

External Restructuring Costs

GOVERNMENT CONTRACT REGULATORY COMPLIANCE

Overview

External restructuring occurs when the assets or operations of one company are acquired by another company and brought under common control. While such restructuring is a common business practice, government contractors must perform additional diligence in order to recover the costs incurred for these efforts. When the acquiring company is a government contractor, it should assess the impact the restructuring will have on its government customers.

While many external restructuring costs are generally allowable costs under the Federal Acquisition Regulation (“FAR”), DoD contractors are required to adhere to the more stringent requirements of the Defense Federal Acquisition Regulation Supplement (“DFARS”). Therefore, a DoD contractor must undertake significantly more effort to recover said costs than a non-DoD contractor. Given these requirements, the Defense Contract Audit Agency (“DCAA”) and Defense Contract Management Agency (“DCMA”) have made it a priority to confirm DoD contractors are correctly classifying restructuring activities and ensuring the resulting costs are reasonable and meet all regulatory requirements.

External restructuring should provide for continued and prosperous company growth, not the loss of government contracts, or disputes and litigation with the Government. Chess Consulting (“Chess”) works with DoD contractors and/or their legal counsel to ensure that these activities are appropriately accounted for, communicated effectively to contracting officers, and properly convey the savings to the DoD.

DFARS 231.205-70 External Restructuring Costs

DFARS 231.205-70 provides the regulatory guidance from the DoD that outlines both the definitions of key terms, as well as the regulatory requirements. Below is a listing of key elements, how it affects DoD contractors, and how Chess can help navigate this regulation.

Business Combinations:

A business combination is “a transaction whereby assets or operations of two or more companies not previously under common ownership or control are combined, whether by merger, acquisition or sale/purchase of assets.” Such transactions can result in a myriad of financial impacts to the entities. Chess’ team has substantial merger and acquisition experience, including understanding the typical costs subject to recovery as well as the applicable regulations and guidelines.

Restructuring Activities:

Restructuring activities are “nonroutine, nonrecurring, or extraordinary activities to combine facilities, operations, or workforce, in order to eliminate redundant capabilities, improve future operations, and reduce overall cost.”

This does not include routine or ongoing repositioning of a contractor’s facilities or workforce, nor does it include ordinary activities charged as indirect costs that would otherwise have been incurred.

External Restructuring Activities:

For an activity to be considered an external restructuring activity, it must occur after a business combination (i.e., M&A, Sale of Assets, Purchase of Assets) and impact both companies that were not previously under common control. This means if it occurs after a business combination but impacts only 1 company it is not considered a restructuring activity. Additionally, transactions within a company that are not associated with a business combination are not considered restructuring. By definition, external restructuring activities are a direct outgrowth of the business combination and are normally initiated within 3 years of the acquisition.

Restructuring Costs:

Restructuring costs are defined as: “[c]osts, including both direct and indirect, of restructuring activities.

Restructuring costs that may be allowed include, but are not limited to, severance pay, early retirement incentive payments, employee retraining costs, and relocation expense for retained employees, and relocation and rearrangement of plant and equipment. All costs associated with external restructuring activities that are less than \$2.5 million shall not be subject to an audit or review; normal rules for cost allowability in FAR Part 31 shall apply” (See “Limitations on Cost Allowability”).

Limitations on Cost Allowability

Not all costs associated with external restructuring are allowable. Under the DFARS, restructuring costs associated with external restructuring activities shall not be allowed unless—

- (1) Such costs are allowable in accordance with FAR Part 31 and DFARS Part 231;
- (2) An audit of projected restructuring costs is performed;
- (3) The administrative contracting officer (“ACO”) reviews the audit report and negotiates an advance agreement;
- (4) An audited projected savings for the DoD, on a present value basis, resulting from the restructuring will exceed either—

Costs allowed by a factor of at least 2:1; or

Costs allowed, and the business combination will result in the preservation of a critical capability that might otherwise be lost to DoD.

Given the unique nature of external restructuring and the requirements placed upon DoD contractors as briefly described above, recovering costs associated with such transactions requires a great deal of effort and expertise. Chess’ experience with these matters, as well as its knowledge of government contract accounting, allows us to provide DoD contractors and/or their legal counsel with the guidance necessary to navigate this difficult process and ensure that they fully recover the costs they are entitled to.

THE CHESS CONSULTING ADVANTAGE

Chess's experienced team of government contract accounting and regulatory compliance experts have worked with contractors on a multitude of matters over many years. Our clients have included DoD contractors spanning a wide variety of industries, including aerospace and defense, healthcare, construction, and technical services. Chess's professionals have been engaged by clients and/or their legal counsel to provide support regarding external restructuring in a variety of capacities including, but not limited to:

- Assist in assessing the restructuring cost categories and provide guidance based on DFARS, FAR, CAS, DCAA Guidelines and other regulations
- Identify and determine external restructuring cost savings
- Develop/review the external restructuring proposal submitted to the ACO
- Model/recalculate Incurred Cost Proposal ("ICPs"), indirect rates, and contract information due to restructuring activities
- Conduct a General Dollar Magnitude ("GDM") to calculate the high-level cost impact to the government.
- If required, Chess can develop a detailed Cost Impact to calculate the increased or decreased cost to the government resulting from the restructuring activities
- Communicate with the DCAA and DCMA prior to, during, and after external restructuring audits

Chess Consulting Differentiators

Deep industry knowledge and technical expertise which helps each client deal effectively with the complexities of the processes and issues facing its business.

Profitability focus concentrating on actions and solutions that create a competitive business advantage while fully complying with regulatory requirements.

Practical and creative solutions that effectively address difficult compliance and business issues.

Supportable positions that have been proven to withstand scrutiny from regulatory agencies such as the SEC, DCAA, DOJ, and GAO.

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When the right move matters, contact Chess Consulting.