



A Tale of Two Court Cases: CAS 418 and State Income Taxes

This past month, decisions on two court cases affecting allocability and allowability of costs were handed down. The following is a brief on each:

Using One Overhead Pool Violates CAS 418: AM General LLC

The ASBCA rendered a decision involving the use of one overhead pool for allocation of costs to both Government and commercial products of the same type. The case involved the allocation of overhead costs to a line of Army procured High Mobility Multipurpose Wheeled Vehicles, which are also produced commercially.

The court deemed the use of a single manufacturing overhead pool as non-compliant with CAS 418-40(b) since the pool represented activities that did not have “the same or similar beneficial or causal relationship to cost objectives”. In other words, the pool was not “homogeneous” in nature when allocating those costs to both contracts of a commercial vs. a Government nature.

The decision largely focused on the fact that the pool included cost for a building that benefited only commercial products, and the value of this building equated to eleven percent of the total pool costs. Consequently, the ASBCA determined that allocation of costs via a single overhead pool, inclusive of significant amounts only serving the commercial products, contravened the intent of CAS 418.



Although not explicit, the decision suggests that two manufacturing overhead cost centers should have been in place--one for commercial and one for Government work.

The Government has calculated a cost impact of \$23.8 million resulting from the non-compliance and demanded payment of this amount.

State Income Taxes on S Corp: Latest Decision – Unallowable

The U.S. Court of Appeals for the Federal Circuit ruled that state income taxes, billed under a reimbursable Government contract, for subchapter S corporations are unallowable, per provisions of FAR 31.205-41. This decision surprisingly reverses an earlier decision issued about 3 years ago where such costs were deemed allowable.

The case involved a cost reimbursable contract awarded to a Maryland company, Information Systems and Networks Corporation, in which state income taxes were allocated to the contract. The State of Maryland allows a subchapter S corporation to avoid tax liabilities for state

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income taxes, since the shareholders are individually responsible for those taxes.

Provisions of FAR 31.205-41(b) states in part that “taxes from which the contracting entity is exempt are not allowable costs.” The court therefore deemed that because the entity is exempt from the state income tax liability, the contractor cannot pass on such costs to the Government. Essentially, the case deems that the tax liability borne by the individual shareholders does not make these allowable costs of the contractor.

Since the court decision is new, the specific application of the ruling to individual S Corp Government contractors is yet to be determined.

Increase in CAS Thresholds Under Fire

The Project on Government Oversight (POGO) group has opened fire on proposed adjustments to Cost Accounting Standards thresholds. If proposed changes were implemented, CAS applicability thresholds would increase as follows:

Trigger contract:	\$8.5 million
Contracts awarded after trigger contract:	\$550,000
Disclosure Statement filing:	\$56.5 million

The watchdog group complains that elevating the existing threshold is unreasonable and will lower the number of Government contractors required to follow these guidelines. Consequently, the general public will be more at risk of paying unreasonable costs for contractor services and products.

The proposed increase in CAS thresholds largely represents adjustments in inflationary trends, according to the CAS Board. POGO's main complaint is that the historical increases in thresholds, as well as the current proposed adjustments, far exceed any annual escalation trends.

CAS Board Proposed Exemption for T&M/LH Contracts for Commercial Items

The Cost Accounting Standards Board has proposed exemption status for time and material and labor hour contracts for commercial items.

The rule, if adopted, would effectively alleviate the requirement of CAS coverage on flexibly-priced contracts, when such contracts provided for services of a commercial nature. Commercially awarded contracts of a FFP nature are currently exempt, primarily because such awards are deemed based on adequate price competition, and do not require the submission of cost or pricing data.

Timely Submission of Incurred Cost Proposals: Don't wait until the last minute!

You've heard it from us before in prior newsletters. And we continuously remind our clients via telephone discussions and emails.

If you are required to submit an incurred cost submission, you have six months after the end of your fiscal year to have an adequate proposal in the hands of DCAA and the ACO. Thus, if your FY ended 12/31/2005, the final deadline for submission is 6/30/2005.

Preparing an adequate submission requires a pro-active attitude and knowledgeable staff as to the information and format required for this presentation.

Information as to the format and general types of data required can be found in the DCAA Information for Contractors guide. Go to the DCAA website for this guide, www.dcaa.mil. DCAA also provides an electronic model (ICES) that may be used for this presentation, although other electronic spreadsheet presentations are acceptable.

If your proposal is due 6/30, then you should have already begun the process of gathering necessary information, and have anointed an employee (or consultant) with this responsibility.

Government Compliance Training

Federal Publications Seminars Course

Government Contract Accounting System Compliance

Dates:

May 17-18, Washington D.C.

Course Instructors:

Darryl Walker and Scott Butler

For more information, go to www.fedpubseminars.com, and click on the Government Contracts tab.

Beason & Nalley, Inc. will develop and provide specialized Government contracts compliance training for client/contractor audiences. Topics on which we can provide training include estimating

systems, FAR Part 31 Cost Principles, TINA and defective pricing, cost accounting system requirements, and basics of Cost Accounting Standards, just to name a few. If you have an interest in training, with educational needs specific to your company, please contact Ms. Sandra Baker at sbaker@beasonnalley.com, or at 256-533-1720.



Future Newsletter Editions

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