

Project Control Essentials: Accounting for Project Risk and Proper Cost Management



Redstone
Government Consulting

Helping You Navigate the Maze of Government Contracting

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- Mary Beth Jackson is a Director with Redstone GCI and brings over 30-years of experience and subject matter expertise to our team. She is an experienced industry veteran with a combination of direct experience working for the government, extensive industry experience in large accounting, IT and compliance organizations, as well as experience providing consulting services for many of the largest government contractors. Her combination of experience in senior-level accounting, compliance and IT roles provides for a wealth of background experience and knowledge in regulation (FAR, CAS, DFARS, and other agency supplements), Sarbanes-Oxley, NIST IT and Information Security and many other areas. She frequently assists our clients with strategic initiatives within the accounting, finance, IT and compliance areas include assessment of internal control design and effectiveness, evaluation of DFARS Business Systems, M&A support and post-acquisition integration, and other projects uniquely suited to her background and experience.



Heather Stroud

Managing Costpoint Consultant

- 15+ Years Government Contracting Experience
 - Program control
 - Financial analysis and forecasting
 - Government cost accounting
 - Procurement
- Heather is a Managing Costpoint Consultant with Redstone Government Consulting, Inc. Her areas of expertise include supporting government contractors in the implementation and operation of Costpoint, assisting with employee training, and providing outsourced accounting services, including program control deliverables, financial analysis, forecasting, general ledger, unbilled analysis, reconciliation, accounts payable, accounts receivable, payroll, and payroll taxes. Heather specializes in best accounting practices, from setup and training to monthly processing.

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Our Focus



Accounting for Project Risk

Proper Cost Management

Learning Objectives



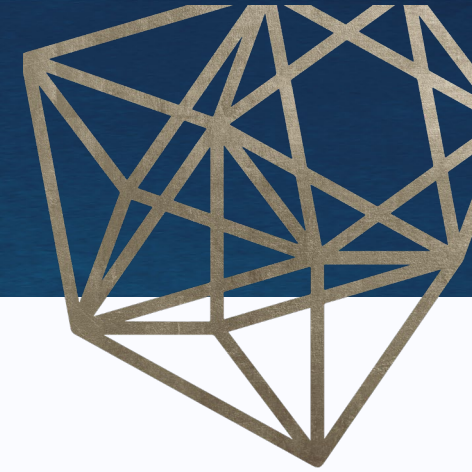
- **Understand Areas of Contract Performance Risk**
- **How to Mitigate Contract Performance Risk**
- **Best Practices for Monitoring Contract Costs**
- **Limitations of Costs/Funds Requirements**
- **Understanding Type of Contract Ceilings**
- **Understanding the Rate Adjustment Process**
- **Project Budgeting**
- **EAC Tracking**

Areas of Contract Performance Risk



- **Precontract Costs**
- **Unallowable Costs/Unbillable Costs**
- **Post Contract Costs**
- **T&M Risk**

Precontract Costs



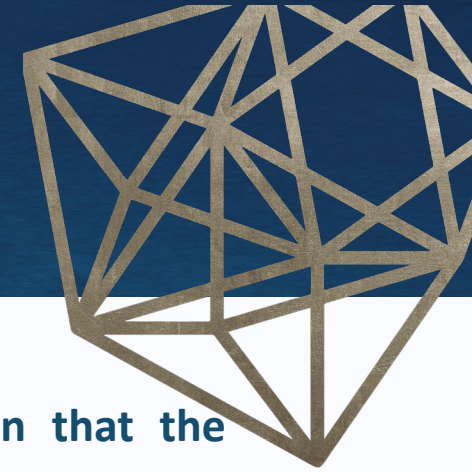
- **FAR 31.205-32**
 - Precontract costs means costs incurred **before** the effective date of the contract directly pursuant to the negotiation and in **anticipation** of the contract award when such incurrence is necessary to **comply with the proposed contract delivery schedule**. These costs are allowable to the extent that they would have been allowable if incurred after the date of the contract (see 31.109).
- **Applies to labor, materials, subcontractor costs, preproduction costs, etc.**
- **Only allowable to the extent they would be allowable if incurred after the date of contract. If unallowable after then unallowable before.**

Precontract Costs



- **What does that reference to 31.109 mean?**
 - FAR 31.109 refers to Advance Agreements which is where the contractor and the government enter into an agreement that establishes the treatment of certain costs.
 - Advance Agreements are not required to establish the allowability of precontract costs.
 - Having an Advance Agreement may be helpful in terms of avoiding disputes or audit findings but is not a requirement.

Precontract Costs - Allowability



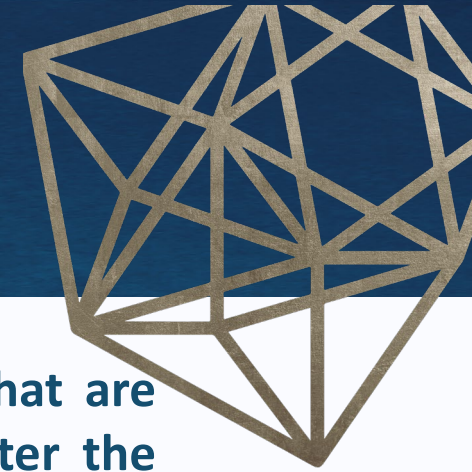
1. Be incurred “directly pursuant to” contract negotiations. We interpret that to mean that the contractor must disclose its early start to government negotiators, and they must not prohibit the early start.
2. In anticipation of the contract award. We interpret that to mean that both parties must believe that the contractor will receive an award. A contractor cannot simply start work based on submitting a proposal; there must be a clear indication that the contractor will be the winning offeror and the government anticipates giving that contractor a contract.
3. Must be necessary to comply with the proposed delivery schedule. The costs must be shown to be related to the proposed delivery schedule, such that, without being incurred, the proposed delivery schedule cannot be met.
4. The cost must be allowable. In other words, a contractor cannot make an unallowable cost allowable by calling it a precontract costs.

Unallowable/Unbillable Costs



- **Project Costs may be Unallowable per FAR 31.205 Cost Principles but still be a direct project cost**
- **Project Costs may be Unbillable per the Contract but still be a direct project cost**
- **Unallowable and Unbillable Costs should be included in the base of any indirect cost pools**
- **Unallowable or Unbillable Cost are NOT Overhead or G&A costs just because they are not allowable to be billed to the Customer**

Post Contract Cost



DCAA incurred cost audit procedures require auditors to examine claimed costs that are outside a contract's period of performance. According to DCAA, costs incurred after the expiration of the contract's period of performance will be disallowed. But note the language carefully. It says "costs incurred by the contractor" not all costs. For example, costs incurred by a subcontractor before the expiration of the prime contract's period of performance, but not recorded by the prime contractor until after the expiration date are clearly allowable costs.

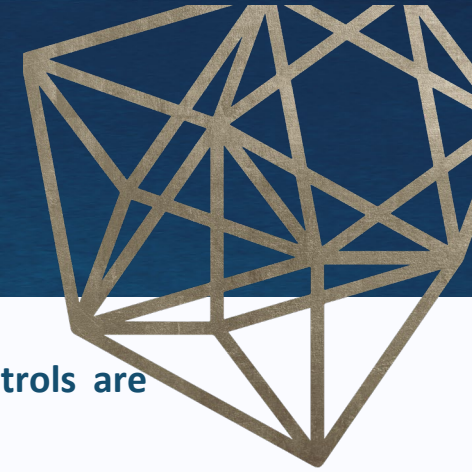
Disagreements with DCAA auditors often center on contract close-out activities, such as efforts to obtain plant clearance for property, security and intellectual property certifications, and costs associated with preparing final invoices. If those efforts are charged as direct costs, and fall outside the contractual period of performance, they run the risk of disallowance. Our recommendation is to consistently treat the costs of contract close-out activities as being indirect costs, thus avoiding that risk.

Time and Material Risk



- For contractors that have T&M contracts with the government, the contract often includes specific qualifications for each labor category (LCAT) that can be billed under the contract.
- In recent years, a significant number of false claims cases related to job qualifications have been successfully pursued by the government against contractors.
- When performing an incurred cost audit, DCAA auditors are charged with verifying that contractual requirements for education, experience, etc., are being met. If auditors find during an audit that this documentation does not meet their expectations, they may question the cost, and could also instigate a review by the Department of Justice or other applicable agency for violation of false claims requirements.
- Contractors should be aware of risks relative to T&M subcontract cost that the prime then bills the government as subcontract cost. These T&M subcontracts also often include contractual provisions relative to education, experience, etc., for the T&M labor categories included in the subcontract. The government expects that prime contractors have controls in place to ensure these subcontract T&M hours are adequately supported with regard to meeting contractual requirements.

Time and Material Risk Mitigation



- After contract award, the contractor should check that LCAT requirements are fully understood and controls are functioning to help ensure compliance.
- Before any hours are billed under T&M contracts, a review should be performed to confirm that the company has documentation that fully supports that the employee meets the requirements for the LCAT under which they are to be billed. The Project Manager for the project should review time charges by category to confirm that personnel are to be billed in the correct category. This documentation should be retained in a way that it is readily available in the event that an audit occurs years in the future.
- The company should perform periodic mock “audits” of T&M billings, conducted by someone separate from the billing function (could be internal audit, human resources, or another program manager), to ascertain that proper documentation is being maintained.
- For any T&M subcontract costs that are being billed under a government flexibly priced prime contract, the prime contractor should have controls to ensure that the subcontractor is maintaining adequate documentation to support its LCAT billings.
- If it is determined that hours have been billed incorrectly to an LCAT for which the person does not fully meet the requirements, the company should be proactive to correct the situation as quickly as possible, to potentially mitigate some of the more serious consequences of the government discovering the billing error.

Takeaways



- **Ensure that all claimed costs fall within specified contract dates.**
- **Where costs fall outside the PoP, see if one of the exceptions noted applies and document appropriately.**
- **Modify the contract or subcontract as necessary to adjust the official period of performance to match the expectations of contract performance.**
- **Ensure adequate controls are in place to monitor T&M LCATs for both the contractor and any applicable subs.**

Proper Cost Management:

- Monitoring costs
 - Limitation of costs
 - Limitation of funds
 - Budget/EAC tracking

Monitoring Costs



Why Monitoring Costs is Crucial



Avoid Overruns



Ensure Financial Health



Facilitate Decision Making



Compliance

Best Practices for Monitoring Costs

Establish a Clear Cost Baseline

Use Cost Tracking Tools

Conduct Regular Variance Analysis

Manage Change Effectively

Report and Communicate

Best Practices for Monitoring Costs



- **Establish a Clear Cost Baseline**

- Create a Detailed Budget
- Document Assumptions

- **Use Cost Tracking Tools**

- Real-Time Tracking
- Integration

Best Practices for Monitoring Costs



- **Conduct Regular Variance Analysis**

- Identify Causes
- Take Corrective Actions

- **Manage Change Effectively**

- Identify Reason for Change
- Formal Change Request Process
- Update Budget

Best Practices for Monitoring Costs



Report and Communicate

Create Detailed Reports



Stakeholder
Communication

Limitation of Costs



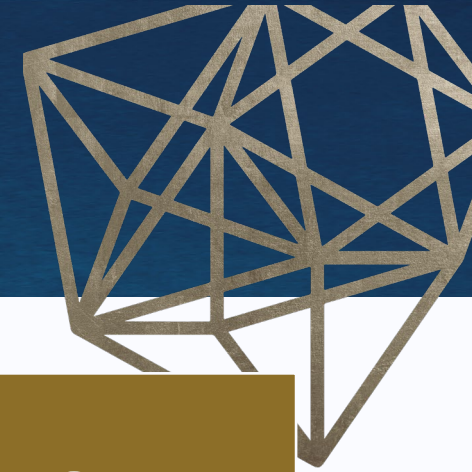
Understanding the Contract Type

Cost Reimbursement Contracts

Fixed Price Contracts

Time & Material (T&M) Contracts

Limitation of Costs



Project Total
Ceilings

Direct Cost
Ceilings

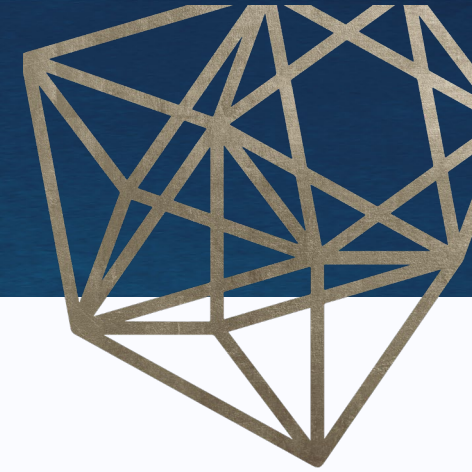
Burden Cost
Ceilings

Cost Fee
Overrides

Burden Fee
Overrides

Hours
Ceilings

Limitation of Costs



■ Project Total Ceilings

- Ceilings imposed on the ENTIRE project instead of specific elements (i.e. cost, labor, etc.)
- Based on contract & funded values
- DCAA will specifically look to see that these ceilings are in place and enforced

■ Direct Cost Ceilings

- Ceilings imposed on specific cost elements charged to the project (i.e. labor, travel, materials, etc.)
- Based on contractual requirements
- Can be used to track unbillable costs

Limitation of Costs



■ Burden & Fee Ceilings

- Ceilings imposed on the burden(s) and/or fee percentages applied to specific accounts on a project
- Fee only on labor
- Fee based on hours or based on cost
- Indirect rate ceilings and/or overrides

■ Labor Hour Ceilings

- Ceilings imposed on the direct hours for labor categories associated with a project
- Typically used in T&M type contracts
- Remember if the employee worked the task, they **MUST** charge the task

Limitation of Funds



Limitation of Funds



- **Budget Constraints & Uncertainty**

- Annual Budget Cycles
- Contract Funding Types

- **Funding Limitation Challenges**

- Cash Flow Management
- Project Delays and Scope Changes
- Compliance Reporting

Strategies for Managing Funding Limitations

Financial Planning &
Risk Management



Close Collaboration with
Government Clients

Leveraging Contract
Types and Clauses

What are you tracking?



Employee Work Authorizations



Period of Performance (PoP) Dates



Total Funded Value



ITD Billing vs. Funding Received



Subcontractor Funding

Project / Funds Monitoring

Project Status Report

BY Project

For Fiscal Year: 2022 Period: 5 Subperiod: 1
For Subperiod Ending: 02/27/22

				ITD Amounts	Total Amounts
				(w/o Future Mods)	(All Mods)
Project:	10001	Status:	Active	Contract Value Fee:	\$8,000,000.00
Project Name:	PROJECT XYZ	Project Classif:	DIRECT PROJECT	Contract Value Cost:	\$132,000,000.00
Owning Org:	10.10.00	Project Type:	CPFF	Contract Value Total:	\$140,000,000.00
Customer:	CUSTOMER ABC	Period of Perf:	Start: 11/01/20	Funded Value Fee:	\$7,240,000.00
Prime Contract No:	A123BC-20-A-0001		End: 08/31/22	Funded Value Cost:	\$131,000,000.00
Subcontract No:		Project Manager:		Funded Value Total:	\$138,240,000.00
PO No:		Rate Type:	Actual	ITD Billed Amount:	\$125,800,000.00
Performing Org:		Budget Revision:		Open Receivable Amount:	\$7,800,000.00
		Budget Type:	B	ITD Retainage Amount:	\$0.00
				ITD Net Withholding Amt:	\$0.00

Account Name	Current Period Actual	Year To Date Actual	Contract To Date Actual			
Revenue	\$9,287,249.82	\$15,767,242.76	\$122,587,577.04			
Direct Labor	1,147,137.94	5,735,402.80	32,873,260.22			
Direct Labor Subcontractrs	584,385.40	3,543,199.91	26,339,157.12			
Accrued Expenses	0.00	-20,753.44	0.01			
Unallowables	4,035.13	19,908.08	50,963.54			
Total Labor Cost, \$:	1,735,558.47	9,277,757.35	59,263,380.89			
Direct Labor Subcontractrs	18,766.09	137,236.70	1,057,091.29			
Materials	1,231,958.32	4,657,369.52	29,915,872.21			
Equipment	146,638.66	983,281.78	7,629,530.77			
Travel	5,854.08	46,753.27	310,857.89			
UNALLOWABLE	0.00	0.00	5,686.12			
Total Non-Labor Cost, \$:	1,403,214.15	5,824,641.27	38,919,038.28			
G&A	0.0000%	0.00	0.00	9.48		
FB-Fringe A	0.0000%	0.00	0.00	14,826,798.91		
FB-Fringe B	0.0000%	0.00	0.00	773,277.25		
FB-G&A	0.0000%	0.00	0.00	3,529,108.10		
Total Indirect Cost, \$:				19,129,193.74		
Total Expense, \$:	3,138,772.62	15,102,398.62	117,311,612.91			
Profit, \$:	148,577.20	664,844.14	5,275,964.13			
Profit, %:	4.73%	4.40%	4.50%			

	Prior Year	Subperiod	Current Period	Year To Date	Contr. To Date
Labor Hours:	1,202,605.92	44,195.05	44,195.05	234,102.49	1,436,708.41
Units:	0	0	0	0	0

Rate Adjustments



When are Rate Adjustment Billings Calculated?



How are the Adjustment Amounts Calculated?

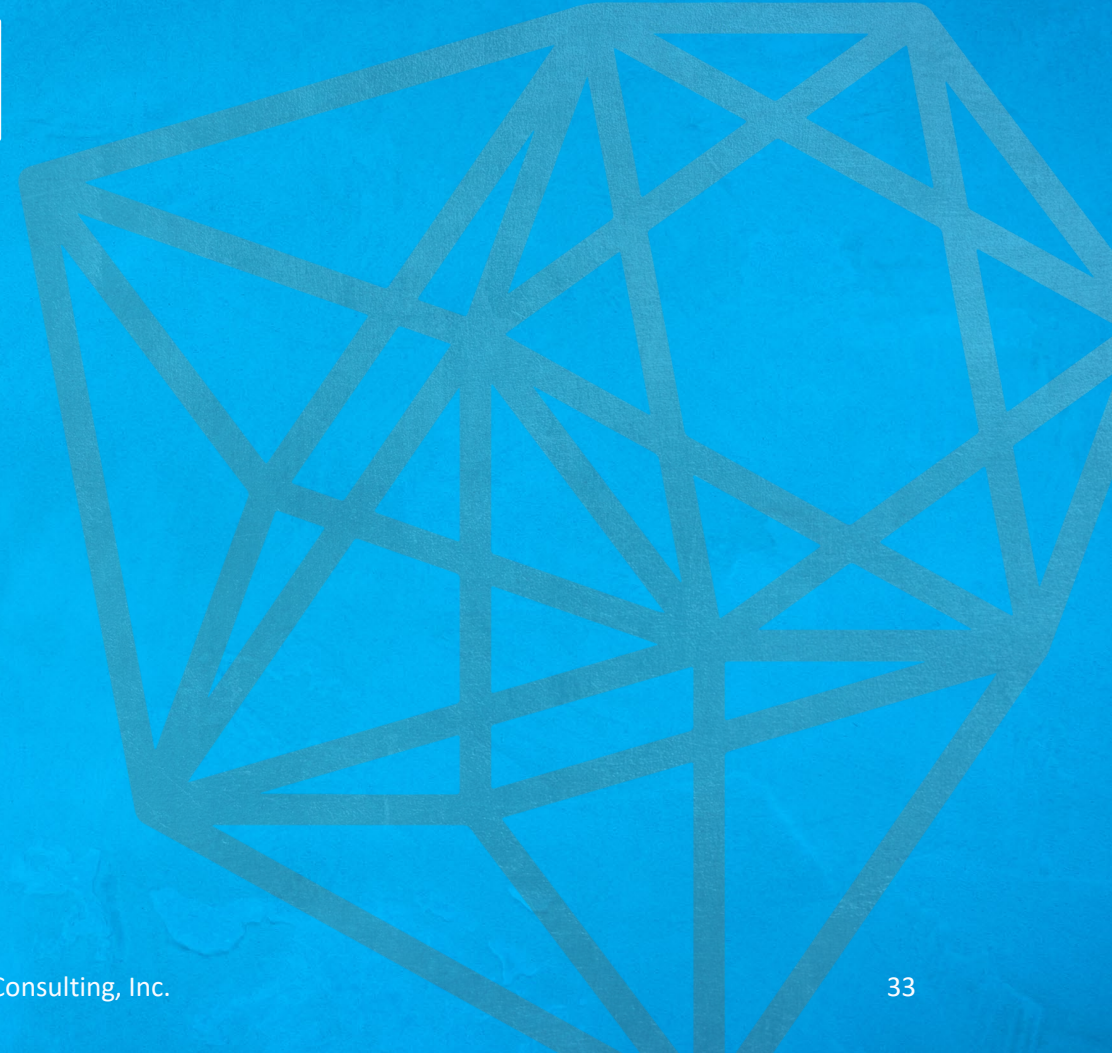


Who Reviews / Approves Rate Adjustments?



How and Who Verifies Rate Adjustments Against Contract Amounts?

Proper Budget and Estimate at Completion (EAC) Tracking



Budget/EAC

Solid Baseline Budget

Monthly EACs/Spend Plan

Ensures Financial Viability & Profitability

Maintaining Compliance with Government Requirements

Enhanced Decision-Making & Project Management

Mitigating Risk and Uncertainties

Questions and Discussion





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