

Pacific Northwest Consultants, LLC

Special Interest Articles

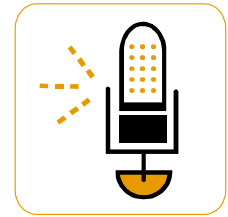
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Earned Value Management Systems

Effective October 1, 2006, FAR requires the use of EVMS for major acquisitions for development and other acquisitions when required by agency procedures. DoD and NASA call for EVMS on contracts over \$20 million. DOE established a lower threshold at \$5 million. For contracts under these thresholds, it is up to the discretion of the Government Program Office as to whether EVM will be required. The decision must be based on a cost/benefit analysis that compares the cost of implementation

with whatever benefits may be derived.

Companies without an EVM system will not be eliminated from consideration for contract award provided they submit an EVMS implementation plan with their proposal.

Earned Value Management (EVM) is a program management tool that integrates the technical, cost, and schedule parameters of a contract. During the planning phase, an integrated baseline is

developed by time phasing budget resources for defined work. As work is performed and measured against the baseline, the corresponding budget value is “earned”. From this earned value metric, cost and schedule variances can be determined and analyzed. From these basic variance measurements, the program manager can identify significant drivers, forecast future cost and schedule performance and construct corrective action plans to get programs back on track, if necessary.

EVMS Guidelines

EVMS guidelines have been published as ANSI/EIA-748. The DoD formally adopted these standards in 1998 for application to major defense acquisition programs. There are 32 guidelines under five broad areas: organization, planning, scheduling and budgeting, accounting considerations, analysis and management reports and revisions and data maintenance.

In designing, implementing and improving an EVM system, the objective should always be to do what makes sense. Government contractors have

flexibility under the guidelines approach to develop a system most suited to management needs. This approach allows contractors to use EVM systems of their choice, provided they meet the intent of the guidelines. Contractors are encouraged to establish and maintain innovative, cost effective processes, and to improve them continuously.

Since ANSI/EIA-748 was published, the cost of implementing EVMS is considered part of the normal management costs that would have been incurred

in any case and therefore the government will not directly reimburse contractors for the implementation cost (these costs are still valid indirect expenses). However, improper implementation and maintenance may create an unnecessary financial burden on the contractor and the government.

If you need to implement an EVM system, we recommend you first contact the publishers of your accounting software. Most mainstream providers have an EVM solution.



Contracts subject to modified CAS coverage must comply with Standards 401, 402, 403, and 404.

Modified CAS Coverage

In our last newsletter, we discussed the various thresholds for CAS coverage. In this issue, we will discuss CAS standards that are applicable to contracts subject to "modified" CAS coverage; CAS 401, 402, 405, and 406. Modified CAS coverage is triggered by a contract between \$7.5 and \$50 million or the sum of contracts falling within that range awarded in the preceding year. In the next

issue, we will discuss the additional standards that are applicable to "full" CAS coverage and in a later issue we will discuss the CAS standards that are applicable to contracts that are not CAS covered - yes, that's right, some CAS standards are applicable to contracts that are exempt from CAS.

Companies should not fret over the prospect of becoming CAS covered -

either modified or fully. CAS simply builds on GAAP (Generally Accepted Accounting Practices) which already serve as the basis for the accounting systems used by Government contractors. For example, GAAP requires accountants to maintain records by accounting period. CAS 406, Cost Accounting Period prescribes that the accounting period be one year, except in certain limited situations.

CAS 401 and 402 - Consistency

CAS 401 – Consistency in Estimating, Accumulating and Reporting Costs. Practices used in estimating costs in pricing a proposal shall be consistent with the cost accounting practices used in accumulating and reporting costs and vice versa. For example, a contractor who estimates average engineering direct labor rates by labor category and records manufacturing direct labor based on actual cost for each individual and collects such costs by labor category complies with this standard. Costs are

estimated and accumulated at the same level, at the labor category level. However, a contractor who estimates engineering labor by cost function (i.e. drafting, mfg, etc) but accumulates total engineering labor in one undifferentiated account is not in compliance.

CAS 402 – Consistency in Allocating Costs Incurred for the Same Purpose. All costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives. No final

cost objective (e.g. a contract) shall have allocated to it as an indirect cost any 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. Further, no final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that or any other final cost objective.

CAS 405 and 406 – Accounting Systems

CAS 405 – Accounting for Unallowable Costs. Costs expressly unallowable or mutually agreed to be unallowable shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. The detail and depth of records must be adequate to establish and maintain visibility of identi-

fied unallowable costs. Contractors have wide latitude in how to satisfy the "visibility" requirement so long as it permits audit verification of the accounting recognition given unallowable costs.

CAS 406 – Cost Accounting Period. The purpose of this standard is to provide criteria

for selecting the time periods to be used as cost accounting periods for accumulating and reporting costs. The cost accounting period used by a contractor must be either its fiscal year or a fixed annual period other than its fiscal year if agreed to by the government.

Random Musings

The Professional Services Council recently published the results of their biennial survey of federal procurement officials. They conclude that federal procurement is under a more powerful microscope than ever before and that tension is heightened by a clear sense of the large and growing chasm between the acquisition and oversight communities. See www.pscouncil.org for the full report.

Oh yes, and in November, the Government Accountability Office (GAO) called on Congress to increase its oversight of government wide acquisition and contracting issues. See <http://www.gao.gov/new.items/d07235r.pdf> for that report.

Someone once said that the sure cure for insomnia is to call the accountant's hotline and have someone explain depreciation.

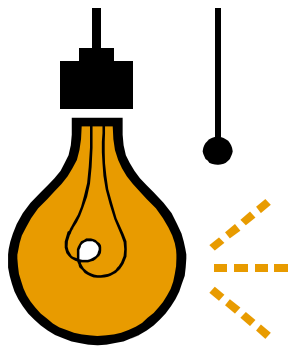
In November, the Justice Department announced that it had recovered a record \$3.1 billion in fraud and false claims in fiscal year 2006. Of this amount, \$1.8 billion re-

sulted from suits brought by whistle blowers under the False Claims Act's qui tam provisions. 72 percent of the recoveries were in the health care industry.

IRS announced its 2007 standard mileage rates. The rate for use of a car, van, pickup, or panel truck is 48.5 cents per mile (20 cents for medical or moving and 14 cents for charity).

Following an 18 month review, the Acquisition Advisory Panel released a draft of its final report recommending steps for improving competition and accountability in the procurement system. They think the government should increase the use of commercial practices (ho hum).

The incoming chairman of the House Armed Services Committee (Skelton, D-Mo) said that making the Defense Department's acquisition system work "much much better" is the committee's strategic priority when the new Congress convenes in January (double ho hum).



Incurring Cost Proposals

For contractors with cost reimbursable contracts and fiscal years ending December 31st, the June 30th deadline for submitting annual incurred cost proposals will be here before you know it. DCAA has developed "ICE" (Incurred Cost Electronically), an electronic version of the Model Incurred Cost Proposal found in Chapter 6 of DCAAP 7641.90. ICE provides contractors with a standard (not to) user-friendly submission package that will assist them in preparing adequate incurred cost proposals in accordance with FAR 52.216-7, "Allowable Cost and Payment." This tool can be downloaded free from DCAA's website,

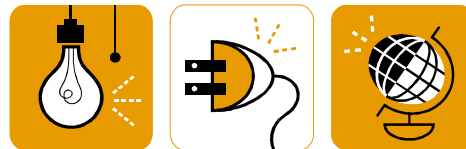
<http://www.dcaa.mil/>.

Our staff has extensive experience in working with ICE and can assist you in preparing and supporting an adequate claim. We can help ensure that all allowable, allocable, and reasonable costs are considered and can help avoid pitfalls caused by inadvertently including unallowable costs in your submission to the government.

Timely submission of your annual incurred cost proposal is not only critical to the annual settlement of your incurred costs on flexibly-priced contracts, but is also a high priority with DCAA and the ACO com-

munity. DCAA has an initiative to have all contractors "current with their submission of incurred cost proposals. DCAA has an additional initiative to have all contractors submit their incurred cost proposals electronically.

Failure to timely submit an adequate incurred cost proposal could result in a government unilateral indirect cost rate determination. Unilateral rates are usually set low enough to protect the government's interest. Avoid this potential unwanted action by ensuring timely submission of an adequate incurred cost proposal.



Pension Protection Act (PPA) of 2006



Hoping to avert taxpayer bailout of failed pension plans, the President signed the PPA of 2006 into law last August.

In order to strengthen traditional plans, the PPA will require significant funding changes to contractor defined benefit pension plans for plan years beginning after 2007.

The PPA changes the rules for computing minimum and

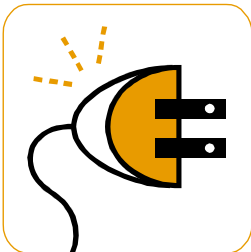
maximum pension contributions.

The minimum contribution requires the use of an interest rate assumption based on the corporate bond rates of return (instead of the usually arbitrary expected return of pension assets) and a seven year amortization period for unfunded pension liabilities (instead of the current 10 to 30 year amortization period)

The PPA permits employers to make additional contributions up to 150 percent of a plan's funding target. This will allow employers to make generous contributions during good economic times and improve worker and retiree retirement security.

These funding changes are expected to significantly increase the amount of required pension contributions.

PPA of 2006 – DoD Guidance



The CAS rules governing the measurement, assignment and allocation of pension costs have not been changed to consider the requirements of PPA. In October, the Director, Defense Procurement and Acquisition Policy (DPAP) stated that it was working with the services, DCAA and DCMA to determine the full impact of the legislation on forward pricing rates and contract pricing. Until guidance is issued, DPAP is requiring

contracting officers to coordinate with the HQ organizations before including any impacts in contract prices for changes resulting from the PPA.

If your company is impacted by the minimum funding requirements, you need to quickly assess the impact on your forward pricing and billing rates – particularly for work to be performed after 2007. Most likely, you will need to en-

gage your actuaries to help make that assessment. Those increases will then need to be incorporated into your indirect rate forecasts. You should notify your contracting officers and or program offices of the impact to their programs. In some cases, they will need to acquire additional funding to cover the impact. For more information, contact Paul Cederwall at 206-508-1849 or Cederwall@pacificnwc.com.

PPA of 2006 – Some Good News

The PPA extends a number of retirement savings and 529 plan opportunities that were scheduled to sunset at the end of 2010 and create new opportunities for savers. Among those expiring provisions that have been made permanent are: (i) permanent

increased contribution limits to IRAs and 401(k)s, (ii) permanent catch-up contributions for those age 50 and older, and (iii) permanent tax-exempt status for 529 college savings plans.

Among the new provisions are: (i) automatic enroll-

ment in company 401(k) plans (employees who do not want to participate must affirmatively opt-out), (ii) authority for 401(k) and IRA providers to offer personalized investment advice to account holders, (iii) the ability to have the IRS to deposit tax refunds di-

rectly into an IRA, and (iv) direct rollovers from retirement plans (including qualified retirement plans, tax-sheltered annuities, or governmental plan) to Roth IRAs.

Is your Offsite Location a CAS Segment?

A "segment" for CAS purposes is defined in CAS 410-30(a)(7) as one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service.

Recently, DCAA initiated a project to determine whether contractor offsite locations were segments and if so, whether their failure to identify offsite location as segments resulted in a material misallocation of costs to cost objectives.

"Offsite" locations are separate geographic locations that are not considered by contractors to be segments

for CAS purposes but are part of other CAS segments.

According to DCAA, there are a number of attributes to consider in determining whether offsites should be considered segments;

Is the location responsible for submitting a Disclosure Statement?

Does the location have profit or loss responsibility?

Does the location have responsibility for a G&A pool?

Are management personnel at this location responsible for the overall management and operation of the location?

Does the location report to a

home office, intermediate home office or other segment?

Does this location submit and certify an incurred cost submission?

Does the location allocate G&A expenses to other contractor business units or locations?

Is the location fully or partially responsible for pricing contracts and submitting price proposals?

We recommend that you use these attributes to assess whether your "offsite" locations may indeed be a "segment" within the CAS definition.



Testing for the proper identification of CAS segments should become routine.

"Roll Forwards"

"Roll Forward" is the practice of authorizing contractors to transfer disputed or questioned costs from the accounting period in which they were properly recorded to a subsequent period.

Contracting Officers and contractors are often frustrated by the fact that at the end of each fiscal year they must reach agreement on all material elements of overhead costs, and until they do so it is difficult or impossible to close out cost-reimbursement contracts. When it takes extended time to resolve select areas of costs, they seek ways to

resolve the overall overhead rates for the year without either settling the difficult or disputed areas in that year, or waiving their rights to continue to disagree. So, the roll-forward concept was devised as a method of deferring a decision on a given cost to a future year while still closing out contracts.

Recently, however, DCMA (Defense Contract Management Agency) issued guidance to put a stop to this practice. DCMA reasoned that the practice is not consistent with applicable cost accounting requirements and therefore should not be followed. In issuing the guidance,

DCMA recommended some alternative techniques to employ where appropriate. These include:

Use "quick closeout" as authorized by FAR 42.708

Submit questions about allowability to subject-matter experts early.

Issue a Notice of Intent to Disallow Costs as early as possible

Execute advance agreements designed to help in proper classification of costs.

DCMA moves to limit the use of "roll-forward" agreements.



The site "contains a wealth of information to help companies make wise decisions in their IT investments. ..."

Smart Stops on the Web

CPA Technology Advisor
cpatechnologyadvisor.com/

This companion website to the magazine by the same name is not just for CPAs. It contains a wealth of information to help companies make wise decisions in their IT investments – especially accounting and related systems.

The site has comparative

reviews and buyers guides for small business accounting solutions as well as for mid-range and high end. There are comparative reviews of construction accounting packages, fixed asset management systems and those tailored for specific industries like manufacturing, non-profits, service, professional, etc.

In addition to the reviews,

the site also contains "how-to" articles and advice on how to get the most out of your existing software. Recent articles include disaster recovery and business continuity coverage. Much of the editorial content of printed magazine is reproduced on the website as well.

Interesting Software – DS FreeTime

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

Digisoft Solutions announced the official release of a new product, DS FreeTime, a web-based, DCAA compliant time accounting system. The cool thing about this product is that it "is FREE to use for-

ever, no strings attached."

We haven't seen this product in operation nor have we had a chance to evaluate it. We like its feature set and we really like the "free" part.

The web-based feature mirrors a growing trend in web-based applications and makes it suitable in any environment where most employees have ready

access to the web.

Among its time accounting features are the ability to enter, submit and approve labor charges, control direct charges through work authorizations, conduct floor checks, and track paid time off.

Go to <http://www.digisoft-solutions.com/> for more information. If you try it, give us your comments.

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 one and two days. Our training qualifies for CPE in most states. PNWC's training modules include:

Truth in Negotiations (TINA)

FAR Allowable Costs

Billing Systems

Labor Systems (includes Timekeeping)

Estimating Systems

Ethics for Government Con-

tractors

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 – DCAA Postaward Audits

This is the fourth article in our series on TINA. In previous articles, we discussed the characteristics of cost or pricing data, adequate submission and disclosure, certification requirements and the use of "SWEEPS" to help avoid the potential for defective pricing. In this issue, we explore DCAA's postaward audit program, the burden of proof in establishing defective pricing and consequences for the contractor.

DCAA's postaward audit objective is to determine if the negotiated contract price on a TINA covered pricing action was increased by defective pricing, that is, where the cost or pricing data submitted by the contractor to the government was not current, accurate, and complete prior to reaching a final agreement on price.. DCAA will examine and analyze records and data

available as of the price agreement date and compare that with data that was submitted.

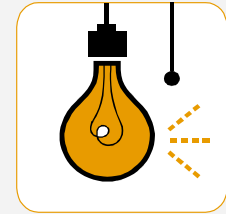
In order to allege defective pricing, DCAA must establish five things.

1. The information in question fits the definition of cost or pricing data.
2. It existed and were reasonably available to the contractor before the agreement on price.
3. It was not submitted or disclosed to the contracting officer (or contracting officer representative) and these individuals did not otherwise have actual knowledge of the data or its

significance on the proposal.

4. The government relied on the defective data in negotiating with the contractor
5. The government's reliance on the defective data caused an increase in the contract price (the "legal" theory of "natural and probable consequences" generally places this burden on the contractor to prove otherwise).

DCAA does not have the responsibility or authority to make a final determination of defective pricing. DCAA only makes recommendations to the contracting officer.



DCAA's postaward audit objective is to determine if the negotiated contract price on a TINA covered pricing action was increased by defective pricing submitted to the Government.

TINA - Consequences

If a contractor is found to have submitted defective pricing, there are a number of consequences.

First, the contract price (including profit or fee) will be reduced.

Second, penalties could be assessed. The FY86 Defense Authorization Act provides for a penalty equal to the impact of the defective pricing if the contractor knowingly submitted cost or pricing data that were in-

complete, inaccurate, or not current.

Thirdly, the government is entitled to recover interest on any overpayment caused by the defective pricing. Interest will continue to accrue until resolution so it is in the best interest of the contractor to resolve any defective pricing allegations as quickly as possible.

Forth, depending on the nature of the defective

pricing, DCAA or the contracting officer may submit a "fraud" referral to an investigative agency.

Finally, positive defective pricing will result in increased DCAA oversight.

Dealing with DCAA defective pricing allegations can be complex and costly. If you have any questions and or require assistance, please contact Terry Nuzzo at Nuzzo@pacificnwc.com.

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From left, Ron Sabado, Paul Cederwall, Bill Vermie, and Terry Nuzzo.

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

Paul Cederwall holds a Bachelor's degree in Business Administration from California Polytechnic State University in San Luis Obispo and a Masters in Administration from Central Michigan University. In his 32

years with DCAA, he held a variety of technical and managerial positions.

Paul teaches Cost Accounting at Central Washington University and holds a QuickBooks Certified Pro

Advisor designation.

In his spare time, Paul enjoys bicycling, camping, hiking, and other family activities.

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