

## CONTRACT COST ACCOUNTING

No aspect of Government contracting differs more materially from commercial norms than the cost accounting principles with which contractors must comply. The reimbursement of costs in connection with "flexibly-priced" and cost reimbursement Government contracts is subject to a startling array of extraordinarily complex rules, many of which are wholly inconsistent with customary commercial practice. The process starts with three deceptively simple, basic preconditions to reimbursability – "allowability," "allocability" and "reasonableness" – principles with respect to which volumes of cases have been litigated. On top of these basic rules, the Government then proceeds to levy upon contractors some 52 separate and specific "Cost Principles," dealing in sometimes minute detail with everything from such Government contracts-peculiar issues as IR&D, B&P, and Manufacturing & Production Engineering costs to everyday issues such as pension costs, employee compensation and relocation, facility costs, interest, advertising, alcoholic beverages and cafeteria expense. If a company is fortunate enough to secure sufficient flexibly priced business, it will also be required to structure its accounting system so that its measurement of costs, its allocation of costs to "cost objectives" and its assignment of costs to cost accounting periods comply with anywhere from four to twenty Cost Accounting Standards.

Additionally, in negotiating certain types of contracts, the Government requires "Truth in Negotiations." This means that the Contractor must disclose – and certify – the "cost or pricing data" relating to those negotiations. If the data ultimately prove not to have been "current, accurate and complete," then the contract has been "defectively priced" and the Government has the right to reduce the contract price, irrespective of whether the contractor made any profit at all in performance.

To enforce its rights in this area, the Government has created a vast infrastructure of contracting officers of all kinds – PCOs, ACOs, TCOs – administrators, auditors, investigators and lawyers, some of whom have carefully delineated lines of authority, some of whom have an unlimited charter. They come armed with an array of enforcement tools – multiple audit rights, threatened and actual disallowances, unilateral indirect rate determination prerogatives, subpoenas, civil investigative demands, search warrants, and the False Claims Act. The qui tam provisions of the FCA are designed to enlist the contractor's employees in the Government's investigative army, offering successful "whistleblowers" a significant share of any Government recovery. The recent Sarbanes-Oxley initiatives only heighten the risks associated with potentially erroneous accounting in this Byzantine realm.

### The Sheppard Mullin Difference

The rules and regulations governing Government contract cost accounting form a veritable labyrinth that is difficult, if not impossible, for the uninitiated to navigate. Sheppard Mullin attorneys negotiate this course on a daily basis for the Firm's clients. Among the services that we provide to our clients in this area are:

- Counseling with respect to the classification and treatment of costs under virtually every one of the 52 Cost Principles and each of the 20 Cost Accounting Standards
- Assistance in the establishment of compliant cost accounting systems
- Assistance in the drafting of Cost Accounting Standards Disclosure Statements and in the preparation of "cost impact statements" relating to "changes in cost accounting practices"
- Providing advice and assistance to clients regarding the requirements of the Truth in Negotiations Act
- Responding to Government audit findings and negotiating the resolution of audit issues of all kinds, e.g., defective pricing, final indirect rate claims, CAS noncompliances
- Assistance in the quantification of claims for equitable adjustments
- Termination accounting
- Defending Government claims and prosecuting Contractor claims to maximize cost recovery, including court and board litigation as well as ADR
- Defense of False Claims Act allegations, whether brought by the Government or qui tam relators, relating to cost accounting issues