unallowable.

Contractors who adopt these new provisions should benefit from reduced documentation and record retention requirements.

Depreciation

A final rule that took effect on July 28, 2006 limits allowable depreciation costs for assets that have been reacquired subsequent to a sale-and-leaseback arrangement.

The allowable depreciation costs for the reacquired assets are based on the original acquisition costs of the assets that have since been sold and leased back, and then reacquired.

The new provision ensures

that the Government reimburses a contractor for its continuous use of an asset at no more than its original acquisition costs.

The new depreciation limitation is applicable only to those assets that generated costs in the most recent accounting period prior to reacquisition. The rule does not apply in those situations where a contractor has re-acquired an asset subsequent to the passing of a full accounting

period after the lease is terminated and the contractor ceases use of the asset.

A previous rule that took effect on July 8, 2005, revised FAR 31.205-11 to adjust depreciation (and/or rental costs) for any gain or loss recognized on a sale and leaseback transaction. This ensures the contractor is not harmed nor benefited by having entered into such an arrangement.

Training and Education

FAR 31.205-44 was completely rewritten by a final rule that took effect on October 31, 2005. The changes eliminated several specific limitations on costs of various types of education, as well as the disparate treatment of full-time and part-time education costs.

At the same time, a new "job-relatedness" limitation was added. Previously, there was no requirement that employee education and training be related to the employee's job in order for the costs to be allowable.

The revision retained six

types of expressly unallowable costs: overtime, compensation for attending during working hours, costs for graduate level education after two years, grants, amounts paid to non-employees, and contributions to college savings plans.

SBA Corner – Contracting with the U.S. Government

Successful contracting with the U.S. Government requires an understanding of the Government's unique requirements. Small companies and those just entering the Government contracting arena often do not have the in-house expertise to maximize profits in this environment.

Negotiated procurements, for example, can affect your company for years to come if you don't understand the concept of indirect rates (such as Overhead and G&A) and the consequences of estimating too low. Often we find our clients have not properly developed their indirect rates and, if not corrected, can result in contract losses and restricted growth.

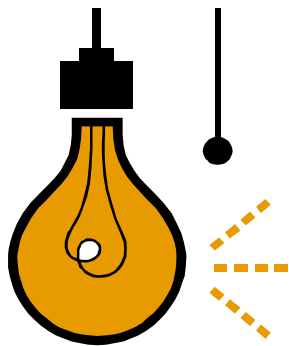
The negotiation process is also critical, not only to maximize the price and profit but to understand the cost impact of specific government terms and conditions and obscure contract requirements.

Contracting officers almost always request DCAA to review proposed costs to assure that the estimates are reasonable and allocable to Government contracts. Interacting with the DCAA auditor is often confusing to accountants and non-accountants not used to the methodology of Government auditors.

After negotiations, requests to change contract terms or performance can have a dramatic financial or legal impact if not adequately addressed. Managing the financial and technical performance of your subcontractors can be complex and challenging.

If your contract is cost reimbursable, you will need to prepare annual incurred cost proposals and be prepared to support it when audited. If you don't understand FAR requirements, the penalties for proposing unallowable costs can be substantial.

If you think you might need assistance in any of these areas, call us to schedule a free consultation.



Keep the Paperwork Flowing

Here's a case where a simple acknowledgement would have preserved a company's ability to stay in the running for a contract.

GSA issued a five year indefinite-delivery, indefinite-quantity solicitation for information technology services.

The RFP advised that proposals would be initially evaluated for acceptability including a review for completeness and adherence to instructions and that any material failure to follow directions, including the omission of a material nature was to result in rejection of the proposal. All offerors were

advised that those who fail the acceptability review would not be considered failure.

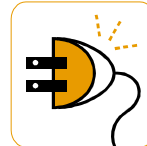
Skyline ULTD, Inc's proposal failed the acceptability review and was rejected from further consideration for award because it failed to acknowledge receipt of a solicitation amendment that the agency considered to be material.

The initial RFP advised offerors that performance of the work could take place in locations subject to designation by the State Department as foreign travel danger areas and the contracting officer was to determine whether or not performance would

continue despite such designation.

Later, the RFP was amended to provide that contractors have an affirmative duty to monitor area status during performance and promptly coordinate with the contracting officer on changes in area status.

Skyline protested the expulsion on the basis that the amendment was not material. In denying the protest, GAO stated that an amendment is material where it imposes legal obligations on the contractor that were not contained in the original solicitation (see GAO decision B-297800.3).



Insurance Costs - General



Government contractors are required by law and regulation to obtain insurance, by purchase or self-coverage, for certain types of perils (for example, workers compensation, employer's liability, general liability, and automotive liability) and in situations when commingling of property, type of operation, ownership or condition of the contract make it necessary to protect the Government (see FAR 28.3).

The regulations also specify the minimum amounts of liability required (see FAR 28.307.2).

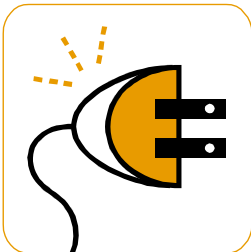
Under cost-reimbursement contracts, before buying insurance under a group insurance plan, the contractor must submit the plan for approval. Contact your contracting officer for specific instructions for obtaining approval.

When provided for in the

contract in accordance with the law, the Government may agree to indemnify a contractor. Also, when specified in the contract, the Government may relieve the contractor of liability for loss of or damage to Government property.

The Government can disapprove the cost of any insurance coverage not in the Government's interest.

Insurance – Purchased and Self Insured



Purchased insurance can usually be obtained from commercial carriers for all types of insurance. Contractors may elect to provide coverage for certain risks from their own resources under a program of self-insurance. Usually a decision to self-insure is based on reduced cost.

All contractors who are self-insured are subject to the provisions of CAS 416, Accounting for Insurance

Costs, regardless of whether they are CAS covered.

Generally, the cost of self insurance (including the cost to administer the program) cannot exceed the cost of purchased insurance. Contractors who use fronting companies and captive insurers are considered self-insured.

Contractors must obtain contracting officer

approval for self-insurance programs when 50 percent of the cost at a segment will be allocated to Government contracts and the amount is expected to exceed \$200 thousand per year.

Self insurance charges for risks of catastrophic losses are unallowable.

Actual losses are unallowable except for nominal deductibles.

Insurance – Allowability Criteria

Self-insurance and purchased insurance costs are subject to certain cost limitations.

The types and extent of coverage shall follow sound business practice, and the rates and premiums shall be

reasonable.

Costs for business interruption or other similar insurance shall be limited to exclude coverage of profit.

The cost of property insurance premiums for coverage in excess of the

acquisition cost of insured assets is subject to special rules (see FAR 31.205-19(e)(2)(iii).

Insurance on Government property is allowable only if the contractor is liable for loss and must exclude premiums for willful

misconduct.

Life insurance on employees are allowable to the extent it represents additional compensation.

Insurance to cover defects in materials and workmanship is unallowable.

Sarbanes-Oxley and DCAA

As a result of the Sarbanes-Oxley Act of 2002, public companies are required to include with their annual SEC filings, (i) a report by management on the company's internal control over financial reporting and (ii) the independent auditor's attestation report on management's assessment of the company's internal controls.

To support the added certification and reporting requirements, these companies and their auditors must perform additional audit effort. DCAA has alerted its auditors to be aware of the potential for reduced audit oversight where Sarbanes-

Oxley audit effort can be reviewed and relied upon to support the adequacy of the various internal control systems that affect costs charged to Government contracts. Auditors are to inquire as to whether contractors are willing to make the data available (CAM 4-202.1.d.).

Some companies have denied DCAA access to Sarbanes-Oxley data on the basis that access is not required under statutory, regulatory, or contractual rights of access.

Notwithstanding this lack of authority, many contractors have chosen to accommodate DCAA's request. There are, of

course, advantages to maintaining a cooperative working relationship with DCAA but there are also risks in granting DCAA access to that which it is otherwise entitled. For example, self-critical analysis can be disclosed to the PCAOB without loss of "privilege". That privilege would be waived however if it were disclosed to DCAA

Contractors should develop policies in advance for the extent of audit access it will grant to DCAA. Abrupt changes in positions will likely raise suspicions, even if the company is not trying to hide anything.



*Granting DCAA
"...access is not
required under
statutory,
regulatory, or
contractual rights
of access"*

Compensation Arising from Stock Options

FAS 123(R) issued by the Financial Accounting Standards Board requires companies to recognize the compensation cost of share-based payments (stock options) on their financial statements. Until now, companies were not required to expense the cost of stock options, giving them the ability to provide employee compensation without recording it on their financial statements. Now companies are required to report as compensation, the fair market value on the grant date. FAS 123(R) provides for a number of ways to determine the fair market value of the options.

Thankfully, FAS 123(R) applies only to financial reporting and has no effect on the measurement and allowability of the cost of stock options charged to Government contracts.

For Government contracts, the cost of stock options is covered in CAS 415 for CAS covered contractors and FAR 31.205-6(k) for all other contractors. (FAR 31.205-6(k) incorporates CAS 415 so for all intents and purposes, the requirements are the same).

Under CAS and FAR, we don't have to determine the fair value of the stock option. We only have to measure the difference

between the fair market value of the stock and the option's exercise price at the measurement date.

Generally, companies award stock options at a price that is equal to or higher than the market price of the stock on the measurement date. Under those circumstances there would be no compensation cost resulting from stock options awarded to employees allocable to Government contracts. If the option price is set lower than the stock's fair market value, the difference would be allowable (subject to other provisions of FAR 31.205-6).

*There is a
difference
between
financial
reporting and
government
costing*



"The easiest way to find these rates is to visit GSA's "per diem" website. ..."

Smart Stops on the Web

Domestic Per Diem Rates www.gsa.gov/perdiem

FAR 31.205-46 states that allowable costs for lodging, meals, and incidental expenses are allowable to the extent they do not exceed, on a daily basis, the maximum per diem rates in effect at the time of travel as set forth in the Federal Travel Regulations (FTR).

The easiest way to find these rates is to visit GSA's "per diem" website. There you will find not only current per diem rates but historical rates back to 1997 (useful for preparing incurred cost claims). In addition, the site contains links to rates for Hawaii, Alaska, and overseas locations.

The rates for fiscal year 2007 are now posted as

well. These will be useful for estimating future travel costs.

To determine allowable per diem rates, you simply click on a state and a listing appears of all rates within the state.

The FTR rates are also available as an Excel download on this site.

Interesting Software- SourceLink

PNWC does not endorse or recommend products. However, from time to time, we come across software, that may provide value to our clients.

SourceLink is a program that adds document management features to QuickBooks. It gives you the ability to easily file, retrieve and organize your source documents associated with each

QuickBooks record!

You can attach, detach, and view linked documents in QuickBooks with a click of the mouse — the process of linking documents is as simple as adding an attachment to an e-mail. Just click and link files already stored on your computer or scan additional files directly into SourceLink.

SourceLink can also be used to easily attach electronic sticky notes to your QuickBooks records. This helps you keep track and stay on top of the issues associated with each QuickBooks record.

Prices start at \$189 for a single user. Visit <http://personable.com/Default.asp> for more information.

Need Training?

PNWC provides specialized training in a variety of government contracting areas. Our standard training modules generally take 3 to 4 hours while our extended training modules are designed for two days. Both qualify for CPE. PNWC's training modules include:

Truth in Negotiations (TINA)

FAR Allowable Costs

Billing Systems

Labor Systems (includes Timekeeping)

Estimating Systems

Ethics for Government Contractors

Terminations and Claims

PNWC can modify any of these packages or develop additional training modules to fit your specific needs.

Please contact training@pacificnwc.com



TINA – Certification Requirements & SWEEPS

This is the third article in our series on TINA. In previous articles, we discussed the characteristics of cost or pricing data, adequate submission and disclosure. In this article, we discuss the Government's certification requirements and the use of "SWEEPS" to help avoid the potential for defective pricing.

FAR 15.403-4(b) generally requires contractors to certify that their cost or pricing data are current, complete, and accurate as of the date of agreement on price or another mutually agreeable date that is as close as practical to the date of agreement on price. These certifications apply to factual data. They do not apply to the accuracy of judgments but do apply to the accuracy of data upon which the judgments are based.

FAR also points out that a contractor's responsibility to provide current, accurate, and complete cost or pricing data is not negated by lack of personal knowledge of the negotiator and that the government and contractor should try to reach prior agreement on criteria for cut-off dates if the date of agreement on price is not used.

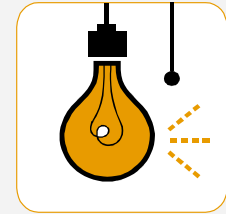
To help ensure that all cost or pricing data gets to the negotiating table, many contractors use a "sweep" process. A "sweep" is a process whereby the contractor, after the tentative agreement on price but prior to certifying its cost or pricing data, makes one last search of its records to ensure that all cost or pricing data were submitted to the Government. Any new or updated data disclosed during the "sweep" is

provided to the contracting officer who will then have the opportunity to adjust the contract price – thus averting a potential defective pricing situation.

The use of "sweeps" is not addressed in FAR but its use is common enough for DoD to issue a policy instructing contracting officer to reflect "sweep" data in the price negotiation memorandum and note the extent to which they relied on the sweep data in establishing the contract price.

Understanding and complying with TINA is imperative to avoiding defective pricing allegations. The use of "sweeps" is one tool we encourage contractors to use to help avoid those situations.

For more information, email Nuzzo@pacificnwc.com



After agreeing to a price but before signing the certification, contractors should make one final search of its record to ensure all factual data was submitted to the Government.

Travel Costs – Required Documentation

It is well known that allowable costs for lodging, meals and incidental services under government contracts is limited to Federal Travel Regulations (FTR) prescribed by GSA for travel in the contiguous United States and Joint Travel Regulations (JTR) prescribed by DoD for overseas travel including Alaska and Hawaii (For easy access to these rates, see Smart Stops on the Web on Page 6).

What is not as well known is the documentation requirement necessary for any travel costs to be allowable.

FAR 31.205-46(a)(7) states that travel costs shall be allowable only if the following information is documented; (i) date and place of the expense, (ii) purpose of the trip; and (iii) name of person on trip and that person's title or relationship to the contractor.

Many contractors fail to maintain documentation and auditors are quick to sense this. Attempting to recreate it several years after the fact is time-consuming at best and sometimes not possible.

To avoid future problems, you should examine your travel policies and procedures to ensure that the required documentation is captured and maintained.



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Bill Vermie hiking near Leavenworth at the 6,000 foot level.

Pacific Northwest Consultants, LLC

PNWC is dedicated to providing Government contract consulting, litigation support, and training services. We provide affordable consulting and training services to help Government contractors grow their business, increase profits, and comply with

Government contracting rules and regulations.

PNWC's consulting and training services include forward pricing, incurred cost, terminations and equitable adjustments, cost accounting standards and defective pricing allegations. We assist in developing

adequate internal control systems and company-wide ethics programs.

PNWC staff has extensive teaching experience. They have developed and presented training classes covering all aspects of Government contracting.

Meet our Staff

Bill Vermie is a Vietnam veteran and a 1973 graduate of Drake University with a degree in Accounting. Aside from his 30 plus years with the Defense Contract Audit Agency, Bill has worked for

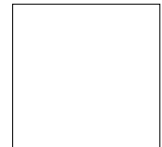
non-profit organizations and provided free tax preparation assistance to the economically disadvantaged.

Bill is a specialist in management information

systems and holds a Six-Sigma Black belt in process improvements.

Bill is also a part-time accounting faculty at Highline Community College.

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