SELECTED AREAS OF COST

Chapter 63 - Restructuring Costs

Authoritative Sources

DFARS 231.205-70 External Restructuring Costs

Introduction

Contractors frequently consolidate and restructure to reduce operating costs and thereby reduce contract costs. Unique requirements have been established governing the evaluation and approval of costs related to restructuring activities resulting from business combinations. This section contains guidance for evaluating the contractor's restructuring proposal and incurred costs.

63-1 Legislation and Regulations

Beginning August 15, 1994, various legislation has been enacted to restrict the reimbursement of restructuring costs associated with a business combination. For business combinations that occur after September 30, 1996, legislation requires that for external restructuring costs to be allowable, the projected savings must either (1) exceed allowable costs by a factor of two to one, or (2) exceed allowable costs and the business combination will result in the preservation of a critical capability that might otherwise be lost to the Department.

DFARS 231.205-70 prescribes policies and procedures regarding a contractor's external restructuring costs. Several steps are required before external restructuring costs may be reimbursed. The procedural steps relating to the Government's responsibilities are provided in the DFARS resource companion guide, Procedures, Guidance and Information (PGI), at PGI 231.205-70.

(1) The first step for the cognizant ACO is to promptly novate contracts when required. The novation agreement must include the provision at DFARS 242.1204(i) which allows increased costs on flexibly-priced novated contracts for restructuring, provided that the transferee demonstrates that the restructuring will reduce overall costs for DoD (and the National Aeronautics and Space Administration (NASA) when there is a mix of DoD and NASA contracts). DoD will not treat a shifting of costs from DoD contracts to NASA contracts as an overall cost reduction for DoD. Restructuring costs are not allowed until execution of the advance agreement required by DFARS 231.205-70(c)(3).

(2) The cognizant ACO must take other steps before restructuring costs may be either reimbursed on the flexibly-priced contracts that were awarded after the business combination or included in the price of future fixed-price contracts. These steps are outlined at PGI 231.205-70(d) and include requirements for the ACO to obtain an adequate restructuring proposal, which must be audited.

(3) The advance agreement will not be executed until the USD(AT&L) or for external restructuring costs less than $25 million over a 5 year period, the Director DCMA, determines in writing that projections of future cost savings from the business combination are based on audited cost data and should either (a) exceed allowable restructuring costs by a factor of two to one on a present value basis, or (b) exceed allowable costs on a present value basis and the business combination will result in the preservation of a critical capability that might otherwise be lost to DoD. Until the determination is obtained, the contractor must segregate restructuring costs and suspend them from billings, final contract price settlements, and overhead settlements, as noted at PGI 231.205-70(d)(ii).

(4) The audit, ACO review, and USD (AT&L) or Director DCMA determination requirements of DFARS 231.205-70 apply only to restructuring activities that:

(a) occur after a business combination,

(b) affect the operations of companies not previously under common ownership or control,

(c) are initiated within three years of the business combination, and

(d) result in costs allocated to DoD contracts of $2.5 million or more.

The phrase “initiated within three years” means that a restructuring decision was made within three years of the business combination. Each of these four conditions must be met in order for DFARS 231.205-70 to apply.

(5) Testing for the $2.5 million materiality threshold should be based on the best information currently available. A decision that the threshold is not met should not be reversed in the future if conditions change (e.g., actual business mix differs from projected business mix) and actual DoD reimbursement exceeds $2.5 million. The materiality threshold applies to all restructuring activities associated with a business combination. It is not to be applied project by project or segment by segment. A general dollar magnitude estimate should be sufficient to determine if the $2.5 million threshold is met.

63-2 Contents of External Restructuring Proposals

The proposals for external restructuring costs, as noted at DFARS PGI 231.205-70(d)(iii), must show projected restructuring costs and savings by year and by cost element. Data supporting the projections and the methods by which restructuring costs will be allocated must also be included.

The following basic elements should be part of any restructuring proposal and its supporting data:

- An outline of proposed restructuring actions, anticipated time span for accomplishing proposed actions, and the affected locations.
- A summary of proposed restructuring costs and savings, by year and by cost element, that includes the present value of the DoD share of projected costs and savings.
- Points of contact for obtaining clarification or additional information.
- A description of how restructuring costs will be accumulated and amortized (if restructuring costs will be accounted for as a deferred charge), and the methods by which restructuring costs will be allocated. External restructuring costs should be identified separately from internal restructuring costs, if any.
- A plan for updating forward pricing rates to reflect the impact of projected restructuring savings. Restructuring costs may also be reflected in the forward pricing rates provided the contracts priced with the rates include a downward price adjustment clause to remove restructuring costs should the written determination required by DFARS 231.205-70(c)(4)(i) not be obtained.
- Supporting data sufficient to establish the reasonableness of the cost and savings projections.

63-3 Coordinated Audit Approach

To accomplish effective and timely audits of contractor restructuring proposals at multi-segment contractors, it is important that the DCAA Contract Audit Coordinator maintain effective communications with all affected DCAA offices throughout the review process.

63-4 Purpose and Scope of Audit

The purpose of the audit of the contractor's external restructuring proposal is to verify that savings projected from the restructuring for DoD contracts will exceed the allowable restructuring costs by a factor of two to one on a present value basis. Specifically, the audit should determine that:

- The contractor’s classification of costs as restructuring costs is proper.
- The projected restructuring costs are allowable, reasonable, and allocable to Government contracts.

- The projected restructuring savings represent reasonable estimates of future cost reductions that will accrue to the Government as a result of the contractor's restructuring activities.
- The restructuring savings will exceed restructuring costs on a present value basis.
- Savings resulting from the restructuring will exceed costs allowed by a factor of at least two to one.

While the nature and extent of audit effort required to accomplish these audit objectives will vary depending on individual circumstances, the scope of audit should be influenced by the following items:

- Risk that projected savings will not exceed projected costs by a wide margin.
- Types of Government contracts.
- Existence of sensitive audit issues.
- Results of other audits (e.g., adequacy of estimating system and past reliability of estimates).
- Input from the contracting officer.
- Contract provisions.

These and other areas which may impact the scope of audit are discussed in detail in CAM 3-104. The audit working papers should clearly document the impact of these considerations on the scope of audit.

63-5 Evaluation of Projected Costs

62-5.1 Definition of Restructuring Costs

Restructuring that is a direct outgrowth of a business combination is termed “external restructuring.” External restructuring costs are defined in DFARS 231.205-70(b)(4) as the costs, both direct and indirect, of restructuring activities. A restructuring activity is defined as:

- A nonroutine, nonrecurring, or extraordinary activity to combine facilities, operations, or workforce in order to eliminate redundant capabilities, improve future operations, and to reduce overall costs.
- It is not a routine or ongoing repositioning and redeployment of a contractor’s productive facilities or workforce.
- It is not a routine or ordinary activity charged as an indirect cost that would otherwise have been incurred (e.g., planning and analysis, contract administration and oversight, recurring financial and administrative support.)

Planning for restructuring would not be a restructuring activity when performed by employees whose costs would otherwise have been incurred (e.g., G&A employees). However, planning for restructuring performed by outside consultants, attorneys, or other professionals whose charges would not otherwise have been incurred is a restructuring activity.

Direct contract costs might increase as a consequence of restructuring (e.g., recalibration of special test equipment that was moved to another plant, increased labor time per unit of production due to relocation of production). In these situations, direct costs may not be reclassified as indirect restructuring costs or allocated to other contracts. This is prohibited by Cost Accounting Standard 402 and applicable cost principles, including: FAR 31.202, Direct costs; FAR 31.203, Indirect costs; FAR 31.205-23, Losses on other contracts; and FAR 31.205-40, Special tooling and special test equipment costs.

63-5.2 Evaluation of Employee Related Costs

Employee Termination Costs. Employee termination costs such as early retirement incentive or severance payments may be incurred to effect reductions in the contractor's workforce as part of restructuring efforts. The auditor should review any proposed employee termination costs to determine if allowable under FAR 31.205-6, Compensation for personal services (Guidebook Chapter 10).

Retention Pay. The cost of a plan introduced in connection with a change in ownership through which employees receive special compensation that is contingent upon the employee remaining with the contractor for a specified period of time is unallowable under FAR 31.205-6(l), *Compensation incidental to business acquisitions*. This cost principle is typically applicable to “golden handcuff” arrangements with key executives upon a business combination. It should not be applied to plans that provide additional dismissal wages to employees who remain with the contractor until their employment is involuntarily terminated (e.g., until a plant is closed). The allowability of such dismissal wages should be determined under FAR 31.205-6(g), *Severance pay*.

Employee Relocation Costs. Employee relocation costs may be incurred when a contractor's restructuring activities involve the consolidation of facilities or functions from different geographic locations. The auditor should review any proposed relocation costs to determine if allowable under FAR 31.205-35 and FAR 31.205-46 (Guidebook Chapter 61).

Recruitment Costs. Recruitment costs may be incurred to hire employees at new or expanded contractor locations as a result of a contractor's restructuring activities. The auditor should review any proposed recruitment costs to determine if allowable under FAR 31.205-34 (see CAM 6-408).

Employee Training. Employee training costs may be incurred to train employees on new or modified practices as a result of a contractor's restructuring activities. The auditor should review any proposed training costs to determine if allowable under FAR 31.205-44 (Guidebook Chapter 71).

Bonuses. See CAM 6-414.6 for limitations applicable to DoD contracts.

Pension and Post Retirement Health Benefit Costs**.** After a business combination, a contractor may have employees who are covered by multiple pension and post retirement health benefit plans. As a result, the contractor may decide to modify the existing plans to provide for comparable benefits or to merge the plans together into a single plan covering all employees. The cost of implementing these changes and any associated increases in pension and post retirement health benefit costs do not meet the DFARS definition of restructuring costs. Depending upon their nature and extent, other changes and their associated cost increases may not meet the definition of restructuring costs (see DFARS 231.205-70). For example, increased pension costs resulting from changes in actuarial assumptions (e.g., changes in interest rates) would not meet the DFARS definition of restructuring costs. On the other hand, increases in actuarial liabilities of the pension plan resulting from contractor implementation of an early retirement incentive plan would meet the DFARS definition of restructuring costs if done in connection with a restructuring activity. In either case, the auditor may need to establish a separate review to determine if the changes are in compliance with the requirements of FAR 31.205-6, CAS 412, and 413 (see Guidebook Chapter 53, 8-412 and 8-413).

63-5.3 Evaluation of Facilities Related Costs

Idle Facilities. FAR 31.205-17, Idle facilities and idle capacity costs, provides that costs of idle facilities are allowable for a reasonable period of time, usually not to exceed one year, depending upon the initiative taken to use, lease, or dispose of the idle facilities. The regulation provides the contracting officer with the flexibility to accept idle facilities costs for a period greater than one year. When the contractor has identified facilities that are expected to be idle in excess of one year, the auditor should recommend that the contracting officer obtain justification from the contractor for the time in excess of one year. The contractor should address, at a minimum, the following areas:

- Whether the facility will be needed in the future, and if so, why.
- If not needed for future operations, the actions that are being taken to lease or dispose of the facility.
- An estimate of the time it should take to lease or dispose of the facility based on an analysis of existing market conditions; such as surveys of real estate prices, public records of real estate sales for similar facilities, etc.

The auditor should assist the contracting officer in determining a reasonable period of time for accepting idle facilities costs. The contractor and Government should enter into an advance agreement specifying the maximum period for which costs of idle facilities will be reimbursed. If there is no advance agreement between the contractor and the contracting officer to accept idle facilities costs for a period greater than one year, any proposed idle facilities costs beyond one year should be questioned.

Extraordinary Maintenance and Repairs. The costs of extraordinary maintenance and repairs are allowable provided those costs are reasonable and assigned to the accounting periods in accordance with applicable provisions of CAS and GAAP. However, such costs incurred to prepare a facility for sale are generally factored into the calculation of the gain or loss on the sale. The costs of restoring or rehabilitating the contractor's facilities to approximately the same condition existing immediately before the start of a Government contract, fair wear and tear excepted, are limited in allowability by FAR 31.205-31, Plant reconversion costs. Ideally, such costs would be covered by an advance agreement on idle facilities or restructuring.

Asset Relocation. Asset relocation costs include the cost of removing the asset from its current location, transportation to the new location, and reinstalling the asset at the new location. Merely moving an asset from one location to another generally does not extend its expected service life or production capacity. Therefore, relocation costs are generally assigned to the cost accounting period in which they are incurred. When incurred in connection with restructuring, Cost Accounting Standard 406.61 provides that asset relocation costs may be included as restructuring costs. When reviewing asset relocation costs, auditors should be alert for the possibility that assets might be improved or bettered in connection with their relocation. If the useful life of a tangible capital asset will be extended or its productivity increased, then the cost of the improvement or betterment should be capitalized and depreciated over the remaining useful life of the asset in accordance with CAS 404.40(d) [see CAM 8-404]. The capitalized costs of betterments or improvements are eligible for facilities capital cost of money under CAS 414. The reasonableness of proposed relocation costs should be determined under FAR 31.201-3, Determining reasonableness.

Gain/Loss on Sale of Assets. Restructuring is an extraordinary activity that may involve mass or extraordinary dispositions of assets. Dispositions may range from equipment, such as surplus furniture or computer hardware, to an entire plant. The actual gains or losses realized upon disposition of depreciable assets should be reviewed to determine if they are allowable under FAR 31.205-16 (Guidebook Chapter 19). Proposed gains or losses, which have not been realized and are not based on a firm sales agreement should be treated in accordance with FAR 31.205-7, Contingencies. The gain or loss expected from the sale of items for which there is a ready market may be foreseeable within reasonable limits of accuracy. Such projected gains or losses should be included in cost estimates as stated in FAR 31.205-7(c)(1). When a gain or loss cannot be measured or timed within reasonable limits of accuracy, the contractor should exclude it from cost estimates and propose it as a contingency in accordance with FAR 31.205-7(c)(2). When reviewing the contractor's proposed gains or losses, the auditor should be alert for any asset write-ups or write-downs that may have occurred as a result of the business combination (Guidebook Chapter 8).

Environmental Remediation**.** Environmental cleanup efforts may arise in connection with a contractor's restructuring activities. In general, environmental remediation costs (e.g., cleanup of soil or ground water contamination, removal of asbestos from buildings) do not meet the DFARS definition of restructuring costs. Therefore, these costs should be excluded from the contractor's restructuring cost and savings proposal and negotiated under a separate advance agreement. The cleaning of a building in preparation for its sale (e.g., cleaning air ducts, removing chemical stains from floors) should normally be treated as extraordinary maintenance and repairs, not environmental remediation (Guidebook Chapter 26).

63-5.4 Evaluation of Other Categories of Costs

Discontinued Operations. During the restructuring process, a contractor may have continuing costs associated with discontinued operations (i.e., a segment that is merged, sold, or abandoned). Generally, costs associated with segments that are merged into one or more new or existing segments should be allocated to the new or existing segment where the work effort or contracts are transferred. However, some costs may be addressed by a specific procurement regulation. Pension costs, for example, associated with closed segments should be measured, assigned and allocated in accordance with CAS 413.50(c)(12). For other costs, special allocations may be required under CAS 403 or CAS 418. To ensure the appropriate regulation is properly applied, the FAO should coordinate with Headquarters (Accounting and Cost Principles Division), through the regional office, when significant costs associated with discontinued operations are encountered.

Organization and Reorganization Costs**.** The auditor should be alert for organization or reorganization costs, unallowable under FAR 31.205-27, that may have been included in the contractor's restructuring cost and savings proposal. In addition, when a contractor's restructuring activities result in the formation or dissolution of separate entities, the auditor should ensure that any organization or reorganization costs are properly excluded from the contractor's restructuring cost and savings proposals and forward pricing rates. Depending upon the nature and extent of contractor organization or reorganization activities, the auditor may need to establish a separate review to ensure that all associated costs have been properly segregated and excluded from Government contracts (Guidebook Chapter 8).

Facilities Capital Cost of Money. Deferred restructuring costs should not be included in the computation to determine facilities capital cost of money (see CAS 406.61(i)). Deferred charges are not tangible or intangible capital assets as defined in CAS 414.30.

Credits. Reductions in workforce and facilities should reduce the cost of various employee benefit plans (e.g., health insurance, life insurance) and property and casualty insurance plans. This may lead to credits from insurance companies as reserves are reduced or policies canceled. Auditors should be alert for such credits and the requirement in FAR 31.201-5 for the applicable portion to be credited to the Government either as a cost reduction or by cash refund, as appropriate (see CAM Section 6-203).

63-6 Evaluation of Projected Savings

Contractor restructuring efforts are intended to result in combinations of facilities, operations, or workforce that eliminate redundant capabilities, improve future operations, and reduce overall costs. Benefits which accrue to the Government from a contractor's restructuring efforts are the overall reduced costs on future contracts and existing flexibly-priced contracts. Cost reductions on already negotiated firm-fixed-priced contracts are not savings to the Government.

Auditors should carefully evaluate proposed restructuring savings to ensure that the contractor's estimates of future cost reductions are reasonable and can be expected to benefit Government contracts. To accomplish this, the auditor must first establish that the contractor's baseline for measuring restructuring savings represents a reasonable expectation of future contract costs had the restructuring not occurred. Contractor budgets, contract estimates to complete, and existing forward pricing rate proposals/agreements can be used to establish a baseline for pre-restructuring costs. It is the contractor's responsibility to establish and support the reasonableness of the baseline used in developing savings estimates.

Once a reasonable baseline has been established, the auditor should review the proposed restructuring savings to ensure that estimated cost reductions are the result of the contractor's restructuring efforts and not due to other factors (e.g., reduced inflation rates, changes in interest rate assumptions) impacting on future contract costs. Materiality should be considered in planning the review. The use of statistical sampling should also be considered (see CAM 3-204.17 and 4-605a.).

63-7 Determination of Present Value and Overall Reduced Costs

DFARS 231.205-70(c)(4)(i) requires a determination that restructuring savings will exceed restructuring costs on a present value basis. The auditor should review the contractor's methodology for discounting projected restructuring costs and savings to determine if it is reasonable under the circumstances. Overall reduced costs should be computed based on restructuring costs and savings that will be realized over the next five years. Those costs and savings that are not stated in current year dollars should be discounted to current year dollars using the most recently published cost of money rate.

PGI 231.205-70(d)(viii) requires the cognizant ACO to negotiate an advance agreement with the contractor that includes a cumulative cost ceiling. Projected savings must exceed allowable external restructuring costs, on a present value basis by a factor of at least two to one. Auditors should provide any assistance requested by the ACO in making present value calculations during negotiation of the advance agreement.

63-8 CAS Considerations

63-8.1 Assignment of Costs to Accounting Periods

The Cost Accounting Standards (CAS) Board issued the interpretation at CAS 406.61 on June 6, 1997. It is based on Interim Interpretation 95-01, "Allocation of Contractor Restructuring Costs Under Defense Contracts," which was issued by the CAS Board on March 8, 1995. The interpretation clarifies whether restructuring costs are to be treated as an expense of the current period or as a deferred charge that is subsequently amortized over future periods. It is applicable to contractor restructuring costs (both external and internal) that are paid or approved on or after August 15, 1994.

Paragraph (e) of CAS 406.61 (and preceding Interim Interpretation 95-01) require that the costs of all restructuring activities comprising a specific restructuring event be accounted for as a deferred charge unless the contractor proposes, and the contracting officer agrees, to expense the costs in the current accounting period. A contractor may defer the costs of one restructuring event (e.g., restructuring in connection with acquisition of Company A) and propose to expense the costs of a subsequent restructuring event (e.g., restructuring in connection with Company B years later), subject to the CAS Board rules governing accounting practice changes. However, a contractor may not defer the costs of some activities and expense the cost of others that comprise a specific restructuring event. According to 48 CFR 9904.406-61(e), "Contractor restructuring costs defined pursuant to this section may be accumulated as deferred cost, and subsequently amortized, over a period during which the benefits of restructuring are expected to accrue. However, a contractor proposal to expense restructuring costs for a specific event in a current period is also acceptable when the Contracting Officer agrees that such treatment will result in a more equitable assignment of costs in the circumstances."

The Director, Defense Procurement, Acquisition Policy, and Strategic Sourcing (DPAPSS), issued guidance on May 20, 1997 which stated that it would be appropriate to accept a contractor's proposal to expense restructuring costs in the current period when expensing should result in overall lower costs for DoD. In making this assessment, the business base (Government versus commercial contracts) and the contract mix (fixed price versus cost reimbursement) for current and future years should be considered.

Deferred restructuring costs should be amortized over the same period of time during which the benefits of restructuring are expected to accrue. However, the amortization period is limited by 48 CFR 9904.406-61(h) which states: "The amortization period for deferred restructuring costs shall not exceed five years. The straight line method of amortization should normally be used, unless another method results in a more appropriate matching of cost to expected benefits."

63-8.2 Allocation to Cost Objectives

Direct Restructuring Costs. Restructuring costs which benefit a single cost objective should be charged directly to that cost objective. For example, if a contractor's restructuring activities result in a need to recalibrate special test equipment which is related to a single contract, the recalibration costs should be assigned directly to that contract.

Indirect Restructuring Costs. 48 CFR 9904.406-61(j) states: "Restructuring costs incurred at a home office level shall be treated in accordance with the provisions of 48 CFR 9904.403. Restructuring costs incurred at the segment level that benefit more than one segment should be allocated to the home office and treated as home office expense pursuant to 48 CFR 9904.403. Restructuring costs incurred at the segment level that benefit only that segment shall be treated in accordance with the provisions of 48 CFR 9904.418. If one or more indirect cost pools do not comply with the homogeneity requirements of 48 CFR 9904.418 due to the inclusion of the costs of restructuring activities, then the restructuring costs shall be accumulated in indirect cost pools that are distinct from the contractor's ongoing indirect cost pools."

63-8.3 Disclosure of Accounting Practices and Changes in Accounting Practices

Accurate disclosure statements are required by 48 CFR 9903.202-3. If the deferral of restructuring costs results in a new or changed cost accounting practice, the contractor is required to file a revised disclosure statement describing the accounting practices associated with the assignment and allocation of deferred restructuring costs. The contractor is also required to revise its disclosure statement for any other changes in cost accounting practice that result from the restructuring. Audits of the revised disclosure statement should be conducted in accordance with CAM 8-000.

48 CFR 9904.406-61(f) states: "If a contractor incurs restructuring costs but does not have an established or disclosed cost accounting practice covering such costs, the deferral of such restructuring costs may be treated as the initial adoption of a cost accounting practice (see 48 CFR 9903.302-2(a)). If a contractor incurs restructuring costs but does have an existing established or disclosed cost accounting practice that does not provide for deferring such costs, any resulting change in cost accounting practice to defer such costs may be presumed to be desirable and not detrimental to the interests of the Government (see 48 CFR 9903.201-6). Changes in cost accounting practices for restructuring costs shall be subject to disclosure statement revision requirements (see 48 CFR 9903.202-3), if applicable."

Contractor restructuring activities may also result in changes to cost accounting practices other than deferral of restructuring costs. For example, as a direct result of restructuring activities, the contractor may decide to change from a value-added base to a total cost input base for allocation of its G&A pool. Effective June 14, 2000, the cost impact process does not apply to cost accounting practice changes directly associated with external restructuring activities that are subject to, and meet the requirements of, 10 U.S.C. 2325. This statute established the allowability requirements and two-to-one savings requirements for external restructuring implemented by DFARS 231.205-70. Cost accounting practice changes associated with restructuring activities that (1) took place prior to June 14, 2000 or (2) do not meet the requirements of 10 U.S.C. 2325 are subject to the administrative procedures outlined in the CAS contract clause at 48 CFR 9903.201-4(a)(4). See further guidance in CAM 8-502.4.

63-9 Reporting Results of Audit

Audit reports should follow the format for Audit Reports on Price Proposals, modified as appropriate. To promote consistency, external restructuring cost and savings proposal audit reports should be reviewed prior to issuance by the CAD or region. Auditors should take appropriate actions to ensure that sufficient time is available to facilitate these reviews within the required due dates.

63-10 Forward Pricing Consideration

63-10.1 Adjustment of Forward Pricing Rates

A plan for updating forward pricing rates to reflect the impact of projected restructuring costs and savings should be developed with the contractor and cognizant ACO at an early stage. Upon receipt of the contractor's restructuring cost and savings proposal, the auditor should be prepared to advise the cognizant ACO on the contractor’s adjustments to forward pricing rates to reflect the impact of projected restructuring costs and savings.

PGI 231.205-70(d)(v) requires that the cognizant Administrative Contracting Officer adjust forward pricing rates to reflect the impact of projected restructuring savings as soon as practicable.

63-10.2 Reopener or Savings Clauses in Forward Pricing Reports

PGI 231.205-70(d)(v) provides that if restructuring costs are included in forward pricing rates prior to execution of the required advance agreement, the contracting officer shall include a repricing clause in each fixed price action that is priced based on the rates. The repricing clause must provide for a downward price adjustment to remove restructuring costs if the written determination required by DFARS 231.205-70(c)(4)(i) is not obtained.

In addition to the repricing clause required by PGI 231.205-70(d)(v), the auditor should recommend a contract reopener or savings clause in the audit report on a contract price proposal when a major contractor acquisition, merger, or associated restructuring is significant and the effect on the price proposal cannot be reasonably determined (see CAM 10-304.4k).

63-10.3 TINA Considerations

A management decision to restructure is certified cost or pricing data that must be disclosed for compliance with the Truth in Negotiations Act (TINA). An adequate disclosure requires current, accurate, and complete information on the nature and magnitude of the restructuring decision. Typically, judgments on the effects of a restructuring decision (i.e., estimated cost reductions) are so intertwined with facts that they cannot be segregated. In this case, complete data must be disclosed to place the Government on an essentially equal footing with the contractor when making pricing decisions. Thus compliance with TINA will usually require disclosure of the impact of restructuring decisions on forward pricing rates and contract price proposals. As indicated in CAM 9-1211, whenever the auditor has an indication that forecasted rates should have been revised for significant changes to reflect more accurate, complete, or current certified cost or pricing data, pricing actions using the rates should be subject to a postaward audit when certified cost or pricing data was required.

63-11 Reimbursement of External Restructuring Cost

PGI 231.205-70(d)(ii) requires the cognizant ACO to direct the contractor to segregate restructuring costs and to suspend these amounts from any billings, final contract price settlements, and overhead settlements until a written determination is obtained from the designated official. When contractors incur restructuring costs prior to obtaining the determination, the auditor may need to evaluate the contractor's internal controls to determine if they are adequate to reasonably ensure that restructuring costs are properly accounted for and excluded from contract billings, final contract price settlements, and overhead settlements. This evaluation should include limited transaction testing to determine if the controls have been implemented and are working effectively. Floor checks (see CAM 6-405) or other time sensitive audit procedures may be performed, when appropriate, for the risks identified.

Costs of activities such as restructuring planning and analysis, contract administration and oversight, and recurring financial and administrative support, when performed by employees whose costs would otherwise have been incurred, are not restructuring costs as defined by DFARS 231.205-70(b)(2). Therefore such costs should not be excluded from contract billings, final contract price settlements, and overhead settlements merely because the written determination required by DFARS 231.205-70(c)(4)(i) has not been obtained.

63-12 Audit Consideration - Internal Restructuring Cost

The term “internal restructuring activities” means all restructuring activities that are not subject to DFARS 231.205-70. While DFARS 231.205-70 does not apply to internal restructuring activities, an advance agreement on internal restructuring costs should be recommended since the costs are unusual and can be substantial. This is particularly true if the cost is to be accounted for as a deferred charge. FAR 31.109(a) advises contracting officers and contractors to seek advance agreement on the treatment of special or unusual costs to avoid possible subsequent disallowance or dispute based on reasonableness, nonallocability, or unallowability.

Auditors may encounter internal restructuring costs in audits of proposals for advance agreements on restructuring, forward pricing rate proposals, contract price proposals, or incurred cost claims. As with any other cost, the policies and procedures within the Federal Acquisition Regulation (FAR) and DoD supplement (DFARS) should be followed in determining the allowability of internal restructuring costs.

The criteria in FAR 31.201-3 should be applied in determining the reasonableness of internal restructuring costs. Evidence of reasonableness might include an analysis of costs and benefits (e.g., reduced costs, more efficient use of resources, improved financial capability). The criteria in FAR 31.201-4 should be applied in determining the allocability of internal restructuring costs. Allocations of restructuring costs should comply with applicable Cost Accounting Standards. The interpretation at CAS 406.61 is applicable to internal restructuring costs. Costs properly classifiable as internal restructuring costs may be deferred and subsequently amortized over a period during which the benefits of restructuring are expected to accrue (not to exceed 5 years).

Auditors should be alert for contracts with provisions for costs associated with restructuring. For example, a contract may contain an allowance for the costs of relocating special equipment and tooling to a vendor from a contractor’s discontinued operation or closed facility. Such costs would be charged directly to the contract and, as direct contract costs, would not be allocable to other cost objectives as restructuring costs. Auditors should also be alert for existing advance agreements covering costs that may arise in connection with restructuring. Significant environmental remediation costs may coincide with restructuring but are not restructuring costs and should be covered by a separate advance agreement.

The contractor should include the reduction in overall cost levels expected from internal restructuring into its forward pricing rates and contract price proposals. If this does not occur, auditors should follow procedures in 9-1208c and 9-1209b in advising the cognizant ACO to request a revised forward pricing rate proposal from the contractor.

63-13 Auditing Incurred Restructuring Costs

The final determination of allowability of incurred restructuring costs can only be made after the contractor provides the annual certified incurred cost proposal. FAR 52.216-7, Allowable Cost and Payment, and FAR 42.705-1, Contracting Officer Determination Procedure, require the contractor to support its proposal with adequate data. The auditor should obtain from the contractor whatever data is deemed necessary to support the amortized restructuring costs claimed (e.g., amortization schedules for deferred restructuring costs and detailed schedules of the incurred restructuring costs by fiscal year, project and cost element). The support should be at a level of detail sufficient to allow the auditor to determine the allowability of incurred restructuring costs.

As actual restructuring expenditures near the negotiated restructuring cost ceiling, there is an increased risk that restructuring costs may be misclassified as other costs. Procedures should be performed to identify costs that should properly be reclassified as restructuring costs, especially when incurred restructuring costs are near or in excess of the negotiated ceiling.